
JAPAN IN 2002

An Up-and-Down Year, but Mostly Down

Robert Uriu

Abstract

Japan in 2002 continued to grapple with many of the same economic problems it has faced over the past 10 years, with a familiar lack of success. Although the economy has not imploded, as some feared last year, it is showing few signs of staging a sustained recovery. Prime Minister Koizumi Junichiro remained in office, but almost all of his efforts to reform the moribund economic system were watered down by resistance from affected groups. The foreign policy agenda was dominated by the growing crisis over North Korea's intensification of its nuclear weapons development program. This crisis cancelled out Koizumi's earlier progress at normalizing relations with Pyongyang.

The year 2002 was a rocky one for Japan. On the political front, the administration of Prime Minister Koizumi Junichiro entered its second year in office, but critics charged that he still had not achieved significant progress toward its goals of economic reform or revitalizing the domestic economy. Koizumi's numerous attempts to retake the initiative on reform were blunted soon after they were made. As a result, the Japanese economy continued to stagnate. Although the situation has stabilized to a degree, the underlying problems remained as bad as ever. The economy entered its third year of deflation, banks and many companies still operated under a mountain of debt, and the stock market reached lows not seen since the Nakasone administration, back in 1983.

In this gridlocked domestic context, regional relations in 2002 took center stage. Specifically, relations with North Korea saw some major develop-

Robert Uriu is Assistant Professor in the Department of Political Science at the University of California, Irvine.

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ments, including a historic trip by Koizumi to Pyongyang in September, the first ever by a Japanese prime minister. Koizumi's momentary triumph soon turned sour, however, following the North's surprise revelation that it had in fact not suspended its nuclear weapons development program during the 1990s. At the end of the year, Japan found itself again consulting with South Korea and the United States on the most appropriate approach to its enigmatic neighbor.

Domestic Politics: Stable but Static

With no major national elections and no surprise party realignments, 2002 was the least eventful year in Japanese politics since 1993, when the Liberal Democratic Party (LDP) lost its unchallenged hold on political power. The three-party coalition led by Koizumi remained firmly in control. Koizumi's LDP and its two junior partners, Komeito and the New Conservative Party, enjoyed solid majorities in both the Lower House and, following its electoral gains in the July 2001 election, the Upper House, as well.

In April, Koizumi marked the first anniversary of his taking office, recently a sign of longevity at the top of Japanese politics (the country has had 11 prime ministers in the past 14 years). But although he has survived, Koizumi has generally received poor marks for his failure to shake up the system or to revitalize the economy.

Just a year earlier, coming off his triumphant coronation as prime minister, Koizumi enjoyed a great deal of momentum. His strong rhetoric of reform resonated deeply with a public that seemed willing to bear the short-term pain of adjustment for the sake of long-term economic vitality. His promise to pursue economic reforms that would spare "no sacred cows" was widely seen as just what the country needed. And his image as a quirky, unconventional politician who was not beholden to any special interests added to his deep personal appeal. All of this added up to an unprecedented initial approval rating, initially around the 85% level, an incredibly high figure compared to other recent prime ministers. (In contrast, Koizumi's immediate predecessor, Mori Yoshiro, left office with an approval rating below 7%.) The groundswell of support for Koizumi thus seemed almost scary, seemingly reflecting a public that was close to desperate for anyone who could demonstrate strong, decisive leadership.

Whatever momentum Koizumi may have had in 2001, however, had largely dissipated a year later. None of his reform initiatives came close to matching his fiery rhetoric, and many of his proposals were subsequently watered down by entrenched interests. In January, Koizumi was forced to compromise with construction interests inside the LDP over his plan to drastically cut highway-related public works projects. Koizumi also supported a bailout of giant retailer Daiei, a company smothered in debt that many ana-

lysts saw as deserving of bankruptcy and restructuring; Koizumi's action thus belied his pledge to spare no "sacred cows."

Furthermore, his efforts to privatize the bloated and inefficient postal system, one of his main promises coming into office, fell far short of expectations. In July the Diet did pass a set of reform bills, one of which will establish a new public corporation in April 2003 that will assume the functions of the current government-run postal system, including mail delivery, postal savings, and life insurance. Another bill authorized the participation of private firms in some parts of the mail service business; critics, however, charged that restrictions on private services were so great that few companies would actually choose to participate. In any case, the perception was that Koizumi had been forced to compromise with vested interests and that the results did not match his original promises of drastic reform.

