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## BREAKING THE IRON TRIANGLE

**H**ASTENING TO WASHINGTON in the aftermath of September 11, the Japanese Prime Minister was dismayed to find the preoccupations of Bush and his aides far from the war on terror.<sup>1</sup> Brushing aside Koizumi's offer of the Self Defence Force, the President's advisors homed in on the main question. When, they wanted to know, was his country going to deal with its bad debts? Japan has been the sick man of global capitalism for over a decade, since the bursting of its eighties' bubble, but the situation is now deteriorating fast. The malaise has spread from the banking and finance sectors to infect the whole system, draining life from a once confident and powerful economy. The IMF has predicted a contraction of GDP by 0.9 per cent in the year to March 2002, followed by a further drop of 1.3 per cent the year after—the most sustained downturn the country has faced since the 1950s. Debt has snowballed to unmanageable proportions. In the face of darkening global conditions and its own intransigent post-bubble recession, the real threat to the US today comes not from a handful of Wahhabi fanatics but from Japan's deflating economy. The process of decay, now gathering momentum, risks triggering an implosion that could suck in the entire region, if not the globe.

Barely a generation ago Japan could aspire to OECD leadership in wealth and productivity. In the early twenty-first century it is Number One in debt. The light fades slowly. GDP grew modestly through the 1990s at an average 1.3 per cent, but is still enormous, second only to the US; per capita GDP rose by 16 per cent. Japan remains the world's greatest repository of wealth, its high savings and under-consumption supporting the US's low-savings, high-debt regime. Its goods are still prized

in the global marketplace and its trade balance, though shrinking, is still positive.<sup>2</sup> But the appearance of normality is deceptive. Japan is the only industrial country in the postwar period to experience chronic deflation. The Nikkei—its 1989 pinnacle of 38,000 points no more than a distant memory when the Koizumi government came to power in April 2001—has broken, at least temporarily, the 10,000 barrier. A staggering 1,364 trillion yen (well over \$10 trillion) has been wiped off the national assets since the bubble burst. Land assets have dropped by 775 trillion yen (\$5.85 trillion) since 1989, and securities by 589 trillion yen (\$4.44 trillion)—sinking to about one third of their 1989 levels—and remain very unstable.<sup>3</sup>

### *Descending from heaven*

With prices falling by about 1 per cent a year, and unemployment rising as companies go bankrupt or shift abroad, there is a real risk of Japan slipping into a savage deflationary spiral. Full, 'lifetime' employment has disappeared within less than a generation and the number of jobless has been rising rapidly. The official rate shows an increase (from a steady 2 per cent ever since 1977) to 3 per cent in 1994 and 5 per cent in 2001 (3.5 million), and 12.4 per cent for the 15 to 24-year-old cohort. A Cabinet Office estimate of September 2001, however, suggested a real figure of 10.4 per cent, or around 7.38 million out of work, based on estimates of jobs lost and of people wanting work, if not actively seeking it. If current estimates of the 'surplus employed', 8.1 per cent of those in employment or around 5.26 million, are added to these—as a possible sum of 'future unemployed'—the figure is 13.5 per cent, or going on for 10 million. The recent suicide figures provide a dramatic index of social distress: over

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<sup>1</sup> Tsurumi Yoshihiro, 'The 7-point Cooperation Plan as seen from the US', *Shūkan kinyōbi*, 5 October 2001. I am grateful to Jennifer Amyx, Aoki Hidekazu, Kaneko Masaru, Mark Selden and Andrew Glyn for advice, criticism and suggestions.

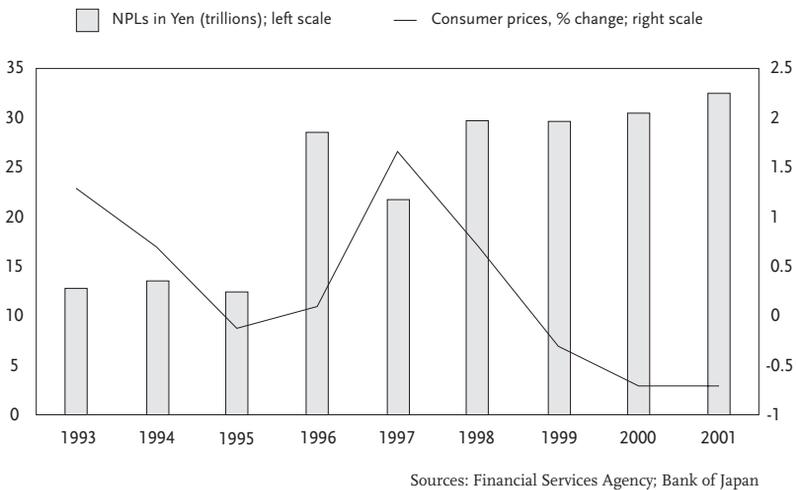
<sup>2</sup> 'Buoyant Americans consume between 4 and 5 per cent more than they produce, while anxious Japanese consume between 2 and 3 per cent less than they produce, and send their savings across the Pacific to help support the consumer debt that sustains the American boom.' Ronald Dore, 'Will Global Capitalism be Anglo-Saxon Capitalism?', *NLR* 6, Nov–Dec 2000, p. 112.

