

# THE ORIENTAL ECONOMIST

## REPORT

VOLUME 75, NO.7

PUBLISHED BY JAPAN WATCHERS LLC

JULY 2007

## It's still the economy, stupid! Election preview

**W**hat a miscalculation! Prime Minister Shinzo Abe staked his job on a simple proposition: the economy was in such good shape that he could ignore it; he could postpone difficult economic choices until after this month's Upper House elections. Hence, he focused on his true passions: "ending the post-war regime" by amending the US-written Constitution, introducing a more "patriotic" school curriculum, and ushering in a more robust security posture.

The penalty for ignoring people's day-to-day concerns will come on election day, July 29. Abe's Liberal-Democratic Party (LDP) is widely expected to lose. A recent *Asahi* poll put Abe's support rate at 28%. The last time support was so low was February 2001 when Yoshiro Mori was prime minister. Two months later, Mori was history.

The LDP has only two hopes of squeaking by. One is the ineptness of the opposition Democratic Party of Japan (DPJ). The second is the possibility that the LDP-Komei coalition could cobble together a majority by recruiting a few independents or the small People's New Party, which is composed of "postal rebels" expelled from the LDP in 2005. In any case, the LDP will stay in power since it dominates the Lower House, which names the prime minister.

Depending on the margin of defeat, Abe will face tremendous pressure to step down. Abe's main hope of hanging on is the lack of a clear successor, but the odds are against him (see box on pg. 4).

### What would an Abe fall portend?

What would be the implications if Abe has to resign?

One relates to the stability of government. The fall of the Berlin Wall and the popping of Japan's late-1980s bubble led to an era of political instability. That's because it immediately made obsolete the old "1955 system" of a ruling LDP and an opposition led by Socialists and Communists. Japan ran through ten prime ministers in only 12 years. The LDP itself split and temporarily fell from power.

Then came Junichiro Koizumi. Merely by staying in office for five years, he seemed to restore stability. In addition, by renovating the LDP, he seemed to reverse, or at least arrest, a seemingly inexorable trend toward LDP split, party realignment, and a move toward a new regime of parties alternating in power.

All of this raises some vital questions. Did Koizumi fundamentally change the course of Japanese politics, or was he merely an interruption in this process of realignment, or some combination of the two? Would an Abe resignation return Japan to the era of short-lived, weak governments? Would a DPJ victory make this fractious party start taking the possibility of governing more seriously?

The second implication has to do with the inevitable prominence of economic policy. Regardless of Abe's own fate, the voters are sending a clear message: "It's still the economy, stupid!" When *Yomiuri* asked voters to list the most important election issues, 67% named pension and welfare problems. Another 40% cited the undue influence of money in influencing government policy. Coming in a lame seventh was Abe's pet issue of revision of the constitution (see article on pg. 5). It's not that people oppose Abe's wish for Japan to become a more "normal" nation on the world stage; it just not their highest priority.

Whatever the prime minister's own personal inclinations, he cannot afford to ignore the economy because the voters won't. Voters want a leader, like Koizumi, who can put political-economic issues on the front burner even as he enhances Japan's security role. Whatever Koizumi's shortcomings in actual achievements, the voters enthusiastically appreciated his efforts—as they showed by giving him a landslide victory in the 2005 Lower House elections.

### Understandable complacency

At first blush, one can understand why Abe felt he could get away with not offering any new economic initiatives. The economy has grown at an annual rate of 2.2% for five years, and most forecasters project growth not far from this pace through 2008. This growth has produced a surge in tax revenue, postponing pressure for unpopular tax hikes to bring down Japan's huge budget deficits. Focusing on the economy would only highlight the possibility of future tax hikes, an issue Abe was desperate to avoid.

Besides, Abe found support for his political calculation among analysts who argued that the economy has been enjoying not just a cyclical rebound, but improvement in long-term fundamentals. Nonperforming loans at the biggest banks plunged to only 1.8% of total loans in March 2006, down from 8.4% in March 2002. Return-on-assets at the 5,000 biggest firms now stands at 4.7%, up from a 3.3% average during the "lost decade" of 1991-2002. Since 2002, labor productivity—the sine qua non for improving living standards—has been growing at 2% a year, up from 1.5% during the lost decade.

Abe's own desire to sidestep economic issues has been abetted by the growing "bypass Japan" profit structures of the country's most powerful and well-connected companies. As Peter Tasker, chief strategist at Arcus Investment, recently commented, "The corporate sector is divided between uncompetitive local companies with the same limited growth prospects as the domestic economy and the



large global companies capable of growing at a faster rate. Blue chip companies have reduced dependence on the low growth domestic economy." In the last ten years, reports Tasker, the top 100 non-financial companies have reduced the share of total revenues coming from inside Japan from 80% to 60%.

Consequently, these firms feel less need to pressure on Tokyo for good, sustainable growth in the home islands. Rather, they seem more interested in making sure that aging is addressed through a hike in the consumption tax rather than corporate taxes.

### Miscalculation

Abe's strategy turned out to be a huge miscalculation. For one thing, improvement in the economic numbers has not translated into substantial improvement in the lives of ordinary people. Secondly, there is less than meets the eye in some of the better-looking fundamentals.

Both the resolution of the NPL crisis, which was indispensable to recovery, and the improvement in corporate profitability have been financed by a huge covert transfer of income from ordinary households to banks and corporations.

The Bank of Japan's zero overnight interest-rate policy meant that, during most of this recovery, the proverbial Mrs. Watanabe could plunk down \$80,000 for a two-year bank deposit and receive interest of no more than \$26 a year. These days, she can

get a still-meager \$260. Gross interest income by households has fallen from nearly 8% of GDP in the 1980s to a skimpy 1% during 2005 (latest data available). For the elderly who hold most of the nation's bank deposits, and who rely on interest receipts to help meet day-to-day expenses, the cut in income has really hurt.

For the banks, however, not having to pay their depositors allowed them to be lenient toward zombie borrowers. Until a year ago, nearly 15% of all loans charged less than 0.5% interest. Even today, 17% of all loans charge less than 1% interest.

Like interest income, wage income has been hit. During the first five months of 2007, real (price-adjusted) wages were 0.7% below the same period of 2006 and 2.7% below the level of 2001. Firms are steadily replacing full-time regular employees with part-timers and temporary workers who get lower pay. Part-timers and temps have soared to almost one-third of the workforce in the past decade.

Stagnant income has, of course, resulted in sluggish consumer spending. However, with exports picking up the slack, leading firms have been satisfied with the outcome. Indeed, one of Abe's chief advisers, Fujio Mitarai, the chief executive officer of Canon and the head of the chief business federation, Nippon Keidanren, has called for continuing wage austerity.

### The politics of aging

With wage and interest income so suppressed, Japan's households have been forced to depend on the government. During the last decade through 2005 (latest data available), the only source of increase in real per capita disposable income has been temporary tax cuts and transfer payments such as social security.

Now, that is being reversed. Temporary tax cuts instituted in 1999 have been rescinded. Premiums for social security and health plans have been raised while benefits have been cut. More of the same is on the way. For a four-person family earning ¥5 million (\$42,000) per year, taxes alone increased by ¥38,000 (\$316) per year last month.

Worse yet, the combination of rapid aging and lackluster productivity growth raises the prospects of more benefit cuts and premium hikes down the road. The LDP has always been built around the politics of "spreading the wealth." Now, in the absence of sufficient reform, politics will increasing-

ly become focused around "spreading the pain." That's a game the LDP is ill-equipped to play.

Under Japanese law, the Diet must set old age premiums and benefits to keep the system solvent for 50 years. In 2004, the Diet cut benefits and raised premiums, but the latest fertility projections have already made that plan obsolete. Without sustained acceleration in productivity growth, Tokyo cannot indefinitely delay hiking the consumption tax. The LDP hopes this chicken won't come home to roost until after the next Lower House elections, which must be held no later than 2009.

### Ministry of *tatemaie*

If Japan's economic fundamentals were improving as much as advertised, time would overcome the problems of household income. However, there are reasons to wonder if that's the case.

