

Transcript of
“Can Japan’s Politics Save Japan’s Economic Troubles?”
with
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First of all, even though there are some critics saying that Prime Minister Koizumi has done less than expected, I would like to express that, as a whole, I am very positively evaluating what he has done since he took his office. However, it is also true that the real negative reactions will emerge soon. The next year’s budget is remarkably retrenching now, so any financial stimulus for the economic recovery cannot be expected to develop. In addition, the level of general consumption that accounts for 60% of our GDP cannot be expected to show any certain recovery for a while. Moreover, in my opinion, an even further depression can occur. If the depression actually occurs, it will be very difficult to expect an increase in capital spending of the private sector in the short run. In other words, the economy may worsen to a greater extent in this year. As an observable social phenomenon of this trend, further unemployment might make progress unavoidable. Mr. Koizumi pointed out that his reforms are accompanied by pain, and that if we are afraid of that pain, we cannot implement these reforms. While the Japanese people agree on this point in light of the current unfavorable situation, they actually misunderstand that that pain would be inflicted on a small number of those people who have enjoyed their privileges until today. However, as the current recession further proceeds and the people start seeing unemployment closer to them, then for the first time many citizens will come to realize that the pain can hurt not only those privileged people but also those ordinary citizens. It is unfortunate to say that I doubt that the people will continue to give the same degree of support to Mr. Koizumi as before. In other words, a sudden drop in Prime Minister Koizumi’s popularity is not only conceivable, but I am sure it can happen.

Here, one question arises: what should be done when these negative reactions actually come out? In my opinion, no matter how much the situation may become severe or no matter how radically

Mr. Koizumi's popularity declines, I wish he would carry out his original promise; indeed, Mr. Koizumi must carry it out at all costs. Fortunately, the House of Representatives has two and a half years before closing its term, and also the next elections for the House of Councilors are scheduled two and a half years ahead. That is, there are two and a half years ahead before the next national elections. Therefore, the Koizumi administration can and should spend this period of time in creating a new Japan, without thinking at all about the mid-term dissolution of the Diet. As mentioned above, it is quite reasonable to forecast that at least within the next two and a half years, Koizumi's popularity will fall down as much as it should. Even so, such actions as the dissolution of the Diet should be avoided to overcome the accompanying distress. Still, I would severely caution Prime Minister Koizumi not to make it a part of his political strategy to win and continue to sit on the seat of power by all means in the forthcoming election two and a half years ahead. I would like to repeat that he should not have even a shred of thought of such scenarios as the mid-term dissolution of the Diet in the remaining two and a half years of its term, nor should he hoist his regime or conversely hold on to his position even after two and a half years.

Next, I would like to discuss the plan for the way out from the current situation of the Japanese economy. The greatest reason why the Japanese economy is unable to find a way out of the lingering stagnation is a delay in the disposal of the bad loans. Then, what has detained us in addressing the bad loan problems? Needless to say, land is the core problem in the non-performing loans held by the Japanese financial institutions. During the period of the bubble economy several years ago, banks competed with one another in offering a large amount of loans with the pieces of land as a mortgage. After the collapse of the bubble economy, however, those pieces of land could not be disposed to work out loans because the prices of the land fell significantly. Banks have been obliged to retain the pieces of land whose value has considerably depreciated. The so-called bad-loan disposal, which is supposed to continue for several years from now on, is actually nothing but a higher level of the reserve fund covering the losses of loans. The reserve fund for loan losses is a fund prepared to cover the loss caused by bankruptcy of borrowers, and favorable tax treatment is given to such funds. Non-performing loans have not been worked out directly, but reserve funds were raised. This means that the indirect "disposal" of bad loans is officially approved for taxation purposes. The disposal method used for the past several years has simply built reserve funds, and therefore the amount of bank loans has not been reduced. In other words, non-performing loans are still recorded on the financial institution's balance sheets. The property market is depressed with the lands kept idle by banks without being traded in the secondary market. Land is not effectively utilized to make profits. As a result, the declining land prices have led to a large amount of the

problematic loans. We have been caught in this vicious cycle for the past ten years or so. How can we break down this cycle and solve these problems at the root?

I suggest that favorable tax treatment should be given only to the direct disposal of bad loans; that is, only when they are really written off and no longer recorded on the balance sheets. Indirect disposal or building reserve funds should not be tax-favored. Then, the financial institutions will be obliged to sell lands in the secondary market, and a further downslide in land prices will be prevented. This will give us a fresh starting point.

