

Abenomics: Has it worked? Will it fail?

Sébastien Lechevalier and Briec Monfort

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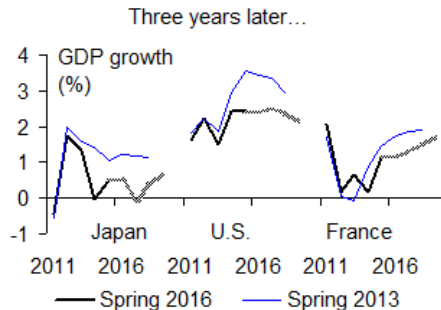
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Three years later...



IMF WEO projections of April 2013 and outcome as of April 2016; forecasts for 2016-19.

Light grey line: recent projection 2016-2019.

Sources : IMF WEO, 2013 and 2016.

- Remember "Abegeddon"?
The most pessimistic predictions - inflationary spiral and rising long rates leading to a series of crises (sovereign, banking, external) - failed to materialize...
- Encouraging results in some areas...
- ... at the same time, the growth performance is lower than the initial expectations.

Abenomics and the lessons of economic history

The presentation this evening: Abenomics; lost decade in Europe.

- **Abenomics.** Our claim: Abenomics is difficult to understand without reference to economic policy history. The right economic policy recipe? What mid-term assessment?
- **The fear of a "lost decade"**. Why has Japan experienced a protracted slowdown since 1990-91? Will Europe experience a similar slowdown and what policies to avoid such an outcome?

The book: economic policies in Japan 1990-2016; revisiting policies and analyses about the Japanese economy over 25 years.

- **Pessimistic predictions.** Full nationalization of the banking system; debt explosion, "Japan's financial Mount Fuji", etc.
- **Optimistic predictions.** The economic recovery is just around the corner and will take care of everything.

Lessons from the Japanese Experience

- 1 Introduction
- 2 Abenomics: What is it?
- 3 Abenomics: Has it worked?
- 4 Abenomics: Will it fail?
- 5 What lessons for Europe from the "lost decade"?
- 6 Conclusion

A flavor of the book. Main themes

The book has two main ambitions:

- Explaining how a plain vanilla economic crisis - mainly financial - was followed by a protracted slowdown for several years.
- Discussing policy choices and constraints faced by policymakers when confronted to an economic slowdown, Japan being here almost a textbook case.

Study period: 1990-2016, from the asset price bubble to Abenomics.

Introduction

Abenomics: What is it?

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What lessons for Europe from the "lost decade"?

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Outline of the presentation

Beyond Abenomics. Outline of the book

Conventional wisdom about Japan

Political or conceptual?

"Japan's economic difficulties are widely viewed as essentially political: if only the politicians would bite the bullet, they would get their country moving again. But in fact it has been far from clear what exactly Japan should be doing - which is to say that the problems are not so much political as conceptual."

(Paul Krugman, 1998)

Economic policy dilemma in a context of uncertainty

Similarity of the dilemma in Japan and in Europe.

- **Banking crisis** : waiting for economic growth to improve bank balance sheets or forcing a brutal restructuring with a recessive impact?
- **Deflation** : continuing carefully with a classic accommodative policy or entering into the new unknown world of quantitative easing?
- **Public finance** : conducting an ultimate fiscal stimulus to boost growth or implementing fiscal consolidation at the price of slower growth?
- **Structural reforms** : what balance between the short-term cost and the long-term gain of structural reforms?

Two precautions

- **Avoid hindsight bias** Our goal is to understand how policymakers perceived the different options available at the time. To *draw* lessons from the Japanese experience not to *give* lessons.
- **Scrutinize conventional wisdom.** Japan is not an exotic or distant country. The Japanese experience is comparable to that of other countries even if it is not transferable.

We argue that there is an urgent need to learn from Japan, whose experience is much more complex than the conventional perception of an economy at a standstill.

Conventional wisdom... and why it is so convenient

"There is little wonder that Japan's slowdown is so profound... It is the most rapidly ageing society... it has epic insularity and an inability to accept immigration... a massive retrenchment by its companies to their home markets, and a utter lack of capacity for entrepreneurial innovation in the area of social network."

(Larry Summers, 2012, debating with Paul Krugman about the risk of "lost decade" in the US)

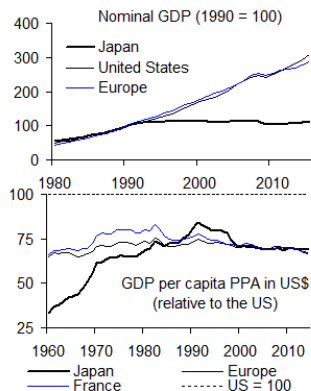
"In a sense, Japan is the perfect country to screw up, because people are always ready to blame the country and its culture rather than to you."

(Foreign banker, quoted by Gillian Tett, *Financial Times* columnist, *Saving the Sun*, 2003)

Conventional wisdom about Japan

- Japan has experienced zero growth over the past 25 years.
- The lack of growth is due to economic and social paralysis ... itself related to ministerial instability.
- Low growth hardly matters, Japan remains a rich and an egalitarian country (the "happy stagnation" hypothesis).
- Low growth comes from the strong dualism of the economy and, in particular, the lack of efficiency of the service sector.
- Public debt comes primarily from building "bridges to nowhere".
- Japan is able to imitate, but not to innovate, and the technological catchup is over.
- Deflation is good because Japanese prices are too high.
- Unemployment is low because Japanese women do not work.

"Japan has experienced zero growth over the past twenty-five years."



