

Will Abenomics Restore Japan's Growth?

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5 Questions on Abenomics

1. What is Abenomics?
2. Will Abenomics restore growth?
 - Why did Japan stop growing?
 - Will Abenomics succeed in regenerating growth?

What is Abenomics?

Three Arrows

 Expansionary Monetary Policy

 Flexible Fiscal Policy

 Growth Strategy

Monetary Expansion

- # Kuroda replaced Shirakawa as the BOJ Governor
- # Introduction of Quantitative and Qualitative Easing (April 4, 2013)
- # Achieve 2% inflation target in 2 years
- # Double the amounts of monetary base, long-term JGB holdings, and ETF holdings in two years
- # Double the average remaining maturities of long-term JGB holdings
- # “These effects will support the positive movements that have started to appear in economic activity and financial markets, contribute to a further pick-up in inflation expectations that appear to have risen, and lead Japan's economy to overcome deflation that has lasted for nearly 15 years.”

Fiscal Stimulus

- # Supplementary budget for FY2012: ¥13.1 trillion
 - ¥3.8 trillion for Reconstruction/Disaster Prevention (public works)
 - ¥3.1 trillion for Growth Policy (including farm and SME subsidies)
- # ¥7.8 trillion of new bond issues
- # FY2013 budget: ¥92.6 trillion: ¥2.3 trillion over the initial budget of FY2012
- # New bond issues (¥42.9 trillion) slightly below the expected tax revenue (¥43.1 trillion), but this does not include Special Case Bonds for Pensions (¥2.6 trillion)

Fiscal Consolidation Plan

- “Medium Term Fiscal Plan” (August 8, 2013)
 - A. Reduce the budget deficit to 3.3% of GDP by fiscal year 2015 (half of the level of fiscal year 2010)
 - B. Eliminate the budget deficit by fiscal year 2020
- “Trial Calculation Concerning the Economy and Public Finance in the Medium to Longer Term” (August 8, 2013)
 - If the 2013-2022 growth rate is 3.4% per annum, A will be achieved but not B.
 - If the 2013-2022 growth rate is 1.3% per annum, A will not be achieved, either.

Growth Strategy

- # “Japan Revitalization Strategy” JAPAN is BACK
(approved by the Cabinet on June 14)
- # During the next 10 years:
 - 3% average annual nominal growth
 - 2% average annual real growth
 - ¥1.5 million increase in nominal national income per capita
- # Three action plans
 1. Industry Revitalization Plan
 2. Strategic Market Creation Plan
 3. Strategy of Global Outreach

Is Abenomics New?

- # Not really
- # Standard policy to get out of recession and restore growth
- # Combination of aggregate demand policy and supply side policy for growth
- # It is new in Japan, where the monetary authority was reluctant to expand aggressively
- # It could be new in Europe, where fiscal austerity has been a problem

Will Abenomics Restore Growth?

- # Goal of Abenomics: **Overcoming Deflation** (デフレ脱却)
- # Two meanings of “Deflation” (デフレ)
 1. Deflation in a narrow sense
 - Persistent decline of the price level
 - Caused by shortage of aggregate demand (relative to potential output)
 2. Deflation in a broad sense
 - Stagnation of the economy accompanied by persistent decline of the price level
 - Demand shortage + decline of potential growth rate
- # “Deflation” in Japanese policy discussion is closer to 2.
Hence restoring growth is important

Why Did Japan Stop Growing?

- Based on two NIRA Reports with Anil Kashyap (Booth School of Business, University of Chicago)
 1. “Why Did Japan Stop Growing?” (January 2011)
 2. “Policy Options for Japan’s Revival” (June 2012)(Both available at <http://www.nira.or.jp/english/papers/index.html>)
- Book in Japanese that combined two reports (with some updates) has been published by Nihon Keizai Shimbun Shuppan-sha, 2013) (http://www.kinokuniya.com/us/index.php/fbs003?common_param=9784532355470)
- Our framework is useful in evaluating Abenomics

Why Did Japan Stop Growing?

