New Japanese government under pressure to slash social spending

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Prime Minister Yukio Hatoyama's government is facing growing demands from big business to ditch its election promises, slash social spending and rein in mushrooming public debt.

The Democratic Party of Japan (DPJ) won the election and ousted the Liberal Democratic Party (LDP) by running a campaign based on the vague slogan of "change". The Democrats were able to capitalise on the widespread discontent and hostility toward LDP rule, which had been in power for more than 50 years, with only a brief interruption in 1993-94.

The Democrats, with the support of the Social Democratic Party and tacit backing of the Japanese Communist Party, promised voters some $77 billion in social spending on child allowances, free education and rural subsidies. It also pledged to axe road tolls. Within months, the new government is preparing major budget cutbacks in the name of restoring Japan's fragile fiscal position.

The budget deficit is expected to hit $US548 billion (49 trillion yen), or a massive 10 percent of GDP, this fiscal year. Finance Minister Hirohisa Fujii admitted in late October that tax revenues for fiscal 2009 would fall below 40 trillion yen, much less than the forecast 46 trillion yen. The government will have to issue up to 50 trillion yen of bonds to cover the shortfall—far exceeding the previous record of 36.6 trillion yen in 2004. For the first time since World War II, the amount of bonds issued will be greater than tax revenue received.

Hatoyama has promised to keep next year's budget below this year's total of $970 billion. However, last month's initial budget requests for 2010 from the ministries total at least $1.04 trillion. Fujii has pledged to keep new bond issuance below 44 trillion yen, but many analysts expect that Tokyo will have to take on more debt.

In recent weeks, investors have been selling off Japanese bonds. The *New York Times* reported on October 21: "For jittery investors, Japan's growing debts raises the nightmarish prospect of a sovereign debt crisis, a currency meltdown or both. Mr. Fujii's remarks raised concerns of a supply glut in bond markets, sending yields on 10-year Japanese government bonds to their highest level in six weeks."

Former International Monetary Fund (IMF) chief economist Simon Johnson told the US Congress last month that Tokyo's public debt was out of control and raised "a real risk that Japan could end up in a major default". The IMF predicts that Japanese public debt will reach 218 percent of GDP this year, 227 percent next year and 246 percent by 2014—up from around 170-180 percent in recent years.

Japan's $1.5 trillion state pension fund, the world's largest, became a net seller of government bonds this year in order to meet its obligation to pensioners. The country's largest public saving institution, Japan Post, already holds $1.7 trillion in government debt and cannot buy more. Once known for high savings, Japan has a savings rate of just 2 percent of national income—half that of the heavily indebted US and down from 15 percent in 1990.

Two decades of economic stagnation have been compounded by the worst global crisis since the 1930s. Japanese exports fell at an annual rate of around 55 percent by volume between the third quarter of 2008 and the first quarter this year—the worst result among Organisation for Economic Cooperation and Development (OECD) industrialised countries.

The IMF predicts that Japan's GDP this year will contract by 5.4 percent, the deepest contraction among OECD countries. Japanese exports have been hit by falling demand in the US and Europe, where its export markets have been further undercut by a weakening of the US dollar. The yen has risen by 18.9 percent against the dollar over the period 2007 to 2009, while other Asian currencies, especially the Chinese yuan, have been kept low against the dollar.

The present discussion in the international press about Japan's huge debt is in part designed to press the new government to make further inroads into the social position of the working class. The Democrats have established an administrative reform council to eliminate so-called bureaucratic waste. Its immediate targets are the ministries of construction, transport, health, labour, welfare and agriculture, in other words rural subsidies and social services. The government is also seeking to cut spending by pegging pay and promotions.

The austerity measures are only beginning, however. If the government is going to rein in the budget deficit, far deeper cuts will have to be taken, including the ditching of some of its election promises. At the same time, cutbacks to public spending will only aggravate the economic slowdown and produce further rises in unemployment.

The slashing of public spending will open up deep divisions within the Democratic Party and with its smaller allies. The DPJ is an unstable amalgam of breakaway LDP factions and sections of the former Socialist Party. The key economic ministries are held by those who quit the LDP over its failure to press ahead fast enough with "free market" restructuring. Other DPJ figures, however, including former Socialist Party members and old-style LDP figures such as Ichiro Ozawa, advocate continued high public spending to dampen social unrest.

The divisions are already evident over the privatisation of Japan Post, which was set in motion by the LDP. Under the pressure from his coalition partners—the Social Democratic Party and the Peoples New Party—Hatoyama has called for a review and has delayed the planned listing of stocks. Postal privatisation was a cornerstone of the LDP's free market agenda, especially under former prime minister Junichiro Koizumi. The original plan was for Japan Post to be divided into four companies, with the floating of its saving and insurance arms next year and full privatisation by 2017. The aim was to free up its huge $1.95 trillion in savings for the private banking sector.

The powerful Japanese Bankers Association has opposed the review. Hatoyama, however, is concerned that privatising the postal services will produce rising joblessness, especially in regional areas, and social unrest. Japan's unemployment rate reached a post-war record of 5.7 percent in July before dropping slightly to 5.5 percent in August. In the rural northeastern prefecture of Yamagata, the job-to-applicant ratio was 0.33 in June, the worst since the 1970s. Last month, the government announced an emergency program to create 100,000 jobs by next March, but did not elaborate how that would be achieved.

Time magazine warned on November 9 that the Democrats would rapidly lose public support if they axed social spending. "By delaying or reducing these [social] programs to hold down the deficits, and by repeatedly setting budget and spending targets he is unable to keep, Hatoyama runs the risk of making it look as if he is being dragged along by events rather than taking charge of a difficult situation. He claims that this apparent waffling will not hurt the DPJ's popularity, saying recently that 'the public is flexible about the [DPJ's] policy manifesto'. Certainly it seems to have done no harm so far. In mid-October, the government's approval rating remained very high at 73 percent. But the honeymoon is unlikely to last forever."

Public support is fading faster than expected. A poll conducted by Kyodo News on October 31 and November 1 found that the approval rating for Hatoyama's cabinet had dropped by 10.2 percentage points since its inauguration in mid-September to 61.8 percent. The rating for DPJ as whole dropped 4.2 points to 43.4 percent, compared to the LDP's 21.1 percent.

Regardless of these warning signals, as the economic crisis worsens the government will come under intense pressure to slash public spending and rein in public debt, placing it on a collision course with the working class.