

Research Institute of Economy, Trade and Industry (RIETI)

# Notes for a presentation to RIETI Special BBL Seminar

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**“An American View on Abenomics”**

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<http://www.rieti.go.jp/jp/index.html>



## **An American View on Abenomics**

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The early results for Japan's Abenomics recovery program are in and look promising. Many observers rightly praise the Bank of Japan's regime shift to positive inflation targeting for its role. But they go too far in attributing any economic improvement to that alone, and they down play the positive medium term prospects for Japan as a result of that error. Others dismiss Abenomics as moot because of the mounting Japanese public debt in an aging society, and just wonder when the assumed crash will come. The fiscal and structural reform components of Abenomics, however, are sound in their priorities. Like the monetary reform before them, fiscal and structural reforms in Japan just need to continue on their current path with conviction, and a 'whatever it takes' attitude, to deliver the desired results.

This is a stronger endorsement than it may at first seem. Far too often, economic reform agendas fail to deliver for a variety of reasons. Some simply get the economic analysis wrong, and pursue the wrong policies, as definitely was the case in Japan in the 1990s, and arguably is the case [with US fiscal policy since the 2009 stimulus](#). Others have the right assessment of the country's economic problems, but fail to prioritize among a laundry list of potentially useful reforms, leading to overload and a lack of sufficient progress on any, as in Indonesia in 1998 or Greece today. Still others falsely assume macro stabilization and austerity alone will induce other needed reforms - [such narrow one-size-fits-all approaches underlie much of the euro area's failures](#), as they did in Argentina a decade earlier. And all too often, even good structural agendas are squandered by an emphasis on process ahead of substance, claiming that governance must be reformed before the economy can be tackled (think of Italy repeatedly).

Surprisingly, Abenomics has avoided all of these errors so far. The economic analysis that reflation would support tax increases for longer-term fiscal sustainability and structural reform in Japan is correct. The clear prioritization of a few key reform targets – notably female labor force participation, agricultural consolidation, the two-tier labor market, and competition in health care – is sensible and feasible. The Abe government has not wasted momentum on administrative restructuring or institutional initiatives before starting its economic reform efforts.

What is needed is now is more of the same. That is, the Abe government has to carry through with its programs in each prioritized area, but do so more ambitiously than it currently is doing. On the

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fiscal front, they have gotten the basic plan right to deal with Japan's debt challenge: Don't Panic. Raise the consumption tax permanently in steps. Spend for emergencies, but make those expenditures temporary, not new ongoing programs. Increase taxation and decrease expenditure on the older generation that has already benefitted from intergenerational transfers. They need to pre-commit, however, [to raising the consumption tax to at least 20% over the next several years](#), a level common in the OECD, not just aspire to maybe get to 10% over the next 20 months.

Similarly, increasing Japanese female labor force participation is absolutely the right priority for structural reform. [There are at least 3 million Japanese women, or 5% of the total labor force, that could readily re-join full-time employment](#). There are a few million other women who are underemployed below their potential capabilities. Increasing the availability of affordable child care and visibly breaking the ceiling for female aspiration are proven approaches for achieving this goal, which the Abe government is rightly pursuing. But instead of providing 150,000 new nursery spots, they should be creating 300-400,000 places. Instead of setting a target for 30% of public sector managers being women, and voluntary guidance in the private sector, they should be setting a compulsory target of 40% for both.

Parallel cases can be made for doing more in agricultural reform (not just breaking down production quotas, as underway, but consolidating farms) and labor market restructuring (new hires should be subsidized nationally rather than lowering the minimum wage commitment as proposed just for new employees in special zones). That is, the Abe government program has repeatedly chosen the right areas to tackle and the right direction for reform, but has repeatedly been insufficiently ambitious in its goals for those reforms. While half a loaf of reform is definitely better than none, that half loaf may not be all that is needed to sustain healthy activity for the Japanese economy for the medium term.

[As I argued in this space 13 months ago](#), Japan will not hit a fiscal wall anytime soon. Even if the country runs small current account deficits from now on, as seems likely, it has a good fifteen-plus years of foreign reserves and savings to draw down, more if its average growth rate increases. But avoiding a crisis is far from putting Japan on a truly sustainable growth path, let alone achieving its goals.

Make no mistake, the goal of Abenomics is more than just raising Japan's long-term creditworthiness or its economic growth rate. Prime Minister Abe and his cabinet want sufficient growth as a means to the end of Japan having an ongoing role in maintaining an open order in East Asia – that is, Japan being a vital ally in both senses, energetic and necessary, to the US and its non-Chinese neighbors. To achieve that aim, however, Japan needs to shoot for an average real growth rate of near 2% annually, and a tax base that permanently closes the current structural budget deficit of the central government. Those intermediate targets in turn require the kind of ambitious goals that I propose for Abenomics' fiscal

and structural reform efforts. The current aspirations, though well-directed, will be insufficient for purpose.

The good news is that attempting to regain some control over a nation's own future, in response to external threats, is historically a much stronger impetus for reform than simply improved economic efficiency. The Meiji revolution of 150 years ago was prompted by Japan's desire to stand up to colonial pressures, like Admiral Perry's fleet, and led to economic transformation. Today, Japan's government should be motivated to not only take on the right vested interests, as [Prime Minister Abe stated at Davos](#) is the core of his Abenomics, but do so on sufficient scale to empower Japan for the years ahead.