

# Japanese Election Marks “Evolutionary” Adjustment to Changing Global Environment

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In the wake of a historic global economic crisis, investors, analysts and political observers are closely watching for transformations in power, institutions, alliances, and markets across the world. The August 2009 election in Japan, which resulted in a landslide Democratic Party of Japan (DPJ) victory, has led to intense speculation as to whether this will result in “revolutionary” change or simply maintenance of the status quo.

Another area of special concern will be the ability of East Asia to continue its development as an increasingly vibrant and important engine of world growth. Japan’s role as host of the 2010 Asia Pacific Economic Cooperation (APEC) Summit in Yokohama will provide a high-level forum in which the nation can demonstrate its ability to assist in this long-term transformation. Planning is now underway to develop a progressive agenda that can achieve the efficiencies of globalization while formulating solutions to problems related to domestic dislocation as well as global climate change.

Resolving issues related to environmental protection, alternative energy and conservation, health and economic development of the world’s poorest countries are all essential to restore and sustain economic growth. They also represent areas of potential business and investment opportunity where Japan has an established track record and ability to compute and contribute moving forward.

## Landslide Victory Allows Reassessment of Japan’s Goals and Objectives

Prior to the September 2009 election, Japan’s Liberal Democratic Party (LDP) governed Japan almost

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continuously throughout its entire 55-year postwar history. Then, the rival DPJ led by Yukio Hatoyama, achieved a landslide victory that gave it 308 seats in Japan's powerful 480-member House of Representatives and an effective coalition-majority with minor parties in the Diet's upper house.

#### Japanese General Election Results – August 30, 2009

Party	DPJ	LDP
Last Election	113 seats, 36.4%	296 seats, 47.7%
Seats before	110	303
Seats won	308	119
Seat change	+195	-177
Popular vote	29,784,743	18,782,218
Percentage	42.4%	26.7%

The government of incoming Prime Minister Hatoyama campaigned on a promise to break the "iron triangle" of the LDP, big business and the bureaucracy. While this model served to propel Japan as it advanced to become the world's second largest economy, it has become increasingly outmoded as the nation finds it can no longer rely on demand in the US and other traditional export markets.

As World Bank president Robert Zoellick recently stated in a speech covered by Kyodo News "Japan rose from the ashes of World War II as a 'trading state,' the model for export-led growth ... It is not clear that ... will be sustainable in a more 'balanced' global economy that does not rely so heavily on the US consumer."

Composed primarily of younger politicians (the average age of freshman legislators is 49) and a party more open to participation by women, the DPJ advocates more attention to domestic consumption and the needs of population segments displaced by the efficiencies of globalization and a more open economy.

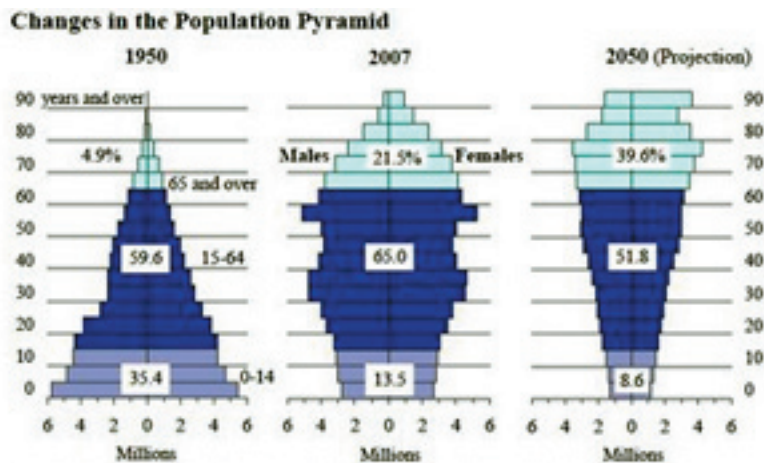
Other goals include a more active role for Japan in Asia and a more independent, but cooperative and stable relationship with the US. This has led to a lot of controversy and real questions as to what the future will bring to Japan and its relationships around the world.

## Is Election More Indicative of “Revolutionary” or “Evolutionary” Change?

Some analysts believe the election marks a seminal moment in Japan’s postwar history akin to the 1868 Meiji restoration. Naoki Iizuka, a senior economist at Mizuho Securities in Tokyo, for example, recently stated in the New York Times “This could be the end of the old system .... It could make possible the changes we all know Japan needs.”

