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ASIA-PACIFIC: Mandarins Reclaim the Bank of Japan

By David Ivison in Tokyo

Junichiro Koizumi, Japan's prime minister, has spent recent weeks insisting he wants a "dedicated deflation fighter," preferably from the private sector, as Bank of Japan governor.

Instead -- to the resigned bewilderment of many -- he chose Toshihiko Fukui, an establishment figure who has been at the bank for four decades, and left dedicated deflation fighters such as Nobuyuki Nakahara, a former bank board member, fuming on the sidelines.

The decision sends out a strong signal that all is not as it seems. As government publicity starts to present Mr. Fukui as a deflation fighter, further clues to his nomination are more likely to be found in the corridors of the Ministry of Finance, the meeting rooms of the bank and the dining rooms of the business elite.

"This decision represents the true re-emergence of the rule of the bureaucrats in Japan," said one commentator close to the selection process. "The Ministry of Finance has reasserted its control over the central bank."

The morning bulletin of the G7 Group of analysts offered this interpretation of events: "This is a classic kabuki dance reminiscent of the days when the nation's powerful mandarins ruled. Top finance ministry and bank mandarins would get together and hand-pick the next BoJ governor.

"Then they notified the PM of their decision, while whispering the name in the ears of business leaders. Business leaders played the role of cheerleader to help create national consensus and the prime minister acted as if he had named the governor by respecting the consensus. The Fukui-finance ministry alliance is following that choreography."

The initial steps in this particular dance have their roots in the concept of an inflation target, which the ministry fears, as it would make servicing Japan's enormous government debt -- about 140 per cent of gross domestic product -- even more difficult.

Faced with the prospect of a Koizumi-style maverick getting the job, the ministry mobilised its forces behind Mr. Fukui, who is against an inflation target.

This influence showed in the decision by powerful business lobby groups to back Mr. Fukui, helped by tacit nods from bank officials, themselves terrified of a wildcard appointment.

Conservative establishment members of the Liberal Democratic party were also brought on board, primarily through ministry lobbying of anti-Koizumi forces within the Hashimoto and Horiuchi factions, which numerically dominate the LDP.

So extreme was the collusion on the part of the establishment to get their man in place that a highly unusual decision to use a campaign of open letters was started by anti-Fukui forces to try to persuade lawmakers to reject him. The letters to politicians drew attention to Mr. Fukui's "shortfalls" in an attempt to expose the behind-the-scenes dealing.

One official close to the selection process said the appointments of the two deputy governors also reveal the Ministry of Finance's sleight of hand, especially through the choice of Toshiro Muto, former vice-minister.

Mr. Muto's title does not do him justice. He is, said an official, one of Japan's most influential and politically astute bureaucrats. "The alliance between Mr. Fukui and Mr. Muto gives the Ministry of Finance far greater influence over the bank."

In a gesture to Mr. Koizumi to ensure that he did not lose all credibility, the official said he was permitted to appoint Kazumasa Iwata as the other deputy governor. A cabinet office member and inflation "targeter," Mr. Iwata is there to represent "new thinking."

Unfortunately, as the official said, he will be outvoted by eight votes to one at every stage by the nine-member BoJ policy board.

"One has to conclude that Mr. Koizumi wanted to placate the establishment and the markets by making Mr. Fukui head, but wanted to ensure that the monetary policy board got shaken up and that different points of view got a better hearing," said Marshall Gittler, strategist at Deutsche Bank.

The official said: "Now we know that Mr. Koizumi is no longer a reformer."