In an interview marking his first anniversary as prime minister, in April, Koizumi appealed to the public to be patient and to give him more time before judging his reform program. He pointed out that even the domestic "revolutions" carried out by British Prime Minister Margaret Thatcher and U.S. President Ronald Reagan in the early 1980s did not show immediate fruit—rather, the effects of their reform measures began to appear only in their second and third years in office. What Koizumi did not mention was that Thatcher and Reagan had each taken advantage of their initial momentum to push through some drastic, painful, and unpopular reform measures during their first year in office. In contrast, Koizumi seems to have squandered his initial momentum, perhaps irrevocably.

Great Expectations?

Although many have criticized Koizumi for his lack of leadership skills, it may be more appropriate to question the inflated expectations that originally surrounded him. Even his strongest campaign rhetoric was always vague on the specifics of how he intended to accomplish drastic change. And without a strong set of initial proposals that he could wield as his mandate, organized interest groups soon mobilized themselves and their political and bureaucratic allies and were quickly able to define the reform agenda. In Japan's world of what might be called "least common denominator politics," this was a recipe for continued gridlock. Indeed, it may be that no political leader will be able to fully achieve the daunting task of revamping the country's hidebound system. And Koizumi's "outsider" status—even within his own party—meant that he had to rely on unconventional means to overcome strong opposition. But he soon found that his one trump card, public support, was a weak one when it came to trench warfare with interest groups and their political and bureaucratic supporters. When it came down to it, strong support for drastic

reform came with a caveat: it seemed that everyone favored reform, but only if someone else was to bear the costs of adjustment.

Koizumi's image as a different politician who was truly committed to a reform agenda was also damaged at the end of January when he decided to dismiss his controversial but popular foreign minister, Tanaka Makiko. Tanaka, the daughter of one of the country's most famous political figures, Tanaka Kakuei, shared her father's reputation for being outspoken, gruff, and tough. Since her appointment in March 2001 as Japan's first-ever female foreign minister, Tanaka had battled with the Ministry's powerful bureaucrats, most notably over the inappropriate use of internal "slush funds." These struggles left many of the Ministry's top officials highly embarrassed and increased internal animosity toward Tanaka. But the sight of Tanaka going toe to toe with the Ministry's old guard also made her a highly popular figure in the public's eye.

In the aftermath of an international conference for the reconstruction of Afghanistan, held in Tokyo in January 2002, however, a controversy arose over a Ministry decision to bar two nongovernmental organizations (NGOs) from participating, allegedly because of their anti-government views. In the following week, the Ministry was embroiled in a public squabble over who had been responsible for the decision, pitting Tanaka against the top Ministry bureaucrat, Deputy Foreign Minister Nogami Yoshiji, and an influential LDP politician, Suzuki Muneo. In Diet testimony and public statements, the three essentially accused each other of lying. On the 29th, Koizumi intervened, citing the disruption the dispute was causing, and unceremoniously fired Tanaka. To appear impartial, Koizumi also fired Nogami and forced Suzuki to relinquish his role as chair of a Diet subcommittee.

The public reaction was swift. In an online poll conducted by the *Asahi shimbun*, more than 70% of respondents opposed Tanaka's firing. Koizumi's own overall approval rating plunged from around the 70% mark down to 46.9%, according to another poll conducted by the *Yomiuri shimbun*. The hit on Koizumi's popularity was not only due to Tanaka's popularity but also the flimsy pretext he used for firing her, and above all the perception that he was siding with the bureaucratic old guard rather than his reformist ally. Tanaka's subsequent criticism of Koizumi for betraying his agenda of reform underscored these perceptions. (In the aftermath of her firing, Koizumi approached another woman, the well-respected Ogata Sadako, who had recently finished a decade-long tenure as the United Nations High Commissioner for Refugees; Ogata turned him down. Finally, Koizumi turned to a third woman, Kawaguchi Yoriko, the environment minister, who accepted. Later in the year, Tanaka was suspended by the LDP over allegations that she had misused public funds in paying the salaries of her personal secretaries. Al-

though it was a relatively minor infraction, Tanaka was forced to give up her House seat. Her political career, however, is far from finished.)