Some of these changes include taking steps to revitalize Japan’s anemic economy, to deal with its aging population, as well as the growing inequalities, job insecurity and dislocations that are a consequence of globalization and reform measures introduced into Japan to create a more competitive and open business environment.

### Japan’s Aging Population – Projected Demographic Trends



Many observers, however, such as Devin Stewart and Paul Scalise in a Foreign Affairs article note “In polls, Japanese voters said they weren’t electing radical change as much as expressing dissatisfaction with the LDP.” In their view this change of government means little and “all signs point to more of the same old stagnation in Tokyo.”

Noted Columbia University Japan expert Gerald Curtis, however, expressed a much different view in a recent Reuters report: “This is about the end of the post-war political system in Japan ...This

is not a story about how the LDP, with an unpopular prime minister and facing economic problems, lost an election ... this is about the end of the postwar political system in Japan."

Others such as Ian Buruma and Tobias Harris take a more middle view. This gives substance to an analysis that sees the election as a moment that has the potential to lead Japan toward significant "evolutionary" change. Both authored pieces that describe the election as a "quiet revolution". Buruma notes in a piece in the NY Review of Books "...even if the promised reforms don't happen overnight, or under Hatoyama's watch, things will not be the same again. Now that Japanese citizens have finally exercised their power to vote the rascals out, going back to the old ways is no longer an option even for conservatives....This is good news for Japan."

In his Observing Japan blog, Harris states "the DPJ does not need to be 'revolutionary' to deliver meaningful change to how Japan is governed," and goes on to conclude "It may not look like much of a revolution, but a quiet revolution is still a revolution."

Even Stewart and Scalise recognize this potential for change, closing their article acknowledging "The realm of the possible has been slightly expanded in Japan."

Given the difficulties Japan has had in recent decades implementing new approaches, a cautious view is warranted. That is not to suggest Japan's recent election is not meaningful. It only suggests while the word "revolution" makes for dramatic headlines -- viewing the recent election more as a significant turning point in an ongoing evolutionary process -- is probably more accurate. It also has a greater chance of success than a revolutionary break with the past.

## **DPJ Government Provides Impetus for Change and Continuity with Past**

Perhaps no concept better illustrates the objectives of the Hatoyama government than the Prime Minister's stated philosophy of "yu-ai" or "fraternity". This has been described as "a

way of thinking that respects one's own freedom and individual dignity while respecting the freedom and individual dignity of others".

The Prime Minister introduced this concept as the basis for Japan and its international cooperation in an eloquent speech at the United Nations (UN) just one week after taking office. He traced the idea back to his grandfather, former Prime Minister Ichiro Hatoyama, who in 1953 wrote of his devotion to "a fraternal revolution" that would "avoid extreme left-wing and right-wing ideologies".

Through this spirit of fraternity, the Prime Minister noted Japan will strive to "become a bridge for the world, between the Orient and the Occident, between developed and developing countries, and between diverse civilizations."

He noted his government plans to make Japan a "bridge" in five specific areas: a) response to the global economic crisis; b) climate change; c) nuclear disarmament and non-proliferation; d) peace building, development and poverty; and e) building an East Asian community.

Most opinion polls indicate that many Japanese have considerable anxieties about the future and to deal with economic pressures, the new government is reevaluating and looking for ways to enhance the efficiency of the previous government's stimulus efforts. Economic statistics released in August show Japan is pulling out of recession. Yet joblessness is expected to increase, and wages are likely to fall at least through this year.





Japanese real GDP and industrial production



Sources: Cabinet Office, Ministry of Economy, Trade and Industry

To address climate change, the new Japanese government has also set a very ambitious target for a 25% greenhouse gas emission reduction by 2020. It plans to bridge environmental concerns between developed and emerging nations by providing increased “green technology” financial and technical assistance to developing countries. The government is showing strong indications it will lead by example and intends to play a leading role in the COP 15 United Nations Climate Change Conference in Copenhagen, Denmark this December.

In addition, the Prime Minister has stated repeatedly that Japan, the only country ever to have suffered the devastation of atomic bombs, should become a leading proponent of US President Barak Obama’s vision of a “world without nuclear weapons”. This includes serving as a bridge between countries who have nuclear weapons and those who do not. He has called North Korea’s rush to nuclear weaponry a threat that cannot be condoned, but left open the door to a positive response if North Korea abides by international agreements and resolutions.

