

MIZUHO RESEARCH PAPER

23

*The Hatoyama
Administration's
Economic Policy Measures:
its impact and challenges*

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Published by
Mizuho Research Institute
Tokyo, December 2009

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Summary

1. The Hatoyama administration's economic policy measures reveal a major shift of policy philosophy. The measures indicate a shift from an economic growth model driven by the corporate sector to one driven by the household sector. Under the successive administrations led by the Liberal Democratic Party (LDP) headed by former Prime Minister Junichiro Koizumi onward, Japanese companies sought to raise their profit-earning capacities and competitiveness by reducing labor costs amid the rise of global competitiveness and labor market deregulation. Under these conditions, households faced with fewer job opportunities and wage declines were unable to enjoy the benefits of economic growth. Furthermore, as evidenced by the sharp economic downturn from the autumn season of 2008, the corporate sector-driven economic growth model proved to be extremely vulnerable to external shocks. The Hatoyama administration seeks to achieve Japan's sustainable economic growth by raising household disposable income and lifting personal consumption through measures such as higher minimum wage levels, stable long-term employment, payment of child allowances, and effectively-free public high school education.
2. Under the economic policy measures of the Hatoyama administration, government expenditures such as public investment will fall sharply in contrast to the rise of household expenditures. In terms of its impact upon economic growth, the measures to support households will start to have a positive impact upon growth in FY2010, lifting nominal GDP by 0.5% from the baseline. However, from FY2011 onward, the slowdown of domestic demand and the impact of government expenditures cuts will have a negative impact upon GDP. Considering that the central aim of the Hatoyama administration's economic policy is the change of income transfers among economic sectors, its overall impact upon economic growth would be neutral. Even so,

since the abolishment of provisional tax rates related to automobiles and the elimination of expressway tolls would push down price levels, the impact of the measures on a real GDP-basis would be positive when taking the price falls into account.

3. Under the Hatoyama administration's economic policy measures, the winners reaping the benefits and the losers subject to the demerits will differ greatly from those under the LDP-led administrations. The private sector, households, workers, small and medium-sized enterprises (SMEs), domestic demand-driven companies and the local regions would be the winners under the Hatoyama administration while the public sector, corporate businesses, large enterprises, export-driven companies and metropolitan areas would be the losers. The elderly, the current working generation and the youth age generation would turn out to be the winners while the future generation subject to higher social security burdens would be the losers. The winners and losers would be reversed from those under the LDP-led administrations. That is to say, the benefits and detriments from a microeconomic perspective would change more drastically than those under a macroeconomic perspective.
4. Several shortcomings have been pointed out with respect to the economic policies of the new administration in terms of their impact upon the economic structure and economic growth over the medium to long term. They are the lack of an economic growth strategy, concerns regarding the loss of fiscal discipline and the absence of a global strategy. Admittedly, the new administration has yet to come up with policy measures possessing specific targets and/or initiatives to raise the potential rate of growth and quantitative gauges of their impact such as those under the previous administration. Furthermore, as far as the FY2010 budgetary process indicates, there are strong expansionary pressures upon expenditures, due in part to the upcoming Upper House elections next summer in 2010. These pressures, coupled with revenue shortages accompanying Japan's economic stagnation, make it very likely that the amount of new

government bond issues to cover new fiscal resources will remain pinned at historical highs. Note the absence of measures to maintain fiscal discipline and specific targets for fiscal rehabilitation. Moreover, its measures regarding the market liberalization of agricultural products and services, and human resources are ambiguous. Doubts also remain as to the effect of each individual measure as well as the consistency of the measures. For example, while the elimination of expressway tolls has the potential impact of contributing to local tourism by reducing the operational costs of corporations, the reduction of greenhouse gases – one of the key measures of the new administration – will have an adverse effect.

5. However, from a different perspective, the new economic policy measures may possess elements which enable the Japanese economy to regain its dynamism and achieve sustainable growth. In other words, implicit economic growth strategies may be built in to the Hatoyama administration's economic policy measures. More rigorous environmental protection regulations may lead to substantial economic gains as a result of Japan taking the initiative to set global environmental standards encompassing the emerging countries. The high hurdles for environmental protection may stimulate corporate technological innovation and business switch-overs, and generate new opportunities for investment and growth. The rise of household and social consciousness toward the environment should spur the Japanese economy's shift to environmental protection. A broader perspective shows that the new administration is definitely not "anti-structural reform". The *Democratic Party of Japan's Platform for Government* (the "*DPJ Manifesto*") explicitly sets forth its stance that it will tackle heretofore unaccomplished reforms such as breaking the government's dependence upon bureaucracy, fundamental pension system reforms and abolishment of business regulation.

