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Japan: Suzuki Facing a Difficult Year

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An Intelligence Assessment

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March 1982*

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An Intelligence Assessment

*Information available as of 26 February 1982
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The authors of this paper are [redacted]
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Key Judgments

Zenko Suzuki's chances for reelection this November as President of the Liberal Democratic Party and thus Japanese Prime Minister will be influenced by how well he handles several complex and interrelated issues over the next few months. In particular, he must demonstrate to his party and the media that he can manage the US-Japanese alliance. Suzuki will have to reduce US pressure on Japan over the trade surplus without appearing to have been bullied by Washington or to have conceded too much ground on other bilateral issues, such as defense. 25X1

The Prime Minister hopes that a rebound in Japan's domestic demand will ease pressure on the trade issue. Because of Suzuki's austere fiscal policy, we, and a growing number of Japanese officials, believe economic growth will be well below the level Tokyo has officially projected and, as a result, the trade surplus will expand. Pressure is building on Suzuki to boost the economy by increasing government spending, but if he does this his critics will charge him with abandoning what he has established as a top priority—administrative and fiscal reform. 25X1

The trade measures announced so far—import subsidies, tariff cuts, and lower nontariff barriers—will have little impact on the 1982 imbalance and will not significantly open Japanese markets to foreign firms. Nonetheless, we expect no major new initiatives in the near future because Suzuki would have to build domestic support before he could remove barriers in politically sensitive sectors like agriculture. 25X1

Unless Suzuki seriously mishandles these key issues—particularly the trade problem—the odds favor his reelection:

- He has the advantage of incumbency.
- The major factions within the party would have difficulty finding another candidate acceptable to all. 25X1


In fact, the future LDP leadership picture is cloudier now than it has ever been. Although we are unable to identify a principal rival, Suzuki does have a variety of potential challengers waiting for a misstep:

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- Former Prime Minister Fukuda might use any serious deterioration in US-Japanese ties as an excuse to try to dump Suzuki; he would attempt to return as prime minister, if even for a short time, or to act as kingmaker.
- The Director of the Administrative Management Agency, Yasuhiro Nakasone, could use a retreat on administrative reform as a reason to launch his own campaign for the prime-ministership. 

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Although all of these challengers would pursue a more vigorous economic policy that could shave the trade surplus, none have the political backing to make the broad changes in nontariff barriers and agriculture Washington demands. 

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Introduction

Japanese Prime Minister Suzuki began the year in a strong position. His Liberal Democratic Party, in power for a quarter of a century, strengthened its hold in the June 1980 elections and does not face another test at the polls until mid-1983. The major factions in the party continue to support him, and his public rating remains unusually high. The new cabinet he appointed in November is talented and experienced. Suzuki, nonetheless, faces several difficult problems that could undermine his chances for reelection as president of the party and thus as prime minister.

To ensure his reelection, Suzuki must demonstrate that he can improve the economy, make progress in reforming the government bureaucracy, and manage the complex US-Japanese alliance. Suzuki would probably have little trouble handling these issues individually. They are interrelated, however, and a solution in one area makes solutions in others more difficult. He could make progress on the US-Japan trade issue and spur domestic economic growth, for example, by increasing government spending. To do this, however, he would have to abandon his commitment to administrative reform, which includes trimming the government's role in the economy and eliminating the budget deficit by the mid-1980s.

The Economic Outlook

Suzuki hopes that an upswing in domestic demand will expand imports, reduce trade friction with the United States, and boost GNP in 1982. Officially, Tokyo is forecasting GNP growth of 5.2 percent for FY 1982,¹ as compared with a projection of 4 percent for 1981. The projection for 1982 assumes that consumer spending will increase as real wages rise and that residential construction will rebound in response to slipping interest rates. If growth falls sharply below

¹ The Japanese fiscal year begins on 1 April.

the 5-percent level, Suzuki will face growing dissatisfaction with his performance as an economic manager, severe criticism from Japanese businessmen the major contributors to the LDP--and perhaps a strong challenge to his leadership of the party.

In fact, the Japanese growth estimate is optimistic. We forecast it at about 4 percent, in the belief that Suzuki's commitment to fiscal austerity will hold down domestic demand.

The budget for general expenditures has been held to a 6.2-percent increase, as compared with a 9.9-percent growth in FY 1981. Public works spending will remain flat. The only stimulative measures are slight increases in the Fiscal Investment and Loan Plan to aid housing and small business.