## **The Spirit of “Yu-ai” or “Fraternity” Will Guide Domestic and Foreign Policy**

As the Prime Minister and his party move to implement this vision, it will give direction to domestic and foreign policies in a Japan that many – both inside and outside the nation – have considered to be drifting for far too long.

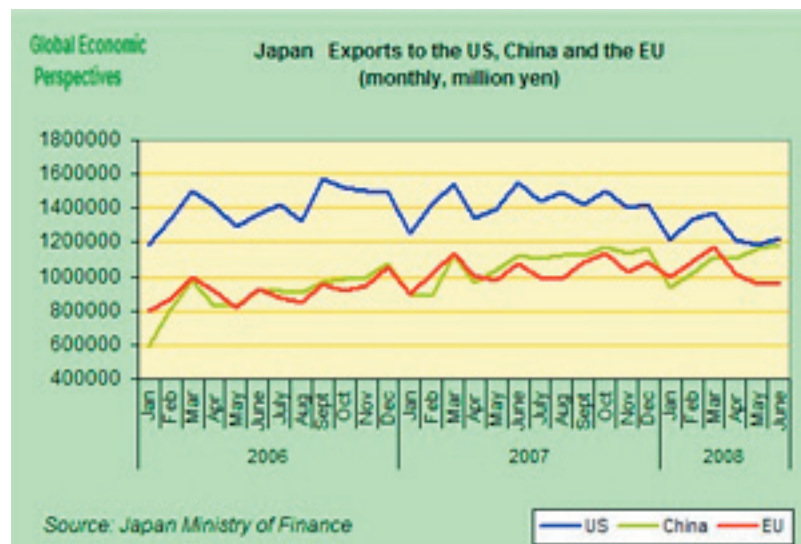
The new government has an ambitious domestic agenda. It plans to fund new projects by eliminating wasteful spending, rather than increased taxation. It has pledged to enhance child welfare and education and promised to give families with young children several hundred dollars a month per child in an effort to reverse the declining birth rate. The DPJ has also noted its determination to tackle the problem of social security through a stronger social safety net, in particular to help the lives of seniors. To promote economic activity outside of Tokyo and in rural areas, expensive highway tolls will be reduced and many car-related taxes eliminated. To raise employment, the DPJ is planning to provide monthly stipends for people in job training.

Perhaps the most important DPJ priority is to give elected politicians the lead role in policymaking – rather than rely on guidance from career bureaucrats as the LDP had done in the past. In the words of Tobias Harris “In short, the changes set in motion by the Hatoyama government will likely result in a stronger cabinet actually capable of leading Japan, and by leading I mean making difficult decisions instead of punting on every decision as the LDP did when in power. A new policymaking process is no guarantee of success, but the Hatoyama government is taking the right steps to give it a chance to change Japan for the better.”

## **East Asian Demand is Vital Component of Global Economic Recovery**

While newly elected governments often tend to focus on domestic affairs, many internal problems can at least partially be resolved through better external policies. For example,

weakening demand from Japan's traditional exports markets in the US and Europe is causing the nation to place a greater emphasis on relationships with its East Asian neighbors.



So far speculation on Prime Minister Hatoyama's foreign policy has largely centered on his statements calling for a more equal relationship and greater independence from the US. This is reflected in discussions on such issues as renegotiation of the Status of Forces Agreement, a review of programs related to US forces at Futenma Air Base and a review of Maritime refueling activities by Japan in the Indian Ocean as part the war against terrorism.

These statements may seem shocking, particularly to western news media, mostly because they differ dramatically from past LDP policy. They are not, however, a threat to US interests or the historic US-Japan relationship and the two countries remain strong allies in pursuit of a robust bilateral agenda.

In fact, the Wall Street Journal reported a White House source as stating in a telephone conversation shortly after the election, Prime Minister Hatoyama directly informed President Barack Obama of his intention to build an "even more effective relationship (with the US)". According to the Journal, Hatoyama stated afterward that he had assured Mr. Obama the



US-Japan alliance is the “foundation” of Japan’s foreign policy.