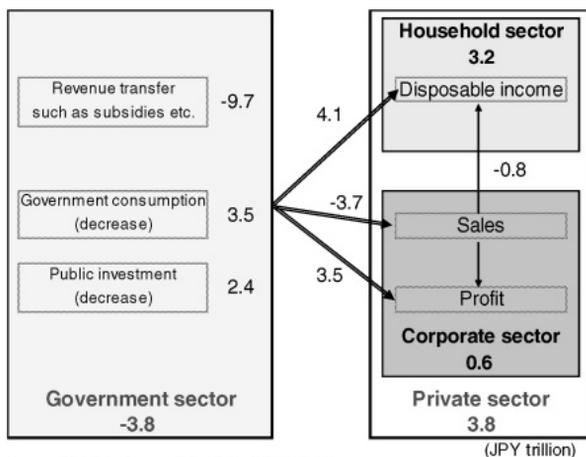
1. The basic philosophy has changed

Since the birth of a new DPJ-led administration, there has been a focus of attention on how the new administration's economic policy measures will affect the Japanese economy. This paper examines the impact of the economic policy measures from both a short-term and mid- to long-term perspective on the basis of the *DPJ Manifesto* and the DPJ's policy measures compiled in *INDEX2009*, the course of policy formation to date from the birth of the new administration, and comments by cabinet members.

Before a discussion on the finer details, the key features of the new administration's policy philosophy at the heart of its initiatives are set forth below along with those of the previous LDP-led administration.

Chart 1 examines the change in income transfers among sectors in the economic policy measures on the basis of the *DPJ Manifesto*. Note that there are two major shifts. (**Chart 1: Income transfers among sectors**)

Chart 1: Income transfers among sectors



Source: Mizuho Research Institute Ltd. (MHRI).

The first is the shift from the government to the private sector. Money controlled by the government will fall by JPY3.8 trillion (FY2013) through tax cuts (abolishment of provisional tax rates on automobile-related taxes) and the reduction of government expenditures (public investment, subsidies toward government-related institutions such as independent administrative agencies). In contrast, income in the private sector will increase by the same amount (JPY3.8 trillion) as a result of the foregoing tax cuts, payment of the child allowance, elimination of expressway tolls and income support toward farm households, and tax cuts and other relief toward SMEs. The foregoing income transfers provide us with reason to believe that the policy measures by the new administration are inclined toward a “small government”.

The second is the shift from corporations to households. While government expenditure cuts will depress corporate sales and earnings both directly and indirectly, the funds thus generated will serve as the financial resources for the measures to support households such as child allowances and high school tuition supplementation. Note also that corporations will need to pay higher labor compensation due to the measures to raise minimum wages and limitations upon employment of temporary workers. This will also increase the transfer of income from the corporate to household sectors.

In simplified terms, the Hatoyama administration’s economic policies will increase household disposable income and consumption through income transfers from the government and corporate sectors to the household sector, thereby raising GDP growth. In essence, this presents a shift from supply-side measures which seek to raise productivity, and ultimately economic growth, through structural reforms such as deregulation and privatization to demand-side measures which seek to achieve economic growth by raising household income and consumption through income distribution shifts.

Amid the acceleration of globalization, the Koizumi administration’s structural reforms (= supply-side reinforcement

measures) succeeded in achieving Japan's export-led economic growth. Putting aside the merits of the issue, it is a fact that economic growth was achieved at the expense of households such as the loss of jobs and decline of wages. Corporations raised their profit-earning capacities and competitiveness by reducing labor costs. This resulted in Japan's export-driven economic recovery. Indeed, 63.9% of the rise of Japan's real GDP from 2001 to 2008 is attributed to exports, which only amounts to 16.0% of real GDP.

Furthermore, the fruits of economic recovery failed to trickle down to households. The labor distribution rate (labor compensation/GDP, on a nominal basis) fell from 54.1% in 2001 to 51.3% in 2007. In other words, the benefits of economic growth did not ripple through to households via the rise of employment and wages. In the process, it led to a widening of the income gap, the increase of the non-regular work force and entrenchment of low-wage labor. This in turn resulted in greater job uncertainties and dealt a heavy blow upon expectations toward future career formation.

However, as shown vividly by the sharp economic downturn subsequent to the financial crisis in the autumn season of 2008, the corporate sector-led or export-led economic recovery was extremely fragile. I suspect that the rise of uncertainties and dissatisfaction toward Japan's corporate sector-driven economic growth coinciding with renewed pressures to cut labor costs in the Japanese economy and corporate sector, was a major factor behind the change of power and accompanying shift of economic policy.

2. How will the Hatoyama administration's policies affect near-term GDP growth?

Then, how much of an impact will the Hatoyama administration's policies have upon Japan's GDP growth in the near term? This will be examined first from the perspective of gross domestic

expenditure (GDE).

