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# JAPAN IN 2007

## *A Divided Government*

\_\_\_\_\_ Kristi Govella and Steven Vogel  
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### Abstract

The ruling Liberal Democratic Party (LDP) suffered a stunning defeat in the July 2007 upper house elections, creating an unprecedented situation in which the LDP-led coalition lost its majority in the upper house while retaining a two-thirds majority in the lower house. In this new environment of “divided government” Japanese style, the LDP and the opposition jockeyed for advantage in foreign and domestic policy debates while preparing for a critical confrontation in the next lower house election.

Keywords: Japan, politics, foreign policy, economy

The ruling Liberal Democratic Party (LDP) followed its overwhelming victory in the September 2005 lower house elections with an equally stunning defeat in the July 2007 upper house elections (see Table 1). This total reversal between the two elections left Japanese politics in an unprecedented situation, with the LDP-led coalition enjoying a two-thirds majority in the lower house and the opposition Democratic Party of Japan (DPJ) gaining a plurality in the upper house. Prime Minister Abe Shinzo vowed to remain in office despite the defeat, only to abruptly announce his resignation in September, citing health problems. Fukuda Yasuo, who replaced Abe, then confronted the challenge of sparring with the DPJ over the legislative agenda and the timing of the next lower house election.

\_\_\_\_\_ Kristi Govella is a Ph.D. student in the Department of Political Science at the University of California, Berkeley. Steven Vogel is Professor of Political Science at the University of California, Berkeley.

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TABLE 1 *July 29, 2007, Upper House Election Results*

<i>Party</i>	<i>Total Current Seats</i>	<i>Total Pre-Election Seats</i>	<i>Seats Won in the Election</i>	<i>Seats at Risk before the Election</i>
DPJ	109	81	60	32
LDP	83	110	37	64
New Komeito Party (NKP)	20	23	9	12
Japanese Communist Party (JCP)	7	9	3	5
Social Democratic Party (SDP)	5	6	2	3
People's New Party (PNP)	4	4	2	2
New Party Nippon (NPN)	1	0	1	0
Unaffiliated	13	7	7	1
<i>Total</i>	242	240	121	119

SOURCE: *Oriental Economist* (August 2007), p. 3.

### The 2007 Upper House Elections

Ironically, the LDP had sowed the seeds of its 2007 defeat with its overwhelming victory in 2005, when Prime Minister Koizumi Junichiro (2001–05) adopted a strategy of saving the party by attacking it. He not only cut the public works budget but struck the party machine at its core with “structural reforms,” including privatization of the postal system and the reorganization of the special public corporations. Throughout the postwar era, the government had channeled postal savings deposits through the special public corporations to finance infrastructure projects. Then, in his most dramatic blow against the LDP old guard, Koizumi banished from the party those lower house members who had voted against his postal privatization bill, recruiting “assassin” candidates to run against them. Koizumi’s personal conviction, media savvy, and sheer audacity played well with the public—if not with his own party colleagues—and the party rode the Koizumi wave to a huge victory. For the first time ever, the LDP matched its strength in rural districts with equal success in urban districts.

This left the LDP vulnerable in the next election, however: the victory relied so much on Koizumi’s personal charisma that it would be difficult to replicate without him at the helm. Koizumi had recognized that the LDP could not rely forever on its traditional social coalition and clientelistic support networks because the farming population had declined precipitously and urban voters were becoming fed up with paying for pork-barrel projects aimed at rural areas. So he accelerated a gradual shift in election dynamics toward a greater focus on personal leadership, media coverage, and policy issues. Yet, this made the LDP more prone to defeat when Koizumi’s prowess gave way to weaker

leadership, declining media appeal, public missteps, and scandals. Moreover, Koizumi had undermined the very foundation of the LDP's long-term rule: the pork-barrel machine and strong support from protected groups, such as farmers and small business people. This gave the DPJ an opportunity to counter-attack in rural districts.

