Zombie Abenomics

Japan’s Missing Economic Revival

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Japanese Prime Minister Shinzo Abe’s economic revival is hardly going as planned. A consumption tax hike that he introduced in April triggered a recession over the following six months, prompting him to announce the delay of the second hike, from October 2015 to April 2017. In his November 18 press conference, he also vowed to make no further postponements, to dissolve the Japanese parliament, and to hold a snap election to gain a mandate for his economic plan.

The tax delay is unquestionably necessary. Before the first hike, the Ministry of Finance and the Bank of Japan had blithely promised Abe that Japan would see only a mild and short-lived response, which proved disastrously wrong. Just as wrong were their warnings that any delay in the second hike would cause stock prices to crash and interest rates to spike. In reality, the first sign of a possible delay sent stock prices to seven-year highs. Meanwhile, the Bank of Japan has easily kept interest rates at near-record lows, not only for 10-year bonds but also for 30-year and 40-year bonds.

The real question is this: If Abe’s strategy, known as Abenomics, is such a miraculous revival plan, why was the delay necessary? And, given Abe’s track record, why should anyone trust his guarantee that he will make the economy strong enough by 2017 to weather another tax hike? Healthy economies are not thrown into recession by relatively small hikes in a consumption tax from five percent to eight percent, but Japan’s was—indicating that it isn’t healthy and that Abenomics has done little to help.

In some ways, Abenomics has made the situation worse. It’s not just the tax hike. There is also the 30 percent yen depreciation that Abe encouraged as a way to increase exports. Just as I discussed in my recent article for Foreign Affairs [1], because Abe left many structural competitive problems unaddressed, the depreciation has done nothing of the sort, spurring no real growth at home. Instead, price hikes sparked by the depreciation have led to a big decline in price-adjusted incomes. Among working families, real disposable incomes are down six percent from a year ago. That is why consumer spending has plunged and why the economy is in recession.

Supposedly, Abenomics has three “arrows”: monetary stimulus, fiscal stimulus, and structural reform. Over time, fiscal stimulus was replaced by austerity. Structural reform was always more talk than action.
As a result, all that remains of the three arrows is monetary stimulus—the Bank of Japan governor, Haruhiko Kuroda, flooding the system with money by buying Japanese government bonds. The Bank of Japan is already purchasing so many that holdings of government bonds by other investors have declined to 142 percent of GDP compared to 154 percent of GDP two years ago. On October 31, the Bank of Japan announced that it would up its Japanese government bond purchases to ¥80 trillion ($690 billion) per year, almost twice as much as the government’s annual budget deficit. So, at the same time that Kuroda sends out false alarms that tax hike postponement would lead to a debt crisis, he is removing the cause of that potential crisis by reducing private holdings of the debt.

Abenomics is banking on the hope that monetary stimulus alone can engender growth by reviving “animal spirits” via inflation. Kuroda is acting like a doctor who says he can make a severe asthmatic run by giving him lots of oxygen. When the patient points out that he also has a broken leg in need of surgery, Kuroda proposes to double the oxygen. If Abe were implementing a genuine three-arrow program, he would use fiscal and monetary stimulus as anesthesia to make possible the long and difficult surgery of structural reform. But for too long, Japan has used fiscal and monetary stimulus as a narcotic to dull the pain and thereby avoid the surgery. And, for too long, it has swung back and forth between poorly implemented fiscal stimulus and ill-timed bouts of fiscal austerity. Abe is continuing that tradition.

Consider just one of the many cases in which Abe talks of bold action, but does very little: the Trans-Pacific Partnership (TPP) free trade talks. The talks are in danger of turning into another Doha Round, where negotiations go on forever and nothing gets signed. There are many causes, but one of the most important is Tokyo’s refusal to eliminate most of the import trade barriers in a few farm products: beef, pork, dairy, and wheat. The tragedy is that Japan, not its trading partners, has the most to gain from freeing up its market. A true reformer would liberalize farming, not because Washington demands it but because the Japanese economy needs it. Japanese consumers spend 14 percent of their household budget on food, far more than the six percent Americans spend. Imports of cheaper food, along with reforms in the food industry, could drastically lower this cost and release consumer spending power for other products.

Instead, Abe is sacrificing the welfare of 46 million Japanese households for the sake of the mere 100,000 households involved in those few products. Most of the latter are aging part-time farmers who get the lion’s share of their income from nonfarm work, government subsidies, and pensions. Abe heeds their demands because malapportionment enables the rural districts to select an outsized share of the Diet members and because one of the pivotal allies for Abe’s Liberal Democratic Party (LDP) is the adamantly anti-TPP farm lobby.

Even though his approval ratings are falling, Abe still has the clout to challenge domestic special interests, just as he has defied the powerful Ministry of Finance. Hopefully, in the snap election, the voters will give Abe a reason to do so. The opposition is too weak and divided to drive the LDP from power. The LDP-led coalition, which now controls more than two-thirds of the seats, expects to lose just 30–40 of those. That would leave it with a very comfortable majority of 45–55 seats. But if the disgruntled voters take away any more of the ruling coalition’s seats, they will send a message that economic malfeasance carries a political price.