

**11 June 2024**

## **LDP's fiscal hawks gain strength as Kishida seeks balance**

### **Key takeaways**

- In the Kishida government's draft basic policy, it retained a longstanding primary fiscal surplus target.
- Prime Minister Kishida Fumio has sought to find a balance between growth policies and fiscal consolidation, as fiscal hawks and doves in the LDP jockey for influence.
- While fiscal hawks may be gaining the upper hand, deficit spending will likely continue – as will the fight within the LDP.

---

On Tuesday, 11 June, the Kishida government presented to the Council on Economic and Fiscal Policy a draft of its 2024 Basic Policy on Economic and Fiscal Management and Reform (known as the “honebuto” policy). The basic policy identifies the government's major economic policies ahead of the start of the budgetary process for the next fiscal year. While a subsequent note will look at the government's broader policy goals, it is notable that in this draft the government will retain a pledge to achieve a primary fiscal surplus by FY 2025. The government has retained this target – first introduced in 2006 with a goal of primary fiscal surplus by FY 2011 and delayed repeatedly thereafter – despite the unlikelihood of meeting it.

By retaining this target, Prime Minister Kishida Fumio has provided insight into mainstream thinking on fiscal policy in the post-Abe Liberal Democratic Party (LDP).

### **Kishida and fiscal policy**

On the one hand, he has repeatedly gestured towards fiscal responsibility and fiscal consolidation over the medium term. The revised version of his government's “New

Capitalism Grand Design and Action Plan,” approved by Kishida’s advisory council on his “New Capitalism” vision on Friday, 7 June, said:

The economy is the foundation of public finances, and there is absolutely no contradiction between taking the necessary policy measures and working towards the goal of fiscal consolidation. To draw out the vitality of the private sector and deliver economic growth and other results, ‘wise spending’ will be thoroughly implemented.

The prime minister is also thinking about the impact of the Bank of Japan’s (BOJ) move to end its negative interest rate policy and normalize monetary policy. Asked about his intentions regarding the primary balance target last week, Kishida noted that he is watching the changing interest rate environment closely.

On the other hand, as the discussion of “wise spending” indicates, Kishida has not been reluctant to use government spending, whether on major policy priorities like the green and digital transformations, larger defense budgets, or natalist policies to combat demographic decline. He has also been reluctant to spend political capital on pushing through tax increases to pay for these priorities – most notably the tax plan he proposed as part of the defense spending debate – and his government has therefore relied mostly on a natural increase in tax revenues to limit the growth in new debt issuance rather than pursuing more fundamental reforms of spending or taxation.

In pursuing this approach, Kishida is to some extent following in the footsteps of the late Abe Shinzō, who as prime minister sought a balance between growth-boosting policies in the near term and fiscal sustainability over the medium term. He is also grappling with an LDP that, in Abe’s wake, is increasingly divided between fiscal hawks and doves over how to manage Japan’s fiscal policies. These divisions – between fiscal doves who think Japan should grow its way out its fiscal problems and who increasingly have embraced Modern Monetary Theory (MMT)-like ideas about deficits, and fiscal hawks allied with the finance ministry who hold to the orthodox MOF view on the dangers of ever-larger deficits for Japan’s economic future – have long been a fundamental cleavage in the ruling party. The debate was muted during the second Abe administration, when Abe, after the 2014 consumption tax hike triggered a recession, repeatedly overruled MOF and its LDP allies to delay the second hike and cut corporate taxes. During Abe’s tenure, the LDP as a whole – and its right wing in particular – became increasingly comfortable with deficit spending, not least thanks to the BOJ’s dominant position in the holding of Japanese government bonds (which BOJ Governor Kuroda Haruhiko repeatedly denied amounted to debt monetization).

### **The LDP’s new fiscal policy debate**

Kishida, however, faces a more active debate over fiscal policy. As Japan moved from the pandemic – during which the Japanese government ran record-high deficits to manage the economic shock – to the post-pandemic world, fiscal hawks have become

increasingly vocal about the urgent need for fiscal consolidation. It was in 2021, during that year's general election campaign, that MOF's administrative vice minister took the unusual step of writing an essay in a public journal warning of a "fiscal Titanic" at the hands of irresponsible politicians, prompting a war of words with Abe and other fiscal conservatives. Abe's death, meanwhile, created more space for fiscal hawks. While many of Abe's lieutenants remain fiscal doves, they lack the late prime minister's ability to shape the policy agenda and marginalize opposing views, enabling fiscal hawks in the LDP to get more of a hearing than they did during Abe years. Finally, the BOJ's policy shift has changed the terms of the debate, enabling both MOF and LDP fiscal hawks to argue that because the government can no longer assume that interest rates will remain low indefinitely, it is imperative to prioritize fiscal consolidation in the near term.