Firstly, government expenditures will fall sharply. In FY2013, government consumption will be pushed down by 3.6% from the base line (MHRI's forecast for FY2010) due to spending cuts to generate financial resources. Public investment is also estimated to decline by 11.3% from the base line, given the likelihood of a major revision.

How about the corporate sector? In contrast to the decline of sales accompanying the reduction of public investment, measures such as the tax relief toward SMEs, the abolishment of provisional tax rates related to cars and fuel, and the elimination of expressway tolls should lead to cost cuts for corporations and ultimately result in the increase of operating surplus. An estimation of how much capital investment would be stimulated through the increase of operating surplus shows that capital investment would rise by 2.3% from the base line.

Turning to the household sector, the rise of disposable income and the accompanying expansion of consumption expenditures are expected. As mentioned earlier, the main pillar of the Hatoyama administration's economic policies is their direct support toward households. Household disposable income will increase by JPY10.3 trillion through measures including the child allowance, childbirth benefits, high school tuition subsidies, tax relief for pensioners, the revision of the health insurance scheme for people aged 75 and over, higher wages for nursing care workers and higher minimum wage levels. Even when subtracting the negative impact stemming from the reduction of public worker labor costs, and the restraints upon employment and wages by corporations, disposable income would increase by JPY2.6 trillion and lead to a rise of consumer spending by 0.8% from the base line.

Looking at the impact of the Hatoyama administration's economic policies upon the entire economy, the household support measures would start to have an effect in FY2010. From the point in time that nominal GDP rises by 0.5% from the base line, from FY2011 onward, the measures will start to drag down GDP as a result of a slower pace of private demand and the impact of the reduction of government

expenditures (**Chart 2: Impact upon GDP growth**). Given that the principal feature of the policy measures is the shift of income transfers among economic sectors, the total impact upon the economy would basically be neutral. However, a note of mention is necessary that the abolition of the provisional tax rates and the elimination of expressway tolls would push down prices and, hence, the economic impact of the policies on a real GDP basis, when taking into account such price changes, would be positive overall.

Chart 2: Impact upon GDP growth

(Y-o-y ch, %pt)	FY2010	FY2011	FY2012	FY2013
Contribution of DPJ measures on nominal GDP (a)	0.5	-0.6	-0.2	-0.1
Effect of DPJ measures on the GDP deflator (b)	-0.5	-0.1	-0.1	0.0
Contribution on real GDP (= a-b)	1.0	-0.5	-0.1	-0.1

Source: Made by MHRI based upon various data sources.

3. And the winners and losers are ...

As shown above, the Hatoyama administration's economic policies differ greatly from those under the LDP government in terms of both concept and specific measures. As a result, various economic entities will be affected in unprecedented ways. **Chart 3** sets forth, in simplified terms, the winners and losers under the new economic policies (**Chart 3: The winners and losers under the Hatoyama administration**).

Chart 3: The winners and losers under the Hatoyama administration

The winners	The losers
The private sector	The public sector
Households, workers	Corporations
SMEs	Large enterprises
Domestic demand-driven companies	Export-driven companies
The elderly generation	Future generations
The current (youth) generation	
Local regions	Metropolitan areas

Source: Made by MHRI based upon the *DPJ Manifesto*.

Firstly, as indicated by **Chart 1**, the private sector will turn out to be the winner while the public sector will turn out to be the loser under the new economic policies due to the transfer of income from the government to the household and corporate sectors. The government's influence – thus far maintained through public investment – will decline while the household and corporate sectors will wield a larger influence upon the economy through their larger purchasing power gained through subsidies and tax cuts.

A comparison of the impacts upon the household and corporate sectors shows that the household sector will enjoy greater benefits. The *DPJ Manifesto* contains numerous measures which will serve to increase household income such as the JPY26,000 (approximately USD280) monthly child allowance, effectively free high school education, expansion of employment insurance to non-regular workers, and higher minimum wage levels. Meanwhile, even though corporate tax cuts toward SMEs are scheduled, policies such as raising the minimum wage level and limiting temporary dispatched labor may serve as a large burden upon corporations.

Looking at the policies' impact upon large enterprises and SMEs, the new administration's policies contain numerous measures which will benefit SMEs such as the corporate tax cuts and measures to help subcontractors such as the elimination of unfair practices in business. In contrast, heavy industries will be subject to numerous burdens as a result of the policies' stricter environmental protection

rules. The policies will also have contrasting impacts upon export-driven companies and domestic demand-driven companies. The government's apparent tolerance of a stronger yen and weaker dollar at an exchange rate around JPY90/USD will have a detrimental impact upon export-driven companies. On the other hand, it will serve as a boon for domestic demand-driven companies because of expectations toward the recovery of consumer spending.