Professor Gerald Curtis from Columbia University reflected further on these issues in an interview with Elizabeth Lynch on her blog China Law and Policy “I think the (Japanese) government understands that this military alliance with Japan is critical for Japanese security and that to have a military alliance you have to provide some facilities but maybe not as much as currently exists. So that is what the negotiation will be about. It’s not about eliminating the U.S. military presence.”

Perhaps part of the reason behind the Prime Ministers desire to introduce a broader foreign policy focus is Japan’s growing recognition of changing structural imperatives. These require it to shift its attention beyond an unhealthy reliance on the US and European markets to one that is based on its own consumption and greater economic cooperation and trade with other economies in East Asia.

Japan is the second largest economy in the world, measured in terms of current dollar purchasing power. Together with the region’s other biggest economies – China and South Korea – they comprise roughly 16% of global GDP. This was achieved largely through an export-led strategy fuelled primarily by demand in the US and Europe. East Asia soon found it could produce more than what it was consuming, yielding a trade and current account surplus and external reserves. In short, East Asia’s trade surplus is a reflection of the US’s trade deficits.

Mohamed Ariff, Executive Director of the Malaysian Institute of Economic Research (MIER) described this phenomenon in an article that appeared in the New Straits Times “The US-East Asia trade imbalances are also a reflection of the serious gaps in the equation between production and consumption on the one hand, and savings and investment on the other”.

Ariff goes on to note “What all this means is that the US has been consuming too much and saving too little, while East Asia has been good at saving a lot and consuming little. To correct

the trade imbalances, there is a need for East Asia to consume more and save less, and the US to consume less and save more." The global recession, he believes, has accelerated a correction of the imbalance "which means that East Asia must generate its own demand for its products in order to grow."

Noting the importance of these changes, the Prime Minister, following a summit meeting in which it was announced that China, Japan and South Korea would explore the idea of a free trade pact stated "Until now, we have tended to be too reliant on the United States ... The Japan-US alliance remains important, but as a member of Asia, I would like to develop policies that focus more on Asia."

### **East Asia Now Represents an Important Market as Well as Supply Platform**

Over the last 20 years there has been a big structural adjustment in the Japanese economy, with major Japanese firms establishing a formidable presence in Asia. Many established efficient international manufacturing bases by taking advantage of lower cost production locations around the region. For example, in 1990 only 11.4% of Japanese electronics manufacturing output was produced offshore, but by 2007 that share had risen to 45.5%.

Today, however, Japanese companies are coming to realize China, India, Indonesia and other countries -- once seen as wellsprings of cheap labor and low-cost manufacturing -- are now thriving markets in their own right. The creation of manufacturing throughout the region has created rising incomes and the birth of new consumer markets outside the traditional, and now shrinking, export markets of the US and Europe.

### **APEC Provides Forum to Develop East Asia as Driver of Global Growth**

Formed 20 years ago, Asia-Pacific Economic Cooperation (APEC) is a forum for 21 Asia-

Pacific economies that cooperate on regional trade and investment. This includes economies in East Asia and other Pacific nations such as Canada, the US, Mexico, Peru and Chile. APEC strives to develop workable strategies in trade and economic diplomacy and has become the central pillar of trans-regional architecture in East Asia and the Pacific. Its' objective is to enhance economic growth and prosperity in the region and to strengthen the member economies. Members account for approximately 40% of the world's population and about 44% of world trade.



Source: APEC

This year's annual meeting in Singapore -- followed by the 2010 meeting in Yokohama, Japan and the 2011 meeting in the United States, will allow for a detailed review of the issues that need to be resolved. As a result, many will be listening carefully to Prime Minister Hatoyama's words in Singapore as indicators of Japan's plans for the 2010 meeting.

In recent talks before the Japan Society in New York and Center for Strategic and International Studies (CSIS) in Washington, DC, Hidehiko Nishiyama, Director-General for Trade Policy in Japan's Ministry of Economy, Trade and Industry and incoming Chair of Senior Officials' Meeting of APEC Japan 2010 noted several important areas where APEC can play an important role.

First, since Asia-Pacific is becoming increasingly important as a driver of global growth, APEC is a forum that can be used to facilitate sustainable growth while strengthening rules for trade and investment.

Second, APEC can help to address the economic imbalances that have arisen among regional economic powers by contributing to a new macroeconomic regime that can correct one-directional excesses in supply and demand.