Thus, Abe came to office in September 2006 with a very tough act to follow. Koizumi had been so successful in the 2005 election that the party had nowhere to go but down in the next election. Koizumi could take credit for the economic recovery, leaving Abe with the thankless tasks of restoring fiscal balance and working out the detailed implementation of structural reforms, including postal privatization. And Abe could not possibly match Koizumi's charisma. Yet, Abe himself made things much worse. He made a fateful decision to allow those postal rebels who had defeated Koizumi assassins to rejoin the party in December 2006, giving the impression that he was stepping back from Koizumi's commitment to reform the party. He also caved in to pressure from the construction lobby, watering down his early proposal to divert road and gasoline taxes to the government's general funds instead of earmarking them for road construction projects. He filled his first cabinet with loyalists rather than leaders known for their skill in managing party and parliamentary affairs. His cabinet suffered no less than five scandals, with four ending in resignation and one in suicide. In late 2006, Administrative Reform Minister Sata Genichiro resigned after admitting to accounting irregularities by one of his political support organizations. In July 2007, Kyuma Fumio resigned as defense minister after making remarks that seemed to justify the World War Two atomic bombings of Japan by the United States. Abe's first agriculture minister, Matsuoka Toshikatsu, killed himself in May amid allegations of office expense fraud and ties with an organization involved in bid rigging. His two successors were also caught up in scandal. Akagi Norihiko resigned in August in a separate incident involving discrepancies in political funding records, while Endo Takehiko acknowledged allowing a farmer's mutual-aid association to claim illegal government subsidies, and left the cabinet after only eight days in office.

Worst of all, an investigation initiated by DPJ politician Nagatsuma Akira revealed in February that the Ministry of Health, Labor, and Welfare had misplaced pension records for over 50 million Japanese citizens. A minor change in accounting procedures at the Social Insurance Agency in 1997 had resulted in data-entry mistakes and numerous "unidentified" accounts with unknown owners. The problem widened in June 2007 when the ministry stumbled across an additional 14.3 million accounts on microfilm that had never been entered into the computer systems. Although Abe bore no direct responsibility for this debacle, his administration's response was seen as lackadaisical, and this more than any other scandal drove plummeting cabinet support and defeat at the polls. The Abe cabinet had started with support ratings around 70% when the new

prime minister took office, the third-highest support level in Japanese history, but its public approval dropped below 30% in the lead-up to the election. For once, the DPJ was able to capitalize on the LDP's unpopularity: DPJ leader Ozawa Ichiro, the former LDP heavyweight who had transformed Japanese politics by defecting from the party in 1993, crafted a campaign strategy to lure rural voters to the party by promising generous income supports for farmers.

### “Divided Government” Japanese Style

Many experts had predicted that Abe would resign if the party failed to win more than 40 seats, but Abe defied the pundits. He formed a new cabinet with a much more experienced lineup, including four faction bosses, and his public approval ratings temporarily improved. The LDP and DPJ immediately began sparring over the terms of engagement in this unprecedented situation. Under the Constitution, lower house votes to elect the prime minister or to approve the budget or treaties are binding after 30 days, even if the upper house fails to act or votes against them. On regular bills, the lower house can override the upper house with a two-thirds majority. And if the upper house deliberates for more than 60 days, the lower house can treat this as a negative vote and proceed with an override effort. These rules were largely academic for most of the postwar era because the LDP had a solid majority in both houses. But after the July 2007 elections, they took on a whole new salience.

DPJ leader Ozawa tested the new power balance by taking a firm position against an extension of the Anti-Terrorism Special Measures Law, discussed below. Ozawa hoped to force the LDP to call a lower house election by bringing Diet business to a halt. The DPJ played a delicate game of blocking progress without looking too obstructionist, for fear that this would alienate nonaligned voters. Meanwhile, LDP leaders puzzled over whether they should ever actually exercise their ability to override the upper house, because this might be viewed as undemocratic.

Abe publicly vowed to push the anti-terrorism bill through. At the September Asia-Pacific Economic Cooperation (APEC) summit in Sydney, the prime minister reportedly promised U.S. President George W. Bush that the law would be renewed. Abe opened an extraordinary parliamentary session upon his return to Tokyo.<sup>1</sup> Only two days later, however, Abe abruptly resigned after Ozawa refused to meet with him to discuss a compromise solution. Abe complained of unspecified health problems and was later admitted to a hospital with a gastrointestinal condition. LDP Secretary-General Aso Taro conceded that Abe had given a hint of his intention to resign a few days earlier, but for the most part the top LDP leaders were caught off guard. Aso reportedly pleaded

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1. Economist Intelligence Unit (EIU), *Country Report—Japan* (London: EIU, October 2007), p. 9.

with Abe to reconsider, given that the administration was in the middle of a Diet session and was trying to push through important legislation.