Although there were no major national elections held this year, six smaller by-elections for recently vacated seats were held in November. The ruling coalition ended up winning five of the six seats being contested, but the more significant news was that the voter turnout rate was the lowest in history, at 30%, reflecting the continuing growth of political apathy in the country.

The results also cast further doubts on the long-term viability of the main opposition party, the Democratic Party of Japan (DPJ), which continued to struggle with low public support rates and doubts about its leadership. In September, Hatoyama Yukio defeated the party's other main leader, Kan Naoto, in a race for party president. But Hatoyama himself stepped down in December, following the results of the by-elections, with Kan taking over as party president. The party's task before the next Lower House election is to define the party's identity in the minds of the voters, and to present a clear-cut alternative to the LDP. Unfortunately for the DPJ, these are the same tasks that the party faced when it was first formed back in 1996. And now the job is even tougher, as the LDP's Koizumi has stolen some of the opposition's thunder on reform.

Despite widespread perceptions that Koizumi had not achieved enough progress on reform, the public was still wondering if there is any viable alternative. Not many had faith in the opposition, and no one else in the LDP is seen as sincerely committed to reform. The question remains, if not Koizumi, then who?

The Economy: Recovering or Still Stagnant?

Koizumi's leadership abilities were also questioned in his handling of the economy. Despite his considerable attention to revitalizing the economy, every initiative he took seemed to be blunted before it got off the ground. It was as if market actors have become almost numb to any new policy initiative even before it is made. In a phrase seen in a great number of analyses, Japan remained "in the economic doldrums."

The good news first. The banking system did not implode in 2002, as some feared a year ago, and the economy did not go deeper into recession. In fact, the economy staged a modest rebound during the year. After a flat first quarter, the country's gross domestic product (GDP) grew over the next six months, achieving an annualized gain of 2.6% in the second quarter followed by a 3.0% upswing in the third quarter. Furthermore, consumer spending rose every month from June to September, with the latest figures showing spending in September up 5.4% compared to the previous year.

These signs of recovery, however, were more than outweighed by other negative trends: Japan's recent period of deflation entered its third year. In October the government announced that the Consumer Price Index had declined for the 36th straight month. Deflation represents a truly vicious cycle in which falling prices erode corporate profits and raise the real value of debt, making the repayment of loans more difficult. Subsequent wage or job cuts lower personal incomes and further erode consumer confidence and thus consumer spending, and so on.

Unemployment remained above 5% for the entire year, recording a 5.4% mark in the third quarter. Although this was slightly lower than the post-war record high of 5.6%, set in December 2001, it is a high figure for an economy that in its past became accustomed to very low rates of unemployment.

The stock market continued to decline. The Nikkei Index plummeted in early November 2002, reflecting another spate of concerns about the nation's banking system, at one point losing some 12% of its value in a period of two weeks. In early November, the Nikkei hit a series of 19-year lows, at one point falling to the ¥ 8,303 level. This put the index at only 21% of its peak value, achieved in December 1989.

The other major component of the bubble economy of the 1980s, land prices, also remained depressed. The National Tax Agency in August announced that land prices were down 6.2% compared to the previous year, the 10th straight annual decline. Overall, national land prices have fallen around 80% from the peak in 1988.

For all of these reasons, analysts remained skeptical about Japan's growth prospects in the coming years. In November 2002, the Organization for Economic Cooperation and Development (OECD) released an assessment that Japan would continue to experience essentially zero growth at least through the end of 2004.¹ In addition to the continuing banking crisis, discussed below, analysts also pointed to a likely decline in exports in the coming months. Exports had recently been one of the better-performing parts of the economy, but in the first half of 2002 they were hurt by a rise in the value of the yen. By fall, the yen-dollar exchange rate hovered in the 119–122 range, up from the 135 yen per dollar level it had reached in February. More alarmingly, problems were expected in the U.S. economy, Japan's largest export market. Not only did exporters take a hit due to the closure of America's West Coast ports in early October, but analysts also expected a serious dropoff in U.S. consumer spending in the year's final quarter.