- # It is partially a result of convergence: Japan finished the catch-up phase of the growth
- # But some countries (such as US and UK) seem to continue to grow even at high level of GDP per capita
- # Japan slowed down more than those countries because:
 1. Aging proceeded more rapidly
 2. Export-led growth strategy ran its course
 3. Government made economic policy mistakes
 - a) Protection of zombies that hurt productivity growth
 - b) Other regulatory policies that also impaired productivity growth
 - c) Macroeconomic policy mistakes

Will Abenomics Restore Japan's Growth?

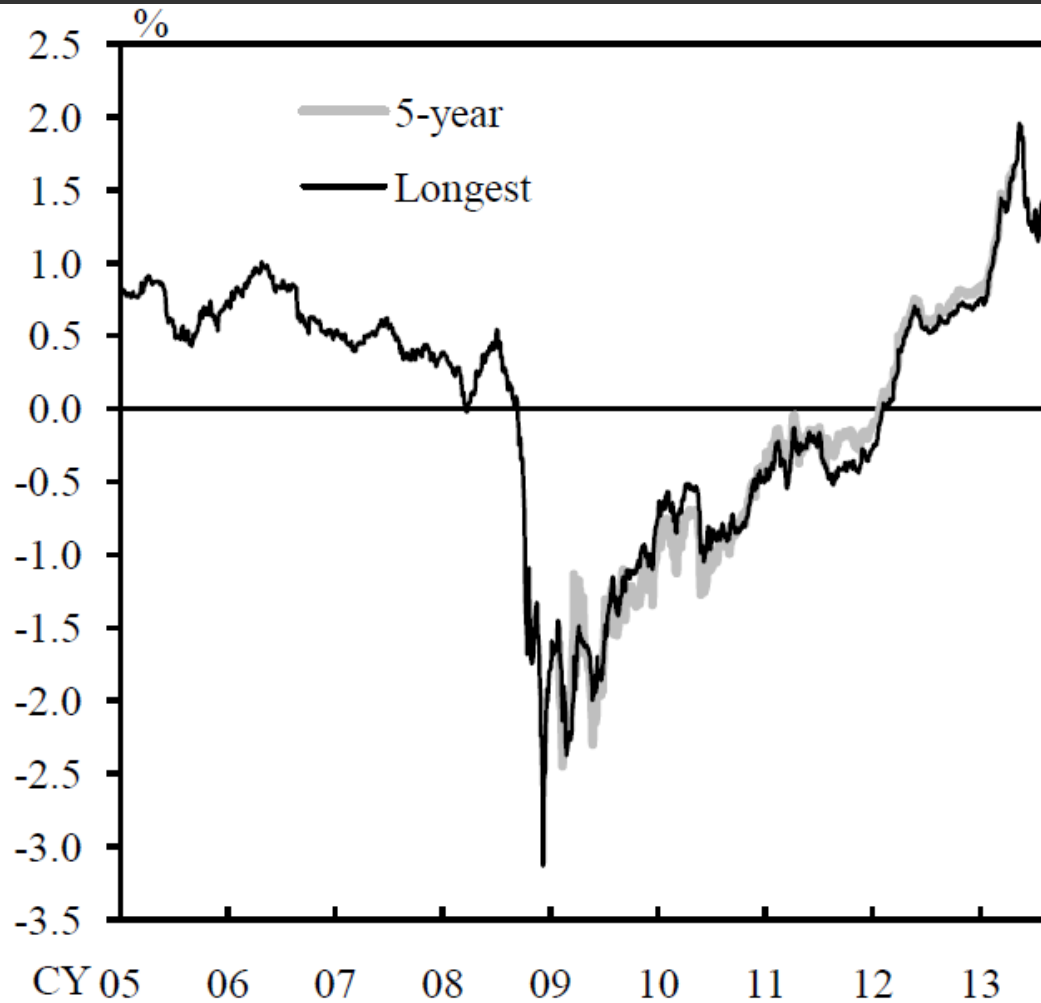
- # Because there are structural causes for Japan's growth slow down,
- # Expansionary macroeconomic policy alone cannot restore economic growth
- # Japan needs structural reform to stimulate growth
- # Third arrow is critical

Will Abenomics Succeed?

