

# Global Economics Monthly

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## Abe's Aim Must Remain True

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As widely predicted, Japanese voters gave Prime Minister Shinzo Abe a resounding vote of confidence in this month's Upper House election, nearly seven months after he energetically rode back into office. How Abe chooses to spend this new political bounty is a matter of great consequence not only to Japan but to the world. In post-election comments, the prime minister suggested that he would push ahead with his ambitious economic strategy known as "Abenomics" rather than pursuing his dream of constitutional revision, at least for now. This is encouraging, because the fastest path to Japan's becoming a "normal nation" runs through renewed economic strength. Now comes the hard part.

The goal of Abenomics is to end two decades of deflation in Japan and put the economy on a sustainable growth path. The strategy has three "arrows": aggressive monetary easing, fiscal stimulus, and structural reform. Its early results, measured by rising business confidence and asset prices, have been impressive.

Yet opinion about Abenomics is mixed. At one end of the spectrum are cynics who see it as a thinly veiled strategy to weaken the yen and otherwise boost the profitability of Japan's export-oriented companies. At the other end are some who believe Japan is on the cusp of a third renaissance, following the Meiji Restoration of the late nineteenth century and the post-World War II revival.

The safe ground on Abenomics is the skeptical middle. Many grand plans to revive Japan's economic fortunes have come and gone over the past three decades, to little effect. Moreover, the structural reforms that Japan needs to bring about sustained growth are formidable; whether empowering women in the workforce, allowing more immigration, or rationalizing Japan's agriculture sector, these changes cut against the grain of well-established social mores or vested interests.

But there are several reasons to be more hopeful about Abenomics than previous efforts of its kind. First, the plan is comprehensive, covering both demand stimulus and supply-side reform. Second, it enjoys strong leadership from a prime minister who is both determined and politically secure for several years following this month's election victory. And third, there is arguably no turning back at this point, not only because of the expectations created both within and outside Japan, but also because of Abe's decision to join the U.S.-led Trans-Pacific Partnership (TPP) trade negotiations, which will help keep Japan's feet to the fire on reform.

The third arrow, structural reform, is the toughest of the three but also the most critical. Without it, Abenomics is likely to disappoint once again. Monetary and fiscal stimulus can temporarily boost demand, but, in the face of demographic decline, Japan's growth will only be sustained if the private economy becomes more productive, and this in turn requires structural reform.

Abe should prioritize three main areas of reform. The first is to follow through on his bold TPP decision by throwing Japan's full energy into completing the negotiations as targeted by the end of this year and not seeking excessive carve-outs. In particular, he needs to follow through on agricultural reforms, including a phase-out of prohibitive tariffs and consolidation of farm size that would revitalize this important sector.



### Past Events

- July 10-11: U.S.-China Strategic & Economic Dialogue (Washington, DC)
- July 12: Outlook for G-20 St. Petersburg (CSIS)

### Upcoming Events

- July 24: TPP & The Digital Economy (CSIS)
- July 25-26: G-20 Sherpas' Meeting (St. Petersburg)

## Abe's Aim Must Remain True *(continued)*

The second priority should be making Japan an easier place to invest. A number of tax, corporate governance, and regulatory hurdles make Japan one of the least friendly markets for outsiders—foreign and domestic—to break into. Japan ranks dead last among OECD countries in inward foreign direct investment as a share of GDP.

Real labor market reform is the third priority. Japanese workers should have an easier time moving in and out of the workforce and between employers, with their incomes, benefits, and dignity intact. This is a particular challenge for female workers, who typically drop out of the workforce following childbirth and rarely rise to positions of management.

In going about reform, the Abe administration should not try to do too much. One of the reasons for market disappointment in the initial growth strategy released in early June was that it was too far-ranging and incoherent. When it puts out a more refined strategy this autumn, Tokyo should pick three to four areas of initial focus, lay out ambitious but realistic goals in these areas, and then announce a few concrete steps toward those objectives to persuade people that the government is serious and headed in the right direction.

Those responsible for mapping out reforms should first ask themselves what government should not be doing: over-taxing, over-regulating, over-coddling.

Japanese officials need to shake the old postwar industrial policy mindset and think about how to get out of the way of the private sector. Only then should the government consider areas where it could intervene in a targeted way to support market outcomes, for example by cracking down on anticompetitive practices or retraining displaced workers. In some areas, temporary affirmative action may be called for, say to mandate a minimum number of outside directors on company boards or set targets for promoting women to managerial positions.

Prime Minister Abe has shown great boldness and determination in laying out an ambitious plan for Japan's economic revival and in starting to carry it out. After two lost decades, the Japanese people deserve a more hopeful economic future, while the rest of the world needs a stronger and more respected Japan. Renewed mandate in hand, Abe should maintain his focus and fire the third arrow firmly toward the target of meaningful structural reform. ■

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## Simon Says...

This month's U.S.-China Strategic & Economic Dialogue largely achieved its objective of enhancing communication between Washington and Beijing, but a few things were lost in translation. Comments by Finance Minister Lou Jiwei that China's goal of 7 percent growth in 2013 should not be seen as a floor (and that even 6.5 percent would be no big problem) were initially reported as is by state-run Xinhua News Agency but later airbrushed to read, "There is no doubt that China can achieve this year's growth target of 7.5 percent." So did the finance minister misspeak, or were the Chinese authorities, in an effort to lower expectations for growth, deliberately "Loulou-balling" the numbers?

Meanwhile, S&ED cochair Wang Yang raised eyebrows during an opening press conference with Treasury Secretary Jack Lew when he compared the U.S.-China relationship to a marriage—a distinctly traditional one, that is: "Although U.S. law does permit marriage between two men, I don't think this is what Jacob or I actually want." At other times during his Washington visit, Wang went out of his way to celebrate diversity by observing that Americans "still have longer noses" than Chinese, and by musing that a world with only a Beijing and no Washington, or vice versa, would be like "a world with only women in it and no men." Perhaps loose translation would suffice next time...