<sup>3</sup> Hideo Tsuchiya, 'Time for Industry to Cede to Intellect', *Nikkei Weekly*, 17 January 2000. Dollar rates (as rough equivalents) are given for 11 January 2002, when the exchange rate was \$1 = 132.6 yen.

30,000 per year from 1997 to 2000, or nearly 100 per day. This is three times as many as those killed in traffic accidents.<sup>4</sup>

How has once-mighty Japan so fallen? The complex of problems the country faces has both a global dimension, in relation to the world economy, and a local one. A key aspect of the latter, it will be argued, lies in the unique system of the *doken kokka* or ‘construction state’, the focus of this essay. First, however, it may be useful to establish the actual scale of the country’s debt. For the private sector, estimates vary widely as to the total of non-performing loans within the Japanese banking system. The official figure of around 32 trillion yen (over \$240 billion dollars) produces a vertiginous gap when set against deflation (see Figure 1); but this is generally considered only the tip of the iceberg. The total sum owed by businesses in trouble or actually bankrupt is set at 80–100 trillion yen (\$600–750 billion) by the US government; 111 trillion yen (nearly \$840 billion) by the IMF; and up to 240 trillion yen—\$1.81 trillion, or

FIGURE 1: *Non-performing loans and deflation*



<sup>4</sup> Hamashino Motoyasu, ‘The Reality of an Age of “Ten Million” Unemployed’, *Ekonomisuto*, 25 December 2001, p. 36. The official survey enumerated only the 3.5 million who actively sought work in the course of one week. Suicide figures: *Asahi Shimbun*, 4 January 2002.

nearly 50 per cent of GDP—by private-sector analysts.<sup>5</sup> This is over three times as much as the total amount—71 trillion yen (over \$500 billion)—written off as bad loans by Japanese banks over the preceding decade.

As recently as 1995 the world's top ten banks were all Japanese; today only two remain in the first rank. At the beginning of January 2002 the Governor of the Bank of Japan warned that the core capital-adequacy ratio of Japan's major banks was just 5 per cent, barely half the level deemed financially sound by the Bank for International Settlements. Yet simply to write off all the debts would bring on a catastrophic wave of bankruptcies, deepening the recession and adding between 0.5 and 1.5 million—in the view of some foreign commentators, more like 3 to 4 million—to the current ranks of the unemployed. To liquidate them through an infusion of public funds would involve a vast amount—up to 50 per cent of GDP—while still merely shifting the load on to taxpayers' shoulders.<sup>6</sup>

Japan's public-sector debt, however, is equally intractable. It now constitutes a staggering 12 per cent of total global debt—20 per cent, if unfunded pension and medical-care benefits are included. Merely to stabilize the current sum by the year 2005 would require an amount equivalent to 10.5 per cent of GDP—about 55 trillion yen or nearly \$415 billion, a larger fiscal shift than has ever been attempted in an industrial economy. The figure has soared from 58 per cent of GDP in the 1990s to an anticipated 140 per cent for 2001, and is on track to reach 200 per cent by 2005.<sup>7</sup> The total for central and local government debt is expected to reach 666 trillion yen (around \$5 trillion, or twelve years of tax revenues) by March 2002—over 800 trillion (\$6 trillion, or sixteen

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<sup>5</sup> IMF, 'Japan: 2001 Article IV Consultation', Country Report, August 2001, p. 22; Economist Intelligence Unit Country Report, December 2001, p. 31.

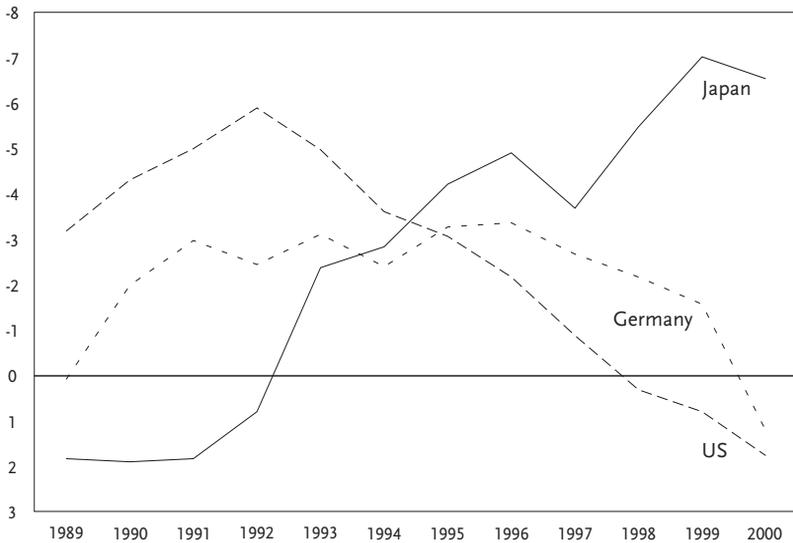
<sup>6</sup> *Mainichi Shimbun* report, cited by John Phaceas, *Australian*, 7 January 2002; Hirano Junichi, 'The Seriousness of the Situation', *Ekonomisuto*, 17 July 2001; Kaneko Masaru et al., 'A Proposal in Opposition to Koizumi's Structural Reform', *Sekai*, August 2001, p. 65; Richard Katz, 'Koizumi's Self-Defeating Policies', *Financial Times*, 9 July 2001.