(1) Monetary Expansion

- ✦ FRB, BOE, and ECB all expanded the monetary policy much more aggressively than BOJ in the aftermath of the global recession of 2007-2009
- ✦ Aggressively expansionary monetary policies were successful at least in avoiding deflation
- ✦ QQE is also likely to succeed in stopping deflation (in the narrow sense of falling price level)
- ✦ Some signs of increasing inflation expectation (at least in financial markets)
- ✦ Little signs for wage increase, yet
- ✦ Monetary policy alone would not restore the growth

Break Even Inflation Rate for Japan



5. Will Abenomics Succeed?

(2) Fiscal Stimulus

- ⌘ Expansionary fiscal policy can be very useful especially when the effectiveness of monetary policy is constrained by the zero bound for nominal interest rate
- ⌘ But, unlike Europe, Japan has tried expansionary fiscal policies repeatedly after the collapse of the bubble in the early 1990s
- ⌘ As a result, Japan has the largest government debt (relative to GDP) among major economies
- ⌘ Financial market has allowed Japan to accumulate public debt without demanding high interest rate because it expects the Japanese government to consolidate the budget before it is too late
- ⌘ Risk that fiscal stimulus at this point leads to a drastic change of the market expectation

5. Will Abenomics Succeed?

(2) Fiscal Stimulus

- # Given the current condition of high government debt, the second arrow is in the wrong direction
- # Government needs to show a credible plan of budget consolidation in the medium run
- # Published Medium Term Fiscal Plan is insufficient

Japan Revitalization Strategy

- # Three action plans
 1. Industry Revitalization Plan
 2. Strategic Market Creation Plan
 3. Strategy of Global Outreach

1. Industry Revitalization Plan

Emergency Structural Reform Program (to encourage economic restructuring)

1. Stimulate business investment
2. Establish a system which enables challenges to frontiers being free from anxiety
3. Increase new entry and exit of firms to 10% (from the current 5%)
4. Encourage corporate restructuring
5. Encourage globalization of Japanese companies

Employment system reform

1. Shift from policy of employment stability to labor fluidity
2. Use private sector employment/recruitment agencies
3. Diversification of employment contracts
4. Promote advancement of women in the job market
5. Promote employment of the young and the old
6. University reforms
7. Strengthen development of human capital capable of operating globally
8. More use of high skilled foreign workers

1. Industry Revitalization Plan (continued)

■ Promotion of scientific and technological innovation

1. Strengthen the Council for Science and Technology Policy's functions as headquarter
2. Establish the Strategic Innovation Program
3. Innovative Research and Development Support Program
4. Enhance function of national research institutes
5. Funding of research support staff at research institutes
6. Public-Private Joint Research and Development
7. Improve intellectual property and standardization strategies

■ Creation of the world's leading IT society

1. Deregulation in IT industries
2. Allow private sector to use public databases; Online public administrative services
3. Government projects to use IT to achieve safety and convenience
4. Develop the world's top-level communication infrastructure
5. Promote cyber-security measures
6. Develop human capital with IT skills

1. Industry Revitalization Plan (continued)

■ Improve Japan's international competitiveness as a business hub

1. Establish National Strategy Special Zones
2. Utilize Public Private Partnership and Private Finance Initiative
3. Invest in industrial infrastructure such as airports and harbors
4. Improve the competitiveness of cities
5. Invigorate financial and capital markets
6. Reform on public pension funds management
7. New energy policy; reformulate environmental policy

■ Small and Medium Enterprises Reform

1. Network and brand strategies for under-utilized resources in regional economies
2. Increase entries and exits of small and medium enterprises
3. Support for SMEs that enter the growth markets
4. Support for SMEs that expand internationally

2. Strategic Market Creation Plan

▣ Lengthen the nation's healthy life expectancy

1. Enhance effective preventive care services and health management
2. Promote medicine-related industries
3. Establish access to better medical care and nursing care