As a result, the Kishida government's deliberations over the primary fiscal balance target prompted LDP bodies representing both the fiscal hawkish and fiscal dovish positions to submit proposals seeking to influence the government's decision. The LDP's fiscal sustainability headquarters, led by lawmaker Furukawa Yoshihisa, prevailed in this round with a proposal that appealed to the prime minister's desire for balance between growth and fiscal consolidation, using key phrases like "the economy is the foundation of public finances" and "public finance is the cornerstone of a nation's credibility" and warning of the need to reform fiscal policy as the BOJ shifts policies. Beyond calling for a primary surplus target, it has proposed numerous public spending reforms, abjuring the emphasis on tax hikes of earlier LDP fiscal hawks.

Meanwhile, the LDP's fiscal policy research headquarters, headed by Nishida Shōji (perhaps Japan's leading advocate for MMT), submitted its own proposal that mostly sought to block the pivot to fiscal consolidation sought by the fiscal sustainability headquarters. This proposal argued, "If spending is restrained by calls for fiscal consolidation, economic growth will be hindered and fiscal reconstruction will be delayed." The headquarters therefore called for scrapping the primary fiscal surplus target; removing legal limits on bond issues; and prioritize policies to end excessive saving by the private sector. As much as Kishida has been inclined to prioritize spending on his policy priorities over fiscal consolidation, this MMT-tinged proposal was unlikely to appeal to his sensibilities, and, in general, the more that the LDP's fiscal doves are represented by Nishida, the less influence they may have on fiscal policy debates going forward. In this instance, Abe's absence – the late prime minister was a senior adviser to the group at the time of his death – is notable; there may be no figure of comparable stature willing to take up the cause of expansionary fiscal policy.

The upshot is that while the fight within the LDP is by no means settled – and the government will likely continue to run deficits for the foreseeable future – the pendulum is shifting in favor of the party's fiscal hawks after a decade on the defensive. Even if Kishida is unable to secure a second term as LDP president, any mainstream successor is likely to seek a balance between growth policies and fiscal consolidation that the

LDP's fiscal hawks are prepared to support. Nevertheless, as long as the LDP has a sizable conservative wing – and a standard-bearer in party leadership elections like Takaichi Sanae, whose platform in the 2021 leadership election was dovish – there will be loud voices in favor of fiscal dovishness within the party. And if the party loses an absolute majority after the next general election and has to govern in a broader coalition or, less likely, goes into opposition again, fiscal policy will likely be a point of friction within the party and between the LDP and its partners.

Copyright © 2024 Japan Foresight LLC, All rights reserved.

This communication was produced by Japan Foresight LLC. The information it contains is intended as general background research and is not intended to constitute advice on any specific commercial investment or trade matter, legal matter, or other issue. You should not rely upon it for such purposes. The views expressed here represent opinions as of this date and are subject to change without notice. The information has been obtained from sources believed to be reliable, but no guarantees can be given as to its accuracy, completeness, or reliability. This communication is provided for your sole use. You may not reproduce, circulate, store, or transmit this communication or any information in it, in any form or by any means, electronic or otherwise, without the prior written consent of Japan Foresight LLC. This material is protected by copyrighted law. By accessing this material, you agree to indemnify and hold harmless Japan Foresight LLC, its officers, employees, agents, and affiliates from any claims, liabilities, damages, losses, or expenses (including legal fees) arising out of or in connection with your use or reliance on the information provided herein. To the extent permitted by law, Japan Foresight LLC disclaims all liability for any direct, indirect, incidental, special, consequential, or punitive damages arising out of or in connection with the use or inability to use this material, even if advised of the possibility of such damages.

Japan Foresight LLC will make PDF versions of its research available at the Japan Foresight LLC archive.