Consider those corporate ROA numbers. That the data is inflated by wage cuts is only part of the problem. An ROA of 4.7% is not only below the 5.4% average of the 1980s, but only about half the level of U.S. firms. Moreover, the rebound is limited to big firms. For the rest of corporate Japan, ROA still lags at 3.6%, somewhat above the 3.1% pace during the lost decade but way below the 5.1% average of the 1980s.

How about productivity growth? Once we take into account the impact of the business cycle, there is no clear evidence that trend productivity growth has accelerated in recent years beyond its post1991 average of about 1.6% (see article on pg. 7).

Abe is not totally oblivious to all this. He knows that a productivity revolution is vital to Japan's future living standards, its economic and geopolitical standing in the world, and the ability to keep the LDP in power.

Hence, in its first economic plan under Abe, the Council on Economic and Fiscal Policy (CEFP) pledged to raise productivity growth from 1.6% to 2.4%. The problem is that the CEFP document read like a directive from the Ministry of *Tatemaie* (public relations). It had lots to say about nice-sounding goals, but very little to say about any concrete way to achieve them. In fact, Abe rejected specific goals like the 3% cut in public works spending urged by the CEFP's private sector members.

That is not the way to win votes and influence elections. (RK)

## THE ORIENTAL ECONOMIST

### REPORT

*Editors* Peter Ennis, Richard Katz  
*Chief Correspondent* Takao Toshikawa  
*Washington* Chris Nelson  
*Contributing Editor* Yoshisuke Iinuma  
Fusakazu Izumura

*Design* December Design, Inc.

The Oriental Economist Report is published monthly by Japan Watchers LLC  
450 Seventh Ave., Suite 808 New York, NY 10123  
Chairman: Takao Toshikawa

*Editorial information:* Tel: (212) 868-4380  
Fax: (212) 868-4392  
e-mail: rbkatz@orientaleconomist.com

Annual subscription price is \$100 in the United States and Canada; \$125 in Japan and all other countries.

*Subscription information:*  
(US) 212-868-4380  
(Japan) (03) 3263-0419  
e-mail: sales@orientaleconomist.com  
http://www.orientaleconomist.com

Copyright © Japan Watchers LLC. All rights reserved.  
Reproduction by any means without permission is strictly prohibited.

## TOKYO INSIDELINE

by Takao Toshikawa

# Pension issue crippling Abe Forced retirement?

With the crucial July 29 Upper House elections just around the corner, the voting public continues to fume over Prime Minister Shinzo Abe's seeming aloofness about pressing 'bread and butter' issues. First and foremost is gross mismanagement of the nation's pension system, which could very well force Abe from office.

### Pension blues

Recent exposure of a pension system scandal resulted from the dogged work of Akira Nagatsuma, a Democratic Party of Japan (DPJ) Lower House diet member who formerly worked for the prestigious *Nikkei Shimbun* newspaper. It turns out that mismanagement at the Social Insurance Agency, which collects pension premiums, makes payments, and keeps pension records, rose to mind-boggling levels over many years.

The SIA is now 'custodian' of no less than 50 million pension accounts that can not be properly matched with pensioners. Agency officials finally wilted under the pressure of Nagatsuma's relentless questioning.

The SIA confessions sent seismic shocks throughout Japan's political system, plunging Abe's public support rate to the low 30s. Public anger has caused social unrest reminiscent of the Rice Riots of 1918.

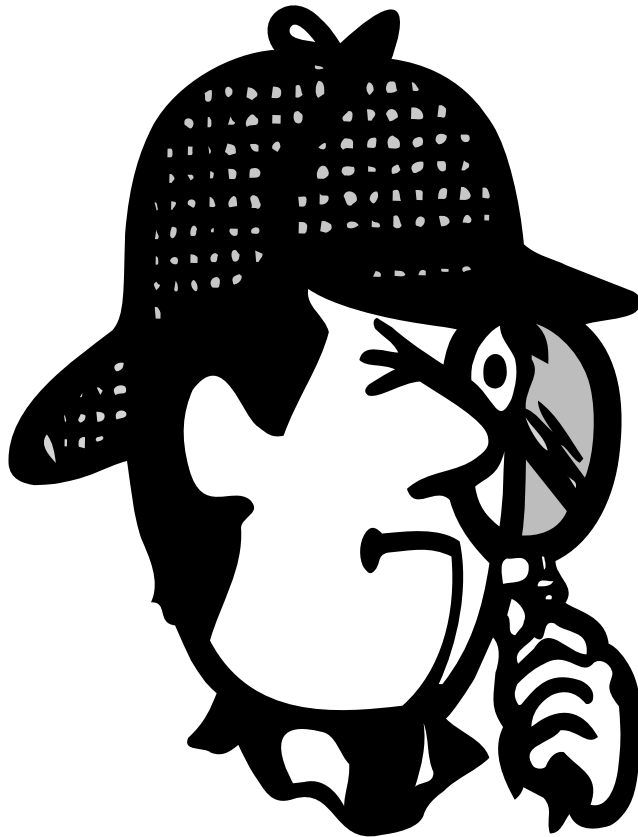
Not surprisingly, the ruling coalition (Abe's Liberal Democrats and the New Komeito) is reaching for straws to win a majority of Upper House seats on July 29. A poor showing could very well force Abe to resign. Indeed, Japanese politicians are already acting with that in mind.

### Searching for answers

How did such monumental mismanagement occur at the SIA, and for so long?

Japan's pension system is a cumber-

some structure consisting of three parallel systems. Employees of companies belong to the employees' pension system (*kosei nenkin*), the self-employed belong to the national pension system (*kokumin nenkin*), and government employees to the mutual aid associations system (*kyosai nenkin*). Legislators may unify the systems, but differing premium structures and financial capacities would make that difficult.



In the past, each of the three pension systems assigned accounts to its own members. A member of the employees' pension system who transferred from Tokyo to Osaka, for example, would receive a new account. People who married and changed their names also received new accounts. Even though there are only 100 million pension system members, there are 300 million member accounts.

In 1997, the Ministry of Health, Labor and Welfare, which supervises the Social Insurance Agency, switched to single accounts for each member. Personnel of the Social Insurance Agency performed the work of unifying each person's accounts. Staffers made many mistakes while inputting data from premium payment ledgers into computers, resulting in as many as 50 million 'unidentified' accounts whose owners are unknown.

The SIA knew it had a huge problem, but it's 'application-based' system led staffers to do nothing unless a pensioner submitted a specific claim alleging shortfalls in payments.

The Agency apparently feared a panic. As the extent of the fiasco became more apparent, the government set up a 24-hour toll-free number for the public, but it received so many calls that the system broke down. While nothing extreme such as arson has occurred, the situation could perhaps be called a 'quiet riot'.

Prime Minister Abe eventually established an 'investigatory committee' to determine the causes and assign responsibility. A report should appear this autumn. The SIA will likely be reorganized as a privatized 'Japan Pension Organization'.

### Structural problems

Many blame the Social Insurance Agency's sloppy work on its three-tiered employment structure. Upper management consists largely of career officials sent by the Ministry of Health, Labor and Welfare. They stay for a year or two and return to the Ministry. Middle management is hired by the Social Insurance Agency proper. The remaining employees are the 10,000-plus hired locally to work at offices all over the country.

With this scattered chain of command, lax work habits grew rampant in the agency. According to the contract between the employees union and the Social Insurance Agency, for example, workers using keyboards were required to conduct a mere 5,000 keystrokes per day. The public was stunned to learn this, since, in simple data-entry work, 5,000 keystrokes would require less than an hour to perform. Not a bad day's work.

## Election patchwork

Not surprisingly, the theme of the Upper House election has dramatically shifted from the 'Constitutional reform' emphasis that Abe favors, to the theme of 'the pension election'.

Abe (who doubles as LDP president) has promised that the unidentified accounts will be integrated within one year. Furthermore, for those who paid pension premiums only to have the SIA records disappear, Abe declared that even those who cannot prove payment would have their shortages made up with no statute of limitations. The proviso: a 'third party committee' made up of lawyers and tax accountants must deem the claims to be 'reasonable'.

Many experts argue that these measures are being slapped together in haphazard fashion to stave off an LDP debacle on July 29. They doubt the measures as now outlined will prove effective.