Turning to the impact of the policies upon the metropolitan area and the local regions, the elimination of expressway tolls, abolishment of provisional tax rates related to cars and abolishment of local contributions to projects under the direct jurisdiction of the central government will lead to the alleviation of burdens upon local governments. In contrast, there are expectations that measures such as the abolishment of earmarked state subsidies to local governments and their replacement with grants whose use can be freely determined by local governments, and the establishment of a forum for discussions between the central governments and local governments will contribute to the reinforcement of initiatives which are unique to local governments. Although measures such as the reduction of public works, which will weaken the local economy, are being implemented, it is also true that there are not many measures to raise the competitiveness and growth of metropolitan areas. In view of the foregoing, the local regions would be the winners and the metropolitan areas are the losers.

Lastly, let us take a look at the advantages and disadvantages of the policies to the elderly, current and future generations. Judging from the revision of the medical care system for people aged 75 and over which will reduce the burdens upon the elderly generation and raise the benefits for the current generation due to the child allowance and effectively free high school education, both the elderly and current generations would be the winners. Judging from the fact that the Hatoyama administration has yet to present a clear picture of Japan's future pension system and the lack of fiscal resources to fund the social security system, the future generations which will bear the ultimate burdens may be the losers.

4. The medium to long term economic strategy lacks clarity

How will the new administration's economic policies affect Japan's economic structure and growth over the medium to long term? Several issues have been raised with respect to this question. The first is the lack of a growth strategy, the second is the loss of fiscal discipline, and the third is the absence of a global strategy.

The lack of a growth strategy refers to the lack of specific initiatives to raise Japan's potential rate of economic growth through, for example, the cultivation of growth industries. Indeed, the *DPJ Manifesto* states that it will provide support toward industries and businesses in areas which possess growth potential such as (1) advanced technologies including IT, biotechnology, and nanotechnology, (2) the environment-related sector, (3) the agricultural, forestry and fishery industries, and (4) the medical and nursing care industries. However, the policies set forth in the *DPJ Manifesto* pale in comparison with the previous LDP administrations' numerical targets and measures as well as their quantitative evaluations set forth in policy packages such as the *Economic and Fiscal Reform 2009 ("Basic Policies")* and the *J Recovery Plan* (**Chart 4: Key points of the LDP's growth strategy**)

Chart 4: Key points of the LDP's growth strategy
(based upon the *Economic and Fiscal Reform 2009*)

<p>Low-carbon revolution</p>	<ul style="list-style-type: none"> * Push forward the plan to become the world's number-one solar power and energy efficient nation (by increasing the proportion of renewable energy in final energy consumption to 20%, the world's highest level, by 2020, and increasing solar power to 20 times the current level by 2020) * Push forward the plan to become the first nation to popularize eco-cars (by increasing the share of eco-cars in new car sales to 50% by 2020) * Promotion of the low-carbon traffic and urban revolution and the plan to turn Japan into a resource-rich country
<p>Health and longevity</p>	<ul style="list-style-type: none"> * Push forward plans to strengthen aged care services (by creating 300,000 new jobs in the aged care sector over a three-year period) * Push forward plans to strengthening local medical care functions and creating healthcare industries * Push forward medical and aged care new technology innovation plans (including support for the development of unapproved drugs and for acceleration of the medical product evaluation process, support for vaccine development and for the establishment of production systems which can significantly shorten the production time of vaccines against the new influenza virus)
<p>Promoting the attractiveness of Japan</p>	<ul style="list-style-type: none"> * Push forward plans to realize the potentials of the agriculture, forestry and fishery sectors (triple the number of plant factories within three years) * Push forward plans to exert Japan's capabilities as producer of software and media contents (raise the export ratio of media contents to levels comparable to the US by 2020) * Push forward plans to turn Japan into a magnet for global tourism (attract 20 million tourists/year from overseas by 2020) * Push forward plans to upgrade human resources and technological potential and bringing out Japan's underlying IT potential

Source: Cabinet Office, *Economic and Fiscal Reform 2009*.

The Hatoyama administration's policy is also ambiguous with respect to its commitment to the recovery of fiscal discipline. Even though the *DPJ Manifesto* refers to the achievement of a primary balance surplus and a definite reduction of the government debt-to-GDP ratio, the deadline for achievement and specific roadmap are uncertain. In contrast to the LDP administrations' target to attain a surplus of the primary balance of both the central and local governments by FY2011 through spending cuts of JPY11–14 trillion and tax hikes of JPY2–5 trillion in the *Sainyu-saishutsu Ittai Kaikaku 2006 (Overall reform of revenues and expenditures 2006)*, the *DPJ Manifesto* fails to provide a message that the Hatoyama administration is extremely conscious of fiscal discipline, even when discounting the rise of future uncertainties due to the subsequent economic crisis.