▣ Realize clean and economical energy demand and supply

1. Promote supply of clean and economical energy
2. Support efficient distribution of energy through competition
3. Promote wise consumption of energy

▣ Build safe, convenient and economical next-generation infrastructure

1. Provide safe and resilient infrastructure at low cost
2. Build safe and comfortable transportation system for people and goods

2. Strategic Market Creation Plan (Continued)

- # Build regional communities that use their unique local resources to appeal to the world (agriculture and tourism)
 1. Promote production of world's best quality agricultural, forestry and fishery products and food produce
 2. Use each region's potential to invite many tourists from the rest of the world

3. Strategy of Global Outreach

- # Build strategic trading relations and promote economic partnership
 1. Promote economic partnerships such as TPP and FTAs
- # Strategic initiatives for obtaining overseas markets
 1. Export infrastructure and secure natural resources
 2. Support potentially international SMEs
 3. Promote Cool Japan
- # Improve infrastructure concerning funds and human resources to support economic growth
 1. Promote inward FDI
 2. Strengthen development of human capital capable of operating globally

Preliminary Evaluation of Japan Revitalization Strategy

- # Some good ideas, including
- # Encourage corporate restructuring (Promote management reform to dramatically improve earning capacity; Promote reorganization in the field that has excessive supply structure; Strengthen corporate governance; Support business takeover and succession)
- # Shift from policy of employment stability to labor fluidity (Increase budgetary resource to support labor movement; Review the employment insurance system to support re-education of the young; Enhance intermediary functions of temporary transfer/ transfer by the Industrial Employment Stabilization Center of Japan)
- # Establish a system which enables challenges to frontiers being free from anxiety (Creating a system to confirm legality; Establishing a system of special arrangements for Corporate Field Tests to allow testing of new products and technology; Increasing a sense of security concerning the use of new Businesses)




Preliminary Evaluation of Japan Revitalization Strategy




- # Similarly, the followings can also be growth enhancing if implemented right
 - Promote advancement of women in the job market
 - Promote employment of the young and the old
 - More use of high skilled foreign workers
 - Deregulation in IT industries
 - Allow private sector to use public databases; Online public administrative services
 - Develop the world's top-level communication infrastructure
 - Promote economic partnerships such as TPP and FTAs

Preliminary Evaluation of Japan Revitalization Strategy

- # Many terrible ideas
- # Strategic market creation plan is just an old fashioned industrial policy
- # Even many potentially useful ideas have flavor of industrial policy
- # Worse, the strategy lacks the focus
- # Impossible to implement reforms in hundreds of areas: not enough political capital
- # Better to pick three or four priority areas

Will Abenomics Succeed?

-  The first arrow is flying toward the target
-  The second arrow is in the wrong direction
-  Macroeconomic policy alone may help ending the deflation in the narrow sense but cannot restore the growth

-  The third arrow is important, but it has not been shot
-  It is not clear what the third arrow(s) is aiming
-  Need to focus on a few important reforms

Abenomics to Change Japan (Finally)?

Japan at present

Present concerns include:

- Deep negativity about the social and economic outlook and pessimism about the aging of the population and consequent decline in the labor force
- Debt overhang, inefficiency, high-cost structure and “sheep mentality” of firms and industries
- Tendency toward the loss of distinctiveness and vitality of regions
- Waste and unfair cost burdens in the areas of social security