In part because of slow domestic growth, Tokyo is locked into a large current account surplus in 1982, which should exceed \$16 billion. With the United States, Japan should post a trade surplus several billion dollars above the 1981 surplus of \$17 billion. Because of slow growth in key markets, we expect export volume to increase 8 percent in 1982, as compared with 10 percent last year. This will outpace imports, which should at best increase by 4 percent if raw material-intensive industries rebuild inventories and energy imports pick up.

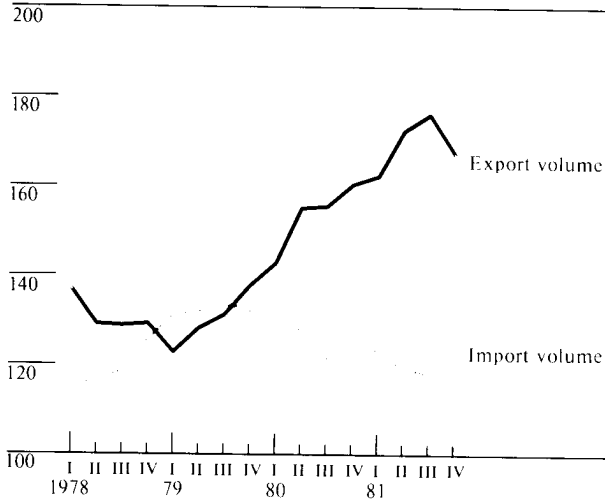
Japan's export success reflects the relative improvement in price competitiveness of Japanese exports. Japan's inflation rate in 1981 was about 5 percent, as compared with 10 percent in the United States. At the same time, high US interest rates kept the yen from substantially appreciating. Tokyo probably will be able to hold inflation below the US rate again this year, further boosting Japan's competitive advantage.

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Figure 1

Japan: Trends in Foreign Trade^a

Index: 1975=100



^aSeasonally adjusted at an annual rate.

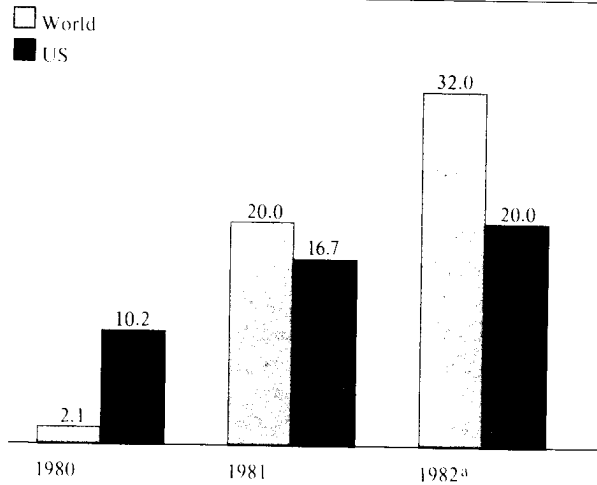
[Redacted]

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Figure 2

Japan: Trade Surplus

Billion US \$, f.o.b. Basis



^aProjected.

[Redacted]

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The US Problem

Suzuki would not consider the expanding surplus a problem if the imbalance with the United States were not growing. The EC has persistently complained about Japan's surplus, but the European countries have little leverage with Japan. The EC absorbs only 13 percent of Japan's exports, and many of the big ticket items—autos, trucks, electronics—already face quotas or other restrictions. Recent plans to initiate proceedings against Tokyo for alleged violations of the GATT code will, in themselves, have no impact on Japanese policy. [Redacted]

Complaints from Washington are another story. The United States is still Japan's principal market—absorbing a quarter of Japan's overseas sales—and is the dominant customer for items such as autos, video tape recorders, and sophisticated electronic components. More important, Suzuki knows that a major task of a Japanese prime minister is to manage the important relationship with the United States. He

realizes that if he lets differences over trade get out of control, his own party as well as the media will question his ability to govern. [Redacted]

At the same time, he must avoid charges of giving in to US pressure. The press and opposition parties accused him of caving in to Washington in December, when his cabinet approved a relatively large increase in defense spending while holding down outlays for social programs. Suzuki could face such charges again as his government responds to US demands for trade liberalization. [Redacted]

Japan's trade problem with the United States was one of the major issues that Suzuki considered as he selected his second cabinet last November. Earlier in 1981 personal rivalries between the Minister of International Trade and Industry and the Foreign Minister had prevented a coordinated government policy on trade with the United States and the EC. Shintaro

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Abe (the new MITI Minister) and Yoshio Sakurauchi (Foreign Minister) are competent team players who worked well together as top LDP executives in 1979-81. Both are sensitive to the problems of bureaucratic coordination and are skilled in the Japanese practice of consensus building and compromise. [redacted]

Suzuki also has reached outside his cabinet for help:

- He has tried to build support in the business community by asking a group that includes senior business leaders to consider methods for easing trade tension.
- He has established a special LDP council on international economic measures in an effort to build a party consensus in favor of trade liberalization.