<sup>7</sup> Ministry of Finance, 'Highlights of the Budget of FY2001', April 2001; David Asher, 'Could Japan become the "England of the Far East"?', American Enterprise Institute for Public Policy Research, June 2001; David Asher and Robert Dugger, 'Japan Faces Bankruptcy if it Continues on this Path', *Ronsō—Tōyō keizai*, September 2000, pp. 35–41.

years of tax revenues) if the deficits of public corporations are included. One helpful commentator has calculated that this sum in 10,000 yen notes would constitute a pile 800 times the height of Mount Fuji.<sup>8</sup> On current projections, the public debt will double by 2010, and treble in the following decade.

Japan is slowly running out of money. Of its current annual budget of around 80 trillion yen (\$600 billion), over a third comes from national-bond issue—in other words, is borrowed; while a quarter of its payments—around 20 trillion yen (\$150 billion)—must go to service the debt.<sup>9</sup> The Maastricht Treaty sets a limit for national deficits at 3 per cent of GDP; Japan only sank into deficit in 1992, after its bubble burst, but the figure has risen since then to 5 per cent in 1996 and to a predicted 11 per cent in the present financial year (see Figure 2).<sup>10</sup> For the decade

FIGURE 2: *Fiscal deficits (-) and surpluses (+) as % of GDP, 1989–2000*



Source: OECD Economic Outlook 70.

<sup>8</sup> Asai Takashi, 2003 *nen Nihon hasan (Japan to go bust in 2003)*, Tokyo, 2000, p. 35.

<sup>9</sup> Ministry of Finance, 'Highlights of the Budget'.

<sup>10</sup> Ishi Hiromitsu, *Making Fiscal Policy in Japan: Economic Effects and Institutional Settings*, Oxford 2000, p. 121.

of the 1990s as a whole, the national product increased by 57 trillion yen (over \$430 billion), or about 10 per cent of GDP, but the debt by 342 trillion (over \$2.5 trillion), or nearly 70 per cent of GDP—a mountain of debt for a mouse of domestic product growth.<sup>11</sup> This is a worse position than that facing Britain in 1976, Italy in 1991 or even Weimar Germany in 1921; in short, Japan is now confronting a deeper public-debt crisis than any other nation in modern history.<sup>12</sup>

The point is often made that Japan's debt is mainly domestic rather than foreign. But the pool of national savings in post-office accounts and state-pension funds—sometimes estimated at 580 trillion yen, or over \$4 trillion—belongs to Japan's people, not to its government; and a significant proportion of it has already been invested in public or semi-public bodies that are in deep financial trouble.<sup>13</sup> Nobody knows exactly how much money has been lost in this way but when, in October 2000, the Ministry of Finance for the first time did a national inventory, it concluded that the state as a whole was somewhere between 130 and 780 trillion yen—up to \$5.89 trillion—in the red.<sup>14</sup>

### *Foundations of the doken kokka*

None of this is any secret in Japan, where economists have been declaring the country either bankrupt or on the brink for several years now, and there is a growing literature of doom. In a perhaps unguarded moment the veteran Minister of Finance, Miyazawa Kiichi himself joined the chorus in March 2001, describing the country as 'near bankrupt'. According to Takemura Masayoshi, Minister of Finance in the mid-1990s, 'the country is ruined': only in the extraordinary circumstances of war has Japan ever experienced such desperate financial

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<sup>11</sup> Kaneko Masaru, Jinno Naohiko and Nomura Hiroyasu, 'Stop the Financial Collapse', *Sekai*, October 2000, p. 60.

<sup>12</sup> British 1947 debt as proportion of tax revenues was 707.5%. Till 2000, when Japan recorded 1,548.45 %, that was the worst on record. See Asher and Dugger, 'Japan Faces Bankruptcy', p. 40.

<sup>13</sup> To the end of 1999, 257 trillion yen (nearly \$2 trillion) was on loan to public corporations. 'Review of Public Bodies Increases Sad Reality', *Nikkei Weekly*, 25 June 2001.

<sup>14</sup> Depending on whether implicit liabilities for welfare and pensions are included. 'Government Finds Itself 780 trillion yen in the Red', *Japan Times*, 6 October 2000.

straits.<sup>15</sup> But these are crocodile tears. The Ministry of Finance's Trust Fund Bureau has for decades been chief player in the unique public-works-based system of the *doken kokka*, or 'construction state', in which a crucial key to Japan's desperate situation lies.

The *doken kokka* centers not on the archipelago's world-famous manufacturers but on an 'Iron Triangle' of politicians and bureaucrats, financial institutions and construction industry. Its mode of operation is opaque, unaccountable, and therefore hard to reform. Essentially, it enables the country's powerful bureaucrats to channel the population's life savings into a wide range of debt-encrusted public bodies—those in charge of highways, bridge-building, dams and development initiatives, for instance—in which many of the same bureaucrats look forward to enjoying lucrative, post-retirement sinecures. For local politicians, the *doken kokka* means promising new public-works projects—viable or not—in their constituency, in return for funds and votes.

