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Abenomics After Japan’s Upper House Election

KAY SHIMIZU

On July 21, the ruling Liberal Democratic Party (LDP) and its coalition partner, the New Komeito Party, won control over the upper house of the Diet, effectively resolving a legislative impasse stemming from a divided parliament (or “twisted Diet,” as it has been called in Japan). Most observers interpreted the victory as a clear mandate for the government of Prime Minister Shinzo Abe and his strategy—widely known as Abenomics—to end Japan’s persistent deflation and stagnation.

The euphoria of victory is quickly subsiding, however, and the more mundane details of the election results may cast a shadow over the future of Abenomics. In fact, the LDP’s election performance failed to meet news media predictions, leaving the party without an outright majority on its own. The coalition partners together also failed to win the 162 seats necessary to pass constitutional amendments in the upper chamber.

Abe had called for changing the country’s post–World War II constitution, lowering the bar for further amendments and allowing Japan’s armed forces to take on a more assertive role. But now, despite the pre-election focus on revising the national charter, the prime minister lacks the necessary votes in the legislature, forcing him to wait at least another three years for such an opportunity.

In the meantime, Abe’s main focus will remain on economic reforms, which must now make the tricky transition from a quick-fix recipe to a longer-term strategy. Although July’s electoral victory was a necessary condition for pushing Abe’s economic program forward, a closer look at the election results and the prime minister’s current

political positioning reveals a number of challenges ahead.

THE BIG WIN

The Diet’s upper chamber, the House of Councilors, has a total of 242 members, each elected for a six-year term. Elections are held every three years to fill half of the chamber’s seats. Of the 121 seats contested in each election, 73 belong to prefectural constituencies, while 48 are filled by nationwide proportional representation. The 73 prefectural constituency seats are apportioned among Japan’s 47 prefectures according to population. Each voter chooses just one candidate, regardless of the number of seats in his or her prefecture, by writing in the politician’s name.

In the proportional representation ballot, voters write in either the name of their preferred party or the name of a candidate from a list prepared by the parties. The number of votes cast for each party and its candidates are tallied, and seats are allocated to the parties in proportion to that tally. Before the July election, the LDP held just 84 out of 237 seats (5 seats were unfilled), of which 34 were up for reelection; the main opposition party, the Democratic Party of Japan (DPJ), held 86 seats, of which 44 were up for reelection.

The LDP won 65 of the 121 seats up for election, surpassing the number of seats it won (64) under wildly popular Prime Minister Junichiro Koizumi in 2001. The Komeito won 11 seats, giving the winning coalition a total of 135 out of 242 seats, an increase of 32 seats. Pre-election polls predicted an even greater winning margin, but the LDP failed to win the 72 seats necessary to secure a majority on its own.

The LDP, however, did manage to win in all prefectural constituencies except for Iwate and Okinawa, demonstrating strong nationwide support. In contrast, the DPJ won just 17 seats, los-

KAY SHIMIZU is an assistant professor of political science at Columbia University.

ing 27 seats and control over the upper house, confirming fears that the party was losing a continuing struggle to remain relevant. The Japan Restoration Party and Your Party did no better, as all three opposition parties failed to mount a credible campaign with clear and attractive alternatives to the LDP's economic policies. The overwhelming loss for the DPJ has left the Japanese political system once again devoid of an effective opposition, ushering in a new period of democratic malaise.

SO FAR, SO GOOD

The good news for Abe is that voters plainly support his government's efforts to dramatically improve Japan's economic trajectory. Soon after he returned to office in December 2012 (he had served as prime minister in 2006–07), his administration unleashed the first arrow of a three-pronged attack, monetary easing, along with a second arrow, a massive supplementary budget to fund a fiscal stimulus plan.

In the context of a sluggish global economy, markets welcomed these bold moves in Japan, providing a much needed boost to economic activity. Since December, the Nikkei Stock Index has risen by roughly 50 percent, and the Japanese yen has depreciated by over 15 percent against the dollar, helping to encourage investment and exports. During the first quarter of 2013 the economy recorded a strong 4.1 percent annualized growth rate, and in June consumer prices rose by 0.4 percent. Presumably in response to these positive signs, nationwide polls taken in late June and early July demonstrated a robust 50 percent to 60 percent approval rating for the Abe government.

At the same time, other polls have shown that many citizens have yet to benefit directly from the economic recovery. Surveys from early June by the national newspaper *Asahi Shinbun* found that only 18 percent of respondents personally felt the economic recovery, while 78 percent said they did not. The Labor Ministry announced that average monthly wages rose 0.3 percent in April from a year earlier to 273,427 yen (\$2,746)—hinting at the possible reversal of a long-standing decline in real wages of about 10 percent since the 1990s. But by and large, Abenomics so far has stopped short of putting real money in the pockets of consumers.