Furthermore, judging from the size of the FY2010 budget request which has reached JPY95 trillion and has surpassed the FY2009 initial budget by JPY6.5 trillion, and the certainty of a sharp tax revenue shortfall under Japan's economic stagnation, the chances are slim that the amount of initial government bond issues will fall far below the historical high of JPY44.1 trillion following the FY2009 supplementary budget under the administration led by former Prime Minister Taro Aso.

The Hatoyama administration's policies to cope with globalization also lack clarity. Prime Minister Yukio Hatoyama wrote in "My Political Philosophy" in the September 2009 issue of the monthly journal *Voice* that "if we look back on the changes in Japanese society that have occurred since the end of the Cold War, I believe it is no exaggeration to say that the global economy has damaged traditional economic activities and market fundamentalism has destroyed local communities." It is from this standpoint that policy concepts such as attention toward nature and the environment, the reconstruction of the welfare and medical systems, the reinforcement of the education and childcare environment and the correction of the income gap are developed.

On the other hand, however, it would be difficult to provide an outlook on Japan's economic recovery away from the currents of globalization. How will Japan cope with the reality that the middle classes of the emerging economies are the drivers of global economic growth? While the liberalization of trade and investment based upon free trade agreements (FTAs) and the World Trade Organization (WTO) provide some of the infrastructure for such purposes, the DPJ does not necessarily provide well-defined policies regarding market liberalization and acceptance of foreign workers into agriculture and professional services such as medical care. Even though Prime Minister Hatoyama commented on the creation of an East Asia community in the future, specific directions or overviews to realize such ends have yet to be provided.

5. Doubts regarding the impact and consistency of the policy measures

Doubts also remain regarding the impact and consistency between each of the policy measures.

The Hatoyama administration is trying to revitalize the local economies by reducing distribution costs and prices through the elimination of expressway tolls and the abolition of provisional tax rates on car-related items. Indeed, there are media reports that the volume of traffic increased and that business is booming for local tourist sites as a result of the reduction of expressway tolls on holidays (“all-you-can-drive for JPY1,000) implemented under the LDP administration and initiatives by local governments such as the reduction of the Tokyo Bay Aqua-Line expressway (a bridge-tunnel combination across Tokyo Bay in Japan connecting the city of Kawasaki in Kanagawa Prefecture with the city of Kisarazu in Chiba Prefecture) toll by Chiba Prefecture. Furthermore, there is no doubt that the reduction of expressway tolls and fall of gasoline prices will contribute to the upturn of earnings among small carriers. According to research by the Japan Trucking Association, current profits of small trucking companies stand at a meagre JPY1.9 million/company (FY2005). Assuming that all other factors are kept constant, the alleviation of expressway tolls (JPY9.5 million/company) and fuel costs (JPY32.1 million/company) would lead to a major improvement of corporate earnings.

On the other hand, some indicate that the measures may have a detrimental effect upon regional economies. The increase of private automobile usage could lead to the reduction of earnings for expressway buses operated by regional bus operators. In turn, this may lead to the reduction of local bus routes which are currently funded by expressway bus earnings, resulting in inconveniences for local residents. Furthermore, there are concerns that the decline of truck operating costs will raise the competitiveness of large truck operators and drive out small regional carriers. The increase of

traffic congestion may also lead to the loss of business opportunities for locally-produced perishable food in metropolitan areas.

Moreover, the increase of traffic is contradictory to the reduction of greenhouse gas emissions which is one of the key policies of the Hatoyama administration. According to estimates by the research arm of the Coalition of Local Governments for Environment Initiative, a nonprofit organization, the shift from railroad, bus and air transport to private automobiles will increase the volume of emissions by 9.8 million tons per year (0.8% of total emissions in FY2007).

The impact of the Hatoyama administration's key economic policy measure to increase household income may also diminish substantially.

The administration is seeking to achieve stable long-term employment by raising minimum wages (setting a national minimum wage level of JPY800/hour and raising the national average minimum wage level to JPY1,000/hour) and banning, in principle, the dispatch of temporary workers to manufacturing jobs and the registration of temporary workers. In fact, there is no doubt that raising the minimum wage level will contribute to the contraction of the income gap among workers. In FY2007, minimum wage levels in 13 prefectures mainly in metropolitan areas fell short of livelihood assistance. Furthermore, Japan's minimum wage level (national average of JPY713/hour, approximately USD8/hour) is lower than the US (USD9.25/hour), the UK (GBP5.80/hour) and France (EUR8.82/hour). However, in view of the fact that 10% of all workers are assumed to be working under the minimum wage of JPY800/hour and that the minimum wage level in regional areas is only slightly above JPY600/hour, the measure to raise minimum wages will serve as considerable labor cost pressures upon SMEs in regional areas and may well result in the reduction of jobs.

