

ECONOMIC AND POLITICAL REFORM

Political Update:

The process of political realignment continues in Japan with the Socialists quitting the ruling coalition, leaving the newly elected (April 25) Prime Minister, Tsutomu Hata, to lead a six-party, minority, coalition government.

Hata's coalition controls just 187 of the 511 Lower House seats. The opposition Liberal Democratic Party (LDP), with 206 seats, the Socialists with 74, and former coalition partner Takemura's *Sakigake* with 15 seats, together hold a clear majority and can defeat the government at any time - unless Hata can attract additional LDP defectors into his ranks. There is speculation that Hata's government could fall as early as mid-June, once the Diet passes the long overdue 1994/95 fiscal year budget.

This ongoing political turmoil further delays the Japanese government's domestic agenda of regulatory reform, tax reform and economic stimulus, and puts Japan in the position of having a leader without a strong mandate in the bilateral trade talks with the USA and during the lead-up to the G-7 Summit in Naples in July.

Background on Political Realignment and the Reform Movement:

This past year has been a watershed in Japanese politics with the end of 38 years of LDP rule and the election of a seven-party coalition government under Morihiro Hosokawa which has now been replaced by Tsutomu Hata's minority, coalition government.

There were four main reasons for the historic fall of the LDP in July 1993: a succession of political scandals eroded the credibility of existing political arrangement; the bursting of the "bubble" economy called into question the LDP's economic competence; the dissolution of the Soviet Union meant that the LDP became less indispensable as a bulwark against the communist threat; and, a younger generation of leaders within the LDP had decided that, in view of the first three factors, it was time to alter Japan's political outlook.

Economic Troubles

During the bubble economy, Japan's stock market boomed. Most investors had their money in the stock market only indirectly, through insurance and pension funds. Operating on razor-thin profit margins which allowed them to penetrate foreign markets, companies tended to pay very low dividends. Success in the stock market relied on continued inflation of asset values. Companies depended on the ability of their partners in the *keiretsu* conglomerates to make capital available