[redacted]

Suzuki has planned carefully to forestall domestic criticism of government proposals for reducing trade friction, but he still runs the risk of not going far enough to ease US pressure or of going too far for his party's supporters. Although Abe and Sakurauchi can work together, the contrasting constituencies and mandates of their ministries will inevitably lead to interministerial friction, which Suzuki may have to settle. Furthermore, many senior party members believe that the bureaucracy—noted for its resistance to change—will procrastinate on the trade issue, thus forcing decisions at the political level. (See the appendix on trade policy.) [redacted]

Because support from rural, agricultural constituencies has kept the LDP in power for 27 years, rapid or significant changes in agricultural quotas are unlikely. In fact, the special LDP council made no recommendation on agricultural quotas when it presented its package at the end of January. According to Masumi Esaki, who heads the council, these issues require "further study." [redacted]

Other lobbies besides agriculture may also create problems for Suzuki. Groups ranging from the automobile industry to the banking community provide political funds to various LDP factions. Members of those factions will oppose any change in trade policy that would provoke their supporters. Although the Ministry of Foreign Affairs and MITI acknowledge the need to liberalize the service sector, the Prime

Administrative Reform

The goals of the reform package are to cut the size of the government and to eliminate the budget deficit. So far the following measures have been recommended:

- A 10-percent cutback in government subsidies.
- Cuts in subsidies to the National Welfare Pension system.
- A reduction of government contributions to national insurance programs.
- Cuts in cabinet ministers' salaries.
- A 5-percent reduction in the number of government employees over the five-year period beginning in FY 1982.
- A reduction in deficit funding from 12 percent in FY 1981 to 8 percent in FY 1982.

[redacted] 25X1

Minister is reluctant. Japanese banking and financial institutions—one of his faction's major sources of political funds—have petitioned him to oppose relaxation of controls on foreign banks and insurance companies. Perhaps as a result, the Esaki council also deferred recommendations on nontariff barriers in the service industries and communications. [redacted]

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Administrative Reform

In part because his predecessors tried to reflate the economy and curb the trade surplus by pumping up government spending, Suzuki inherited a large and growing budget deficit when he took office in July 1980. To rectify this he established as his top goal a comprehensive program—known as administrative reform—to curtail public outlays and eliminate [redacted] deficit. With the support of a broad coalition of forces, including the business community, his own party, and several opposition parties, Suzuki last fall won Diet approval of broad fiscal and budgetary reforms [redacted]

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The next stages of administrative reform will be more difficult because they require cuts in government personnel and in politically sensitive subsidies. Nonetheless, Suzuki has said that he intends to move ahead, probably because he believes the political cost of publicly backing away from a goal on which he has placed top priority would be too high. [redacted]

His commitment to trimming government spending, however, limits his options for solving the trade problem. [redacted] although the plan to accelerate the tariff cuts agreed upon at the Tokyo Round of the multilateral trade negotiations and to remove some tariff barriers will contribute to reducing the trade imbalance, those measures will not be sufficient to ease foreign pressure. [redacted] the government must stimulate domestic demand in order to increase imports and reduce trade friction. If the Prime Minister remains committed to fiscal austerity, however, he will be unable to take some of the traditional steps designed to increase demand, such as increasing public works spending or significantly cutting individual income taxes. [redacted]

Defense

Pushing ahead with administrative reform will also undercut Suzuki's ability to respond to US pressure for an increased defense effort. The administrative reform program includes budget reductions in such popular areas as education and welfare. Opponents of these cuts will demand that defense be included. If it is not, the opposition parties will charge that Suzuki has bowed to US pressure. [redacted]

The Prime Minister tried to preempt some of that criticism before the Diet session opened in late January by stressing that the increase was not a reflexive response to the deteriorating international situation but rather was carefully designed to allow Japan to defend its own territory. [redacted]

[redacted]

Despite Suzuki's efforts to defuse the defense issue, the opposition parties and much of the media will continue to protest. They are also likely to play up

increased defense cooperation with the United States as a possible threat to Japan's peace Constitution.