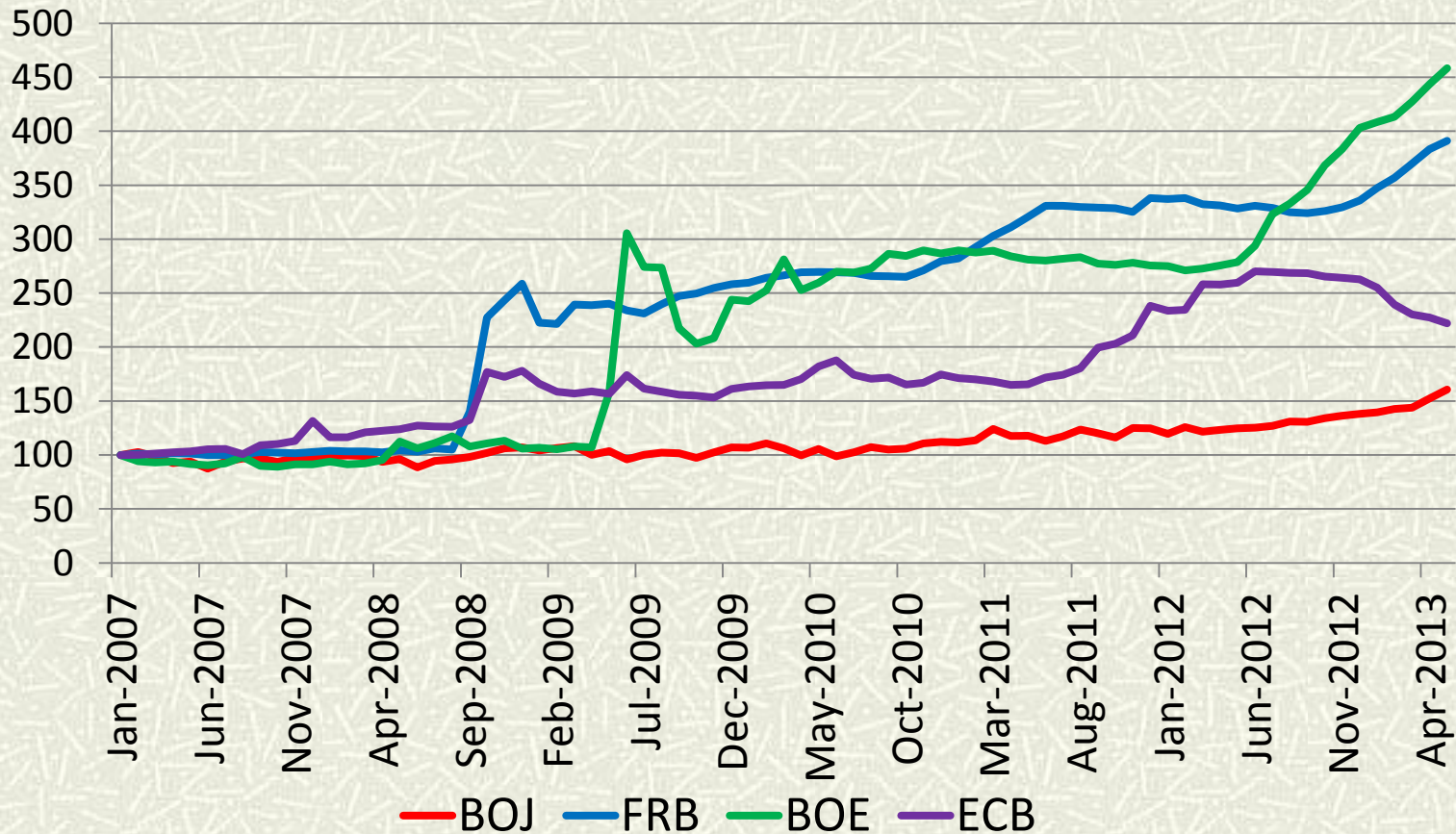
Japan in the future

- A society in which people are filled with pride and self-confidence, and in which those with vision and ambition can realize their dreams
- A society in which market rules and social justice are a reality
- A society in which everyone can lead safe, secure, and affluent lives side by side with nature
- A society that is open to the world and attractive to foreigners