The stricter regulations upon the dispatch of temporary workers may not necessarily lead directly to the expansion of stable long-term employment. Note that the shift of temporary workers to direct and regular employment will serve as considerable costs for

companies. Furthermore, if temporary dispatched workers are shifted to contract workers, the odds are high that it will not necessary lead to a significant rise of wages for workers.

6. Implicit growth strategies

As mentioned above, the Hatoyama administration's economic policies are subject to criticisms that they lack growth strategies to spur the economy over the long term. In a survey of corporate managers conducted by Nikkei newspaper, an overwhelming majority of the responses cited the need for a growth strategy such as the nurturing of new industries and innovation (September 1, 2009, Nikkei newspaper)

In its *Supplementary Sentences to the Party Manifesto* released on August 11th, the DPJ did in fact set forth measures to support advanced technologies such as IT, biotechnology and nanotechnology, and to support future growth industries such as the environment-related sector, the agricultural, forestry and fishery industries, and the medical and nursing care industries. Even so, the measures' lack of depth and novelty may have led to the strong expectations among corporate managers.

In contrast, Professor Eisuke Sakakibara of Waseda University claims that the path to Japan's economic recovery will become self-evident through the measures such as the promotion of agriculture, abolishment of provisional tax rates, elimination of expressway tolls and payment of child allowances (“*Seichosenryaku nado nakutemoyoi*” (We don't need a “growth strategy”), *Bungeishunju*, October 2009).

My views are slightly different from both.

Indeed, the Hatoyama administration has failed to deliver a clear growth strategy. For example, it does not provide any strategies which would satisfy corporate managers such as details on

assistance toward bio-industries and environment-related industries and concrete figures on employment and economic growth stemming from such assistance. While it goes beyond doubt that the DPJ's policies possess the potential to spur the growth of the agricultural sector, reflecting the rise of domestic and overseas interest in the quantitative security and safety of food resources, the measures do not provide how Japan's agricultural sector can upgrade its competitiveness, and how it can contribute to sustainable economic growth and income growth.

On the other hand, Professor Sakakibara's indications are also ambiguous. While the elimination of expressway tolls may lead to the reduction of physical distribution costs and contribute to local tourism on one hand, it is unclear whether they are capable of achieving Japan's sustainable economic growth when considering (1) the negative impact upon public transportation such as railroads and ferries, (2) the rise of physical distribution costs accompanying road traffic congestion, (3) the oligopoly of carriers and shakeout of regional carriers, and (4) its negative impact upon the environment. With respect to the stimulation of the agricultural sector, doubts remain as to how the individual household income support allowances will strengthen the competitiveness of the agricultural sector.

My impression is that "even though the Hatoyama administration itself may not be aware of it and that doubts remain with respect to its consistency, the *DPJ Manifesto*, the *INDEX2009*, and the administration's policies based upon such policy platforms may contain basic policies which enable the Japanese economy to regain its dynamism and achieve sustainable growth." Put differently, instead of individual and specific growth strategies, there are implicit growth strategies embedded in the measures.

7. Environmental measures will spur Japan's dynamism

Take environmental measures as a start. The DPJ's medium-term target (2020) of reducing greenhouse gas emissions by 30% from 2005 surpasses the 15% target set forth by the previous administration.

The previous administration led by former Prime Minister Taro Aso of the LDP claimed that a 15% reduction target is extremely ambitious and estimated that it would need to maximize the usage of the most efficient energy-saving appliances currently available, such as increasing solar power electricity by 20-fold. Furthermore, the previous administration claimed that a 15% reduction would impose costs such as the decline of the economic growth rate (0.6%) due to the fall of global competitiveness and fall of exports, and the rise of burdens upon households (JPY70,000 a year/household). Such estimates lead to the view that a further reduction of greenhouse gas emissions would neither be desirable nor realistic for the industrial sector, the household sector and the Japanese economy as a whole.

However, the reinforcement of environmental regulations possesses the potential to develop into an important growth strategy for Japan.

Firstly, the reduction of emissions in emerging countries which emit approximately 50% of the total volume of emissions is essential for the progress of greenhouse gas emission reductions on a global scale. If Japan sets forth a target surpassing other industrialized countries and accelerates its innovation of environmental and energy-saving technologies and social systems, it may develop into a global standard encompassing the emerging countries (**Chart 5: Greenhouse gas emission reduction targets**). The Windows OS is more than enough to illustrate the tremendous influence, competitiveness and economic benefits stemming from the establishment and maintenance of a global standard. At the same time, the possession of brilliant technology on an individual and

separate level may eventually be swallowed in the wave of global competition without the strong will and strategy to develop it into a global standard.