Of course, the expected side effects cannot be neglected. The financial institutions, which own lands as a mortgage for their non-performing loans, will have to suffer large losses, and some of these financial institutions may go bankrupt. Then, what caused the Japanese financial institutions to struggle with such massive bad loans? Among many causes, one thing is worth mentioning. During the years of the bubble economy, the financial institutions aggressively offered loans to constructors as well as developers. After the collapse of the bubble economy, however, they were unable to collect these loans and the situation has remained the same as it was ever since.

Why then could they not dispose of these bad loans immediately after the burst of the bubble economy? We can find the basic reason in the traditional system of arranging these loans in Japan. Generally, once a project is started, the developers, the contractors and the cash providers take part in as stakeholders. If the project should end in failure in the United States, these losses would be allocated among all the stakeholders with the predetermined percentages, and the account would be closed so far as the project is concerned. This is what is called a non-recourse system of loan. In Japan, the account is not closed in the failure of a project. The developers and the constructors are expected to bear most of the losses, while the financial institutions that advanced the funds usually remain as creditors and try to collect the full amount of principals and interests. Banks do not bear any losses that might be produced. Such a system presented no serious problem in the days when the economy expanded year by year, because the developers were able to pay their debts by starting new projects and by making profits on them. From the onset of the depression, however, such a method of payments turned out to be impossible; hence, the present situation. I do not think that entrepreneurs who will start any new projects will come in unless the traditional system of loan is replaced by the non-recourse system, which is common in the United States, for instance.

Another problem in the Japanese financial system is that personal guarantee is demanded when receiving a loan. Those smaller businesses that request certain loans are usually requested to

offer the personal assets of their owners as a mortgage. On the other hand, the large corporations are exempt from such practices. Once a smaller business fails, banks demand the payment of debts from the persons who have run the company. The demand for payment will not stop until the debt is fully discharged, even after they are dead and succeeded by their children and/or grandchildren. An innumerable number of family members of the small business owners are suffering from the direst distress in this depression. The Japanese financial system has not yet got rid of its pre-modern characters. So long as the financial institutions alone are immune from any risks at the cost of others, the venture businesses will not proliferate in Japan. This is also an underlying cause of the lingering bad debt problems.

The rebirth of the Japanese economy will not be possible without the radical reforms of the financial system. So far, the injection of public funds that prevents a collapse of the financial system is being advocated. However, to use taxpayers' money without the radical reforms to focus on the points above would not solve the problems. The financial institutions should also bear pain and shed blood in the course of the structural reforms. No matter how large-scaled the possible impact on the society as a whole may be, we cannot afford to avoid any structural reforms without sanctuaries. Such reforms may throw a large number of people out of work, but we should be prepared for such unfavorable situations. The highest political priority is to be given not to prevent any further increase in unemployment but to take necessary measures for those people who have lost their jobs. They were thrown out of work partly for their faults, but it was also because they were caught up in the tide of time. All of us must share their pains, and this is what politics should address.

So far, I have sketched out the still lingering, antiquated features in the Japanese economy. Another example can be found in the labor movement. The labor unions in Japan are one of the most fossilized organizations in Japan; indeed, they are the most out-dated organizations in postwar Japan. For instance, there remains a system called "check-off," under which the employers collect union fees on behalf of the labor unions from their employees, or from the labor union members. This is of course an illegal and unfair practice that violates laws concerning the labor unions. However, it had originally been exempted from the labor laws by the occupation authorities in the postwar period as a temporary expedient in order to foster the labor unions. The problem is that it has survived almost unchanged in the following 50 years. Two years ago, the Liberal Democratic Party (LDP) proposed to eliminate this out-of-date system, and astounded the labor union leaders. If the labor unions have to collect union fees on their own, the number of the union members will sharply drop and the labor movement will fall into a shamble, a great concern for these labor unions. In the general election one and a half

years ago, the union leaders made desperate efforts to defeat the LDP candidates in order to stop this movement, and gained considerable success in the end. It was the so-called “the first constituency syndrome.” In the first constituencies of many prefectures, which are relatively urbanized compared to the second or third constituencies, many strong LDP candidates were defeated. Of course, union members accounted for a considerable percentage of the voters in such constituencies. These labor unions are still promoting the unfair labor practices instead of stopping them. Labor union is one of the hindrances against our efforts to surmount the stagnation in the Japanese economy. Prime Minister Koizumi should take the initiative in abolishing the check-off system and in reconsidering the role of labor unions.