The most salient problem facing Japan is the same one it has grappled with for more than a decade: the huge numbers and amounts of nonperforming

1. OECD, *Economic Survey of Japan*, 2002, <<http://www.oecd.org/pdf/M00036000/M00036495.pdf>>.

loans held by the country's banks. By the summer, Koizumi's handling of this issue had become a litmus test of sorts for his handling of economic reform. Part of the difficulty was that experts did not agree even on the magnitude of the problem, much less how best to solve it. In November, the government revealed that nonperforming loans at the 15 largest banks totaled around \$395 billion. Although this was more than twice the level reported a year earlier, it was still substantially lower than most outside observers believed. Estimates of the actual total amount of nonperforming loans ranged from \$400 billion to \$1 trillion or even higher. Essentially, all agree that the problem is a big one, but no one knows just how big it really is.

The Banking Reform Debate

Through the summer, Koizumi's administration remained divided over how best to handle the crisis. Those in favor of harsh banking reform, including most professional economists as well as the Bank of Japan (BOJ), insisted that structural reform was needed, including the provision of new public funds to recapitalize the system's weakest banks. The injection of public funds not only would allow these banks to write off their nonperforming loans, it also would allow for closer government oversight of their operations, in extreme cases including the replacement of current management or other steps toward restructuring. Others in the government, however, insisted that the banks already had adequate capital and thus could deal with their nonperforming loans on their own without further government intervention. Advocates of this position included Yanagisawa Hakuo, the head of the government's bank regulatory agency, the Financial Services Agency (FSA). Yanagisawa insisted that the real problem was the stagnant economy and called on the BOJ to increase the money supply in order to reflate the domestic economy. For most of the year, Koizumi had sided with the FSA.²

Things began to change in the fall, however. First, the BOJ announced in September that it would provide some \$16 billion to purchase private stocks held by domestic banks. Many described this unprecedented action as a "wake-up call" designed to call attention to the repeated failure of the banks (and by extension, the FSA) to deal with the nonperforming loan problem. Then in October, Koizumi sided with the reformers when he decided to fire Yanagisawa as FSA head and replace him with a well-known advocate of reform, Takenaka Heizo. Takenaka, a former academic economist who had been one of Yanagisawa's harshest critics, now called for strong measures to deal with the banking crisis, including accounting changes that would force banks to a lower and more realistic statement of their assets, which in turn

2. The tension between the BOJ and FSA is discussed in Peter S. Goodman and Akiko Kashiwagi, "Japan Bank Prepared to Launch Bailout," *Washington Post*, October 12, 2002.

would force them to confront the nonperforming loan problem more squarely. This and other steps would also compel banks to cut off some of their weakest clients, many of whom continued to survive only because the banks were still willing to extend additional loans. Takenaka also used rhetoric reminiscent of the early days of the Koizumi administration, arguing that no bank or borrower should be deemed too big or too important to fail. Many took these words as a sign that Koizumi had retaken some of the initiative on reform.

Takenaka's proposals, however, ran into immediate and concerted opposition. LDP politicians soon pressed Takenaka to apologize for his statement that no company was too big to fail, an attitude that was not surprising given that three of the LDP's main support groups—construction, retail, and real estate—accounted for nearly two-thirds of the total amount of nonperforming loans.³ Conservatives also pushed hard to take some of the bite out of Takenaka's proposals. The four main opposition parties also got into the act, submitting a motion of censure and demanding that Takenaka resign.

