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BRIEF ANALYSIS

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WHERE IS JAPAN HEADING?

Alexandra Zoltai

Abstract

Japan is the third largest economy in the world, however, it seems that nowadays Japan has been stuck in an economic time wrap and failed to keep pace with the growth it has seen around in Asia. In 2021 the country faced numerous challenges, not only because Japan was hosting the Olympic Games, but the country also got a new prime minister right before the elections, which took place in October. However, Japan's everyday life was about how to deal with the coronavirus epidemic, the Japanese people and government had been in constant struggle with the epidemic and its waves. After a brief overview of Japan's last year, this paper analyzes where Japan and the Japanese economy are heading under Fumio Kishida's presidency to and what can we expect from Kishidanomics?

Keywords: Japan, Fumio Kishida, coronavirus, Kishidanomics, new capitalism

Japan in 2021

In addition to foreign policy events,¹ the Japanese government is constantly struggling with the epidemic and its waves, which have completely overshadowed the Summer Olympics in Tokyo. Contrary to expectations – the recovery of the Japanese economy and the strengthening of tourism were expected with the postponement of the Summer Games in 2020 – the Tokyo Olympics were held behind closed doors without spectators and under extremely strict conditions, in addition most countries have not recommended their citizens to travel to Japan (including the United States), and a majority of the [Japanese population was opposed](#) to holding the Olympics.

The year 2021 also brought important domestic changes in Japan. On September 3, 2021, Japanese Prime Minister Yoshihide Suga resigned, only one year after he took over the office from Shinzo Abe in September 2020. According to a nationwide survey of Suga's popularity, his support dropped from 66.4% in September 2020 to 26% in August 2021 due to a failed treatment of the coronavirus epidemic. His resignation triggered an intra-party race for the office, from which [Fumio Kishida, Japan's former foreign minister](#), eventually emerged victorious.²

As the coronavirus epidemic is expected to continue to have a major impact on the daily lives of Japanese people and its management will greatly affect political life, the Japanese parliament passed a record special budget of nearly JPY 3,600 billion (USD 317 billion) for the fiscal year ending in March to help affected households and businesses. Bigger part of the budget will be used to fund measures against COVID-19, including booster vaccines and medicines. Kishida plans to use the supplemental budget to revive the economy, which has not yet fully recovered from the pandemic, and to promote stronger growth and a more equitable distribution of wealth under the policy of the so-called "[new capitalism](#)".



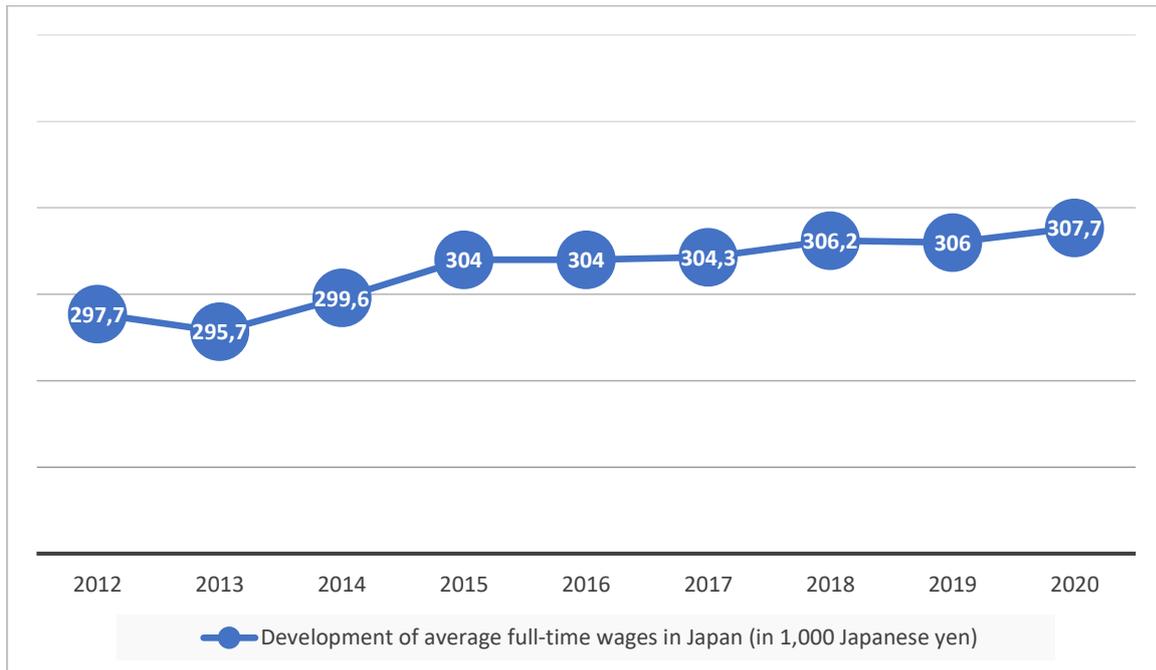
Kishidanomics or the "new capitalism"