Until now, Mr. Koizumi has dealt with the political difficulties by riding on his popularity among the people. Then, how can he manage politics when his popularity declines? As a result, he will have to depend on support from the conscientious Japanese people and also from the United States. Specifically, the first question he faces is how mass media, which is responsible for representing the people of conscience, will react. The posture adopted by mass media over the next two and a half years will probably be of extreme importance for Mr. Koizumi and for Japan’s future. The true value of mass media will be seen from now on.

Second, in order to obtain US support, there must be held much closer discussions than now. In addition, what is most important is for both the United States and Japan to proceed with their domestic policies based on mutual agreement; that is, to construct the mature US-Japan partnership. There is no doubt that the world, especially Asian countries, will increase their demands for Japan's economic recovery. We could never know how to answer this demand without gaining US cooperation. In this point of view, the direction of the US economy will also be very influential. Should the US economy not improve, Koizumi's scenario for the structural reforms in Japan could become impossible to accomplish.

Incidentally, looking at the current Japan-US relations and its vitality, I ask myself whether the Japan-US alliance has become a truly equal alliance both in name and in fact, or whether it has become a matured alliance. I [am not sure] it has not reached at that stage yet, and I would like to focus on this point by citing one example. During the Clinton administration the United States enjoyed unprecedented prosperity. At the same period of time, in contrast, Japan could not clean up the aftermath of the collapse of the bubble economy. In the state of agony, moreover, the recovery of the Japanese economy did not go as effectively as planned. Even the disposal of bad loans, had it been undertaken boldly, would have led to the restructuring of the whole financial system, thereby unavoidably thwarting the economy at least temporarily.

Could such a scenario actually have been deployed considering the large impact it would have had on the global economy and especially on the Asian economy? While such a bold decision was not actually made, a variety of short-term measures were instead taken as time went on. For example, the United States demanded Japan to take concrete measures that would lead to economic recovery immediately. Specifically, the United States pursued economy-stimulus measures focusing on tax reduction. The Japanese government accepted these demands and, even though it has already issued a huge amount of deficit-covering bonds, it sought to implement the economy stimulus measures by issuing a large amount of national bonds again.

This US demand on Japan was basically wrong, and it was a big mistake for the Japanese government to accept it. It is uncertain whether the Japanese and US officials really held a policy discussion during that time. Japan seems to have been forced to accede to the US demands. At that time, the message from the United States to Japan should have been: “Fortunately, the United States is prosperous at present. So, take this opportunity and do not be scared of the temporary hard times. We wish Japan to undertake genuine structural reform measures by starting with the disposal of bad loans and dealing with the post-bubble situation. During this period, the United States would convince the neighboring Asian countries that Japan’s reform would have a big impact upon them and that Japan herself need not be worried.”

I wish that the US message had been like this. I am disappointed to ask why such a scenario for resolving this situation could not be painted. As a result, now that the US economy is worse than at that time, it has become markedly difficult for Japan to implement any drastic structural reforms. What I want to point out is that in the current global age, it is upon policy cooperation that the mature Japan-US relationship should be centered. In my opinion, the current Japan-US relations are still quite far from equality or asymmetry in policy discussions. At any rate, Japan and the United States need to stand on an equal basis and watch widely the state of global affairs. At the same time, for future developments they should make sufficient discussions on the actions necessary at the present and reach any conclusions based on the mutual understanding, which should be then implemented jointly by Japan and the United States. It is only when such a process takes place that the Japan-US partnership develops as the most important relationship in the world as Ambassador Mansfield cherished before. It is important that Japan and the United States share the recognition that this is the historical responsibility for both countries.

Katsuyuki Yakushiji

Thank you for this opportunity to speak at CSIS. I am looking forward to sharing my view today on the Japanese Prime Minister Koizumi's Reform.

1) The Uniqueness of Koizumi Administration

Many Americans are focused on whether the Japanese reformist Prime Minister Koizumi will succeed in reviving the Japanese economy. But before talking about it, I must say that the Japanese political situation is now in chaos. Last week, Koizumi met president Bush in Tokyo, and he promised measures to stop deflation, reform of the Japanese economic structure by forcing banks to write off the bad loans, and deregulations. President Bush publicly declared support for Koizumi's reform and praised Koizumi as a great reformer.