It is now generally agreed that the system is deeply flawed and in need of reform; yet most politicians, many bureaucrats, thousands of companies and millions of people depend upon it, to some degree. Japan's public-works sector has grown to be three times the size of that of Britain, the US or Germany, employing 7 million people, or 10 per cent of the workforce, and spending between 40 and 50 trillion yen a year—around \$350 billion, 8 per cent of GDP or two to three times that of other industrial countries. Naturally there have been short-term benefits for many, not least in terms of soaking up unemployment during the long 1990s recession. Gradually, however, public-works infrastructure has been replaced by 'extrastructure'—developments undertaken for their own sake, while the collusive alliance at the system's core has corrupted both politics and society. Japan now has more dams and roads per unit of land than the continental US. Half its coastline and most of its rivers have been wrapped in concrete, 90 per cent of its tidal wetlands have been drained and lost, its ground-water is drastically depleted and its bio-diversity under threat.

At the heart of the *doken kokka* lie two peculiarly Japanese institutions. The first is the *zaitō*, or Fiscal Investment and Loan Programme, under

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<sup>15</sup> Miyazawa's expression was '*hakyoku ni chikai*'. 'Japan Nearly Bankrupt', *Sydney Morning Herald*, 9 March 2001; 'To Grieve Over the Fiscal Deficit?', *Asahi Shimbun*, 31 December 1999.

which the Ministry of Finance's Trust Fund Bureau exercises virtually unfettered discretion over the investment of the vast pool of national savings in post-office accounts and state pension and insurance schemes.<sup>16</sup> Referred to with good reason as Japan's second budget, the *zaitō* was supposed to ensure that public-works projects necessary for the long-term development of the nation could be carried out, whether or not private-sector funding was available. The second institution, the *Zensō*, or National Land Development planning system, was established in the 1950s to direct postwar redevelopment, although its origins lie in Japan's pre-war state-building efforts in Manchuria. The need for the public development of social infrastructure was clear in the early post-war decades, and growth was so rapid that the large public-investment programmes were quickly paid off. From the first oil shocks of 1973, however, the 'miraculous' rates of growth gave way to levels of 3 per cent and below; the ratio of debt to GDP, still low in 1974 at 9.7 per cent, began to rise.

During the postwar decades growth had occurred within a fiscally conservative framework; Keynesian fiscal activism was only adopted after 1973, when the state turned increasingly to pump-priming, public-works packages, funded by the issue of national bonds. Under Tanaka and his successors, the *doken kokka* spread a web of power and corruption throughout the country, substituting interest-representation—brokering—for politics in the strict sense, legitimated by its short-term benefits and by the engine for growth that it seemed to provide.

### *Concreting the archipelago*

The *zaitō* became a machine for supporting the large-scale construction companies allied to the LDP and the semi-public corporations headed by retired bureaucrats—a domain scarcely penetrable by the cold winds of the market. With the onset of chronic recession after the bubble burst at the beginning of the 1990s, the government turned to ever larger—and decreasingly effective—Keynesian deficits. It was at this stage that the snowballing effect began to assume an uncontrollable momentum, and the decades-long expansion of this public-works core could be seen for

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<sup>16</sup> Aoki Hidekazu, *Zaiseitōyūshiron* (On the Fiscal Investment and Loan System), unpublished manuscript, provides the best discussion of this system. I am grateful to Mr Aoki for access to this manuscript.

what it was: unsustainable and 'future eating', characterized not only by immense environmental and social costs but by inbuilt collusion, corruption and fiscal irresponsibility. By the late 1990s, the deficits had become chronic, structural and unsupportable, exerting a steadily growing, negative pressure that has helped to drag the Japanese economy to its present nadir.

The landscape of regional Japan is still littered with the disastrous industrial-development projects erected under Tanaka's 'Restructuring the Archipelago' *Zensō* of 1969 to 1976. In Hokkaido, the East Tomakomai project has recently collapsed with debts of 180 billion yen (\$1.35 billion); Mutsu-Ogawara, in Aomori, accumulated 230 billion yen (\$1.74 billion) in debt before being transformed into a huge nuclear-waste reprocessing facility, at a cost of a further 2 trillion yen (over \$15 billion). In the 1980s, as the speculative bubble blew up to its peak, Nakasone's 'Resort Archipelago' vision replaced Tanaka's gigantic industrial estates, while joint public-private sector projects became the order of the day. The biggest such was Sea Gaia's Ocean Dome, a model resort in Miyazaki prefecture with a 750-room hotel, 5,000-seater conference hall, covered beach and artificial waves. Sea Gaia collapsed in February 2001, leaving a debt of 276 billion yen (over \$2 billion) and, although 200 billion yen (\$1.5 billion) had been spent on its development, it was sold off along with two other projects to an American company, Ripplewood Holdings, for a mere 1.8 billion yen (\$14 million).<sup>17</sup>

Like East Tomakomai and Miyazaki, countless towns and villages throughout Japan now face financial crisis because of the legacy of the collapsing construction state, in both its Tanaka and Nakasone forms, and the debt burden will continue to weigh on their populations long after liquidators have sold the assets off. Local-government debt has soared from 70 trillion yen to 187 trillion during the 1990s (\$500 billion to \$1.4 trillion), or from 15 per cent to 36 per cent of GDP, and one prefecture after another has fallen into financial crisis. After decades of wallowing at the public-works trough, constructing bridges, highways, cultural centres, athletic grounds, galleries and concert halls, often financed to 90 per cent by Tokyo, accumulated debt and increased management charges for the facilities are bearing down on welfare services,

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<sup>17</sup> For a recent list of failed local public corporations, see Araya Hirotake, 'The Daily Performances of Rustic Theatre by which the Third Sector Functions in Your Town', *Ekonomisuto*, 10 July 2001.

just as costs—especially of pensions, medical and nursing care—are rising for the ageing population.<sup>18</sup> Arguments that these projects would provide a Keynesian kickstart have fallen flat: as administered by the Iron Triangle, pump-priming infusions have served as steroids, bloating rather than strengthening the economy.

