



BULLETIN

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Shinzo Abe's Government: Changes in Japan's Economic and Foreign Policies

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The policies of Japan's new prime minister, Shinzo Abe, are aimed at rebuilding the country's status after years of decline. First and foremost, Abe is determined to reinvigorate Japan's economy. Modifications in foreign policy, including enhanced ties with other Asian states and a softer approach towards China, are subordinated to economic goals. Abe's drive to ease monetary policy, based on setting an inflation target and pressing ahead with open-ended purchases of assets with a view to depreciating the yen and expanding exports, may pose an additional challenge for the upcoming EU–Japan negotiations on an Economic Partnership Agreement.

Shinzo Abe took over as Japan's prime minister at the end of 2012 after his Liberal Democratic Party (LDP) won an early election to the lower chamber of parliament and roared back to power after three years in opposition. The LDP has a two-thirds majority in that house of parliament together with the New Komeito Party (NKP). Abe's first decisions as prime minister show that his overall policy goal is to improve Japan's status after years of decline by boosting the economy, strengthening the country's defence capabilities through a closer alliance with the United States, and enhancing ties with other Asian countries, especially those that make up the Association of Southeast Asian Nations (ASEAN). Compared to the agenda of the previous Cabinet formed by the centre-leftist Japan Democratic Party (JDP), Abe has made some noticeable policy modifications relating to the economy and diplomacy.

“Abenomics.” The top priority of Abe's government is the economy. Japan faces serious economic challenges: 20 years in stagnation, a public debt estimated at about 240% of the country's GDP, deflation, and a strong currency negatively affecting export competitiveness (e.g. in 2011, Japan recorded its first annual trade deficit since 1980, at \$32 billion, followed by \$77 billion in 2012). Other challenges include the need to reconstruct regions devastated by the March 2011 earthquake and tsunami. Unlike the previous prime minister, Yoshihiko Noda, whose economic approach was based on fiscal tightening, Abe is viewed as a supporter of monetary and fiscal easing, and he also advocates an increase in the inflation target to fight deflation and a strong yen. Moreover, Abe aims to increase spending on public works and promote exports and foreign investment. This approach has come to be known as “Abenomics.”

One of the first decisions of the new government was a 20-trillion-yen stimulus package expected to spur Japan's GDP growth by 2% and create 600,000 new jobs. The package is designed to aid the reconstruction effort, help finance infrastructure projects and stimulate the private sector. To meet these objectives, the government has authorised an extra 13 trillion yen for the current fiscal year, which ends in March, to cover part of the stimulus plan, a 92.6-trillion-yen budget for the fiscal year 2013, and has urged the central bank to seriously modify its monetary policy. In a joint statement released by the government and the central bank, the latter has agreed to set a medium-term 2% inflation target (but without giving a deadline to achieve this goal) and launch a programme of mammoth open-ended government bond and treasury bill purchases of around 13 trillion yen every month beginning 2014. This is one of the most fundamental changes in Japanese economic policy and a step aiming to inject more money into the market in order to decrease the exchange rate of the yen and increase inflation. This move is expected to stimulate spending and expand exports, a mainstay of Japan's economy. Additionally, the government is preparing a growth strategy to be unveiled by June.

The priority being given to the economic agenda is related to institutional modifications. Abe intends to encourage the central bank to stimulate Japan's economy. The term of the incumbent bank governor expires in April and Abe is expected to take this opportunity to anoint a new governor who would share his economic views. Furthermore, the new prime minister has revived the Council on Economic and Fiscal Policy (CEFP), a body under government control that decides about economy policy but which has lain dormant in recent years. The council is seen as a venue for closer cooperation with (or even exerting pressure on) the central bank governor, who is a member of the CEFP.

Major Foreign Policy Directions. Economic problems, mainly the rising trade deficit, but also territorial disputes, the nuclear threat posed by North Korea, and China's military posture, which could destabilise the situation in the region and deteriorate economic cooperation, have prompted Abe to consider modifying Japan's foreign and defence policies. Relations with the U.S., the main guarantor of Japan's security, remain the cornerstone of the country's foreign policy. Abe has emphasised that his priorities include strengthening bilateral cooperation and supporting the "U.S. pivot to Asia."