In short, we might interpret votes for the LDP as a show of support for the aggressive approach of Abenomics, with high hopes that growth will continue and that economic recovery will soon reach the average consumer. So how will the results of the upper house elections affect Abe's ability to answer the hopes of his supporters?

EASY MONEY

From the moment the LDP took power in December, the first goal of Abenomics was to win this year's House of Councilors elections. Toward that end, the government adopted an aggressive approach to combat deflation and stimulate growth quickly. In early January, despite a prevailing global economic consensus calling for limited monetary expansion and fiscal austerity, the Abe administration unveiled a 10.3 trillion yen (\$116 billion) fiscal stimulus package to boost growth. About 3.8 trillion yen was to be used for disaster prevention and reconstruction, with 3.1 trillion yen directed to stimulating private investment and other measures. The government hoped that the extra spending would help achieve a 2 percent increase in gross domestic product and create 600,000 additional jobs.

By March, Abe had appointed Haruhiko Kuroda as governor of the Bank of Japan with a mandate to achieve a 2 percent inflation target. Since then, the central bank has greatly expanded the monetary supply. Abe has bolstered this strategy with a series of concerted moves, everything from getting out the message that "Japan will grow" to placing staunch supporters in the right positions. The government has also agreed to join negotiations over the Trans-Pacific Partnership (TPP), a free trade agreement in the works for the Asia-Pacific region, taking even the most optimistic of Japan watchers by surprise. Japanese voters in July responded by rewarding Abe's vigorous leadership, clear goals, and quick success.

In truth, the policy content of Abenomics is nothing new. Economists have long argued for just such an aggressive attack on long-term deflation. What is new is that Japan has at last stopped making fiscal policy the hostage of monetary policy. Instead, it has launched the kind of two-pronged monetary/fiscal stimulus that has thus far eluded Europe's troubled economies.

Structural reform will need to be instigated with the same kind of fervor and coordination that Abe brought to monetary policy.

It may seem odd that of all the countries suffering from economic sluggishness, Japan with its long-stagnant economy and consensus-style politics is the one able to overcome the political barriers to change. Yet the revived LDP was uniquely positioned to quickly organize a nationwide rally around voters' primary concern, the economy. For most of the postwar period, the LDP has enjoyed control over Japanese politics, save a brief period of DPJ rule (2009–2012). The LDP support base remains wide, and bureaucrats are familiar with its style of leadership. The real battle, however, lies ahead, as Abe must carefully navigate past many obstacles.

THE ELUSIVE THIRD ARROW

Abe's greatest challenge in the months ahead will be to put Japan firmly on track toward long-term economic recovery and growth. The Bank of Japan has already pushed the limits of monetary expansion. And given the country's high level of debt, which is expected to reach 240 percent of GDP next year, further fiscal stimulus may place too much pressure on the economy, notwithstanding Japan's seemingly bottomless appetite for government debt. Thus attention inevitably will turn to the third arrow of Abenomics, broadly characterized as structural reforms.

Of the three parts that make up the core of Abenomics, the third has proved the most elusive. Vaguely titled "a growth strategy to entice private investment," its content has been specified much less than the plans for monetary easing and fiscal stimulus. On June 5, the administrative body for microeconomic policy, the Economic Revitalization Headquarters, issued a report entitled *The Japan Growth Strategy—Japan Is Back*. This was the government's first attempt at articulating its vision for the third arrow. During the recent electoral campaign, the LDP also incorporated several policies aimed at achieving long-term economic growth into its campaign promises. Combined, these statements offer the best hints about the reforms to come until further details emerge.

Cautiously released just before the upper house elections, the June report's content proved largely disappointing to reformers who hoped to see more concrete plans that would lead to fundamental changes in the economy. To be sure, the revitalization report called for some strong measures, especially for the health care industry. It outlined lifting a ban on the online sale of drugs, for example, and steps to allow patients to pay privately

for advanced drugs without forfeiting public coverage of the rest of their treatment, as happens now. Much of the rest, however, amounted to old-fashioned industrial policy—which has been tried, and has failed, before.

Several concrete proposals—including for the expansion of airports in the greater Tokyo metropolitan area, and the creation of special deregulated economic zones for select industries, such as medical services and agriculture—seem promising. But the content and scheduling of these plans remain unclear.

Meanwhile, more meaningful deregulation in key industries such as the energy sector, labor market reforms to allow for downsizing and greater turnover, and steps to make agriculture more competitive in preparation for the Trans-Pacific Partnership were all set aside. Truly bold measures, such as boosting immigration or changing the electoral system to give proper weight to young and urban voters, were left off of the agenda entirely.

Now several key decisions on the economy await, including consumption tax hikes and the TPP. How the Abe government deals with these issues will be strong indicators of where Japan is headed over the next several years.