Throughout the nineties, however, the *doken kokka* has continued intact. The present *Zensō*, announced in March 1998 as a blue-print for national development up to 2010, is a grandiose design calling for the construction of new railway lines, express highways, airports, information systems, no less than six new bridges between the islands, large dams and nuclear installations and, last but far from least, a new capital city—at a cost of somewhere in the vicinity of 14 trillion yen (over \$100 billion), with an additional 3 to 6 trillion yen (\$20 to \$40 billion) for ancillary transport infrastructure—to take over many functions from Tokyo. The ‘Basic Plan for Public Investment’, under which central and local governments, together with public corporations, are to invest 630 trillion yen (\$4.75 trillion) of taxpayers’ money over the period 1995–2007, remains intact.<sup>19</sup>

Plans proceed to increase the country’s expressways from 6,861 to 9,342 kilometres and the forest roads from 127,000 to 270,000 kilometres; to construct substantial stretches of new *shinkansen* express-rail line in Hokuriku and Kyushu, at a projected cost of 7 trillion yen (over \$50 billion). The Kobe, Chubu and Shizuoka airports will go ahead, as will the massive expansion of Kansai airport, the Yamba, Nagashima and Tokuyama dams, a ‘central link road’—*Ken’o dō*, a Japanese version of London’s M25, designed to cut a 270-kilometre-long swathe through Chiba, Ibaraki, Saitama and Kanagawa prefectures, as well as Tokyo itself—and the drainage and reclamation of the Washiro wetlands in Fukuoka City, to construct a new ‘Island City’. The pathological ‘super-dyking’ process, designed to protect the country’s major rivers against a once-in-two-hundred-years flood is also proceeding as planned, though scheduled to take 1,000 years to complete. The government is also com-

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<sup>18</sup> Jinno Naohiko and Kaneko Masaru, *Zaisei hōkai o kuitomeru—saimu kanrigata kokka no kōsō* (Preventing Financial Collapse—Outline of a Debt-Regulation State), Tokyo 2000, pp. 32–3; 21st Century Environment Committee, *Kyodai kōkyō jūgyō* (Large-Scale Public Works), Tokyo 1999, p. 42.

<sup>19</sup> Hiramoto Kazuo in ‘Shin shuto tanjō’ (Birth of a New Capital), *Jitsugyō no Nihon*, special issue, June 1996, pp. 52–57.

mitted to building at least ten new nuclear power stations in the coming decade, which will necessitate not only huge construction costs but also vast sweetener payments to win over hostile local opinion, while the new base it is determined to construct for the US Marines in Okinawa is estimated to have a price tag of around 1 trillion yen (\$7.5 billion). Like the Battleship Yamato, the Ministry of Finance-run public-works system was conceived of as the most splendid construction but has proved so vast and unmanoeuvrable as to be almost impossible to turn around.

### *Official strategies*

Koizumi won the landslide elections of 2001 on the basis of campaign promises of fundamental structural reform: 'No Sanctuaries' is an oft-repeated slogan as he warns of the pain to come. But the *doken kokka* is not just the creation but a virtual *alter ego* of Koizumi's LDP and, nearly a year after entering office, there is still no sign that he really plans to dismantle the system that bred him. For all his braggadoccio, Koizumi's proposals for dealing with the debt problem—a limit to yearly national-bond issuance, further public funds for the banks, more privatizations—have been distinctly modest. The 30-trillion yen (nearly \$230 billion) ceiling on annual issues of national bonds merely amounts to limiting the creation of new debt. Though drastic in fiscal-policy implications, since expenditure will have to be cut by 4 trillion yen (over \$30 billion), it is still no more than a prelude to any real solution.

Japan's major banks have already absorbed large quantities of public funds, including a 7.5 trillion yen (\$60 billion) recapitalization package in February 1999, in exchange for which the banks were supposed to undergo a thorough restructuring. Instead, however, many of the large city banks merged to form four colossal banking groups that were 'too big to fail'—and then carried on as before. Koizumi has now proposed that the government-run Resolution and Collection Corporation should come to the banks' aid by using taxpayers' money to acquire the bad loans. Quite apart from abandoning the February 1999 pledge of no more public funds, there are major problems with the plan. If the debts are to be disposed of at market prices, it should not be necessary to call on the RCC at all. If, on the other hand, the RCC becomes a medium for significant bureaucratic intervention, selecting the loans to be liquidated and then determining their price, the potential for collusive manipulation and corruption is plain. Since neither the plan nor

the draft legislation makes any provision for assigning responsibility, it carries no assurance that new debts will not simply be generated in place of those liquidated, and a further cycle thereby opened that would end in yet another batch of bad loans being off-loaded to the RCC at some future date.