For example, it is possible that new software might facilitate verification of the unidentified accounts floating in the Social Insurance Agency's computers within one year or so. But that would amount to 'name identification' only. The SIA can not simply alter records on its own. Instead, SIA staff

will have to spend countless days contacting each person to verify vital information.

Moreover, the data already input may be mistaken, which means new software alone can't replace the tedious work of checking much of the computer data against paper ledgers. With the enormous amount of work and large number of people required, some insiders say that 10 years will not be enough to resolve the mountainous problem. Truth be told: until the work actually gets underway, no one can reasonably forecast how long a resolution will take.

## Election fallout

Keep in mind that the record keeping disaster comes on top of long-festering concerns in Japan that the pension system would ultimately prove insolvent for structural reasons. The national birth rate is falling, so there are fewer workers available to support pensioners. Eventually, the system would be unable to balance pension payouts with premiums paid by the nation's workforce.

Mistrust of the government is building at a feverish pace prior to the July 29 election, and Abe is suffering dearly. The latest polls show the support rate for his Cabinet to be a mere 28%, with 60% saying his govern-

ment has not dealt effectively with the pension problem.

In short, events are building toward a big Upper House election loss for the LDP (see page 4 box).

## 'The man'

The consensus is that the key man in the political situation following the Upper House election will be former Prime Minister Yoshiro Mori, the de facto leader of the LDP's largest faction, the Seiwakai (Machimura faction). The faction has produced the last three prime ministers, including Abe, but in the event of a historic loss, it would probably be humbled enough to not field a candidate to replace Abe.

Of the three likely post-Abe candidates, Mori is closest to current Foreign Minister Taro Aso.

Mori would likely have two conditions. One: appointment of the faction's head, former foreign minister Nobutaka Machimura, as party secretary general. Two: appoint Mori, who is in good health, as foreign minister, for which he is convinced he is suited.

In any event, the focus of the Upper House election has shifted to how badly the LDP will lose.

# Election scenarios

## Election scenarios

Here is a guide to the July 29 Upper House elections.

The Upper House has 242 seats, half of which are contested every three years. A working majority requires 122 seats. The ruling coalition parties currently hold 132 seats (109 LDP, and 23 Komeito).

Of the 132 coalition seats, 75 will be contested this month (63 LDP, and 12 Komeito). To maintain their majority, the coalition parties must limit their losses to no more than 11 seats, since 64 wins this time around, added to the 58 coalition seats not being contested, would add up to the required 122.

Assuming Komeito retains its 12 seats, the LDP would need a minimum of 52 wins (maximum of 11 losses).

Before the 'pension shock', most analysts posited the following scenarios:

- The LDP wins 55 seats;
- The LDP garners 1-2 seats above the required 51;
- The LDP falls 2-3 seats short of 51
- The LDP wins about 45 seats.

Among these, scenario 2 was most prevalent in political circles.

Today, the 'post-shock' scenarios are very different:

- The LDP falls 3-4 seats short of 52;
- The LDP falls 6-7 seats short of 52;
- The LDP wins only 40-44 seats;
- The LDP suffers a historic loss by falling below 40 seats.

Nagatacho watchers consider scenario 3 most likely. Incidentally, in 1998 then-Prime Minister Ryutaro Hashimoto was forced to resign when his LDP won only 44 Upper House seats.

## Insider polling

Prior to the pension shock, a much-trusted polling firm retained by the LDP told party leaders to expect 20 wins and 9 losses in key single-member districts that best capture the national mood. In early June (post-'pension shock'), the same firm forecast 10 wins and 19 losses in those key districts.

## Succession fight

Abe might survive under scenarios one and two, but would have to win support from a few independents and the conservative People's New Party, led by former LDP anti-reformer Shizuka Kamei and Tamiyuki Watanuki. That might prove difficult.

Scenario four – fewer than 40 LDP wins -- would compel Abe to resign. In a rush, the LDP might turn to former Chief Cabinet Secretary Yasuo Fukuda. The opposition would press for dissolution of the Lower House, so Abe's replacement would widely be seen as a caretaker.

The most likely scenario – 40-44 LDP wins – would probably lead to an LDP presidential election to replace Abe, with LDP Diet members and prefectural representatives casting votes.

The three likely candidates would be: Foreign Minister Taro Aso, former Finance Minister Sadakazu Tanigaki, and former Director General of the Defense Agency Fukushima Nukaga. Realistically, it would become a battle between Aso and Tanigaki. Abe and Mori would probably endorse Aso. (TT, PE)

## Pension fiasco reveals “give a damn” gap “Frankly, my dear...”

Japan's bureaucrats and politicians could learn a lot from Bill Clinton's famous phrase, "I feel your pain." Sure, it is not only bureaucrat-dominated governments or one-party dominant governments that don't seem to give a damn about the people. But somehow the syndrome seems worse in countries where the political elite has less fear of being tossed out of power. Tokyo's slow response to the Kobe earthquake and Shinzo Abe's focus on constitutional revision in the face of a recovery that has left so many people behind are typical of the cases that have provoked public resentment.

Now comes the pension debacle, the loss of 51 million records of pension payments. To add insult to injury, it turns out that Prime Minister Shinzo Abe has known about the problem since February. Not only did he refuse to focus on it, but he urged a hush-hush posture, ostensibly on the grounds of preventing public anxiety. That is the indifference that so outrages the public—an indifference for which Abe and the Liberal Democratic Party (LDP) will pay on July 29 when elections are held for the Upper House of the Diet.

### The salience of pensions

Each year the graying of Japan accelerates and 1.5 million to 2 million people join the ranks of pension recipients. Naturally, then, pensions are one of the public's main concerns. When voters were asked in a June 26-28 poll, "What do you see as the most important issues in the upcoming elections?" a sweeping 67% of the respondents chose pensions.

Recall that, just before the July 2004 Upper House election, it was revealed that many politicians, including Prime Minister Junichiro Koizumi and Democratic Party of Japan (DPJ) leader Naoto Kan had failed to pay the pension premiums that ordinary mortals are obliged to pay. In the ensuing public uproar, Kan was forced to resign as head of the DPJ and Koizumi's LDP won fewer seats than the DPJ.

The problem this time is even worse: millions of citizens may not get their money.

It seems hard to believe that such a high-tech country as Japan could lose the records on 51 million pension accounts, but that is exactly what has happened. Since each person has several accounts under Japan's system (see accompanying article on pg. 3), the number of people affected is not yet known. It certainly numbers in the millions, perhaps tens of millions. Already, there are 28.5 million known records for people who are currently old enough to be eligible for benefits.

The upshot is that millions of people could be hurt: some may not receive any benefits at all; some may receive less than they should; and some who already depend on such payments will certainly receive them very late.

### Officiousness

People are besieging the Social Insurance Agency (SIA), which is in charge of government pensions. SIA offices throughout Japan are making people wait hours for answers to their inquiries and on some days the agency receives as many as 400,000 phone calls. The public's inability to make inquiries by phone is causing a new round of anxiety and anger about bureaucratic arrogance and officiousness.

The snafu dates back to 1997 when the SIA attempted to integrate management of pensions by providing individual subscribers with a single identification number. Records had been kept in a slipshod manner even before this date: names were misspelled, birthdates were wrong, and some records did not adequately track name changes after marriage, movement from one job to another, and status changes from employee to self-employed person. As a consequence, a person's various records could not always be classified under one identification number, and so 51 million records were orphaned.

Adding to the public shock is that all this turns out to be ancient history. It occurred ten years ago under LDP Prime

Minister Ryutaro Hashimoto who headed an LDP-led coalition government. The problem was then neglected for four administrations until Abe was left holding the bag. The intense public criticism of the Abe administration is testimony to its ineptitude in handling the issue.

Misgivings about the accuracy of pension benefits are not new. Last October the news media reported that approximately 20% of the people who tried to confirm their payment records at the SIA found that the records did not agree with their actual period of enrollment. In November, after a survey of people making claims, it became clear that 34,000 people experienced altered pension benefits in 2005 alone. Even though claimants were sure the premiums had been paid, the SIA is said to have cited the lack of records and rejected large numbers of claims. The SIA paid no attention to critics who said that all the records should be checked if they were this imprecise.

