

Abenomics 2.0

What will we see in year two?

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February is here and after a month of New Year's celebration parties (*gashi kokan kai*) and overseas trips (*gaiyu*), political life in Nagatacho is finally returning to normal (if life in Nagatacho should ever be called be "normal").

With the 2014 Ordinary Diet session starting on 24 January, the second year of the second Abe administration is just getting under way. The first succeeded to a degree rarely seen in politics, in Japan or anywhere else, meeting or exceeding the hype – at least for now – in kick-starting the Japanese economy and reviving animal spirits.

The economic impact on the Nikkei 225 (up more than 50% since the day the December 2012 election House of Representatives was called), the value of the yen (down from ¥76 to ¥104 to the dollar), not to mention the expectations created by those policies, have been impressive. But there is also a political aspect to this remarkable change of mood, much of which can be attributed to astute political communication, not seen since the administration of Junichiro Koizumi.

The fact that the three arrows are used whenever anyone evaluates the policies of the Abe administration bears witness of the extent to which it has been able to set the agenda, and its success in communicating a clear vision. Abe's economic agenda is so clearly defined by his determination to kick-start growth and end deflation that any attempt at opposition is made to look obstructionist and anti-reform. The opposition remain flummoxed and ineffectual.

A less visible factor behind the success of the Abe administration to date is a streamlined decision making process within the LDP. Although the LDP reinstated its Policy Affairs Research Council as the party's top policy making body, the scope of its authority has been confined more than in the past, meaning that rank and file Diet members have not been allowed to take draft legislation or other policies hostage for any length of time. The ability of the party to allow its members to have their say yet quickly reach a single view and unite behind it, has helped to maintain the perception of momentum and enhanced the sense of the government being in control, in stark contrast to the endless divisions and contradictions under its DPJ predecessors (and indeed Abe's first premiership).

The feeling of solidity has been further strengthened by Abe's decision not to play the usual game of musical chairs with his Cabinet, but to keep his team together, providing a rare sense of continuity (even if it has only been for one year).

Although his approval ratings did drop at the end of last year, partly due to passage of the Secrets Protection Law, Prime Minister Abe still has the highest approval rates one year into office of any premier in modern Japanese history.

The big question now is whether the second year of Abenomics will live up to the first. While his position remains strong – there is no sign of effective opposition (inside or outside of his own party), no elections due for the whole calendar year of 2014, and the Japanese and international media remain very friendly and forgiving, a handful of challenges are surfacing, and the government will have to navigate these carefully in order to maintain the sense of momentum.

The first and most obvious challenge is Abe's ability to focus (or re-focus) on economic policy and to refrain from spending too much political capital on a conservative agenda that is closer to his heart but not as popular with most of the electorate, such as reform of the constitution, more proactive defence and security policy and educational reforms.

It is natural that Abe's policies will be coloured by his own ideology and that of his closest allies – all of whom are on the conservative side of the LDP. But at the same time, it is also clear that his popular mandate is based on his economic reform programme. Abe himself was genuinely surprised by the strength of opposition to the Designated Secrets Protection Law when it was debated and passed by the Diet in the very last days of the Diet session at the end of the year. The bill crowded out discussion on other issues for months, turning what was supposed to be the "Diet session for execution of the growth strategy" into the "Diet session for enactment of the secret protections law". The decision burned up some of Abe's political capital, leading to dropping popularity rates (although they have since stabilised) and reigniting questions about the priority Abe really gives to economic reforms.

Disappointingly, the government has not yet decided what the key bills for the current Diet session will be – besides the obvious initial focus on budgets and the FY2014 tax revisions, and the expectation that we will see bills on modest corporate governance reform and lifting the ban on casinos. In the absence of other substantial initiatives, there is a possibility that the main theme of this session will be on collective self-defence the main theme of the session. This would prove to be a dangerous path for the Abe Cabinet.

The bill which was supposed to be the shaft of the third arrow – the Industrial Competiveness Enhancement Law – provided few concrete reform measures, so ambitious initiatives in the areas of labour mobility, corporate tax, or regulatory reform may be necessary to help investors keep the faith, particularly around the time of the consumption tax hike from 5% to 8% in April.

In order to get there, the policy-making process will have to be altered again to allow more direct political leadership. The streamlined decision-making within the LDP created a certain policy momentum, but it came at the cost of a high degree of involvement by the bureaucracy and, with that, an inability to address contentious reforms.

The current policy-making process will not, for instance, be able to reach the decisions necessary to make when it comes to the energy situation. Although his pro-nuclear views are clear, he has skilfully stayed away from that discussion, referring to the Nuclear Regulatory Authority's safety assessments. But all 54 reactors, of which 33 were operating before the accident Fukushima Daiichi, remain closed, leading to

enormous fuel import costs (an estimated ¥294 billion annually), which only increase as the yen depreciates on the back of Abe's first arrow.

Utilities have submitted application for restart of 17 reactors and will be dependent on quick decisions, preferably ahead of the new fiscal year starting in April to allow for new loans and for refinancing of old. But restarts require also approval from local governments on top of the technical evaluation and it is far from clear that this will be granted. GR Japan has evaluated both the technical and political aspects of restarts, concluding that a mere ten reactors are likely to get the green light as things currently stand. Without knowing the size of the gap to fill, it has been impossible to revise Japan's pre-Fukushima Basic Energy Plan and start capacity planning for the future.

Political leadership is necessary. In a sign of the more direct political involvement likely to come, the LDP Policy Affairs Research Council is polling all LDP diet members for their views.

Thus far, Prime Minister Abe has leant on the bureaucracy, especially the Ministry of Economy, Trade, and Industry, to deal with the all-important third arrow of Abenomics. He will now have to find a way of leveraging the political capital built up by his administration and the LDP to go one step further – forcing through some of the crucial changes the bureaucracy will resist. Should he be successful in that daunting task, we could have many more years of Abenomics ahead of us.

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