TAX AND TRADE

While still in opposition in 2012, the LDP and Komeito negotiated an agreement with the then-governing DPJ to raise the country's consumption tax by 3 percent to 8 percent in April 2014, and then again to 10 percent in October 2015. Over the medium to long term, such efforts toward fiscal consolidation are necessary to control the country's vast public debt. Raising tax rates prematurely, however, could undermine efforts to stimulate domestic demand and will incite strong voter opposition, a prior mistake the LDP is determined not to repeat.

Opponents of the tax hikes have played to such fears, proposing to abandon them in light of currently strong economic indicators, which they assume will allow the country to grow out of its debt. The economists Gary Hansen and Selo Imrohoroglu have calculated, however, that if we assume current levels of social welfare provisions, at an inflation rate of 1 percent, Japan will need to raise consumption taxes to roughly 33 percent to avoid runaway debt.

Even if Japan were to achieve its target inflation rate of 2 percent, thereby alleviating some of the

pressure from pension expenditures, preventing runaway debt would still require consumption tax rates of around 28 percent, they figure. Thus, absent a drastic reduction in social welfare spending, monetary expansion alone cannot serve as a long-term growth strategy. Abe appears to recognize these limits, and if economic performance in the second quarter looks promising, his cabinet most likely will raise the consumption tax as scheduled. The question is at what political cost.

Even more divisive than the consumption tax, the issue of whether to join the TPP is perhaps the most difficult decision facing the Abe government, largely due to the presence of numerous opponents within his own party. The Central Union of Agricultural Cooperatives, Japan's leading agricultural organization, claims that 121 of the 294 LDP members in the Diet's lower chamber oppose participation in the TPP negotiations.

Abe first announced in March the decision to participate in the trade talks, citing the need for greater economic openness to stimulate domestic growth. He demonstrated his resolve to stand by his decision by having Japan formally join the round of TPP negotiations under way in Malaysia immediately after the election. But Abe's suc-

cess in this endeavor will depend largely on the government's ability to negotiate a good deal for Japanese agriculture within the TPP, so as to minimize intra-party opposition and contain the short-term economic and political costs of participation.

Unfortunately, the nature of such negotiations means that Abe must bargain with his opponents and distribute some direct income compensation to farmers well before the Japanese economy realizes any gains from joining the regional free trade agreement. According to a joint survey by the *Asahi Shinbun* and the University of Tokyo, there is now more LDP opposition to the TPP within the parliament's upper house than before the election. Even if Abe succeeds in guiding Japan to full participation in the TPP, the political costs are bound to be quite high.

CHALLENGES FROM WITHIN

Gaining control over the upper chamber was critical for pushing Abenomics forward, including on issues such as the consumption tax hike and the TPP. But a coalition majority does not guarantee support for Abe's policies. LDP control over the two houses of parliament may facilitate some changes, but not all. For a number of reasons,

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there will be limits to what resolving the “twisted Diet” can achieve.

One challenge lies within the LDP, particularly among its House of Councilors members. Since the LDP came to power late last year, Abe has shown strong leadership, especially in economic affairs. In a speech in London in June, Abe articulated his own commitment to further reforms by borrowing the words of Margaret Thatcher: “There is no alternative,” he said. Whether other members of his party are equally committed to pushing reforms forward, however, remains questionable.

In the July election, the LDP benefited from a weak opposition, which failed to put together a clear and viable alternative to Abe’s policies. LDP candidates rode to victory on the popularity of their party and its recent economic success, allowing them to gloss over detailed policy positions during campaign speeches in favor of their party’s broader campaign slogans. Yet, less than a year ago, both the LDP and the DPJ revealed deep internal fissures precisely on the contentious issues currently under consideration, including the consumption tax hike and the TPP.

Before the upper chamber elections, LDP members could pacify anti-reform constituents by playing up the benefits of belonging to the ruling party and maintaining direct influence on the government. Now that the elections have come and gone, interest groups such as the regional farmers’ organizations and their representatives are freer to voice their opposition to the Abe administration’s policies, including the plans to join the TPP negotiations. While Japan’s farmers may no longer be able to stop their country’s participation in the TPP, they may pressure the more cautious members of the LDP to form opposition groups within the ruling party, creating potential headaches for Abe.

SPECIAL INTERESTS

Another challenge arises from the makeup of the newly elected members of the House of Councilors. Many of them are first-time Diet members who represent strong regional or industrial interests. This outcome is in part the result of institutional design: The current rules governing upper chamber elections make it more likely that a disproportionate number of regional representatives will win seats. Malapportionment of elec-

toral districts also contributes significantly to this outcome. In the July election, a candidate from Yamanashi won with just 142,529 votes, while a candidate from Tokyo lost with 547,569 votes—nearly four times the number of ballots.