### Abe knew months ago

The news of 51 million unidentified records was only revealed in February 2007 after the Lower House Research Bureau conducted an investigation and issued a written report at the request of Lower House Member Akira Nagatsuma, a member of the DPJ. In contrast to Nagatsuma, who asked questions about the report, declared a state of emergency and requested a complete investigation, Prime Minister Abe showed a tin ear when he stated, "The government is doing what it can. It is best not to stir up anxiety."

In May, Nagatsuma, using the prestigious Lower House Budget Committee as a forum, urged that the government deal with the issue. The media picked up the topic and the pension records immediately became a huge political scandal. The government did nothing to head off the issue until it was upon them. All at once the public believed that Abe didn't care.

Abe tried to retrieve his footing by saying, "An investigation will be concluded in one year." This only added fuel to the fire, since the public understood his statement to mean, "Everything will be resolved in a year." In the subsequent uproar it became clear that it would take a year just to check the computerized records. Incomplete computerized records would then have to be checked against any original microfilm and paper ledgers that still existed – an undertaking that could possibly last ten years.

To make matters worse, media and opposition-party research revealed that another 14.3 million records had been discarded and never entered into the computer system. Bit by bit, more revelations came. The SIA had engaged in other deceptions such as underreporting the number of erroneous records that were discovered by sampling computer records. Now the public reacted with such statements as, “The facts are probably still being hidden;” “Both government and prime minister still don’t have a firm grip on the situation,” and “The government is just being expedient when they say that this and other things will be cleared up in a year – they’re afraid of the impact on the election.”

The government is trying to catch up to the public uproar. Under current rules, even if the SIA had made a mistake, there was a five-year limit on pension claims. The government is now repealing the time limit to aid people who have not yet requested an inquiry or corrections. Fifty independent panels will be set up throughout Japan to pass judgment on whether benefits can be given to claimants lacking written records to prove they have paid their pension premiums. Investigation of the 51 million unidentified payments will be put on the fast track. The SIA will be abolished and replaced by a new pension agency. And so on. Prime Minister Abe recently stated, “Everything that should be done has been done.”

### Voters don't buy it

None of this has restored public confidence in a public that thinks Abe is just trying to make it look like he's doing something on the eve of crucial elections.

The June 26-28 *Yomiuri Shimbun* poll (conducted after these actions) shows bad news for the Abe government. When asked, “Do you think the government’s policy will resolve the issue of the unidentified pension records?” 66.5% of the respondents replied, “No.” Only 25.8% said, “Yes.” When asked about the Abe Cabinet, 34.4% said they support it and 51.8% said they do not.

Ten days earlier, when another *Yomiuri Shimbun* poll asked about support for the Abe Cabinet, 50.6% had said they did not support it. These are their reasons: First, “I can’t evaluate its political position;” second, “It doesn’t seem consistent;” and third, “I don’t trust the prime minister.”

“I can’t evaluate its political position” is a fairly vague response, but the June 26-28

poll offers clues about what this means. When asked, “What do you see as the most important issues in the upcoming elections?” a sweeping 67% of the respondents chose pensions. 41% chose education; 40% chose the connection between politicians and money; 32% chose the economy; and 30% chose the gap between rich and poor. The constitution, Abe’s own preferred battle zone, came in seventh with only 24%.

Abe is clearly out of touch with the public in putting priority on the notion that, “replacing the post-war regime” should start with constitutional revision.

### Abe's tactic

Abe wants the ongoing pension problem to be seen as part of “replacing the post-war regime.” This is evident in his rushed Social Insurance Agency reform bill. The SIA is an organization controlled by labor unions where sloth and inefficiency have hardened into a malignant sense of entitlement. The bill will disband the SIA, separate health insurance and government pensions, and create a public corporation called the Japan Pension Corporation to manage the pension system. The new corporation will not be staffed by civil servants.

The SIA’s own labor union supports the DPJ and so, claims the LDP, the DPJ cannot reform the organization. This is the picture the ruling party is trying to sell. They are trying to appeal to popular distaste for civil service unions while relying on the aura of privatization that Koizumi used in his battles against the Postal Services and Japan’s public highway corporations.

But the electorate isn’t buying this interpretation. At this point everyone has heard until they are sick of it that the SIA is the epitome of bureaucratic irresponsibility and incompetence. But since the actual situation is still poorly understood, the public is fairly unresponsive to the prime minister’s attempt to put an ideological twist on the issue. Besides, even if the SIA is at fault, it is the job of elected politicians to supervise such agencies and make sure problems are corrected. Abe’s stance makes him look like he’s passing the buck.

To extricate himself from his predicament, Abe attempted to emulate former Prime Minister Koizumi’s techniques, as when he broke up the postal services last year. Abe railroaded through legislation that was strongly opposed even within his own party, and demonstrated his own leadership.

Ignoring protests from within his own party, he extended the Diet session in order to enact pension-related legislation mandating the disbanding of the SIA and legislation reforming the civil service system.

The civil-service reform bill will set up a personnel center in the Cabinet Office that will take over the job of placing bureaucrats into post-retirement jobs. This, claims Abe, will stop the practice of *amakudari*, where each bureaucracy finds positions for its retirees at closely-connected private-sector companies. Here, too, Abe’s theme is “destroying the post-war regime” by breaking the iron triangle of government, bureaucracy and private sector interests. Not surprisingly, the LDP joined the bureaucracy in its opposition to the legislation. Reforming *amakudari* is a laudable goal and the bill may help a bit. But the bill’s loopholes are well-known. Enactment will not gain many points for Abe in this month’s elections.

### Abe is no Koizumi

It is true that Abe lacks Koizumi’s personality, genius, and instinctive ability to grab public attention with terse and punchy phrases. His style and wordy explanations make it difficult for him to reach the public with his message. But that’s not the whole story. Koizumi seemed passionate about people’s daily concerns; Abe does not.

When a *Yomiuri Shimbun* poll asked whether the public valued Abe’s intense pressure to extend the Diet session: 27% replied, “Yes” and 61% replied, “No.” Abe has become associated with the image of his late grandfather, former Prime Minister Nobusuke Kishi, who was branded by his strong-armed attempts to institute his convictions during the tumultuous process of revising the Japan-US Security Treaty.

### Beyond bad records

The pension debate is likely to move beyond the missing pension records and target the stability of the pension system itself. In the past, the DPJ has advocated a uniform and integrated pension system. Basic benefits would be funded by a 3% hike in the consumption tax. However, in the effort to win elections, the DPJ has now abandoned the idea of a tax hike and their proposed revenue sources are unclear.

Whatever is done to solve the record-keeping problem, aging means pension issues will continue to jolt Japanese politics. So will the “give a damn” gap.

# ECONOMIC OUTLOOK

by Richard Katz

## Orchestrating productivity revival, part 1 Still tuning up

It was the trumpet section of Prime Minister Shinzo Abe's Council on Economic and Fiscal Policy (CEFP) that blared out the goal of raising Japan's productivity growth by 50%: to 2.4% from the 1.6% average prevailing since 1991. But it was to the quieter violas that maestro Abe turned when it came time to let the audience hear how to realize this noble ambition.

Raising productivity is both vital and achievable.

It is vital because of aging. With the working age population falling, growth in GDP per work-hour is fast becoming the only source of overall GDP growth. In fact, since the working age population will drop 0.9% faster per year than the total population between now and 2025, the first 0.9% in labor productivity growth will be absorbed in just preventing per capita GDP from falling. That would leave just 0.7% productivity growth to raise per capita GDP. At that rate, it would take a century to double living standards.

Moreover, without better productivity growth and the better returns to capital that it produces, Japan would not be able to finance social security and healthcare for the growing ranks of elderly without insufferable hikes in the consumption tax and draconian cuts in benefits.

Fortunately, productivity growth of 2.4% is achievable. Japan lags so far behind global benchmarks that it could achieve tremendous leaps just by catching up. For example, while some export-oriented parts of manufacturing, such as autos and electronics are world leaders, overall Japanese manufacturing output per man-hour is 30% below US levels.

### Start the revolution without me

Some analysts argue that deregulation and corporate restructuring have already produced a productivity revolution. They note that annual productivity growth has risen to 2% during 2002-07, up from 1.5% during the lost decade of 1991-2001.