Kishidanomics' predecessor, [Abenomics](#), was intended to revive the Japanese economy, but nine years and several prime ministers later, growth remained sluggish while wealth inequality widened. Although Abenomics drove up stock prices and ensured high corporate profits, wage increases for lower-wage workers and growth for small businesses remained slow. Kishidanomics aims to change that to better distribute the benefits of growth throughout society. Although Abe Shinzo is still the dominant figure in the ruling Liberal Democratic Party and promises a risky strategy that goes against his policies, Kishida sees his economic policies as an opportunity for greater fairness. The program, which Kishida calls nothing less than a "new capitalism," includes tax breaks – and in some cases tax penalties – for companies depending on whether they raise or lower wages. Japan's newly elected prime minister has developed populist economic policies that provide subsidies, seek to support potential growth sectors, and force companies to raise wages, which have long been stagnant. These measures certainly sound good, but they also imply a greater role for the state in an economy where it used to be thought that successful economic policy required less, rather than more government intervention. [Kishida warned that neoliberalism](#) has led to greater income disparities between rich and poor and between urban and rural areas, which weakens the stability of society. To reduce income inequality, one of Kishida's priorities is to raise the wages of low-income workers. According to Kishida, digitalization, climate change, economic security and technology are areas that are potential sources of growth and can help solve social problems.

It is worth noting that between January 2020 and April 2021, [Japan](#) spent the most among the G20 and Japan's Asian neighbors on addressing the economic crisis caused by the pandemic (44%). Japan spent 15.9% of its GDP on this in the form of an augmented budget, and 28.3% of GDP went to liquidity facilities. Part of Kishida's first economic package is a major stimulus program of JPY 3,600 billion (USD 317 billion) – or about 5% of the country's GDP – by the next fiscal year, which begins in April. Kishida's goal here is, first, to secure Japan's leading position in semiconductors, digitization and green technology. One of the priorities is to [strengthen economic sovereignty](#), producing certain products in Japan rather than in China to boost domestic production. The package also addresses growing security and strategic challenges to accelerate the deployment of missile defense systems and other military costs. It also seeks to benefit voters, promising to pay each family with children JPY 100,000 yen (about USD 870). These incentives are by no means an invention of the Kishida government, as was the case with previous administrations.

The biggest challenge for Kishida, however, is to achieve economic growth through growing domestic demand. This would have been justified by the aforementioned increase in corporate profits, which should have meant higher wages and, at the same time, growing consumer sentiment. [The Japanese economy experienced a prolonged recession in the 1990s](#), which coincided with the collapse of the economic bubble of the 1980s. Although it is still among the most developed countries, the Japanese economy failed to keep pace with growth in Asia and the rest of the world. Most telling is the fact that wages in Japan have stagnated. Government data show that average wage growth has barely exceeded one percent since 2012.