However, after only two days, Koizumi had not enough time to think about these promises, because opposition discovered the corrupt relationship between MOFA and a Diet member, Mr. Suzuki. He is the symbolic politician of the resistance group and people think he is the enemy of Mrs. Tanaka, the former Minister of Foreign Affairs. In the budget committee of the Diet, opposition discovered new facts and accused the government everyday. So the LDP is suffering whether to accept the opposition's demand to summon Mr. Suzuki as a witness to the committee. And Koizumi decided to fire two other top members of MOFA, and ordered Mrs. Kawaguchi to reform MOFA drastically. Mrs. Kawaguchi is now considering firing some ambassadors who had deep relationships with Mr. Suzuki. Last weekend the approval rate of Koizumi continued to decrease to about 30%. Many TV shows and essayists criticized that Koizumi protects MOFA and does not strive to reform it. Some essayist said Koizumi should resign. I think Koizumi is now in the hardest situation since he came to power.

Koizumi knows that if he fails to deal this problem, he will lose power. This problem is not only the relationship between the LDP politicians and MOFA. All the bureaucrats, we say Kasumigaseki, the LDP politicians and industry, have had an informal corrupt relationship for many years. I think these are the real axis of evil. So the reform of this became the most important problem, even more than the economic system reform. And for Koizumi, it is a chance to do it because nobody can oppose it, even LDP's resistance group. And this is the very reform that Koizumi has insisted on for these ten years. Of course it will take few years to finish, but I think without bureaucrats-LDP relationship reform, the economic reform will be impossible.

By the way, before tackling the economic reform, I will talk about the character of Mr.

Koizumi's administration.

The first characteristic is that all parties are in the opposition. There are no parties which support Koizumi, not even the LDP, of which Koizumi is the president. He has only a small-organized faction of support in the LDP. The Conservative Party and the Koumei Party also make up the coalition, and are often against Koizumi's reforms. Under the parliamentary system of government, such a situation is unbelievable. Furthermore, not only the parties, but also the bureaucrats are often against Koizumi, and refuse the reforms.

The second characteristic is Koizumi's motivation of the reform. I must say the strongest motivation is for revenge on the old Mr. Tanaka faction. Historically speaking, Koizumi studied under former Prime Minister Fukuda. Politically Fukuda fought against Mr. Tanaka for long years during the 70's and 80's, and almost always Fukuda lost. Mr. Tanaka made the so-called iron triangle between politicians, bureaucrats, and industry, which now many people criticize as a structure of corruption.

Koizumi hates Mr. Tanaka's way, and said to me, "I must change the LDP in which Tanaka's political way has spread. Such a style will destroy not only the LDP but also Japan. If I become the prime minister, I will destroy the Tanaka faction".

2) What Happened

About ten months has passed since Koizumi came to power, so next I want to explain what he has reformed and the character of his reforms.

First, I will enumerate his challenges. The privatization or the consolidation of the public corporations. The privatization of the Japan Highway Public Corporation, which the so-called road-tribe politicians strongly opposed. Medical insurance reform, which Koizumi intended to increase the burden of the insured, the patients, and the hospitals and clinics. On this issue, the so-called Kousei-tribe politicians are strongly against him. The reconstruction of finance. He reduced the annual expenditures in this year's budget by cutting traditional public works. He controlled the new national bond under three billion yen as he promised.

And he also tried to reform the policy making process. This is what I said at first and it is most important and significant. It means to exclude the participation of the LDP and establish the leadership of the Prime Minister's office. For long years under the LDP government, the Policy

Affairs Researching Council of LDP has had great power in the policy making process. No ministry could decide policies or bills without agreement in advance. There are such cases that if some powerful politician had a complaint, he could amend the policy by complaining to bureaucrats, even if the cabinet council had already decided. But there is no legal ground for this. There are no laws that authorize the LDP to participate in this process. So for example, if a powerful politician succeeded in amending a bill, that his important supporting organization wanted, he would sometimes receive money from the organization. Do you think this is a crime? In Japan, it's not a crime. Because legally he doesn't have the power to amend the bill. He will explain the money as a political donation.

As you know this structure is the corrupt iron triangle, and LDP politicians often use it. It is the LDP's pork-barrel politics. And Koizumi wants to destroy this structure.

But many of these reforms have not been accomplished. LDP members and other coalition party members are against it. They are now in dispute, so there are no effects of reform. And a more important point is that these reforms aim to destroy the old Tanaka faction as I said before. The reform of the public corporations and the change of the policy making process are, of course, very important, but they are not the most urgent problems that the Japanese government must resolve.

The urgent problem is economic revival. But Koizumi is insensitive to economic problems. He explained many measures to revive the economy, but he walked along the same path as the bureaucrats. There was no originality or aggressiveness or sense of impending crisis. My friend, a bureaucrat of MOF, phoned me a few days ago, and complained that when he visited the prime minister's room and explained the economic problems, Koizumi read the papers and said only "It is very difficult." He left the economic issues to ministers and bureaucrats.