[redacted]

If Suzuki is not responsive to US pressure on defense, however, some in the LDP worry that Washington will tie the issue to trade. Tokyo is already concerned about charges by several US Congressmen that the Japanese have used their "free ride" on defense under the Security Treaty to build their economic advantage. [redacted]

Suzuki's Options

The Prime Minister cannot avoid decisions on these problems. Japanese officials believe that US pressure will continue and are concerned that Washington will make more demands on Japan, particularly on agricultural issues. As a result, they will be looking to Suzuki for help in defending Japan's policies or in taking new initiatives to reduce tensions. From his point of view, the Prime Minister does not want to be criticized or politically embarrassed at any of the already scheduled international meetings such as the Economic Summit in France in June. [redacted]

Faced with the growing trade imbalance, sluggish domestic growth, and falling tax revenues, Suzuki could decide to focus more attention on economic policy in the next few months. A likely step would be to relax monetary policy further. Although this would help the housing industry, it could also aggravate the recent depreciation of the yen, thus enhancing the competitiveness of Japan's exports and increasing the trade imbalance. [redacted]

Suzuki could also advance the schedule for JFY 1982 general accounts expenditures to stimulate domestic activity. Some LDP officials are pushing this idea.

[redacted]

[redacted] Suzuki has adjusted the ceiling on government borrowing during January-March to prevent a shortfall in public spending because of slipping tax revenues. Suzuki also has hinted that he may slow the pace of administrative reform without abandoning the effort entirely. [redacted]

[redacted]

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Suzuki's Calendar

Early 1982 Japan will be under considerable pressure from the United States to make progress toward trade liberalization.

May The Diet will be in session until at least mid-May; it will be debating the budget, the transfer of military-related technology to the United States, trade friction with the United States and the EC, and economic policy.

By June Japanese officials expect pressure from Washington for a decision on the transfer of defense-related technology.

By June Suzuki will want difficulties in relations with the United States and the European Community smoothed over prior to the Economic Summit this summer and a private meeting with President Reagan that may take place during the summit.

Midyear The second report of the commission on administrative reform will be issued.

Early fall The verdict in the Lockheed bribery trial involving former Prime Minister Tanaka may be in.

November LDP presidential elections will be held.

[REDACTED]

and those of Kakuei Tanaka and Takeo Fukuda would have difficulty identifying a mutually acceptable alternative. Suzuki has the advantage of incumbency and of a record in office that shows some successes. Although economic growth remains below hoped-for levels, inflation has dropped sharply. After a series of missteps in handling US-Japanese relations last spring, Suzuki has won support from most of his party for several moves in trade and defense policy designed to put bilateral relations back on an even keel. In addition, he skillfully built support for Diet passage of the first stages of his administrative reform program. [REDACTED] 25X1

In November Suzuki improved his political position when he named a new cabinet and appointed new party executives. He ensured continued support from former Prime Minister Tanaka by naming a senior leader of the Tanaka faction, Susumu Nikaïdo, to the powerful post of party secretary general and appointing other Tanaka faction members to the important posts of acting secretary general and chairman of the Diet Policy Committee. He also made certain he named a factionally balanced cabinet that included his potential rivals, in an attempt to lock them into support for his policies. [REDACTED] 25X1

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The Political Outlook

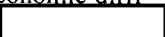
If Suzuki seriously mishandles any of the problems facing his government, he will damage the chances for achieving his primary political goal for 1982—reelection as president of the LDP, and thus as Prime Minister. At this point, the odds are still in his favor. The three mainstream factions in the LDP—his own

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In addition to dissension within the cabinet, Suzuki will confront increased factional maneuvering within the LDP as the election of the party president approaches:


- Unless additional measures to increase imports are thoroughly worked out within the party—especially those related to such politically sensitive items as beef, citrus fruit, leather, and tobacco—Suzuki could be in enough political trouble with party members to threaten his reelection.
- Komoto could use Japan's domestic economic difficulties to build a case against Suzuki. 