Chart 1: Average earnings in Japan

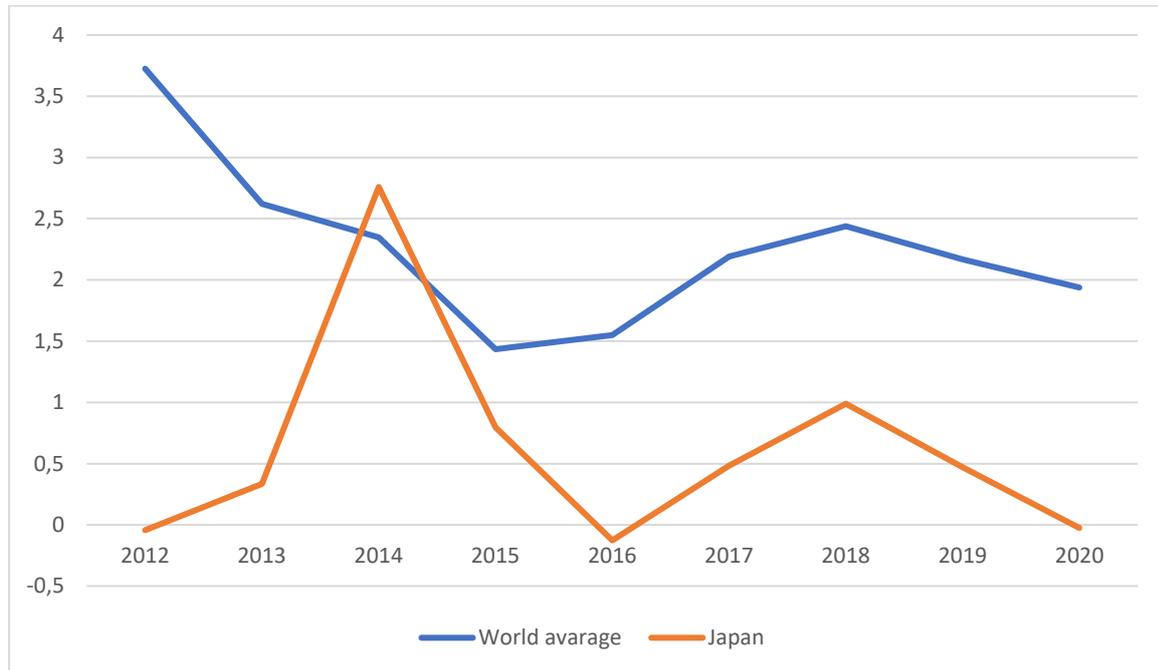


Source: Statista, <https://www.statista.com/statistics/1123481/japan-average-monthly-wages-among-full-time-workers/>

Meanwhile, Japanese companies have performed quite well. Corporate profits rose to a record high in 2018, returning to 2018 levels after the decline caused by the Corona virus, and it is estimated that [retained earnings will rise to USD 6.5 trillion](#) in 2019. Japanese companies continue to accumulate the value they create instead of sufficiently converting it into wages and capital investment. Not to mention the coronavirus pandemic, because in this environment, both businesses and individuals postponed their demand in many cases, contributing to weak domestic demand and deflationary tendencies. At the time of the epidemic COVID-19, government aid mainly flowed into banks' savings accounts rather than boosting the economy. Economists are skeptical that the new cash payments or tax breaks to raise wages will have any real effect. Even while in office, Shinzo Abe has tried to pressure businesses to raise wages, but the promises have not been kept, meanwhile Japanese workers have prioritized job security over financial gain. Companies have taken advantage of this since they were not forced to spend their profits on labor when the likelihood of their employees to quit was slim. And this is likely to continue for a while, as COVID -19 has made Japanese workers even more cautious.

Japan's economic situation is further complicated by the fact that, after two decades of monetary easing, the Japanese economy is still characterized by deflation.

Chart 2: Inflation (%) Development in the World and in Japan



Source: Worldbank

The Japanese cabinet approved the [2022 budget](#) back in December 2021. The draft budget is JPY 107.60 trillion yen (USD 940 billion), making it the largest budget Japan has ever had. It will fund measures to combat the coronary virus pandemic, rising social security costs and record spending on population protection. The budget for the new fiscal year, which begins in April 2022, will be at a record level for the tenth consecutive year. The largest component of policy spending is Social Security, which accounts for more than one-third of the total budget as the aging population continues to be a major drag on the economy and health care costs rise. Defense spending was also increased to an all-time high of JPY 540 billion, a record high for the eighth consecutive year, reflecting Japan's efforts to advance the development of new technologies and enhance capabilities in new security areas such as cyberspace and outer space. In addition, the government expects real [economic growth of 3.2%](#) in fiscal year 2022-2023, compared with the preliminary estimate of 2.2% underlying the budget plan. [Kishida promised a precise timetable for the spring in his vision of new capitalism](#), which he sees as a key to boosting the economy.

Foreign economic issues

[The Regional Comprehensive Economic Partnership \(RCEP\)](#), one of the largest trade agreements in the world, entered into force on January 1. As two members of RCEP, the economic partnership between China and Japan is expected to grow stronger every year. The two countries will also celebrate the 50th anniversary of the normalization of their post-World War II relations. With RCEP, not only economic but also political cooperation between the two countries could be improved, Kishida said, that he wants to build a "constructive and stable" relationship with China. [Japan could benefit from one of RCEP's](#) key points, especially because of its impact on trade. Chinese tariffs on Japanese auto parts and other products will be gradually



reduced, which could lead to an 86% increase in exports of Japanese industrial products to China from the current 8%. As a result of the RCEP, Japan's annual exports are expected to increase by USD 20 billion, up 5.5% from 2019 exports. On the other hand, Japan will also have the task of countering China's influence in the region, especially as an ally of the United States.