Extra Slides

Reluctant BOJ

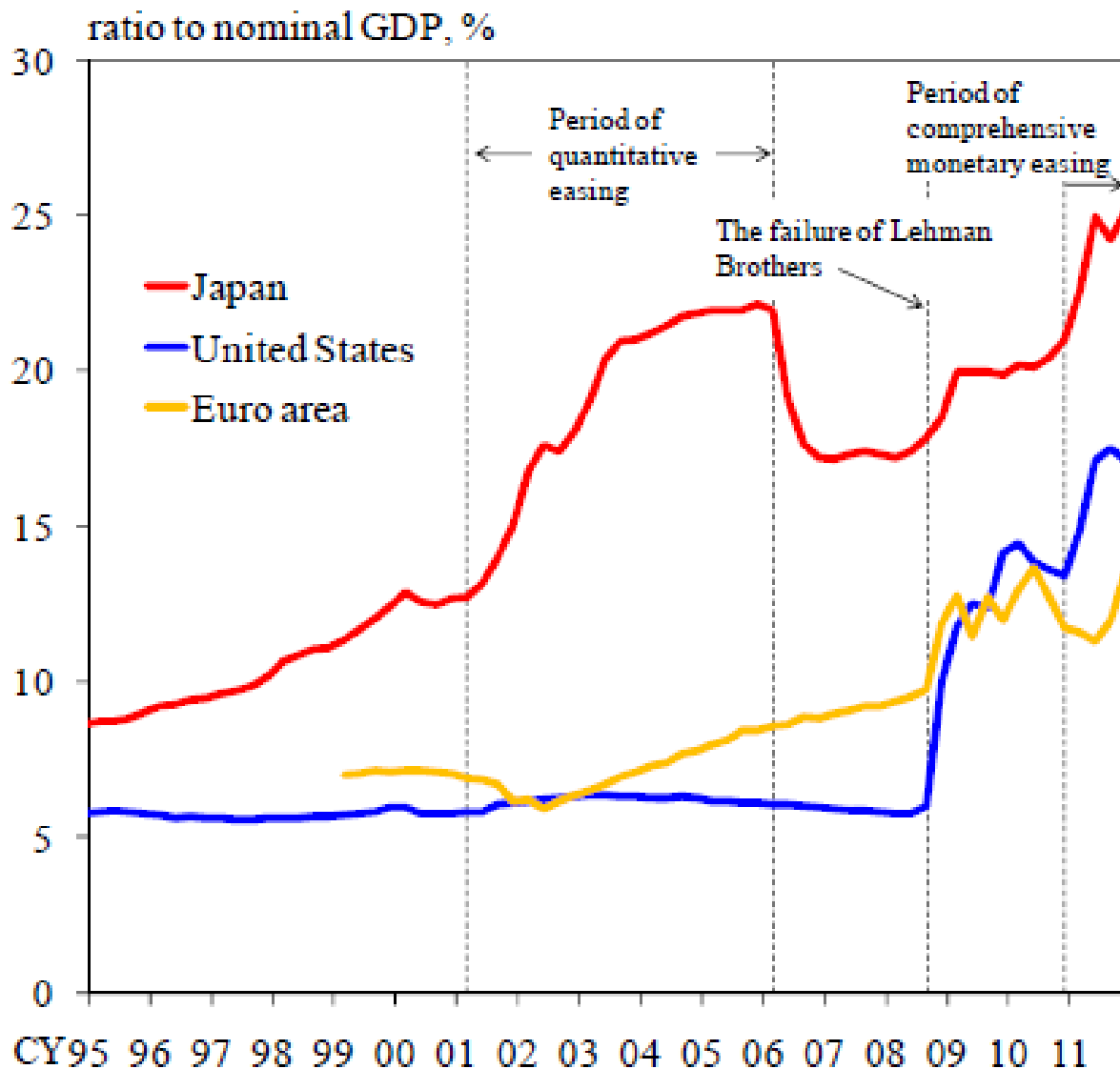
Central Bank Assets (January 2007 = 100)