Third, global climate change needs have to be addressed, and APEC can help to reconcile differences between emerging economies with fewer resources and developed economies while determining ways to share the burden multilaterally.



Fourth, globalization is often seen as the cause of income disparities and dislocations in domestic economies, leading to fear, anxiety and resistance to change. APEC can help to find ways to mitigate these “negative effects” to preserve the social consensus necessary for further change and reform.

Fifth, APEC can seek to minimize the impact of massive fluctuations in commodity prices such as those for oil and food since they affect low-income individuals and disrupt the incentives for exploration activity and the development of new alternative energy technologies.

He noted that these and other factors are now being considered as the Ministry actively works with Japan’s new political leadership to develop an agenda for next year’s Yokohama meeting. There intent is to balance the potential of regional growth with new strategies that embrace *yu-ai* and allow for inclusive, sustainable and knowledge-based growth.

APEC members can also address issues raised in the Doha Development Agenda, which is the current trade-negotiation round of the World Trade Organization (WTO). The talks commenced in 2001 and are now the longest-running global trade negotiations in history. Regional Economic Integration (REI) is another issue likely to be addressed, since it involves trade financing, protectionist measures and trade policy monitoring.

Nishiyama believes APEC is ideally suited to tackle these tough issues. He notes "APEC is not a negotiating body like the WTO, so it can serve as a laboratory for new initiatives and economic measures. Some criticize APEC as non-binding and thus lacking impact, but APEC's non-binding nature is integral to its beauty. Precisely because it is not binding, it enables member economies to discuss a wide range of issues not possible at the WTO.

In addition, APEC brings in the regional powerhouses -- China, Japan, South Korea and the US -- while also providing a forum for businesses through organizations like the Pacific Economic Cooperation Council (PECC) and the Pacific Basin Economic Council (PBEC). Nishiyama states "APEC is uniquely designed so that business leaders in the region can directly submit their recommendations on economic issues to political and government leaders in a multilateral setting. It is only in APEC that the business sector can have a direct dialogue in this way. APEC listens to the voice of business."

### **Japan Believes US Involvement Essential to Build East Asian Community**

Japan's emerging APEC agenda will build on the leadership of Prime Minister Hatoyama, who has announced his intention to help build a strong East Asian community. The Prime Minister noted "Reducing the region's security risks and sharing each others' economic dynamism based on the principle of 'open regionalism' will result in tremendous benefits not only for Japan but also for the region and the international community."

However, the Prime Minister emphasized, there is no way to realize this vision in the Asia Pacific region without the US. The concept of an East Asian community "certainly is not intended to exclude the US dollar or the United States. Quite the contrary, as a step beyond this initiative [we] believe we should envisage an Asia-Pacific community, and [we] do not think that this could readily be achieved without the United States."

### **Renewable Energy and Conservation Vital to Reverse Climate Change and to Restore and Sustain Global Growth and Development**

Japan's new government strongly believes climate change will require a global response.



When the world's leaders meet in Copenhagen this December, they will hear about a "Hatoyama Initiative" as a framework of a new initiative to replace the expiring Kyoto Protocols. This will include a new emphasis on bridging the energy and conservation issues that divide developed and emerging economies.

The Prime Minister's initiative, outlined in a speech at the UN, is comprised of four principles that Japan deems essential.

First, developed countries, including Japan, would provide new and substantial public and private financing. Second, rules would be developed to facilitate international recognition of developing countries' emissions reductions, in particular those achieved through financial assistance, in a measurable, reportable and verifiable manner.

Third, in assistance to developing countries, consideration would be given to innovative mechanisms. An international system would be established under the auspices of the UN climate change regime. This system would facilitate one-stop provision of information on, and matching of, available bilateral and multilateral financing, while securing transparency and effective utilization of assistance.

Finally, Japan proposes to establish a framework to promote the transfer of low-carbon technologies which ensures the protection of intellectual property rights.

As Prime Minister Hatoyama noted "Japan has relatively strong potential for technological development as well as considerable financial capacity. Thus I recognize that Japan is expected to take the lead in the international community in setting its own reduction target, and to achieve such target through the development of innovative technologies". Furthermore "I have full confidence in the abilities of the Japanese people and our companies. Political leaders at this time also have a responsibility to future generations to create a sustainable society by transforming the social structure that we have known since the Industrial Revolution."