Others, however, (including us) reply that productivity growth typically rises above the long-term trend during recoveries, just as it slips below the long-term trend during slumps. As we examine the statistical evidence carefully, we see no clear evidence of any acceleration in productivity growth from the rate prevailing during the lost decade. Let's look at the data.

### Work-hours below 1990

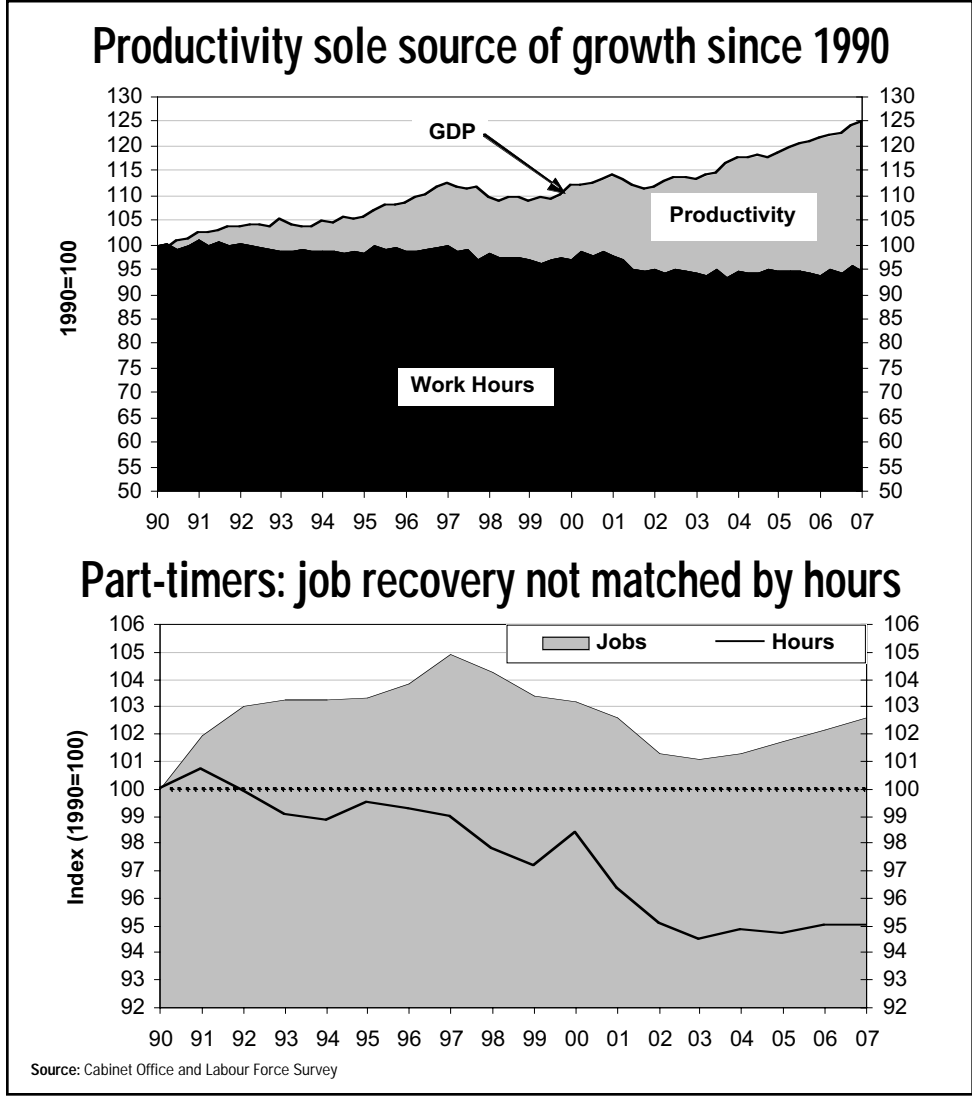
We expected to find that productivity growth would become the sole source of

Japan's GDP growth in the future. GDP growth equals the sum of growth in the number of hours of work plus growth in output per worker-hour (i.e. productivity). What surprised us is that, going all the way back to 1990, productivity growth has been the sole source of GDP growth.

Since 1990, real GDP has grown 25%. Yet, working hours have steadily declined and are now 5% below the level of 1990. The only reason that GDP has grown is that GDP per hour has risen 32% (see top figure).

The reason for this surprising result is that each worker is working fewer hours. Increasingly, firms are hiring lower paid part-timers. Thus, even as jobs rose 5% during 1990-97, hours worked fell 1%. Today, the number of jobs is 2.5% above the 1990 level, but hours worked is 5% below the 1990 level (see bottom figure).

This makes accelerating productivity even more urgent than we had assumed.



## Has Productivity Accelerated?

As noted earlier, some people argue that productivity has already accelerated. In reality, productivity growth is a highly cyclical measure. Especially in Japan where wages are lowered but workers are not laid off, output usually falls more than working hours during slumps. In effect, some workers who remain on the payroll have little to do. So, productivity growth appears to plunge. Then, as demand recovers, these staffers suddenly have work and can increase their output without increasing their official working hours. So, productivity growth appears to surge.

Consequently, the ups and downs of annual productivity growth mirror the ups and downs of the business cycle in a way that does not reflect real changes in the long-term trend of productivity growth (see top figure). In fact, during 1991-2007, there was a high 68% correlation between the ups and downs of GDP growth and the ups and downs of productivity growth.

Hence, it is possible that much, perhaps all, of the apparent rebound of productivity growth in the past few years is simply a temporary statistical artifact of the recovery. How can we tell? There are a couple ways

One way is to create a scatter diagram showing the link between GDP growth and growth in productivity, i.e. GDP per hour (see bottom figure). Then we can draw two trend lines: one for the 1991-2001 data and one for the 1991-2007 data. As we move along the line, we see that, when GDP is growing 1.5%, productivity growth tends to average about 1.7%. When GDP is growing 2%, productivity growth tends to average about 2%. At 2.5% GDP growth, productivity growth shows up at around 2.2%.

If trend productivity had risen during 2002-07, then we would have seen an upward shift in the whole line. The 1991-2007 trend line would be markedly higher than the 1991-2001 trend line. As we can see in the figure, this is not the case. In the range of 1.5-2.5% GDP growth, the two lines are quite close.

There is another test we can use. We can show the data points for GDP and productivity growth for the last nine quarters—from the first quarter of 2005 through the first quarter of 2007—as the recovery matured. If trend productivity had accelerated, then most of the data points for 2005-07 would be above the trend lines. In fact, as we can see in grey boxes in the figure, only

two of the nine data points are significantly above the trend lines. Three of the points are very close to the trend lines and four points are significantly below the trend lines.

This suggests to us that, as the economy reaches full-capacity levels of operation (full use of labor and capital) then both productivity growth and overall GDP growth will decelerate toward their longer term trend levels. Since productivity growth has averaged 1.6% since 1991, we figure that sustainable productivity growth is probably closer to 1.5% than to 2.0%.

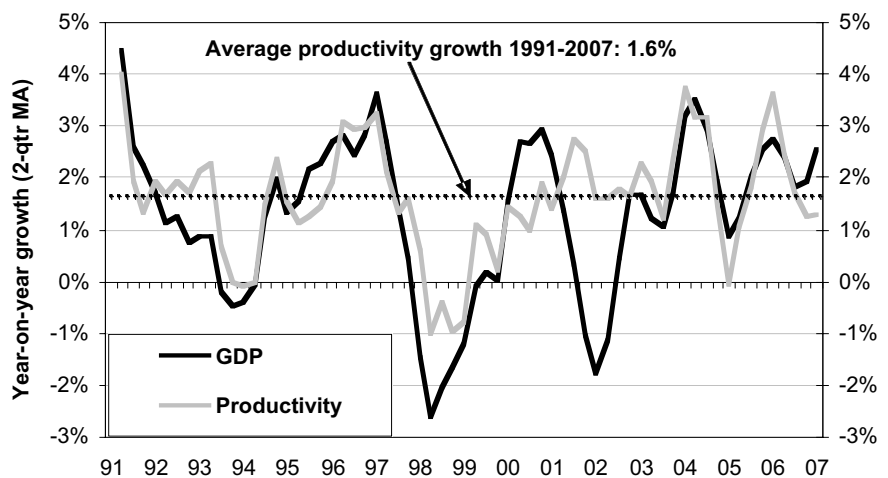
### Caveats

We should note that we cannot be fully confident of our conclusions. For one thing, hindsight makes it clear that, in the American case, there was a significant lag