What sort of timetable does the Japanese government have in mind? In August 2001 Yanagisawa Hakuo, state minister for financial affairs, suggested it might take seven years to halve the 17.4 trillion yen of worst-category debts, although not eliminate them; and these in turn are only a tiny proportion of the total regarded as 'bad' by the IMF, US Treasury and other analysts. To Bush's brusque inquiry about deadlines at their post-September 11 meeting in Washington, referred to above, Koizumi gave an airy rejoinder: 'Two to three years'. Later he emerged, shaken but clearly not sobered, to give an impromptu speech in English to the press corps assembled on the White House lawn. 'I am very pleased to say we are friends,' he announced:

Had a great talk, friendly. And I convey what I am thinking. We Japanese are ready to stand by the United States government to combat terrorism. We could make sure of this global objective. We must fight terrorism with a determination and a patience. Very good meeting. Fantastic meeting.<sup>20</sup>

Asked what Japan would actually be contributing to the war budget and—a point stressed by the White House—to the postwar reconstruction not only of Afghanistan but of the surrounding region, Koizumi immediately replied: 'Everything'. Recent acquisitions of 'non-performing' Japanese assets at giveaway prices by US investment houses and hedge funds—known here as *hagetaka*, or vultures—indicate that he may have meant it. The Sea Gaia resort is only the best publicized of these.<sup>21</sup>

Privatization is a central plank of Koizumi's reform proposals, yet the record gives grounds for doubting that this will solve anything much. The most remarkable case of privatization in recent years was that of Japan National Railways, carried out by the Nakasone govern-

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<sup>20</sup> Office of the Press Secretary, White House, 25 September 2001.

<sup>21</sup> Tsurumi, '7-point Cooperation Plan'; 'Why is the US Urging Japan to Dispose of Bad Loans?', JPS News, 18–21 July 2001.

ment in 1987 on grounds of its huge debt—37 trillion yen (\$280 billion). Fourteen years later, the assets had all been sold but the debt remained and was transferred back to the state in 1998 by a special law, *Kyukokutetsu saimu shorihō*, now swollen to 38 trillion. Koizumi's current candidates include the Post Office and the Japan Highways Public Corporation, which alone carries a debt of around 23 trillion yen (over \$170 billion) and is thought to be in an even worse financial situation than the Japan National Railways on the eve of its privatization.<sup>22</sup> Other morsels for the asset-strippers may include the Honshu–Shikoku Bridge Authority, responsible for the three bridges that now link the two islands, with debts of around 4 trillion yen (\$30 billion); and Kansai Airport, 1 trillion yen (\$7.5 billion) in the red, and slowly sinking into the mud of Osaka Bay—despite which it has been given the green light to proceed with Phase Two of its expansion, estimated at an additional 1.56 trillion yen (nearly \$12 billion).

### *Bureaucratic fortifications*

It seems inevitable that, ultimately, taxes will be raised and expenditures cut. In 1998 Takenaka Heizo, then a prominent academic economist, formally proposed to Prime Minister Obuchi's Economic Strategy Council that the consumption tax be raised to 14 per cent. His recommendation was apparently endorsed but not adopted; presumably on the grounds that the last time the tax had been raised—from 3 to 5 per cent, in 1997—the weak recovery promptly lost momentum, and the LDP political favour. Takenaka is now State Minister for Economic and Fiscal Policy and Koizumi's right-hand man. His tax increase will presumably be implemented whenever political circumstances permit, although recent estimates suggest it will now have to be raised to 20 per cent or more.

As to expenditure cuts: an official policy of reviewing public-works commitments has been pursued by the LDP and its coalition partners since 1999 but this has been a cosmetic rather than a surgical exercise: fewer than 0.5 per cent of the 8,000-odd developments examined have been cancelled as a result, and not a single one of the 'Hundred Worst' listed by an influential group of economists and environmentalists. One

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<sup>22</sup> Katō Hideki and Kōsō Nihon, 'The Hocus-Pocus of "Healthy Administration" of the Highways Corporation', *Chūō kōron*, August 2001, p. 154; 'Review of Public Bodies Increases Sad Reality', *Nikkei Weekly*, 25 June 2001, p. 6.

of the most notorious cases is the hugely expensive, unnecessary and unwanted project for the drainage and reclamation of the Isahaya wetlands area of the Ariake Sea in Nagasaki prefecture—the largest in Japan but now drying up, its famous clams dying in vast numbers and its seaweed industry collapsing. Questioned on this in his first Diet session as Prime Minister, Koizumi responded in the time-honoured manner by reciting an essay in justification, penned by one of his bureaucratic minds. It is clear, too, that commitments to nuclear power and the US military alliance remain the holy of holies.

When Koizumi did briefly threaten that other sacred cow, the annual 6 trillion yen (\$45 billion) fund designated as the core allocation for highway construction—regularly supplemented by large subsidies of FILP public funds—virtually all local governments across the country united in protest, and the uproar that followed gave a foretaste of what would happen if he proceeded seriously to tackle the *doken kokka* as a whole. Road-building has been central to Japan's construction state, the amounts appropriated to it under successive five-year plans steadily increasing from 6.6 trillion yen (\$50 billion) in 1967 to 78 trillion yen (\$588 billion) for the current one. Its beneficiaries range from local farmers who rely on supplementary income from construction work to *amakudari* ('descending from heaven') bureaucrats, fattening on lucrative post-retirement posts in the various semi-public bodies that run the nation's roads. Less than a month after the cuts in highway construction were announced the LDP back-pedalled, saying it was committed only to 'studying' the problem.