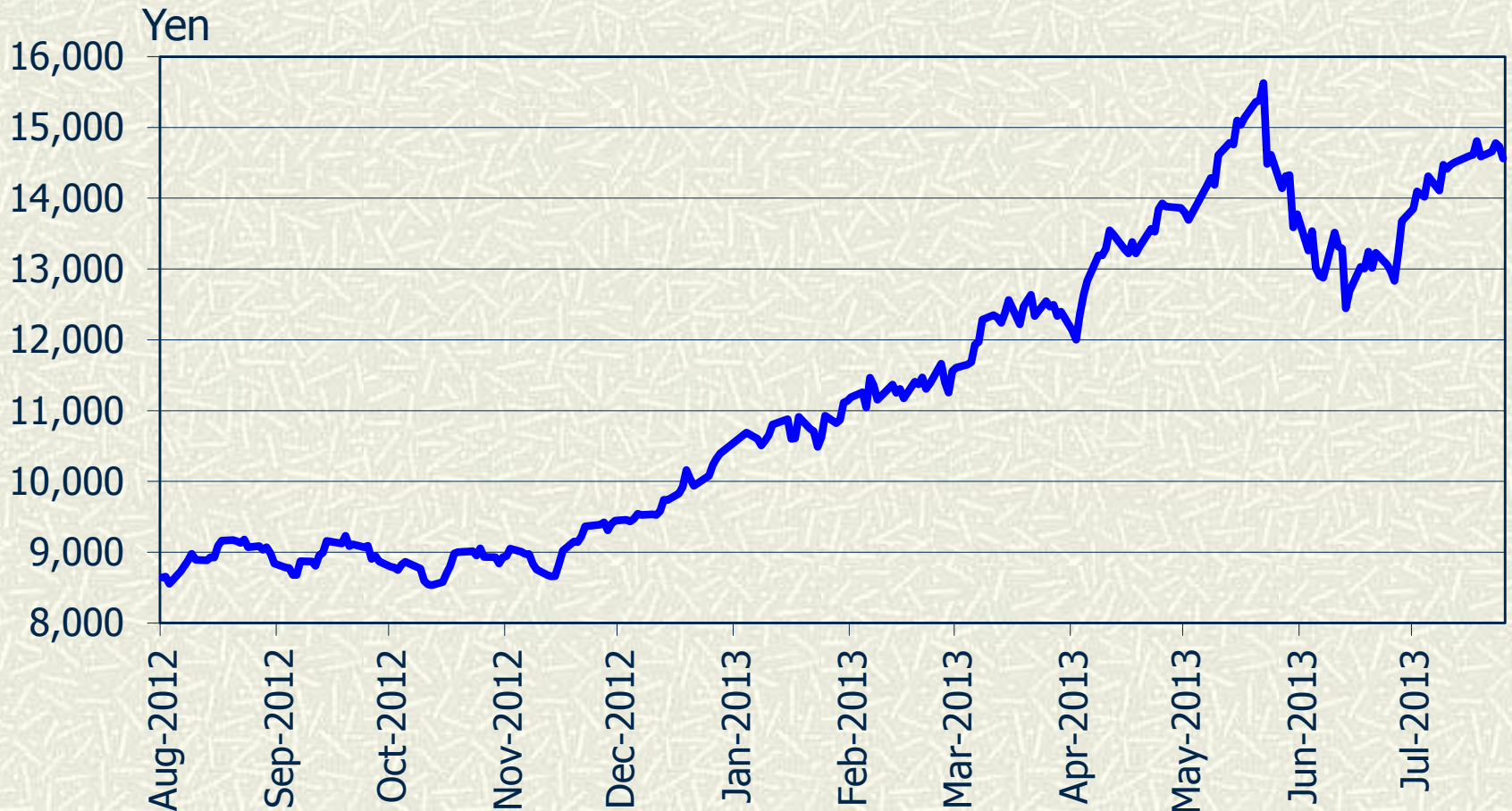
Monetary Base

BOJ used the ratio of monetary base to nominal GDP to argue that the BOJ policy had been expansionary

