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Not Beyond Hope: Japan and TPP

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Dr. Samuel Johnson called second marriage “the triumph of hope over experience.” In restoring the Liberal Democratic Party (LDP) and its leader Shinzo Abe to power last month, Japanese voters seemed to be sending the opposite message: after three years of vesting their hopes in the Democratic Party of Japan (DPJ) with disappointing results, they opted to fall back on the LDP’s greater experience in governing.

Abe himself seems to have learned from his previous, unhappy experience as prime minister in 2006–2007. In his first public remarks after taking back the job in late December, he said, “There is no future for a country which has given up on growth.” The sentiment marked a refreshing change not just from the DPJ’s focus on austerity, but from Abe’s own disinterest in economic affairs during his earlier tenure in office. An older and wiser Abe is right to pay more attention to Japan’s economic health—and right that more growth is what the patient needs—but his policy prescriptions to date will not be enough to produce the lasting recovery he is hoping for.

Abe has declared war on deflation and promised to use all the macroeconomic firepower he can find to fight it. He instructed his new finance minister to ignore the ¥44 trillion annual debt issuance ceiling established by the previous DPJ government and to prepare a new fiscal stimulus package this month. And he effectively ordered the Bank of Japan (BOJ)—under threat of taking away the central bank’s statutory independence—to flood the economy with liquidity until a new 2 percent inflation target is reached.

Analysts have questioned both prongs of Abe’s strategy. In a thoughtful report, Paul Sheard of Standard & Poor’s argues that haranguing the BOJ is unlikely to work until the central bank itself adopts an aggressively reflationary posture—enough to create real public expectations of future inflation.¹ Moreover, threatening the BOJ’s independence risks undermining the central bank’s credibility, a fragile asset that may someday be needed when prices are rising again. As for fiscal stimulus, skeptics argue that the new spending will once again go to wasteful infrastructure projects while driving up Japan’s already world-high debt.

Some of the criticism of Abe’s approach is unfair; he is right that tackling the scourge of deflation will require forceful use of macroeconomic tools. The real problem is that, while necessary, these tools will not be sufficient to sustain growth in Japan over the medium term. With a sharply declining labor force—the United Nations forecasts Japan’s working-age population to drop from 85 million in 1995 to only 55 million by mid-century—the country needs more productivity, not just more liquidity, in order to sustain growth. And only structural reforms that result in more efficient use of agricultural land, more flexible labor markets, and fewer regulatory burdens on business will produce these productivity gains. To use an overused metaphor, monetary and fiscal stimulus can act as morphine to ease the patient’s pain, but it will only have a lasting effect if it serves as anesthesia to facilitate the needed structural surgery.

¹ Paul Sheard, “Japanese Reflation Is in Play, but Hurdles Galore Stand in the Way,” Standard & Poor’s, December 28, 2012, http://www.standardandpoors.com/spf/upload/Ratings_US/JapanReflationDec2012.pdf.



Upcoming Events

- January 14: Food Security in Southeast Asia: Why Fish are Key (CSIS)
- January 21: U.S. Inauguration Day
- January 29: Asia Policy in the Next Administration (CSIS)
- February 25: Korean Inauguration Day

Not Beyond Hope: Japan and TPP *(continued)*

Representing the U.S. Treasury in Tokyo in the mid-1990s, I dutifully delivered forceful talking points to the Japanese government on the need to keep the macroeconomic spigots open (warning of what we termed a “fiscal abyss”). The advice was right but incomplete: in hindsight, it was clearly not lack of stimulus but lack of structural reform that accounts for what has now become the country’s two lost decades of growth.

To be sure, structural reform is painful. There would be losers, including many in the LDP’s rural base of support. And with important Upper House elections approaching in July, it is understandable that Prime Minister Abe would find monetary and fiscal painkillers more politically expedient than surgery. The problem is that by summer it could be too late for Abe to use the most potent tool he has to push through structural reform: getting Japan into the Trans-Pacific Partnership (TPP). If the 11 existing TPP members are serious about wrapping up the trade negotiations within this year—and Tokyo should not underestimate the Obama administration’s resolve in this regard—Japan needs to be at the negotiating table no later than this spring or risk being unable to shape the final agreement. As a practical matter, acceding to TPP after the basic contours had been settled would be politically untenable for any Japanese government.

Abe should take a strategic view of TPP—in all senses of the term. From the perspective of political strategy, a decision to join the talks would enable him to pin the blame for needed structural reforms on external forces, whether Japan’s need to be more competitive in a globalized market or,

if he prefers, American bullying. In terms of economic strategy, joining TPP would allow Japan to have a seat at the table in shaping the rules that will govern international economic behavior in the twenty-first century. Foreign policy interests would also be served: participating in TPP would bind Japan more closely to its partners in the region, starting with the United States. And there is a further strategic incentive to move quickly: signals are emerging that Korea’s new administration under President Park Geun-hye may be interested in joining TPP—something that would make Japanese nonparticipation unthinkable.

If Abe signaled his desire to join TPP and willingness to offer sufficient “confidence-building measures,” this would likely be welcomed by the Obama White House, despite the undeniable complications it would create for the negotiations. Japanese participation is strongly in U.S. economic and strategic interests—because a TPP agreement without Japan is of limited economic value and because Washington needs a growing, confident Japan to help address a plethora of regional and global challenges. Let’s hope that Abe really has learned from experience and embraces TPP as a central pillar of his economic strategy. ■

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Simon Says...

Just how does Japan measure up as a global competitor? In the World Economic Forum’s “Global Competitiveness Index 2012–2013,” Japan weighs in at #10 overall. (Switzerland is #1, and the United States #7.) No one beats the Japanese when it comes to health, life expectancy, business sophistication, and capacity for innovation. And the country ranks second in several other categories, including quality of railroad infrastructure, primary education enrollment, company spending on R&D, and availability of scientists and engineers. With the possible exception of longevity (not entirely a bad thing), all of these are underlying competitive strengths that provide a promising basis for Japan’s long-term growth and prosperity.

On the other hand, Japan ranks dead last—#144—when it comes to the burden of general government debt, and second-to-last for the size of its government budget deficit (only Lesotho is worse). And dismal rankings in several other categories highlight Japan’s formidable structural challenges: #142 in agricultural policy costs, #134 in hiring and firing practices, and #87 in both burden of government regulation and ratio of women to men in the labor force. Somewhat surprisingly, following the New Year’s fiscal antics in Washington, Japan cannot even beat the United States in one telling category: at #57, the Japanese rank three rungs below their American counterparts in their trust of politicians...