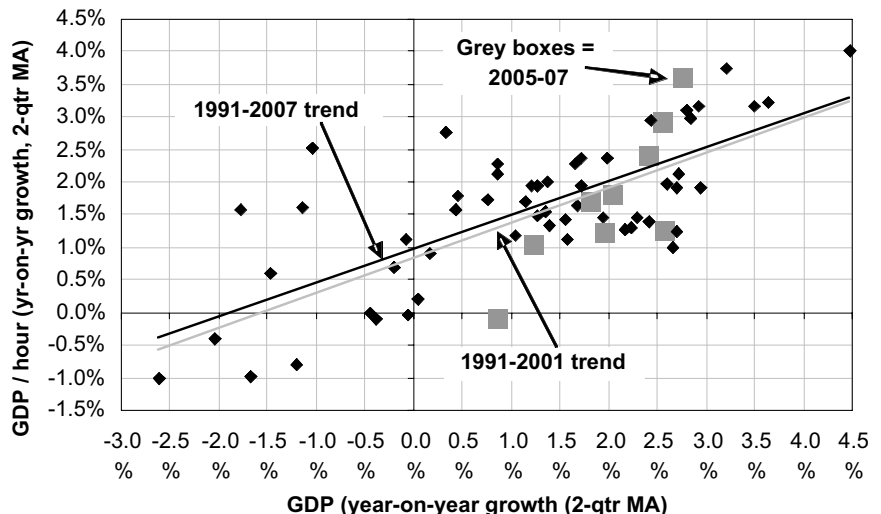
between the onset of the productivity revolution and its manifestation in the statistics. The same thing could be happening in Japan. Secondly, Japan has already undergone a lot of reform and we remain fully confident that, eventually, the reform process will result in a productivity takeoff. The issue is whether—or to what degree—this has happened yet. Thirdly, in every country, measuring medium-term productivity growth is fraught with uncertainty and there is a significant difference of estimates even among experts using the most sophisticated techniques.

Hence, we have to remain open to the possibility that there is more improvement than we see. Nonetheless, our best judgment is that Japan's productivity revolution is yet to come.

## Statistical artifact: productivity mirrors GDP

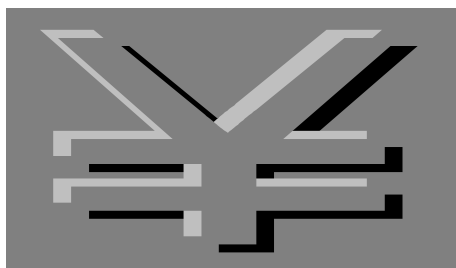


## No trend productivity hike in recent years



Source: Cabinet Office and Labour Force Survey

Note: Both charts show year-on-year growth in two-quarter moving averages. In the bottom chart, the black dots are all the data points between 1991 and 2007; the grey boxes show the data points for 2005-07. See text for further explanation.



## Economy Watch

### Share and share alike

The good news is the defeat of every resolution submitted by activist shareholders at this June's round of annual corporate meetings. How is that good news? Because, in the past, resolutions seeking higher dividends, new directors, or other policy changes would never have been offered in the first place. Sure, the resolutions failed this time around. Eventually, some will succeed. Once they do, they'll snowball.

The wheels of shareholder revolt may grind slowly in Japan, but grind they do. What makes them grind is the steady rise of foreign shareholders to a critical mass. As of March 2007, foreigners owned a record 28% of Japanese shares by value—up from 12% a decade ago (see top chart).

Less than half of shares are now owned by so-called "stable shareholders"—the banks, insurers, customers, suppliers and sometimes even competitors who hold shares for a long time and tend to vote with management, i.e. each other. Stable shareholders now own only 46% of shares, compared to 64% a decade ago (see bottom chart).

The foreigners hardly vote as a bloc. Moreover they often have trouble making their case among the householders who hold 18% of the shares or the pension funds and investment trusts (mutual funds) who own another 13% of the shares.

Nonetheless, their growing presence has led some domestic and foreign activist investment funds to press their desires in a more aggressive fashion. Whereas in the past they might simply have voted no on a management proposal, this year they proposed their own resolutions at about 30 of the annual meetings. Not a huge number, to be sure, but still a new phenomenon for Japan.

We'll report on the shareholder-management fights in the future. For now, let's note some important ownership trends.

Despite the widespread notion of a household "flock to stocks," the household share slipped to 18.1% from 19.1% last year. The household share has remained flat at 18-20% for the past 20 years. Nor are households shifting to investment trusts (mutual funds). The latter's share stood at 3.7% in 1990, then fell during the lost decade, and has slowly rebounded to 4.7%.

More impressive is the dramatic fall in the share owned by city and regional

banks—due to tighter regulations and the need to finance their write-off of nonperforming loans. Their share has fallen from 15% in 1998 to only 4.6% at today—below the level of the investment trusts.

The share owned by nonfinancial corporations fell from 30% in 1995 to 22% in 2001. Since then, it has remained stable in the 20-22% range.

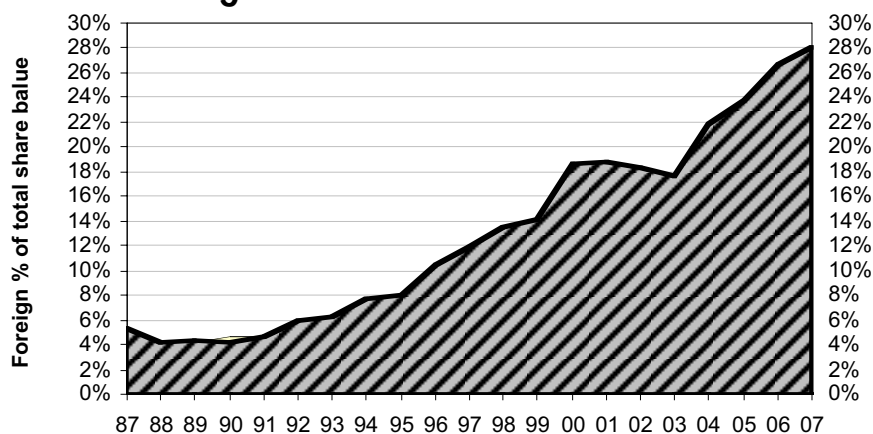
### Managing women

Good ol' supply and demand. It may just have the power to do what years of equal opportunity laws did not: enable more Japanese women to combine career with family life.

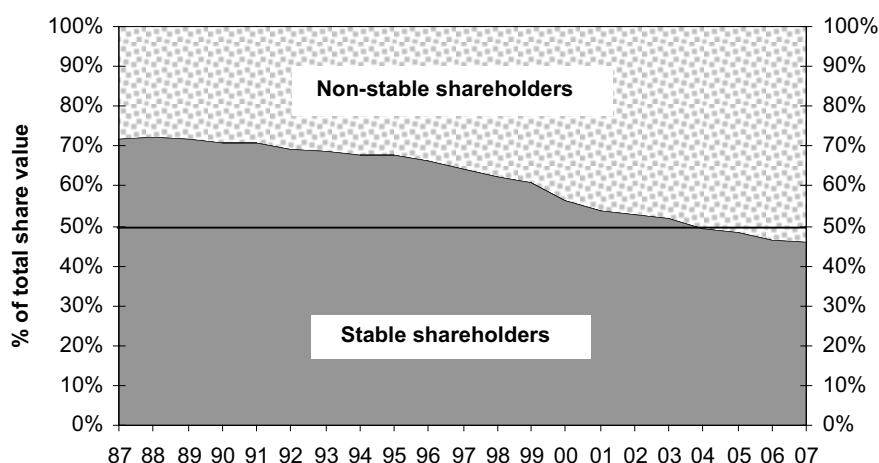
Top firms looking into the future see a dearth of young men able to replace retirees. Hence, some are beginning to make more attractive offers to the women they once spurned.