In November, when Takenaka finally revealed his revised bank reform plan, the media and most analysts were nearly unanimous in the judgment that key reform proposals had been so weakened that the entire plan was nearly worthless. At the end of the year, the jury is still out, however. Robert Feldman of Morgan Stanley was one of the few analysts who gave the Takenaka plan high marks for achieving some substantial reforms, including stricter standards for assessing loans, and stronger measures for the government to deal with financial institutions in distress.⁴

Even if the banking crisis were somehow cleared up, however, the problem of Japan's deflationary economy would still remain. Analysts all seemed to have a favorite solution, ranging from further fiscal stimulus and monetary easing, to tax cuts or structural reforms, but no consensus emerged as to which combination of remedies was the right one—or indeed if any such combination actually existed. For instance, with government debt already immense—the OECD estimated that public debt stood at 150% of the country's GDP—the government was constrained in how much it could utilize further fiscal stimulus. Still, in late November, Koizumi announced a supplementary budget totaling ¥ 3 trillion (\$24 billion), half of which was to be used for public works spending. And as part of his latest “anti-deflation” package, his third so far, Koizumi also moved to create a new ministerial post for “industrial revitalization,” and named a veteran LDP legislator, Tanigaki Sadakazu, as its first head. The new agency's exact functions and mission have yet to be determined.

3. Ken Belson, “Japan's Economy Czar Caught in Bitter Revolt,” *New York Times*, October 25, 2002.

4. Feldman's commentary, “Total Triumph for Takenaka,” can be found on Morgan Stanley's website, at <http://www.morganstanley.com/GEFdata/digests/20021108>.

Foreign Relations: Warm and Then Cold

The up-and-down nature of 2002 was also evident in relations with North Korea. The beginning of the year was dominated by tensions surrounding what Japan referred to as the “mystery ship,” which its coast guard had chased and sunk 240 miles off Japan’s southwest coast back in December 2001. At the time, Tokyo suspected that the boat, disguised as a fishing trawler, was on some sort of spy mission for North Korea, a charge that Pyongyang vehemently denied. Japan conducted the salvage operation and by September was able to reveal evidence that the ship was of North Korean origin, although its exact mission remained unknown. Among the 700 items found on the ship were North Korean cigarettes, items bearing the image of former North Korean leader Kim Il Sung, rocket launchers that bore Korean writing, and a large number of weapons and ammunition.

At the same time, Japan and others in the region were disturbed by the decision of U.S. President George Bush to lump North Korea together with Iraq and Iran in his “axis of evil.” Japanese diplomats pressed Bush administration officials to clarify that the president had no intention of utilizing preemptive military force against North Korea, as he was clearly contemplating in the case of Iraq. Japan instead advocated the continued use of diplomacy and inducements to deal with Pyongyang.

In April, Koizumi indicated that he was interested in establishing diplomatic relations with North Korea, which the two countries have never shared. Informal talks held over the summer touched on various complicating issues, including the question of the mystery ship and the resumption of food and economic aid. The biggest stumbling block, however, was allegation that North Korea had abducted at least 11 Japanese nationals in the 1980s, an issue that had derailed similar normalization talks two years earlier. But this time, enough progress was made so that high-level talks could be convened at the end of August. Koizumi announced soon thereafter that he would visit North Korea in September, for the first face-to-face meeting between leaders of the two countries.

During this meeting, held on September 17, North Korean leader Kim Jong Il surprised the Japanese delegation by acknowledging that North Korea had indeed been involved in abducting 13 Japanese nationals in the 1970s and 1980s, and that at least five had survived and were still living in North Korea. Kim apologized for these actions, promised that “those responsible” had been or would be harshly punished, and promised not to allow such actions to happen again. The summit also resulted in an agreement to proceed with normalization negotiations and a promise by Kim to extend the North’s moratorium on missile testing beyond 2003.

Public reaction in Japan was mixed, with some expressing outrage over North Korea’s actions. For the most part, though, the reaction was positive.

In an overnight poll by the *Asahi shimbun*, some 81% of respondents viewed the summit results favorably, and Koizumi's job approval rating immediately leapt from 51% to 61%. The euphoria following the summit was short-lived, however, as the unpredictable North Korean government in early October 2002 admitted that it had secretly continued its nuclear weapons program, and specifically its efforts to enrich uranium, in violation of agreements it had entered into in 1994. Koizumi was further hurt by press reports that U.S. officials had briefed him about the North's uranium enrichment efforts well before his September 2002 summit trip. Koizumi was thus criticized not only by the opposition but also by conservatives in the LDP for failing to press the issue with Kim more strongly.