The newly elected members also include several industry representatives who may oppose reform from within the coalition. These include the vice chairman of Japan’s medical association and candidates supported by agricultural cooperatives and their political organizations. Once in office, these legislators can pose a challenge for party cohesion. Their supporters, and consequently the lawmakers themselves, have region- and industry-specific interests that often diverge from mainstream LDP positions.

As a result, deregulation in targeted industries and plans for fiscal expenditures that may appear to support public works in select regions may meet resistance from within the party. Interest group politics in Japan has weakened considerably over the past several elections, but where it does remain active, such groups are very effective in winning proportional-representation seats in House of Councilors elections. Abe will have to work hard to get their agreement on the more difficult third arrow of Abenomics, structural reforms.

Lastly, although gaining control over the upper house was critical for the LDP, the institutional structure of the House of Councilors places limits on the Abe cabinet. Unlike the House of Representatives, which the prime minister can dissolve, the upper chamber is impervious to such threats, and members are guaranteed a six-year term. This strongly limits cabinet control over the chamber.

Furthermore, the House of Councilors has significant de facto legislative power. In theory, in the event of a conflict between the cabinet and the upper house, the Japanese constitution gives the House of Representatives precedence over the House of Councilors. In the case of budget proposals or treaties, the decisions of the lower house have priority. But over all other legislative proposals, the upper house has significant sway. If a bill passed by the House of Representatives is rejected or amended by the upper chamber, as is often the case in a divided parliament, the original bill can pass only if it is resubmitted to the lower house and approved with a two-thirds majority. Since the

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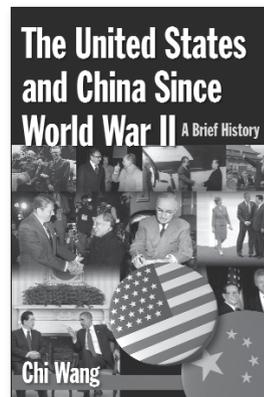
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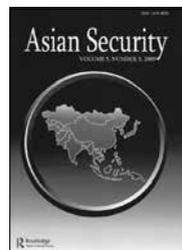
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House of Councilors was founded in May 1947, the ruling party or coalition has held a two-thirds majority in the House of Representatives on just two occasions.

The upper house, moreover, has the ability to delay or even block legislation simply by deferring final action. Thus, even though the LDP controls a majority of seats in the House of Councilors, the cabinet may still face significant hurdles in enacting structural reforms if it encounters strong opposition within its own party.

LEADERSHIP AND PRAGMATISM

So far, Abe has demonstrated leadership and pragmatism when it comes to economic policies. While some may dismiss rapid monetary expansion as an easy short-term fix relative to the challenges ahead, and while in hindsight these policies may not seem entirely unconventional, Abe has faced significant political challenges and swum against a tide of economic scholars ringing alarm bells over allegedly reckless actions. Admittedly, monetary expansion requires a delicate touch and careful monitoring, but for an economy battling seemingly endless deflation, perhaps the psychological uplift from rapidly executed policies that change the status quo will prove effective.

On more controversial topics such as constitutional revision, fears of right-wing extremism have been unwarranted. Despite broad media coverage regarding the dangers of revising Article 96, which requires that two-thirds majorities in both houses of the Diet first approve any proposed charter amendment, there have been no signs of any such changes coming to fruition thus far.

The prime minister seems clearly aware of not just the legislative but also the public support he

will need to change the constitution. During a press conference shortly after the election, Abe did assert that he wanted to revise Article 96. But he went on to say: "I am not sure whether we can with the two-thirds necessary to propose the revision. But more importantly, the reality is that [revising the constitution] does not have the understanding of the nation, so I want to continue my efforts to expand and deepen the discussion to gain public support over time." Such comments are evidence that he is a pragmatic politician who retains a firm grip on reality.

The July election presented the Abe government with a green light to move forward with its plans for revitalizing Japan. Further details of these plans are expected to be revealed in the fall when the government will announce its next "growth strategy." In that document, voters and observers will want to see clear signs of commitment to a feasible and sustainable plan for broader economic rejuvenation. The June report was limited in scope, sowing fears that once again, too little will be done too late.

Critics have pointed out, and members of the various governing committees seem well aware, that fundamental structural reform will need to be instigated with the same kind of fervor and coordination that Abe brought to monetary policy. While the obstacles are many, one can only hope that, in his second turn at the helm, Abe will successfully navigate Japan through choppy waters with a steady hand. In the meantime, opposition party members could contribute to the endeavor by playing a meaningful role as a check on the LDP and by offering voters the choice of a viable alternative. Only then will a healthy democracy thrive in Japan and work to serve its people. ■