- If Suzuki retreats on administrative reform, Nakasone could try to work this to his advantage.
- Finance Minister Watanabe may be a possible compromise candidate for LDP president, and he may begin gathering support.
- The Fukuda faction, although now part of the triumvirate that supports Suzuki, might lead the criticism if Suzuki mishandles the US-Japan relationship. 


We expect that Suzuki's ties to Tanaka will last through the November election. The former Prime Minister is currently one of those on trial for involvement in the Lockheed scandal, and he is trying to delay the verdict until after the LDP elections. He probably believes his chances are improved by supporting the current Prime Minister. If Tanaka is found guilty before the LDP elections, however, Suzuki could face widespread criticism for his links to corrupt officials. 

Implications for the United States

Suzuki is sincerely anxious to ease the strain in US-Japanese relations, but he is cautious by nature and will not move out ahead of his party or government in initiating policy—either in the near term or if he is reelected. In the months ahead he will continue to look for specific problems in trade or other areas to which Japan can make limited responses. 

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Although Suzuki hopes to thread his way through the difficult months ahead, criticism of his performance will mount within the LDP as the elections approach and various factions jockey for power. If he is accused of giving in to Washington, he will be less likely to take or to follow through on bold initiatives. He will also be inclined to try to wait out US pressure, which many Japanese believe will subside once the US economy picks up and the Congressional elections are over. 

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If Suzuki is not able to win reelection, no one successor stands out. None of his rivals, in any case, would have much more freedom of action. Fukuda or EPA Director Komoto would probably try to stimulate the economy to boost imports. They might have more negotiating room than Suzuki on agriculture but, because of strong factional ties to industry, less on nontariff barriers. Tanaka has suggested that the time has come to liberalize the agriculture sector. With Tanaka's powerful backing, a prime minister from his faction (such as LDP Secretary General Nikaido) might be able to build the party consensus necessary for some movement in this area. 

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If the party opts for a president outside of the three mainstream factions now supporting Suzuki, Nakasone, who heads his own faction, and Watanabe, an independent, are clear possibilities. Nakasone would probably be more in favor of an enhanced defense effort than Suzuki but would have difficulty selling an ambitious plan to the cabinet and the Diet. Watanabe would likely be more flexible on trade barriers than the Prime Minister but would be less likely than Komoto to advocate stimulation of the domestic economy. 

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Appendix**Tokyo's Trade Policy** [REDACTED]

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Foreign pressure, particularly from the United States, has pushed Prime Minister Suzuki to take initiatives to trim Japan's trade surplus. Suzuki's policies apparently are tailored to give the impression that Tokyo has made a long-term commitment to open Japan's domestic market. [REDACTED]

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In mid-December, Suzuki announced his External Economic Measures Program, which included:

- Accelerated cuts in tariffs.
- Subsidies for raw material stockpiling.
- \$330 million in funds for increased oil reserves.
- \$500 million in foreign currency loans for emergency imports on the condition that the yen appreciates.
- A reported \$90 million could be made available to purchase foreign grain to be used as food aid.
- A promise to review Japan's nontariff barriers. [REDACTED]

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The net short-run impact will be small, however, because the plan included money for oil stockpiling that would have been spent anyway and money for raw material inventories that probably would have been rebuilt without government help [REDACTED]

The longer term impact is harder to judge. We estimate that Tokyo's plan to accelerate tariff cuts on 1,653 items could cause Japan's imports to increase roughly 0.6 percent annually. In 1980, for example, the total impact would have been \$900 million in additional purchases. [REDACTED]

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In late January Tokyo announced that 67 nontariff barriers would be removed or relaxed and that an Office of Trade Ombudsman would be established to handle specific problems. Measuring the impact of lower nontariff barriers is almost impossible. It is not clear, for example, how Tokyo will change some of the unwritten customs inspection standards that have been in practice for years. Tokyo will have to follow up with specific rulings demonstrating that barriers described as being relaxed "in principle" have actually changed. Nonetheless, foreign firms will probably face fewer aggravations in selling to Japan [REDACTED]

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The Next Step

Most Japanese officials believe that the recent policies, although played up as a major program, will not substantially ease US pressure:

- Government officials still project the trade surplus to increase this year.
- MITI Minister Abe is very concerned that Japan will be used as a scapegoat in the US Congressional elections in November.

Tokyo, however, has no major new initiatives under serious consideration. Some officials are suggesting Suzuki adopt a more flexible position on agricultural quotas. Others want him to stimulate the economy to spur imports. [REDACTED]

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