For now, some of the moves seem

### Foreign investors rise to record 28%



### 'Stable' shareholders fall to less than half



Source: Tokyo Stock Exchange

Note: See text for explanation of stable vs. non-stable shareholders

more like putting a toe in the water than diving in. According to *Nikkei*, within three years, Asahi Mutual Life wants to increase the number of women in the position of section chief or higher from today's 4% to 6% or so. Asahi will also exempt women on the career track from job relocations if their children are under age three. Kirin Beer wants to triple the share of women in management to 5% by 2015. Mitsui Corp. and Mitsubishi Corp. say they will now permit women who've had to leave the firm because their husband was transferred to come back under certain conditions.

## Korea trade-off

The auto caucus may not be able to stop Congress from raising gas mileage standards or to compel the White House to pressure Tokyo on the weak yen, but it just might be able to block a Free Trade Agreement (FTA) worth billions of dollars to banks, IT firms, farmers and a host of others.

On June 29, the Democratic leadership of the House of Representatives issued a statement that declared the just-signed Korea-US FTA virtually dead on arrival. House Speaker Nancy Pelosi and Ways and Means chairman Charles Rangel, among others, said that they "cannot support the KFTA as currently negotiated." Candidates Hillary Clinton and Barack Obama also oppose the pact, commonly called KORUS.

The big stumbling block is that the United Auto Workers, other unions, Ford and Chrysler all strenuously oppose KORUS (General Motors says it's neutral). Automakers say they have little to gain on the export side, despite Korean concessions like eliminating taxes that discriminate against big vehicles. The auto lobby contends that, in the past, as soon as one non-tariff barrier came down, another took its place.

Whatever the legitimacy of their complaints—the Bush administration argues that KORUS resolves these problems—the industry's main interest is not in selling in Korea anyway. Its priority is protecting the home market, particularly from the 10-year drawdown of the 25% tariff on pickup trucks. Korea does not yet export any trucks to the US, but might if KORUS removes the prohibitive tariff. Any increase in Korean market share in a lucrative product niche adds a few more straws that the camel's

back is ill-prepared to withstand.

Most other industry groups back KORUS, but are not twisting many arms on Capitol Hill. They are asking themselves: if we spend our political capital on this issue, will we have less leverage on issues like taxes or regulation? Are the economic gains from KORUS worth the political cost? The Bush Administration is hoping that, once KORUS is submitted for a vote, the pro-trade lobbies will come out in force. That remains to be seen.

Why is pro-KORUS lobbying so lax? There has already been so much market-opening from past agreements, and from countries unilaterally recognizing the benefits of open trade and investment, that the *additional* benefit of new formal agreements is less than in the past. That was particularly true for the now-defunct Doha Round of multilateral trade talks. But it's also somewhat true for KORUS even though the benefits for US industries are more focused and substantial than in Doha.

Korea's imports have risen from 24% of its GDP in 1970 to 40% by 2005. America is Korea's third largest supplier, behind Japan and China. Cumulative inward foreign direct investment (FDI) grew from 2% of Korean GDP in 1990 to 8% by 2005. Cumulative US FDI in Korea has increased from \$10 billion in 2001 to \$18.8 billion in 2005.

Nor do most US industries have a beef regarding trade imbalances. The US trade deficit with Korea is only 2% of the overall US trade deficit. 87% of the bilateral deficit consists of passenger cars, auto parts, engines and tires. (See companion piece on pg. 11.)

## No smoking, please

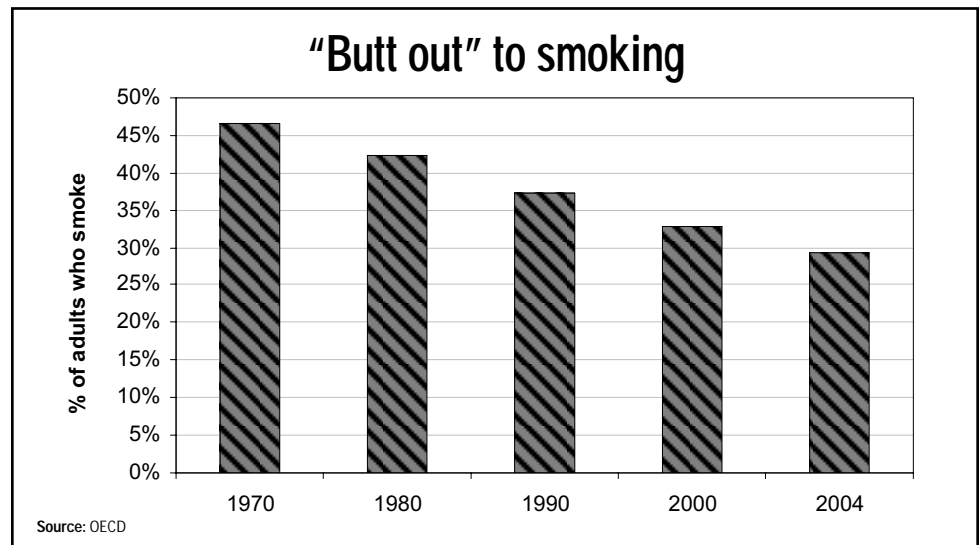
At first, we didn't believe it. A survey conducted by Johnson and Johnson reports that 88% of all new workers in Japan are non-smokers and that 25% of new workers want to work for companies that provide non-smoking environments.

As it turns out, the times are indeed changing. While smoking rates in Japan are still among the highest in the rich countries, they are going down.

Among all male adults, smoking fell to 39% in 2005, down 4% from 2004 and the lowest rate since the Ministry of Health started collecting statistics in 1986. In fiscal 2006, Japan Tobacco suffered an 8% fall in sales. Overall, reports the OECD, "only" 29% of adults still regularly smoked in 2004 compared to 47% back in 1970 (see chart). In the US, the rate fell from 37% to 17% during the same period.

There is a big difference between men and women. Among males aged 21-24, according to International Smoking Statistics, 80% were smokers back in 1970, a figure that fell to 65% by 1995 and presumably has gone lower since then. Back in 1970, only 9% of young women smoked, but 25% did so by 1995. Since then, female smoking has reportedly gone down again.

You'd think Tokyo would want to curb smoking due to the huge economic and personal health consequences. There have been some efforts, like increasing no-smoking zones in public areas. However, since the MOF's coffers are laden with both the tobacco tax and profits from its half-ownership of Japan Tobacco, the Ministry has steadfastly resisted domestic and international anti-smoking efforts.



(Continued from page 12)

legislation to codify Japan's right in this regard.

## Ishiba talks

Meanwhile, the LDP's Special Committee on Collective Self Defense has also begun its work. Technically, the committee is run by the LDP's Policy Research Council chief, Shoichi Nakagawa, an Abe ally. But the real work is run by former defense minister Shigeru Ishiba, who is not particularly close to Abe but is widely respected for his knowledge of defense issues. He is close to former chief cabinet secretary Yasuo Fukuda, who could wind up replacing Abe if the latter is chased from office.

Public perception is that Ishiba is an expert on security matters, but not a particularly deep thinker. The enduring image is of Ishiba handling LDP responses to opposition party queries during heated Diet debates on security, proving well-versed in even the most obscure of legal matters covering defense policy. But Ishiba is much deeper than that, as shown by the way he is guiding the Special Committee's discussions.

Ishiba argues that Yanai's Group of 13 is designed to explore specific scenarios that Japan might have to confront. The LDP's Special Committee, he says, has a very different role: to explore in detail the full implications of exercising the right of collective self-defense.

He told *Asahi Shimbun* several weeks ago that, as things stand now, the United States is obligated to defend Japan, while Japan is only required to provide the US with military bases. The prohibition on exercise of collective self-defense, Ishiba says, means that "Japan is not on equal footing with the United States. I would like to see the committee discuss even the question of whether Japan-US relations should be left as is," Ishiba says.

Ishiba insists he wants Japan to "become America's true ally," which means wielding a bigger voice. "Once Japan is allowed to use the right of collective self defense," he says, "it no longer has to offer bases to the United States." He says Japan "can tell the US armed forces here to leave, as they are no longer needed. That's what an independent country does." Ishiba is not saying he wants US forces to leave Japan. He is saying that a truly independent Japan should fully recognize that it has that inherent right.