Another problem for Koizumi was continuing public anger at North Korea over the plight of the five returnees, who had arrived in Japan on October 15 for a scheduled two-week stay. The nation was emotionally transfixed as it watched the five reunite with relatives, receive passports, and, for one, even a belated high school diploma. At the end of the two weeks, the Japanese government bowed to public opinion and announced that it was "too early" to allow the five to return to North Korea, arguing that they needed more time to "make up their own minds freely." In late December, the five announced their decision to remain in Japan, asking that the families they had left behind in North Korea be allowed to join them.

Despite these setbacks, Koizumi was not ready to embrace a harder line toward the North, and worked to make sure the United States did not do so either. The Bush administration at that point found itself in an awkward situation, having pointed to a similar nuclear weapons program in Iraq as a means to convince the U.S. Congress to pass legislation backing the use of military force against that nation. If intelligence suspicions were correct, Iraq's "partner" in the "axis of evil," North Korea, was even further along in this effort. Koizumi, along with South Korean President Kim Dae Jung, cautioned the Bush administration against a military solution to the North Korean crisis. Koizumi also announced that he would continue his efforts to establish diplomatic ties, albeit in a much more cautious frame of mind.

The first round of normalization talks was convened at the end of October, but the atmosphere had already been poisoned by the events of the preceding two weeks. The Japanese side raised the stakes on the abduction issue by announcing that the five returnees would remain in Japan "indefinitely," and called on Pyongyang to allow their immediate families, who had been forced to stay behind in North Korea, to leave. Japan also pressed the North to abide by its prior commitments, most notably in putting an end to its nuclear weapons program. The North Korean side accused Japan of breaking its promise to release the returnees and for withholding economic, food, and energy aid. North Korea also issued a bald threat in early November that it would resume

its testing of ballistic missiles if the two did not make more progress in their normalization talks. In response, officials in Japan speculated openly on the need to cooperate more actively with the United States to develop and deploy a theater missile defense system. By late December, the growing crisis over North Korea's efforts to intensify its nuclear weapons program, including the expulsion of U.N. inspectors, had completely overshadowed all of Koizumi's efforts to create a more constructive relationship with the North. At year's end, Japan and its allies debated how best to deter the North from developing nuclear weapons without precipitating a major conflict on the peninsula.

Regional Relations

Relations with the United States continued to be warm, though tinged with various disagreements. Japan continued to be a supportive ally in the U.S.-led war on terrorism. Pursuant to a bill passed in late 2001, Tokyo had already sent a number of naval vessels to the Indian Ocean to support U.S. forces in the war effort in Afghanistan. In May 2002, and again in November, the government agreed to extend these efforts for another six months. And in December, the government took the controversial step of dispatching one of its Aegis-class destroyers to the Gulf, a move that the U.S. favored but one that Japan had been resisting for a year. Japan was also given high marks by the U.S. government for its cooperation in other anti-terror efforts, including the freezing of funds owned by suspected terrorist organizations, and the provision of information and intelligence.

The issue of a potential war with Iraq, however, was a different matter. Japanese government officials openly opposed the unilateral use of force by the United States, urging instead the utilization of the security apparatus of the United Nations. Japan thus supported the Bush administration's decision to at least consult with the U.N. Security Council, and urged Iraqi President Saddam Hussein to cooperate with U.N. weapons inspectors, which would remove the main pretext for war. Public opinion remained strongly opposed to military action against Iraq; an *Asahi shimbun* poll in September showed that some 77% of respondents opposed any U.S. attack. In spite of its obvious reluctance, the Japanese government by the end of the year was quietly signaling that it would support the U.S. in the event of a conflict in Iraq.

Other aspects of U.S.-Japan relations were kept low key. In May the two countries quietly marked the 30th anniversary of the reversion of Okinawa to Japanese control. Local Okinawa officials used the occasion to again call for some progress on reducing the U.S. military presence on the island. Meanwhile, U.S. forces there became involved in some highly publicized near-accidents, and crimes by U.S. military personnel continued to make headlines. Another bilateral sore point, the accidental sinking of a civilian vessel, the *Ehime Maru*, by a U.S. submarine off the coast of Hawaii in February

2001, also appeared to have been settled. By the end of 2002, the U.S. Navy had agreed to pay compensation totaling \$13 million to all but two of the families of the victims in the *Ehime Maru* incident, in addition to its earlier payment of \$12 million to Ehime Prefecture. The Navy was expected to conclude negotiations with the remaining families in early 2003. And finally, the two governments downplayed a potentially embarrassing public relations gaffe. In February, a Department of Defense list of countries that had supported Washington in the war in Afghanistan inadvertently failed to include Japan, an omission that reminded many of a similar incident following the 1991 Gulf War. This time, the United States responded quickly to a protest from the Foreign Ministry, adding Japan to the list the following day.