As Igarashi Takayoshi—probably Japan's leading authority on the *doken kokka*—notes, the Koizumi road proposal opened up the question of all the sacrosanct accounts: the five-year-plan allocations for water management and sewerage for example (24 and 23 trillion yen, or \$181 billion and \$174 billion, respectively). Indeed, it threw into doubt the entire *Zensō* system under which bureaucrats appropriate huge amounts of taxpayer monies without public scrutiny or accountability. Meanwhile, amid talk of structural administrative reform, the former Ministry of Construction has just been significantly upgraded, and merged with the Ministries of Transport, the National Land Agency and the Hokkaido Development Agency to create the National Land and Transport Ministry, a super-ministry staffed by about 70,000 bureaucrats and commanding 80 per cent of all tax monies targeted for public works—40 to 50 tril-

lion yen, or around \$350 billion. It seems unlikely that this will be a preface to severe budgetary and public-works cutbacks. By October 2001 the new ministry was reported to be firmly opposed to any reduction in the highway-construction mileage fixed in the *Zensō* of 1987.

### *Environmental discontents*

There are, however, signs of resistance to the *doken kokka* at regional level, where the need for a radically different, democratic, sustainable alternative is starting to be taken seriously. Intense local campaigns have led to the cancellation of the planned Yoshino river estuary dam and the Kitō village Hosogōchi dam, both in Tokushima prefecture, on Shikoku (following in the case of Yoshino River a plebiscite). In Shimane prefecture, the desalinization and reclamation of large sections of Lake Nakaumi has finally been stopped, even though the works were almost completed. In Aichi prefecture a long citizen campaign has succeeded in partially blocking the planned Expo because of its feared environmental impact on the site. In the traditionally conservative prefectures of Nagano, Tochigi and Chiba electorates have recently chosen governors who took a stance against the LDP's interest-rooted public-works structures. Nagano governor Tanaka Yasuo now talks of substituting 'green dams' for concrete ones—strengthening nature's capacity to cope with phenomena such as typhoons and floods, rather than imposing human-engineered solutions. Tanaka's attempts to negotiate a formula by which the direction of local politics would be determined by residents and civil society, rather than by the special-interest groups of the *doken kokka*, attract wide attention.

Dissenters from Koizumi's programme struggle to articulate a politically persuasive and economically feasible alternative. In one such widely publicized essay, the economists Kaneko and Jinno have called for far-reaching structural reforms.<sup>23</sup> Predicated on opening the national books—and, therefore, the dealings of the bureaucrats who manage them—to full critical scrutiny, their proposal involves a drastic revision of the Japanese state, shifting key government functions from Tokyo to the regions in a decentralized system in which the core tasks of food, energy and care, together with the necessary fiscal resources to

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<sup>23</sup> Jinno and Kaneko, 'Stop the Financial Collapse'; Kaneko Masaru, *Nihon saiseiron* (How to Resuscitate Japan), Tokyo 2000, pp. 143ff.

run them, would be entirely in the hands of local governments. Public works, subject to locally responsible controls and deprived of deficit funding, would be forced to meet local needs. The funds presently circulating through the hardened arteries of the *doken kokka* system would be diverted into socially necessary sectors such as welfare, care for the aged, housing, the environment and education.

The central state would be responsible for setting minimum national welfare standards, and for regulating inter-regional differences, but otherwise it would be recast, its domestic functions drastically reduced, into a 'Debt Management State' (*Saimu kanrigata kokka*). The debt itself would be frozen and slowly reduced, under a long-term strategy for managing the national finances: selling stock in national assets when share prices are high and converting national bonds when interest rates are low. What Kaneko and his colleagues propose is nothing less than a redrawing of the modern nation-state compact, put together in the Meiji constitution of 1889 and little questioned since then; and a return, at least in part, to the highly decentralized patterns of the pre-modern Edo era. Their 're-localization' may be seen not only as a response to the domestic fiscal and economic crisis but also to the alienating forces of globalization: local standards to replace global, or American, ones. While their goals may seem implausible, they are indicative of a widespread sense of the need for fundamental democratic change.

### *Beyond developmental capitalism?*

The *doken kokka* can be seen as a facet of the 'developmental capitalism' once analysed by Chalmers Johnston.<sup>24</sup> But while Johnston's work took as its focus the Ministry of International Trade and Industry, the Ministry of Finance is far more powerful, and the workings of its Trust Fund Bureau have greater impact than any MITI policy. Over the last three decades, *doken kokka* forms of development have shifted slowly from fiscally benign or neutral—so long as growth, and its accompanying increase in tax revenues, prevented any major accumulation of deficit—to malignant, once the inflated revenues of the 1980s disappeared and growth effectively ceased. While the manufacturing sector has adapted—albeit at great social cost—to the neoliberal order, the core construction sector

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<sup>24</sup> *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925–75*, Stanford 1982.

has, if anything, tightened its grip on the state. The vested political, bureaucratic and economic interests accreting around the *doken kokka* have constituted a formidably ramified, seemingly impregnable structure, even as the assumptions on which it was built—the ever-rising rightward graph, or *migikata'agari*—crumbled away.