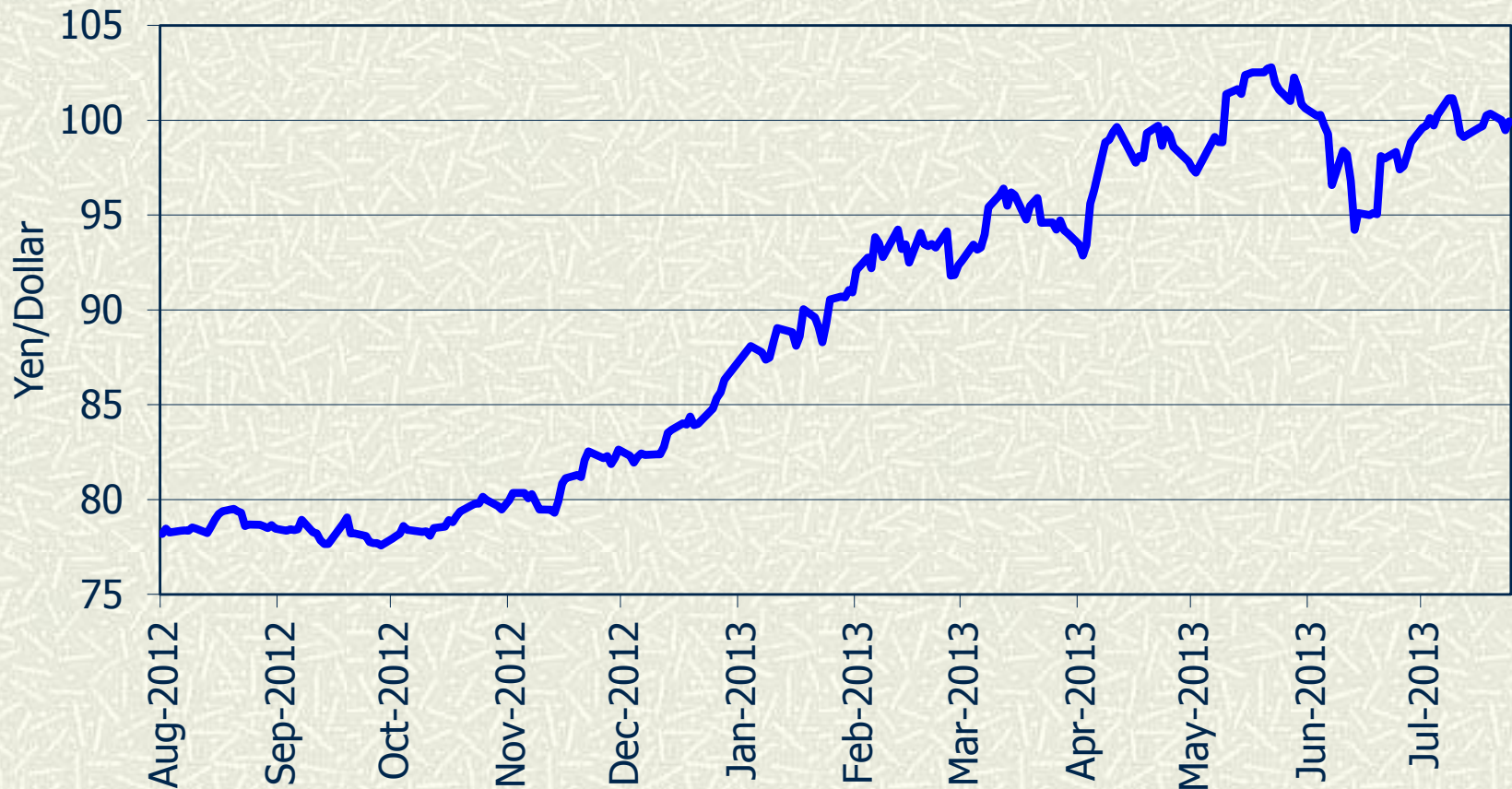
The measure is problematic because it jumps up whenever GDP contracts sharply



Nikkei 225: August 2012 – July 2013



Yen/US Dollar Exchange Rate: August 2012 – July 2013



Japanese Inflation Expectation

Mandel, Benjamin R. and Geoffrey Barnes (2013). “Japanese Inflation Expectations, Revisited” in Liberty Street Economics (New York Fed Web Site)

<http://libertystreeteconomics.newyorkfed.org/2013/04/japanese-inflation-expectations-revisited.html>



Net Debt to GDP Ratios for Selected OECD Countries (%)