Relations with China also remained stable in 2002, although in a context that has gradually worsened over the past decade. In May, the two governments sparred over the actions of Chinese police in entering the Japanese Consulate in Shenyang to forcibly remove a group of five North Koreans who were seeking asylum. The Japanese government protested what it saw as a violation of its sovereign space. The public furor in Japan quieted down once the five were allowed to leave China for the Philippines and then South Korea. The fallout of this incident was felt more by foreign ministry personnel, who reportedly had given the Chinese police permission to enter the compound. In an unrelated move, the Japanese government announced in September that it was cutting its foreign aid to China for the second straight year. Although Japan was to cut its overall aid budget by about 10%, aid to China was to be reduced by some 25%.

At the end of the year, the political world continued to debate a series of bills that would clarify the parameters of Japan's military response in the event of an "armed attack" on the country. These bills had been debated in the Diet since being submitted in April but remained stalled over opposition worries that the bills' language was dangerously vague. Specifically, debate revolved around the provision that would have authorized military action when an armed attack was deemed to be "imminent" or even "anticipated." At the end of the year, the LDP-led coalition was continuing to redraft the legislation for further consideration by the Diet.

On the international economic front, Japan in May joined the European Union in threatening to impose up to \$4.9 billion in tariffs on American steel after the Bush administration announced in March that it was imposing protective tariffs to safeguard American steel producers. Japan called Bush's action a violation of the rules of the World Trade Organization (WTO), which the administration denied. Tokyo soon dropped its threat after the U.S. government agreed to exempt certain Japanese steel products. At the end of the year, both sides awaited a formal WTO dispute panel decision on the legality of Washington's safeguard measures.

In November, Japan stepped up its efforts to establish a free trade agreement (FTA) with the Association of Southeast Asian Nations (ASEAN). Earlier in the year, Japan and Singapore had signed their first-ever FTA, negotiated at the end of 2001, and in January 2002 Koizumi announced his interest in a regionwide free trade zone. If achieved, this would represent the largest free trade area in the world, encompassing some 1.7 billion people. Koizumi's announcement, however, came some two months after China had announced its own plan to negotiate a regionwide FTA within 10 years. And while Japan made little progress in the ensuing months, in early November China was able to announce that it was set to begin negotiations with ASEAN based on its original proposal. The very next day, Koizumi declared his intention of establishing a "comprehensive economic partnership" with the economies of the region, a move seen by many to be a belated response to China's initiative. Furthermore, skeptics pointed out that negotiating an FTA with an economy like Singapore was relatively easy because it was not an exporter of agricultural goods. Japan's protectionist farm lobby, however, was expected to oppose the inclusion of agricultural trade in any regionwide FTA.

Conclusion

The biggest highlight of the year for Japan was the successful co-hosting of the 2002 World Cup tournament in conjunction with South Korea. Both governments were relieved that the event went off with almost no hitches, and that it received generally positive reviews internationally. Furthermore, teams from both of the co-hosts advanced farther than any Asian team ever had, with Japan being eliminated in the Round of 16 and South Korea making it all the way to the semifinals. Japanese television media, at least, received good marks for sportsmanship for its genuine appeal to viewers to root for South Korea even after Japan had been eliminated. There was a downside, however, as the event did not lead to a boost in the economy or much improvement in Japan-South Korean relations, as some had hoped.

With the Japanese economy still unable to escape the pall of pessimism that has surrounded it for more than a decade, and Koizumi's leadership abilities still in question, it is by no means clear that 2003 will see substantially more ups than downs compared to 2002. Much will depend on whether Koizumi is ultimately successful in regaining his lost momentum on reform and whether Japan and its allies can resolve the most recent North Korean crisis.