In the flurry of activity after Abe's sudden resignation, Aso seemed to be the most likely candidate for prime minister. An outspoken and charismatic conservative, he was politically and personally close to Abe. Within a day, however, the leaders of the LDP's biggest factions had expressed their support for Fukuda Yasuo, a politician noted for being the longest-serving chief cabinet secretary in Japanese history under Prime Ministers Mori Yoshiro and Koizumi. Despite holding only one cabinet position, Fukuda had earned strong marks for managerial skills and skillful handling of party executives, as well as developing a reputation for moderation in foreign policy. LDP Diet members and party branches voted for Fukuda to succeed Abe as party president, and the LDP-dominated lower house made him prime minister two days later. Fukuda ran neck-and-neck with Aso in the party branch vote but defeated Aso by a margin of 254 to 132 among LDP Diet members.

Fukuda was more inclined than Abe to work with the opposition. He decided not to try to extend the Anti-Terror bill but to propose a new one instead. He tried to arrange a settlement with the DPJ, but Ozawa refused, insisting that the two sides should engage in a public debate rather than make a private deal. Then Ozawa stunned his own party and political circles in November by agreeing in a private meeting with Fukuda to form a grand coalition with the LDP. DPJ members recoiled at this proposal; Ozawa promptly offered to resign. DPJ leaders managed to convince Ozawa to stay on and to give up on the grand coalition plan. Ozawa apparently had judged that the DPJ would be hard pressed to win the next lower house election because voters lacked confidence that the party could govern, and he felt that the experience of governing in a grand coalition might enhance the party's credibility. However, most DPJ members felt that they should confront the LDP rather than collaborate with it, and subsequent public opinion polls showed that voters felt the same way.

Meanwhile, the two parties prepared for a showdown over the 2008 budget and related bills. The LDP coalition would be able to push through the budget on its own, but it would need DPJ cooperation to pass related bills. Fukuda would not have to call elections before September 2009, but gridlock in the Diet could force him to call the election as soon as early 2008. If party leaders felt that their fortunes were improving, they might take the risk.

### Foreign Policy

Abe started the year with strong strides toward ushering in a more robust security posture for Japan, although his initial success would soon be undermined by turbulent domestic politics. In his first press conference of 2007, Abe announced his intention to make constitutional revision a campaign issue for the

July elections; the Diet later passed a referendum outlining amendment procedures. In January, the Defense Agency was upgraded to ministerial status, a move Abe hailed as “an end to the postwar regime . . . and the basis for building a new nation.”<sup>2</sup> He paid a historic visit to NATO headquarters, the first by a Japanese prime minister, announcing that Japan would not hesitate to send Self-Defense Forces overseas on peacekeeping missions. The Diet passed laws implementing plans to realign U.S. forces in Japan and enabling the extension of the Air Self-Defense Force’s reconstruction support mission in Iraq. Abe also took substantive steps toward expanding relations with Australia and India, signing a joint declaration calling for closer security cooperation with the former and agreeing to cooperate with the latter on greenhouse-gas emissions and the construction of an environmental framework to succeed the Kyoto Protocol.

Though many of these actions worked to affirm and strengthen the U.S.-Japan alliance, Abe’s relationship with President Bush was distinctly more distant than that enjoyed by Koizumi. In an unusually long delay for a postwar prime minister, Abe waited seven months to make his first visit to the United States, a decision that was widely interpreted as signaling Japan’s increasing independence. Also, the Six Party Talks process, initiated in 2003 to resolve the North Korean nuclear situation, provided another source of tension among the allies. In sharp contrast to the leading role that the Koizumi administration played in responding to North Korea, Abe’s own administration in 2007 came under fire for maintaining an overly rigid policy stance, resulting in Japan’s increasing isolation within the talks. Ironically, Abe had risen to political prominence by championing the concerns of dozens of families whose relatives had been kidnapped by North Korea. However, his strong stance on the abductee problem became more of a liability than an asset. His inability to compromise or produce a satisfying solution hurt his reputation abroad, while the issue did little to bolster his flagging public support domestically. As the United States adopted a more conciliatory attitude toward North Korea, many in Tokyo were left feeling that the Bush administration had made a deal with Pyongyang without sufficiently consulting Japan or taking its concerns about the abductees seriously.