3) Forecast

I guess that many of you are most interested in whether or not Koizumi will succeed in his reforms. Or, whether Japan can revive its economy. Of course I don't know. But today I must say something on this issue. Before that, I want to tell about the changes inside the Japanese political world. My job is to watch the Nagatatyo everyday, so I noticed some important changes during these three months. There were 4 significant changes.

1) Mr. Fukuda became the most powerful politician in the Koizumi administration, even more powerful than Koizumi. 2) Next is that the possibility of Koizumi and the Democrats

cooperating have completely disappeared. 3) The third point is the revival of old LDP. Correctly speaking, they have never died and now are openly moving. 4) The fourth point is a serious conflict in the cabinet on economic policy. As you know, all these points will be obstacles of reform. These points are also structural problems, and they are impossible to resolve quickly.

I will explain some points. First, I will talk about Mr. Fukuda. When Koizumi started his administration, Mr. Fukuda, the Chief Cabinet Secretary, was skeptical of Koizumi's reform. Fukuda's style of politics is moderate, and different from Koizumi's radical way. But he knows the center of Japanese politics much better than Koizumi. Fukuda studied politics as a secretary of the prime minister, his father Fukuda. He believes, in Japan, the way to change is by gradual progress. And actually, he coordinated or pulled strings on many things with LDP, bureaucrats, and foreign governments as the Chief Cabinet Secretary. During such a process, Fukuda was appreciated and got into power. Now he is one of the most influential politicians, and Koizumi decides many things according to the Fukuda's advice. That is the important point. Fukuda's way is moderate. He always said, "Japan is not America. We can change the economic system in our own way, not in the American way". And he said "To establish Koizumi's reform, It will take 3 or 4 years. Koizumi should intend the long-term administration."

It is easy to imagine his policy for economic reform. He would reform the system gradually, and avoid the bankruptcy of big banks or large companies. He wants to avoid using public funds to prop up weak banks, or nationalize the big banks, if this is possible.

The next point is the lack of consensus on economic policy in Koizumi cabinet. For example, about using public funds to bank, Mr. Takenaka, minister of Economic and Fiscal Policy, and Shiokawa, minister of Finance, think it will be inevitable. But Yanagisawa, minister of Financial Services and Fukuda are strongly opposed to this. Considering stimulative measures, Takenaka insists on increasing the budget. But Koizumi and Shiokawa are opposed. And the relation between government and Bank of Japan has been bad. Shiokawa and Takenaka often request new measures of monetary ease, but Hayami, the president of BOJ, said that, "BOJ has already done enough. Now it is the time for fiscal measures." [Behind] each minister, bureaucrats exist, and are struggling against each other. And Koizumi has not enough expert knowledge on markets or finance, so it's very difficult for him to take the initiative. It is unusual that the cabinet members' opinions about the most important policy are so inconsistent.

These factors make it difficult for Koizumi to decide drastic policy and move quickly. Obviously Koizumi has changed in December. Now his policies look more moderate. His dashing style has disappeared. The typical case is, as you know, the Daie problem. It looks like Koizumi changed from hard-line to soft-line.

I can come up with three scenarios of Koizumi's economic reform. One, he does almost nothing, and the Japanese economy will be bankrupt soon. Two, he takes drastic and dynamic reform measures, and the Japanese economy will be hurt seriously, but in a comparatively short time it will revive. Three, he does something but only formally, and the Japanese economy will go down gradually.

Some specialists or bureaucrats say ironically that they hope for the first case, because it is the quickest case in which Japan will revive. I think the third case is the worst, but it is most possible. There is no possibility to change the prime minister. There is no good candidate. And Koizumi wants to keep his power for a few years more. And there is no possibility of a general election. No party wants an early election. And now, for the resistance group, Koizumi's more moderate approach is useful.

But yesterday I hit on the forth scenario. Off course, I think the American style of economy is not the only style in the world. There are many ways. And Japan should find its own way to solve the long economic depression. But the LDP considers only how to keep political power, and politicians think about how to keep their seat. Bureaucrats consider how to keep their authority. And they have kept the relationship with each other to get profit.

Now I return to the chaos of the Japanese political situation. I said that Koizumi's aim to reform is to destroy the Tanaka style. This means changing the relations between politicians, bureaucrats, and industry, so that if he succeeds to overcome this political chaos by reforming such a corrupt structure, it will [lead] to economic reform. Of course, it will take very long time, but without political reform, I think, nobody can reform the economic system in Japan. It is an indirect and irritating way, but I think it is the Japanese way.