While the construction industry and its financial backers fattened on the artificial life-support system sustaining the *doken kokka*, sustenance has drained from the rest of the economy—especially from the small and middle-sized business sector in which most people are employed. Koizumi likes to stress the pain his reforms will bring; but the government's past record—bailing out the very banks and construction companies who had pumped up the bubble and debt, while ignoring the politically weaker small businesses—suggests that suffering is likely to be distributed in inverse proportion to responsibility for its cause. Naturally Koizumi has had nothing to say about where this responsibility should be attributed, behaving as though the severe losses faced by the Japanese people had been caused by some act of God rather than by the greed and malpractice of the Lords of the Iron Triangle.

Paradoxically, Japan is still one of the safest, most convenient and prosperous of countries; but its fiscal and banking foundations are eroding. The faultlines are manifold. Even if the private-sector loans could be resolved, the system still depends entirely on its capacity to roll over or expand its massive public debt. For demographic reasons alone it will soon no longer be possible to meet the state's obligations at the current level of under 50 trillion yen per year. From around 2003, the proportion required for welfare and public pensions in this rapidly ageing society will rise steeply, with a bill of over 70 trillion yen—plainly impossible to meet. Furthermore, for the debt to be constantly rolled over, investor confidence in the system must be maintained. While the Japanese state clearly remains a stable guarantor, the country's credit ratings have been steadily lowered by international agencies; from 1999, as the scale of the debt became more widely known, private investors began to withdraw from the bond market, to be replaced by institutional investors and banks.<sup>25</sup> With a zero-interest-rate policy and the economy in

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<sup>25</sup> Bank holdings of national bonds jumped from the level of around 30 trillion yen (\$226 billion), maintained throughout the 1990s, to 79.4 trillion yen (over \$600 billion) between April 1999 and April 2001.

recession, it made better sense for the banks to invest in national bonds or US treasuries than in the small and medium business sectors that have borne the brunt so far. If the yen weakens further, Japanese post-office, life-insurance and pension-fund deposits may start to leak away into other systems, offering more competitive rates; the bureaucracy's power to compel banking and pension-fund institutions to buy up large quantities of national bonds may begin to erode.

### *Rising regional tensions*

While Koizumi constantly reiterates his 'structural reform' and 'no sanctuaries' slogans—to general applause—he offers no credible programme. Indeed, the brokering system of interest politics is so deep-rooted that he is said simultaneously to be securing huge pork funds in order to construct the world's longest bridge in his own electorate: across Tokyo Bay from Yokosuka City in Kanagawa Prefecture to Futtsu City in Chiba Prefecture. On the brink of a deflationary spiral, and with no vision of what sort of new order is sought, budget cuts and banking-sector moves to dispose of bad loans are set to increase social tensions while offering no certainty of a better outcome.

Popular support for the prime minister during Koizumi's first summer in office rose to an unprecedented 90 per cent (having languished a few months earlier, under Mori, at an equally unprecedented 8 per cent). His email magazine boasted two million subscribers and his image adorned tee-shirts, posters and mobile phones. At 59, Koizumi was relatively young, had a fresh face, a clean background and a more open manner; but to the extent that this popularity cult had political roots, it probably owed most to his being seen as the best hope of ending LDP politics—in other words of combating, perhaps even liquidating, the party to whose service he had devoted his political career. But after close to a year in office the euphoria is draining away, while the crisis grows deeper. Any viable reform will take at least a decade and will have to tackle the deep-rooted interests of the construction state. In the interim, the Japanese people face increased social and political tensions and sharp reductions in income. There are fears that, in such a climate, Koizumi's populism may be opening the door to more authoritarian currents. Meanwhile, the request for an IMF 'special audit' in September 2001 looks like the now familiar recourse of craven politicians to 'outside pressure' to push through neoliberal restructuring.

With tacit US blessing the yen has now been allowed to weaken considerably, falling 8 per cent against the dollar since October 2001 in hope of boosting Japanese exports sufficiently to bring the economy to life. There is limited room for manoeuvre: a sufficiently low yen could lead to capital flight, creating pressure for an increase in interest rates; given the gargantuan scale of debt, even the smallest rise would have calamitous effects. At the same time, the yen will have to weaken much further to make any genuine impact. HSBC calculates that a 10 per cent depreciation would add only a half a percentage point to GDP growth over two years—not enough to pull Japan out of recession.<sup>26</sup> Already there have been sharp warnings from China, South Korea and Malaysia that the falling yen risks setting off a competitive spiral of East and Southeast Asian devaluations, subjecting a region still recovering from the financial crisis of 1997 to a fresh wave of instability. But it also threatens to export Japanese deflation into a global economy far less equipped to cope with such traumas than it was at the height of the US boom. Throughout the 1990s Japan's economic deterioration was regarded as an essentially domestic problem; that has now changed. In such a situation, Koizumi's postmodern brand of vulgar nationalism can only exacerbate regional tensions that are already on the rise.

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<sup>26</sup> David Pilling and John Thornhill, 'Japan's Currency Trap', *Financial Times*, 16 January 2002.