

Moody's credit downgrade sends warning to Japan's next leader

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As Japan's ruling Democratic Party prepares to elect a new leader next Monday to replace Prime Minister Nanto Kan, the international rating agency Moody's has downgraded Japan's credit rating from Aa2 to Aa3—one notch below Italy and Spain, which are engulfed in a debt crisis.

The downgrade, announced on August 23, was widely expected and did not produce the kind of financial shock that followed Standard & Poor's downgrade of US debt earlier this month. Nevertheless, Moody's move was obviously meant as a warning to the next Japanese government to implement the austerity agenda being imposed in Europe and the US on the working class.

Moody's expressed frustration that successive governments had failed to rein in Japan's huge \$12.2 trillion public debt, which at more than 200 percent of gross domestic product is the largest of any industrialised country. "Over the past five years, frequent changes in administration have prevented the government from implementing long-term economic and fiscal strategies into effective and durable policies," the agency declared.

Kan had been an advocate of doubling the country's hugely unpopular consumption tax to 10 percent by 2015 and of budget cutbacks. But Moody's warned that this was insufficient. Moreover, it declared that Japan, which has been savaged by the March 11 earthquake and tsunami, needed to grow at 3 percent annually simply to get its deficit under control.

Japan has had negative growth in the past three quarters, and the official growth rate for this fiscal year is predicted to be just 0.5 percent. The next government faces the impossible task of boosting growth amid deepening global economic turmoil, while cutting spending and imposing

greater tax burdens on working people.

Around 40 percent of this year's \$1 trillion budget is being financed through government bonds, which are also being used to cover supplementary budgets for reconstruction costs. Currently, 90 percent of Japanese debt is held internally by the country's banks and financial institutions, insulating Japan somewhat from international turmoil. However, there are concerns in financial circles that this cannot continue indefinitely and the debt level must be slashed.

Asahi Shimbun warned recently of the danger of a sudden shift in market confidence: "No problems would arise as long as everyone continues to buy the bonds. However, if a reverse trend should arise, any delay in selling off the bonds could lead to massive losses. In other words, the collective purchasing of bonds is closely tied to the danger of triggering a collective selling of those bonds so that one is not left holding the joker card."

Moody's has now pointedly reinforced this warning, effectively intruding directly into the choice of the next prime minister. But none of the seven possible candidates has any answer to the dilemma that plagued the Kan government and its predecessors: how to retain the support of voters while implementing austerity measures that will result in a sharp decline in their living standards.

Last June, Kan replaced Yukio Hatoyama who had led the DPJ to victory in the 2009 elections, ending half a century of virtually unbroken Liberal Democratic Party (LDP) rule. Kan's main economic policy was to shift Japan from the stimulus measures enacted during the height of the 2008-09 global financial crisis to austerity. His advocacy of a higher consumption tax, as well as his government's inadequate response to the March 11

earthquake and subsequent nuclear crisis, resulted in his approval rating plunging from 66 percent last year to a mere 15 percent.

Kan survived a no-confidence motion in June only by promising his opponents inside the DPJ to step down once key reconstruction and energy bills had been passed. He resigned yesterday, paving the way for a new party leader and prime minister to be installed next week.

Neither of the leading candidates in next Monday's inner party poll—the current finance minister Yoshihiko Noda and former foreign minister Seiji Maehara—is known for advocacy of tough austerity measures. Noda, who has pushed for consumption tax increases, most closely matches the requirements of Moody's and international finance capital, but he too is acutely aware of the political obstacles to imposing such measures. Last year the DPJ lost control of the upper house after Kan's plans for "tax reform" caused voters to desert in droves.

Noda's economic policies also face strong opposition within the DPJ from powerbroker Ichiro Ozawa, who has consistently advocated stimulus policies despite their contribution to the rising public debt. Ozawa engineered the DPJ's 2009 election campaign that promised limited increases in social spending—promises that have been largely sidelined. His faction, which controls an estimated 120-140 of the 398 DPJ lawmakers, will be a major factor in Monday's vote.

Noda's main rival, Maehara, who has been reluctant to support an increased consumption tax, cautiously told his party supporters on Monday that the government would "eventually" have to implement such a measure. While positioning himself as an economic "moderate"; Maehara has a record of implementing ruthless measures. As minister of infrastructure and transport in 2009, Maehara oversaw the restructuring of the debt-stricken Japan Airlines that led to the destruction of thousands of jobs.

On the other major dilemma facing the Japanese political establishment—foreign policy—Maehara stands on an opposite pole to Ozawa. As foreign minister, he earned a reputation as an anti-China hawk during last year's diplomatic row between Beijing and Tokyo over Japan's arrest of a Chinese fishing boat captain in the disputed waters near the Senkaku islands. Ozawa, on the other hand, is an advocate of closer relations with Beijing as a

means for boosting the Japanese economy.

Like countries throughout the region, Japan confronts a deep quandary in balancing between its top trading partner, China, and its longstanding strategic ally, the United States. The difficulty has been compounded by the Obama administration's aggressive drive to reassert its dominance in Asia and undermine China's growing influence. Hatoyama resigned last year after Obama refused to renegotiate a previous LDP government deal to maintain a controversial US military base on the island of Okinawa. The base's removal had been a major Democrat election pledge.

After taking over from Hatoyama, Kan quickly demonstrated his full support for the US-Japan alliance and secured Washington's backing for last year's standoff with China. In what appears to be a deliberate attempt to make foreign policy an issue in next Monday's ballot, Kan once again raised tensions with China by making a formal protest to Beijing on Wednesday over the alleged intrusion of two Chinese fishery policing vessels into disputed waters near the Senkaku islands.

With both Noda and Maehara at odds with Ozawa over economic and foreign policy, it is possible that a relative outsider might be installed on Monday. Other candidates, including agricultural minister Michihiko Kano, economy minister Banri Kaieda, former infrastructure minister Sumio Mabuchi and former environment minister Sakihito Ozawa, have all been courting Ozawa for his backing.

Whoever wins, however, as Moody's demand for austerity makes clear, the next prime minister will confront the same basic problems as the last. As the government begins to slash social spending and raise taxes, opposition and resistance will inevitably emerge from working people who are deeply alienated from the entire political establishment.



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