[Japan may have an opportunity to improve its relations with South Korea](#), which analysts believe will depend on the results of the March 2022 presidential election in South Korea. Before the South Korean election, there was little hope remained for improving relations between Japan and South Korea. Some analysts believe that Japan's new Prime Minister Kishida Fumio could be a good partner for South Korea's new president, whoever it may be, to restore or at least improve relations between the two countries.

Tokyo remains willing to consult with Moscow on joint economic activities in the Kuril Islands, especially in the south. However, the fact that Russia deployed a mobile parachute missile system in the disputed territory in December 2021 raises serious security questions.

Summary

Prime Minister Kishida faces a difficult year because, as in 2021, success in combating the coronavirus pandemic and the ability to boost the Japanese economy will depend on government support. If he succeeds in winning over the public, the LDP could do well in the upper house elections, giving Kishida three valuable years between now and the next election to address diplomatic, economic and other political challenges and prove his ability to lead Japan.

In 2022, the China-U.S. rivalry is expected to continue, in which Japan must learn to adapt to an ever-changing geopolitical environment. The former foreign minister's government is expected to seek a balance in 2022. On the one hand, closer political and military cooperation with Quad member states is expected, and Japan also anticipates the United States, the United Kingdom, and Australia to strengthen their roles in the region under the AUKUS security partnership. In terms of economic cooperation, however, Japan is likely to open up to China, where diplomatic relations may also improve with the RCEP entering into force and the 50th anniversary of the establishment of diplomatic relations. This could improve with the 50th anniversary of the establishment of diplomatic relations. Russia remains an important partner, but the growing presence of the U.S. and its allies in the region could cast a shadow over relations between them and the fact that the two leaders agreed at the Kishida-Biden summit to work closely together in preventing Russia's invasion of Ukraine. Kishida is willing to sit down to negotiate and improve relations with Seoul after the 2022 elections in South Korea, which would be a major step in the history of the two countries and could be considered as a major foreign policy success.

The Kishida government is under enormous pressure from all sides. On the one hand, it may not succeed in combating the coronavirus pandemic, which is once again causing high infection rates in Japan due to the Omicron variant and seems to be making the situation worse. On the other hand, it must deliver on its economic promises, not only by promising a more equitable distribution of wealth, but also by achieving 3.2% growth, for which a record-breaking budget was passed. If it fails to do so, not only will the government be in trouble, but the Japanese economy will find



itself in a difficult position and will be more indebted, than ever. In addition, Kishida is under intense pressure regarding Japan's foreign and security policy, as he must strike a balance between China and the West.

¹ From Japan's perspective, several important events have defined 2021, both in the country's foreign and domestic policies. For example, on April 12, the Japanese government approved the discharge of 1 million tons of radioactively contaminated water into the sea from the [Fukushima nuclear power plant](#), which suffered its worst disaster 10 years ago, this news sparking widespread outrage worldwide. China, Russia, South Korea, the Philippines and other countries in the region have opposed the Japanese plans, as most experts were on the opinion it could cause serious problems in the surrounding seas in the long run. On April 16, the first foreign chief of state was hosted by the new U.S. President Joe Biden in Washington after taking office, who was the Japanese Prime Minister Yoshihide Suga. The meeting was followed by a [joint statement](#) emphasizing security and peace in the East Asian region and the United States' commitment to protect Japan without hesitation, using its nuclear capabilities if it would be necessary. On September 15, the UK-US-Australia Tripartite Security Partnership (AUKUS) was announced, focusing on the Indo-Pacific. The announcement not only surprised many, but also created deep diplomatic tensions between the United States and France, as well as between Australia and France. Washington's plans not to invite Japan to take part in the AUKUS also had a negative impact on the leadership in Tokyo.

² The new prime minister took the office on Oct. 4, a rather risky move for the ruling Liberal Democratic Party (LDP) with less than a month to go until Japan's lower house elections and with Japanese opposition parties joining forces in Oct. 31 general election to break the LDP's hold on power. The Constitutional Democratic Party of Japan (CDPJ), the Japanese Communist Party (JCP), and [two smaller parties have joined forces](#) to coordinate their election pledges and field fewer candidates to reduce competition for voters. [Japan's ruling LDP party ultimately exceeded expectations](#) and won an easy victory in Japan's 2021 general election. Kishida's decision to hold the election a few weeks after taking office proved to be the right decision: it is likely due in part to the fact that the ruling party saw a dramatic drop in Covid-19 cases in the country the month before.