"Lawmakers have never asked the people if Japan-US relations should be left as is," Ishiba says. "If the people want to leave things as is, that's fine, but I don't want to live in such a country."

## Kyuma insights

After demonstrating a severe case of 'political foot in mouth' disease, there was little chance that Defense Minister Fumio Kyuma would retain his job. The last thing Prime Minister Shinzo Abe needed was the kind of controversy that ensued after Kyuma's ill-timed suggestion that the United States had little choice but to use nuclear weapons to bring World War II to a close.

However clumsily stated, Kyuma's comments came in the context of a larger point he was trying to make. The Japanese people want to have it both ways. On the one hand, their experience has led many of them to oppose nuclear arsenals or the presence of nuclear-armed US submarines in Japanese ports. On the other hand, Japan overwhelmingly depends on the United States nuclear umbrella for its security. The implication: without US nuclear backing, Japan would have to either develop its own, independent strategic capabilities, or find some other 'unarmed' method to survive the rise of China and the threats posed by North Korea.

A host of taboos that have long-suppressed debate in Japan over everything from wartime responsibility to the nature of security ties with the United States are rapidly eroding. Kyuma's comments are best understood in this context.

## Aso trouble

US-Japan relations will surely face a rocky period should Shinzo Abe be forced from office and Foreign Minister Taro Aso emerge as his replacement.

Some key members of Congress have recently demonstrated great interest in Japan's wartime use of forced labor from China and Korea, forced employment of allied prisoners of war, and the apparent heavy involvement of military authorities in the establishment of brothels in which 'comfort women' were forced to perform sexual services. At times, Aso has come across as less-than-enthusiastic about repeated apologies issued by high-level Japanese government officials for those activities. Aso has been reluctant to discuss the apparent

wartime use of forced labor by his family's business.

Despite his impeccable English and cosmopolitan demeanor, a 'Prime Minister' Aso would have a lot of work to do to win friends in Washington.

## Seoul smiles

The United States and South Korea, after intense negotiations, recently agreed to enact a far-reaching bilateral free trade agreement. The ink of the agreement had barely dried when top Congressional leaders made clear they would oppose the deal, at least in its current form, making passage very unlikely, at least anytime soon (see article on pg 9).

Despite the missed chance to deepen an already robust bilateral economic relationship, rejection of the proposed free trade agreement will not have the hugely negative impact on ties between Washington and Seoul than might have been the case just a few years ago.

When the trade negotiations began, many analysts hailed the prospect of a free trade agreement as a way to revamp a bilateral alliance that had become dangerously frayed. A new generation of leaders had taken over in Seoul, one determined to end the days when Washington seemed to dominate political events in the country. In Washington, meanwhile, the Pentagon was anxious to reorganize the US military presence in South Korea, leading many in the country to fear American abandonment.

To make matters worse, the two countries were butting diplomatic heads over the best approach to North Korea. Many in Seoul saw the Bush administration's hard line as dangerously provocative, while Washington saw Seoul's "Sunshine" diplomacy toward Pyongyang as dangerously naïve.

Today, the mood is very different. Washington and Seoul recently announced they would set up a new security alliance structure by 2009, and that Seoul would assume wartime operational control of its armed forces by 2012.

Meanwhile, officials in Seoul have welcomed the new flexibility shown by the Bush administration toward North Korea.

Thus, while disappointing, the prospect of Congress turning down the bilateral free trade agreement does not carry the broader implications for US-South Korea relations that it might have just a few years ago.



## Off the Record

### Abe retreats

Prime Minister Shinzo Abe has run into big political obstacles in his quest to reform Japan's 60 year-old Constitution. Since taking office last September, Abe has made constitutional reform his top priority, arguing that it is crucial to "shedding the postwar regime." Abe is particularly anxious for Japan to play a bigger role in regional and global security affairs, which would require a reinterpretation or actual amendment of the existing Constitution.

Abe's problem is that the public does not share his priorities. The prime minister's popularity rating has plummeted in recent months, as voters have grown increasingly frustrated with lack of progress on fixing the nation's troubled national pension system. Anxiety is also widespread over the failure to stem the growth of social and economic inequality in traditionally egalitarian Japan.

The upcoming Upper House elections mean that Abe is in no position to disregard public opinion. A poor showing by Abe's Liberal Democratic Party would leave the prime minister severely weakened politically, and could even force him to resign. Either way, momentum for constitutional reform is likely to slow.

Former defense minister Shigeru Ishiba, a staunch LDP supporter of constitutional reform, acknowledged Abe's problem recently. Ishiba said that "the outcome of the Upper House election could affect the speed of the discussion." He argued that, "If the prime minister wants to address such big issues as constitutional revision and collective defense, he must first properly respond to such everyday issues as political funds and pension problems, and win the public's trust." In an ominous warning, Ishiba pointed out that Abe's grandfather, Nobusuke Kishi, was forced to resign as prime minister after he used his political muscle to impose a major revision in the US-Japan bilateral security treaty in 1960. "The public reacted

more furiously to his high-handed approach rather than the revision itself," Ishiba said. "I don't want to see Prime Minister Abe follow in Mr. Kishi's footsteps."

In the weeks leading up to this month's elections, Abe has shown signs of heeding these warnings, emphasizing social and economic issues of concern to voters, while largely steering clear of constitutional reform discussions.

Still, while Abe is bending to prevailing political winds, there is no doubt that his personal priorities have not changed. He strongly believes his legacy should be the ushering in of a new era in which Japan can participate in regional and global military operations with other nations deemed ultimately critical to Japan's national defense. That would require overturning a 50-year interpretation of the Constitution by the unelected but powerful Cabinet Legislation Bureau. The CLB argues that Japan may exercise use of military forces only to repel a direct attack on Japan itself.

To push the process along, Abe is closely monitoring the work of a special 13-person panel he appointed to study four specific scenarios in which Japan might feel obligated to engage in "collective self-defense" with another nation facing attack. The panel is headed by former ambassador to the US, Shunji Yanai.

Abe is also working closely with Ishiba, who is heading an LDP panel studying the broad implications of Japan adopting the right to exercise 'collective self defense.'

There is broad consensus in Japan that the country must modernize its approach to regional and global security problems. But translating that consensus into actual policy changes will take longer than Abe expected.

### Group of 13

Despite Abe's political setbacks, former diplomat Yanai and his special Group of 13

continue their work on 'collective self-defense'. Specifically, Abe charged the commission to study four scenarios under which Japan might find itself compelled to go beyond the boundaries of the existing ban on 'collective self-defense.'

The scenarios are: helping defend US vessels that come under attack on the high seas in areas around Japan; using a missile defense system to intercept ballistic missiles fired by an enemy toward the United States; use of Self Defense Forces to defend troops from another country that come under attack while participating in United Nations Peacekeeping Operations; and, expanding the definition of 'logistical support' to include possible transport of weapons.

By virtually all accounts, a consensus has already emerged among panel members that Japan should openly exercise the right to collective self defense. Yanai himself said recently that Japan's alliance with the US would be jeopardized if Japan did not help thwart a ballistic missile launched against America. One source of contention is whether this can be accomplished by a simple reinterpretation of the Constitution and existing laws, or if new legislation is needed to clearly codify Japan's stance.

Yanai says that reinterpretation would be sufficient. "The current interpretation was made based on neither law nor approval of the Diet," he said. "The Cabinet Legislation Office made the current interpretation," Yanai says, and that decision was then accepted by successive cabinets and the Diet. "The Constitution does not stipulate that Japan is not allowed to exercise the collective defense right or participate in UN collective security," Yanai says. "So there is room for another interpretation."

On the other hand, panel member Kazuya Sakamoto of Osaka University argues that a simple reinterpretation of the Constitution would cause some troubles. Critics would argue, he says, that reinterpretation might result in "expanding Japan's use of armed force to a boundless extent." Therefore, Sakamoto advocates new legislation that would specify "areas and preconditions" for Japan to exercise its right of collective self defense."

In late June, the panel met with Abe at the prime minister's official residence, and reached agreement that Japan must attempt to intercept a ballistic missile launched at the United States. Abe hinted that he favors new

*(Please turn to page 11)*