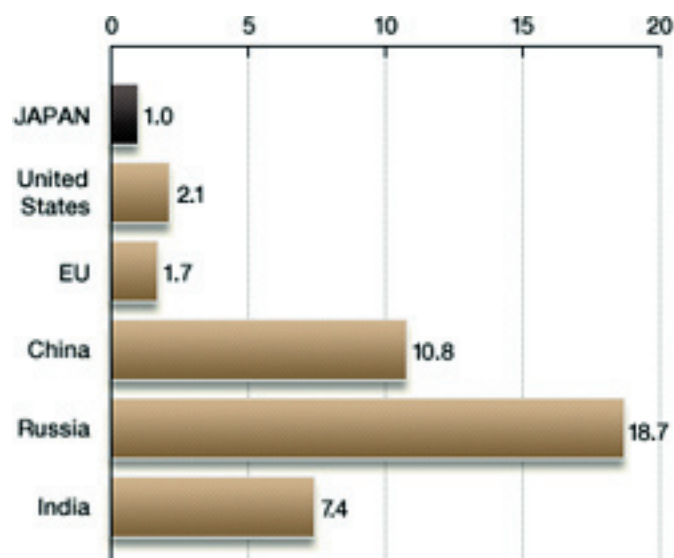
In a paper prepared for the CSIS Pacific Forum Professor Curtis emphasizes Japan's ability to contribute to the climate change issue, noting environment, health and energy conservation are areas where Japan can form a tri-lateral initiative with the US and China. He stated: "Environmental protection, energy conservation, and the economic development of the world's poorest countries are high on today's international agenda. These are issues where Japan has superb technology and expertise. They should be high on the US-Japan agenda and on a trilateral US-China-Japan agenda as well."

Such a unified market has the potential to lift not only these and other APEC member economies, but also to create new markets that could push forward a global economic recovery. While expanded economic activity and consumption is indeed vital to achieve long-term growth and prosperity -- there is little hope of sustaining this activity without development of new sources of energy, sustainability and more efficient use of existing technologies.

If for no other reason than insufficient investment in new exploration and procurement activity, combined with rising living standards in China, India and other emerging economies, strains will continue to be placed on existing energy supplies. That is because emerging economies possess younger populations, higher levels of savings and greater potential demand for cars, homes, consumer goods, telecom and other possessions that have already been accumulated in more mature markets. Ironically these are the same characteristics that give these markets such great appeal as business and investment destinations.

The development of renewable energy will therefore be key to achieving any long-term goals for sustainable economic growth around the world. It can also function to reduce political and economic tensions between countries over concerns about access to energy and natural resource supplies.

## International Energy Efficiency Comparisons



CO2 equivalent tons required to produce US\$1 million worth of GDP, with the Japanese value normalized to be one (in 2004).

Source: Institute of Energy Economics, Japan

Japan is already ahead on a number of fronts, many of which were highlighted in the last FOCUS newsletter of this series. Given Japan's almost total reliance on external sources for its energy and natural resource needs, the nation has more than 20 years experience creating techniques for managing energy efficiency and renewable energy applications. It also remains one of the world's lowest per capita energy consumers. More than 25% of global solar cell production already takes place in Japan and it is considered a leader in fuel cell development. In addition, Japan places great emphasis on new technologies for energy delivery and conservation, often called the "smart grid."

Finally, Japan has also been working to create international partnerships for energy efficiency and has been an advocate of considering nuclear energy as a green technology and viable alternative to fossil fuels.

## Election Opens Door to New Opportunities Without Constraints of Past

The bottom line is Japan is advancing into a new era and is taking an “evolutionary” step to advance beyond the path that transformed it into an economic success in the aftermath of the Second World War. It is a path that can be said to be no longer adequate to serve its needs as the nation seeks to position itself to meet the pressures of globalization and the new world emerging before us.

Japan’s recent election opens the door to candid and productive discussion and an ability to question many of the assumptions and institutional “legacy concepts” that have accumulated in Japan during its postwar history. The full implications of this change will become clearer over time.

Given the many economic, social and political changes that are occurring in the world today, this is a healthy development which will allow policymakers, executives and the Japanese public an opportunity to evolve, re-evaluate and develop a basis for more solid footing moving forward.

Change by nature presents both opportunities and risks and globally-focused companies and investors are well advised to monitor these developments so that they will be able to benefit and position themselves accordingly.

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