Nevertheless, China will remain the most important country in the region. Despite his tough stance on China in the midst of the recent territorial disputes and election campaign, Abe's China policy appears to be softer than expected. A clear reason for easing frictions is to improve damaged economic ties. The economies of both countries are tightly interdependent. China is Japan's biggest trading partner, while Japan is China's largest source of investment, after Hong Kong. The tension over the Diaoyu/Senkaku islands that escalated in September 2012 broke a long-term unwritten rule of "cold politics, hot economy" approach in bilateral relations. Anti-Japanese riots in China resulted in a temporary suspension of production by Japanese companies in China, having a negative impact on Japan's economy (i.e. Japan's biggest car manufacturers said they recorded a 3%–5% slump in sales in China). At the end of January, Abe sent an envoy—Natsuo Yamaguchi, leader of the NKP—to China. The latter met with Xi Jinping and conveyed a proposal for organising a high-level bilateral summit with an economic agenda in an effort to defuse tension and reinvigorate economic ties.

ASEAN countries are another significant direction of Abe's diplomacy. Japan is anxious to establish a stronger economic presence in Southeast Asia through further economic expansion on these markets, but it also wants to strengthen its alliance with nations that enjoy "intimate" relations with the U.S. and are waging territorial disputes with China. The first overseas trip by an official from Abe's government, Deputy Prime Minister and Finance Minister Taro Aso, was to Myanmar, a promising untapped trade and investment market with abundant resources (raw materials and energy production), cheap labour and a strategic location. Aso offered Myanmar financial assistance and a debt reduction deal. The trip was also recognised as a way to counterbalance China's economic influence in Myanmar. Abe's own first trips as prime minister were to Vietnam, Thailand and Indonesia. All these trips, much as Foreign Minister Fumio Kishida's visits to the Philippines, Singapore, Brunei and Australia, focused on economic and security cooperation to underscore Japan's role in the region.

Conclusions and Consequences for the EU. Economic revival will remain Abe's priority until July, when an election to the upper house of parliament is due to be held. The election is expected to see the LDP fighting to win a majority in the house. Visible positive economic changes, or at least noticeable steps towards them, are necessary to win the vote, especially taking into account the recent "swing votes" trend in Japan. An economic approach focusing on boosting the competitiveness of Japanese exports could have an impact on EU–Japan cooperation.

The latest monetary policy steps, including pressure on the central bank to launch a policy of quantitative easing to decrease the value of the yen and improve Japan's terms of trade, have triggered accusations among EU members, mainly Germany, that Japan is curbing central bank autonomy and launching a "currency war," thus posing a threat of currency depreciation in other countries. This policy poses a challenge for the EU as measures aimed at lowering the exchange rate of the yen could worsen the terms of trade in the EU's exports to Japan, which is the bloc's second biggest trading partner in Asia (with a significant trade surplus for Tokyo).

Furthermore, Abe's unclear stance on free trade agreements may also impact EU–Japan relations. In November 2012, the EU agreed to launch negotiations with Japan on an Economic Partnership Agreement (EPA), but Abe has not disclosed his opinion on this accord so far. But his recent comments on the U.S.-led Transpacific Partnership Agreement—he suggests that Japan may not take part in the negotiations if the tariff-removal-without-exceptions clause is maintained—may mean that reaching satisfactory consensus during the EPA negotiations could prove difficult. The EU–Korea FTA, which took effect in July 2011, creating advantages for South Korea, Japan's main competitor on the EU market, is an important incentive for Japan to begin negotiations with Brussels. Nevertheless, lifting Japan's tariff and non-tariff measures, though in the interest of the EU and Poland, could pose a challenge for Japan's relatively closed market with a low volume of foreign investment. Therefore, during the EPA talks, the EU should underscore reciprocity in mutual concessions, paying special attention to the removal of Japan's market access barriers. Poland should support such a "reciprocity" approach, especially as it has a deficit in trade with Tokyo and its businesses are not investing in Japan. Moreover, Japanese FDI growth rate in Poland is decelerating. For all these reasons, better access to Japan's market could encourage investment and facilitate export expansion, for example, through the removal of non-tariff barriers for agri-food products. The EPA could be a significant step to achieving these goals.