Despite early concerns about his nationalistic and hawkish attitude, Abe took important steps toward improving relations with China and South Korea. His initial visits to the two countries helped to smooth tensions caused by Koizumi’s visits to the Yasukuni Shrine. Abe himself refrained from visiting the controversial war shrine, where a number of Japanese war criminals are

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2. “Ministry of Defense Launched: Kyuma Appointed First Defense Minister,” *Japan Brief*, <<http://fpcj.jp/modules/news8/index.php?page=article&storyid=5>>.

memorialized, removing a major source of contention among neighbors. Relations with China appeared to be back on track, with Premier Wen Jiabao visiting Japan in April and talks resuming on topics ranging from environmental and energy cooperation to food safety. Fukuda was subsequently able to continue these efforts with his December 28 visit to Beijing, which brought together the largest number of Cabinet officials from the two countries since they opened diplomatic ties 35 years ago. Unfortunately, however, the year also witnessed setbacks. In particular, Abe sabotaged some of his own success when he told a Diet committee that there was no proof that the Japanese military was directly involved in coercing Korean, Chinese, and other women into prostitution during World War Two (seemingly contradicting an official statement issued in 1993 in which the Japanese government acknowledged its guilt on this issue). Though Abe later backed down, his words sparked outrage from Korea and prompted the U.S. House of Representatives to pass a non-binding resolution urging Japan formally and unequivocally to apologize and accept responsibility for the suffering of these women.

Unfortunately for Abe, his grand vision for Japan's enhanced role in the international system lacked the backing of the Japanese people. Though constitutional revision was initially flagged as a key election issue, the public became increasingly concerned on several counts: the string of government scandals, Abe's apparent disregard for the everyday concerns of those hurt by economic reform, and growing disparities between rural and urban areas. When the *Yomiuri Shimbun* asked voters to list the most important election issues, 67% named pension and welfare problems, while 40% cited the undue influence of money on government policy. Constitutional revision ranked a mere seventh on voters' list of concerns.<sup>3</sup>

In the wake of the July 2007 elections, it became clear that the volatile domestic political situation would inhibit Abe, and subsequently Fukuda, from taking strong action in the foreign policy arena. The Anti-Terrorism Special Measures Law arose as the first test case. Passed in the aftermath of 9/11, this law authorized Japan to provide logistical assistance to U.S. and allied naval vessels involved in anti-terrorist actions in Afghanistan, including supplying these vessels with oil. The Bush administration put enormous pressure on Tokyo to continue the operations by renewing the law prior to its November 1, 2007, expiration date, but the deadline came and went without any action, stalled by DPJ opposition on the grounds that operations were not fully sanctioned by the U.N. Security Council. The LDP offered up a compromise bill removing any reference to Afghanistan and backing away from the notion of Japanese collective self-defense, but the DPJ still rejected it in favor of the

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3. "Election Preview," *Oriental Economist* (July 2007), p. 1.

party's own alternative, which allowed more narrowly for the dispatch of SDF forces in non-combat capacity to assist in police, humanitarian relief, and reconstruction efforts. On November 13, the lower house passed the LDP version of the revised bill. Then in December, the Diet approved a second extension of the parliamentary session through January 15, 2008, thereby giving the lower house the ability to override the upper house 60 days after the bill passed. Thus, despite Abe's determination to elevate Japan to a more assertive security posture, momentum for foreign policy changes dissipated in the face of everyday social and economic issues and increased partisan conflict.

### The Economy

The relatively healthy state of the economy enabled Abe to focus on longer-term issues such as boosting labor productivity growth, improving international competitiveness, and reducing the fiscal deficit. However, he lacked a clear implementation plan for these goals. This reflected unwillingness on Abe's part, as well as that of his LDP colleagues, to address sensitive reform questions in advance of the July 2007 elections. Their ability to tackle controversial issues was even more constrained in the aftermath of the election loss, leaving little prospect of deeper cuts in public works spending or deregulation of the agricultural sector. Likewise, Abe and Fukuda avoided any commitment to raising the consumption tax, even though economic analysts projected it would have to rise substantially both to balance the budget and to finance increasing welfare costs to support the growing ranks of elderly Japanese. Koizumi had established the goal of reducing the primary deficit to zero by 2011 and achieving a budget surplus by 2015, yet the LDP was not likely to consider substantial tax hikes prior to the next lower house election.