Chart 5: Key Greenhouse gas emission reduction targets (2020)

	Reduction rate (%)	Reference year	Inclusion of LULUCF
Norway	30	1990	Y
EU	20-30	1990	N (20%), Y (30%)
Switzerland	20-30	1990	Y
Lichtenstein	20-30	1990	N
Australia	5-25	2000	Y
Canada	20	2006	TBD
Monaco	20	1990	-
Ukraine	20	1990	TBD
New Zealand	10-20	1990	Y
Japan	25 (30)	1990 (2005)	Y
Iceland	15	1990	Y
Russia	10-15	1990	TBD
Belarus	5-10	1990	TBD

Notes: 1. Abbreviations: N = no; TBD = to be determined; Y = yes;

LULUCF = land use, land-use change and forestry

2. The figures in () for Japan refers to the breadth of reduction from 2005.

Sources: Made by MHRI based upon United Nations, *Information on possible quantified emission limitation and reduction objectives from Annex I Parties* (August 19, 2009) and DPJ material.

Secondly, the establishment of higher hurdles may spur technological innovation. As mentioned above, the previous administration's 15% reduction target was established upon the premise of the maximum usage of top level energy-saving appliances on a realistic basis. However, various companies including venture corporations are stepping up their development of electrical cars, following the tightening of US environmental regulations. At the same time, efforts to reduce the weight of vehicles and raise their fuel efficiency through the use of new materials is also progressing. The mutual effect of regulatory tightening and technological innovation will enable a far larger reduction of greenhouse gas emissions.

Thirdly, it would also be necessary to take heed of the changes progressing in the entire society. A look at the trends in emissions by sectors reveals that emissions are declining in industrial sectors such as factories in contrast to the sharp rise of emissions in offices and households. Amid these trends, there seems to be a rising awareness toward energy conservation and environmental protection particularly among households and individuals. Sales of bicycles are rising in contrast to the decline of car sales and ownership. Energy-saving household electrical appliances are also selling briskly, due partially to the impact of government subsidies. Energy-saving and environment-conscious consumer behavior has the potential of developing into a major trend.

Assuming the current economic and industrial structure as the basis for discussions, there is no doubt that the higher reduction targets would serve as a large burden upon the corporate and household sectors. There are estimates that the Hatoyama administration's reduction target would raise costs by a maximum JPY360 thousand/year on a per household basis and JPY190 trillion in 10 years for the entire domestic economy. On the other hand, however, the costs may be absorbed if the technological innovation and creation of new markets spurs economic growth and leads to the rise of income. While it would be necessary to conduct quantitative analysis as to whether the size of the cost increase accompanying the tightening of regulations can be absorbed, the socioeconomic shift to a low-carbon society will fail to progress if we perceive the reduction targets as cost pressures and avoid challenges. The path toward growth will only unfold by perceiving the higher greenhouse gas emission targets as opportunities for the creation of new markets and new business chances.

This can be illustrated by looking back upon the past oil crises. The two oil crises in the 1970s brought about a 13-fold rise of energy prices (the rise of the yen-based unit price of crude oil imports from 1970 to 1982). As a result, the value of crude oil imports as a percentage of nominal GDP rose sharply from 1.1% in 1970 to 5.0% in 1980 and the rate of economic growth also declined.

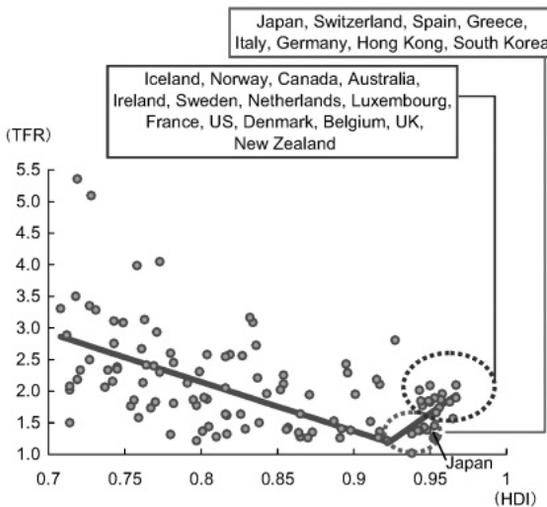
Energy-intensive industries such as aluminum smelting, open-hearth furnace and petrochemical industries fell into a crisis as structural recession-prone industries. Looking back, the absorption of such sharp cost pressures must have been perceived as an enormous challenge.

In reality, however, the industrial and corporate sectors stepped up their energy and resource conservation efforts, leading to their structural transformation into energy efficient industrial sectors such as electronic products and small automobiles. By analogy from such experience, the tightening of environmental regulations and strong inclination toward a low carbon society may be perceived as a major turning point to generate the dynamism of the Japanese economy in the private sector leading to sustainable economic growth. In other words, even though the Hatoyama administration does not have a clearly focused economic growth strategy such as the one set forth by its predecessor or one that would satisfy economists and corporate managers, it may have a growth strategy of a different sort which would spur the dynamism of the Japanese economy and lift its growth rate.

Moreover, the spate of measures to raise Japan's birthrate and increase the number of children such as the creation of a child allowance, payment of a lump-sum childbirth benefit and elimination of child day-care waiting lists should raise Japan's economic growth rate over the long term. **Chart 6** examines the relationship between the birthrate and the Human Development Index (HDI) (composed of factors such as per capita GDP and school attendance rate) based upon "Advances in Development Reverse Fertility Declines" in *Nature* (August 6, 2009) (**Chart 6: the Human Development Index and the birthrate**). The chart indicates a downward-sloping relationship between the two (meaning that the birthrate declines as the HDI rises). However, there is a tendency of the birthrate to turn upward once the HDI rises above a certain threshold. While the various measures taken by each of the countries may be a plausible factor behind this tendency, note that Japan falls below the trend line. This supports the interpretation that Japan's lag in measures to

address the falling birthrate is hampering the recovery of the birthrate. Given the rising awareness that childrearing should be supported by society as a whole (evident in the Hatoyama administration’s plans to abolish the tax deductions for spouses and dependents in a bid to provide for fiscal resources for the child allowance), the steady implementation of measures to support childrearing such as the improvement of child day-care facilities and promotion of childcare leave should eventually raise the birthrate and lead to the improvement of Japan’s long-term economic prospects.

Chart 6: the Human Development Index and the birthrate



- Notes: 1. The Human Development Index (HDI) measures the average achievements in a country in three basic dimensions of human development: a long and healthy life, knowledge and a decent standard of living. More precisely, it uses average life expectancy, educational attainment and GDP per capita as measures. The HDI has been reported in the Human Development Report of the United Nations Development Programme (UNDP) from 1993 onward. Readings in the chart above are based upon the HDI for 2005.
2. Data on the Total Fertility Rate (TFR) pertains to 2005 to 2010 in the United Nations *World Population Prospects* from the perspective of global comparison.

Source: United Nations Development Programme (2008), *Human Development Report*, United Nations, *World Population Prospects: The 2008 Revision*.

8. Pro-reform or anti-reform?

There appears to be a growing perception among the media and economists that the Hatoyama administration runs counter to structural reform. Admittedly, there are sections in the aforementioned “My Political Philosophy” by Prime Minister Hatoyama which claim that market fundamentalism brought about socioeconomic collapse. Many of the administration’s measures such as the reexamination of temporary workers and postal privatization also seek to adjust the reformist policies thus far. Such developments have led to the view that “Japan’s Victors Set to Abandon Market Reform” (*New York Times*, September 1, 2009).

However, a look at the entire *DPJ Manifesto* reveals many policies which seek to succeed or accelerate the reforms from the previous administrations. As evidenced by the review of the FY2009 supplementary budget and the course of preparations of the FY2010 budget, the Hatoyama administration takes an extremely clear politician-led stance departing from Japan’s past dependence upon bureaucrats in the policy formation process. These are initiatives which were attempted but could not be achieved under the LDP-led administrations. The revision of the budget and the adoption of multiple-year appropriations were also achieved only on a partial basis despite indications of their necessity. The fundamental overhaul of the pension system including the unification of an income-scaled pension system and the creation of a minimum guaranteed pension is also based upon cumulative discussions on reform across a wide spectrum including politicians, bureaucrats, experts, mass media and citizens.

The DPJ has traditionally aspired for a free market society under fair and transparent market rules and has championed for, in principle, the abolition of business regulations. If these principles were leading to the Hatoyama administration’s “reforms”, the perception that “the new administration is seeking to stop the structural reforms and runs contradictory to market mechanisms”

would be too much of a stereotype.

As discussed above, there are many facets of the Hatoyama administration's economic policies which differ substantially from the preceding LDP administrations. Given the severe state of Japan's economy and fiscal conditions, all of the initiatives will not necessarily be implemented at once. The policy measures might eventually be faced with forces requiring its contraction or policy reversal. From an overall perspective, my current view is that there is no doubt that the new economic policies will change the structure and growth mechanism of the Japanese economy and that it will have a positive impact upon the rate of sustainable economic growth.

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