The year 2007 started with strong growth in the first quarter. Despite enjoying the longest period of growth since World War Two, however, most Japanese people did not feel that they benefited from the recovery. Although unemployment continued to drop, workers failed to see an increase in their wages, primarily because of changes in labor force composition. Since the 1990s, Japanese companies have been cutting costs by reducing new hires and substituting full-time regular employees with lower-wage part-time workers. As a result, income inequality has boomed among those in their 20s and 30s, with a sharp gap emerging between those with permanent jobs and those with part-time jobs—or no jobs at all. Low wage levels continued to generate concern over the future of aggregate demand. The public was particularly anxious about pensions, given the combination of fiscal constraints and an aging population, even before the DPJ exposed the pension records scandal. Persistent deflation remained an issue, leading the central bank to raise the overnight call rate only once during 2007, adjusting it from 0.25% to 0.5% in February.



The Koizumi administration had vowed to improve the climate for foreign direct investment, but the Japanese have remained wary of hostile takeovers from abroad. A government decision to allow triangular mergers went into effect in May, opening the door for overseas firms to acquire Japanese businesses through local units, but the reforms remained restricted by unresolved tax and legal ambiguities. In tandem with this step, the government had also issued guidelines to clarify which measures companies could use to defend against hostile takeovers. Foreign investors were especially keen to participate in mergers and acquisitions (M&A) deals in Japan because they felt that residual inefficiencies in the economy meant huge potential gains from rationalization. Steel Partners, a U.S.-based investment group, fought and lost high-profile takeover battles over Sapporo Breweries and Bull-Dog Sauce, a well-known producer of Worcestershire sauce, in 2007. In the latter case, Steel Partners challenged the takeover defense in court, but the Supreme Court ruled in Bull-Dog's favor because its shareholders had voted in favor of management.<sup>4</sup> A record 2,775 M&A deals involving Japanese companies were announced in 2006, up 1.8% from the previous year, followed by 2,010 M&A deals in the January-September period in 2007.<sup>5</sup> However, absolute levels remained far below those in the United States and Western Europe.

The August financial crisis in the U.S. sub-prime mortgage market and the resultant global credit crunch created financial and economic uncertainty and caused a sharp appreciation of the yen. This in turn resulted in a reduction in the yen carry trade, a strategy in which investors sell relatively low-interest yen and use the funds to purchase other higher-interest-yielding currencies in order to capture the difference between rates. The U.S. crisis also evoked concerns about Japanese dependence on exports to the United States, particularly since the critical factor in the 2002–07 recovery had been growth in net exports and greater corporate investment aimed at expanding capacity to meet future demand from abroad. Japan continued to cultivate economic relations with its neighbors through preferential trade agreements, concluding economic partnership accords with Thailand and Indonesia and working out basic terms for a similar arrangement with the Association of Southeast Asian Nations (ASEAN).

### A Two-Party System?

Koizumi had transformed the dynamics of Japanese politics by undermining the old LDP political machine and devising a new campaign style focused more on leadership, image, and media. He orchestrated a massive victory in 2005 by

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4. EIU, *Country Report—Japan* (September 2007), pp. 35–37.

5. Kaho Shimizu, "Quick Profits, Yes, but Merger Mania Has Its Share of Failures," *Japan Times*, November 8, 2007.

appealing to urban voters, whereas the DPJ's Ozawa countered in 2007 by trying to cut into LDP support in rural areas. Japan had moved substantially toward a two-party system in the 2001 upper house and 2003 lower house elections, with the DPJ gaining ground at the expense of the smaller opposition parties. Then the DPJ produced a marginal victory over the LDP in the 2004 upper house election, followed by a decisive victory in 2007, giving it a majority in that house. Could the LDP finally lose power in the next lower house election?

A DPJ victory could transform the logic of Japanese politics. Although the LDP was out of power briefly in 1993–94, a more sustained period of alternation in power could redefine the relationship between politicians and bureaucrats in Japan because a DPJ government would strive to assert control over ministries that had collaborated with the LDP for decades. Alternation might also press the two major parties to differentiate themselves more clearly on policy issues. And it could shatter the presumption that the LDP is the party of government and therefore the only party capable of bestowing tangible benefits on voters and interest groups.

As of year-end 2007, the DPJ still enjoyed some momentum from its upper house victory, despite Ozawa's ill-fated courtship with Fukuda over plans for a grand coalition. DPJ leaders could find some solace in the fact that they no longer had to face Koizumi; also, support for the LDP remained low. The LDP would be less vulnerable in the lower house than in the upper house, however, because strong incumbent candidates could be counted on to fare well in the single-member districts. Moreover, they could hope that their own pragmatic flexibility and the DPJ's leadership deficit might help them to retain power once again.