- Nominal GDP growth is almost zero ...
- ... yet real growth per capita from 1990 to 2015 was of 0.9% in Japan (against 1.0% in France and 1.5% in the US).
- The gap between the US and Europe and Japan remains almost constant (around 30%).
The 30% glass ceiling.

"The lack of growth is due to an economic and social paralysis".

A claim very similar to that of eurosclerosis cf. "Arthritic Japan", Ed Lincoln (2001). Change is certainly gradual, but ultimately Japan did experience a "great transformation". Some examples:

- Electoral reform (1994), administrative reform (1997-2000).
- Independence of the Bank of Japan (1997).
- Quantitative expansion policy, the first time in the world (since 1999, but with partial reversals in 2000-01 or 2006-10).
- Financial liberalization (1996 "Big Bang"), banking reform (1998 and 2002).
- Structural reforms: liberalization of the labor market (1999 and 2003); "macro slide" for public pensions (2004); "trinity reform" for local public finance (2003); etc.

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The three arrows

An innovation in economic policy?

A nationalist program? "Japan back on its feet"

Abenomics: What is it?

The "three arrows": a medieval anecdote or a marketing plot?

Akira Kurosawa, Ran, 1985.



The "three arrows": a medieval anecdote or a marketing plot?

Abenomics 1.0: taking the three arrows together instead of one by one.

- **Exiting deflation.** Several waves: QQE April 2013, QQE II in October 2014, "QQE with negative rates" in March 2016..
- **Flexible fiscal policy.** Fiscal consolidation without dogmatism. VAT increase in April 2014 but postponement of 2nd increase in October 2015, now in April 2017.
- **Growth through private investment** Several measures: FTA, TPP signed in February 2016, corporate governance...

Abenomics 2.0 in Sept. 2015 (or is it simply Abenomics 1.1?): fertility target of 1.8 (against 1.4), kindergartens, social security, higher nominal GDP by 22% [when exactly?]....

An innovation in economic policy?

Compared to the previous practice in Japan, a double break with the past:

- **#1 Coordinating all three instruments** (monetary, fiscal, structural policies) towards growth and exiting deflation. Contrast with previous prime ministers with either a single instrument (Aso, Kan, Noda: fiscal) or a limited focus on the economy (Abe I: constitution; Hatoyama: U.S. bases ...).
- **#2 Conceptual break in monetary policy.** Reverse the proposition that structural reforms and fiscal consolidation should precede monetary policy. Abenomics embodies a proactive economic policy and an appropriate attempt to use in a consistent manner all instruments of economic policy.

Innovation #1 : policy coordination

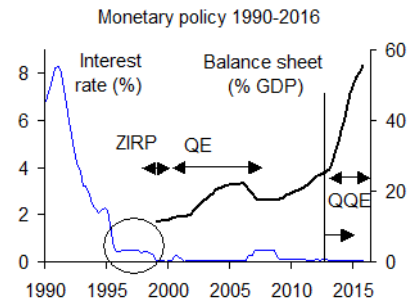
Inadequate policy coordination mid-1980s-2010s. Two coordination models that do not work between the MOF and the BOJ:

- **Before 1997**: domination of the Ministry of Finance (veto over central bank decisions, banking supervision) with strong priority on fiscal variables (tax revenues from stock market gains and real estate before 1990, reluctance to bailout before 1998 except 0.1 % in 1995 for agricultural cooperatives, etc.).
- **After 1997**: independence of the Bank of Japan at the very moment at which Japan entered into deflation; mentality of "inflation fighters", with memory of the double-digit inflation of the 1970s (blamed on the MOF). "Independence trap".

Autonomy of banking supervision (FSA) since 1998-2000.

Innovation #2 : a clear direction in monetary policy

Delays and hesitations of monetary policy 1990-2012. When to move from conventional policy to unconventional policy?

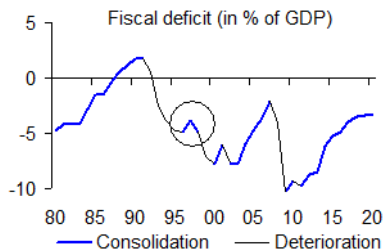


Sources : BOJ.

- 1990-1995 Late and slow conventional easing (consistent with a Taylor rule... if based on overly optimistic projections).
- 1995-1999 Standstill. Bernanke: a "self-inflicted paralysis".
- 1999-2012 Great caution: the BOJ supported the idea that deflation is mainly structural (imported deflation, aging, wage-price nexus...) and therefore outside of

Continuity #1: same dilemma in fiscal policy, to stimulate or to consolidate?

When to move from fiscal stimulus to fiscal consolidation?

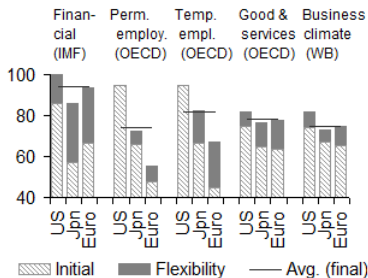


Actual 1980-2015 and projections 2015-20

Sources : IMF WEO.

- Several fiscal consolidation cycles ("fiscal reconstruction" 1980-90, PM Hashimoto 1996-98, PM Koizumi 2000-2005, since 2010 ...)
- Broadly countercyclical policy ...
- ... but with a decreasing fiscal multiplier (low yield of some stimulus measures, poor interaction with monetary policy).

Continuity #2: structural reform, "just do it"!



- Structural reforms broadly at the same speed than elsewhere (market of goods, financial liberalization, business climate, deregulation), sometimes above Europe ...
- ...yet two exceptions: agriculture and immigration (in both cases, limited reforms and reversals).
- Possible adverse impact of some measures (e.g. labor duality).

Degree of liberalization (from 0 to 100).

Initial state: shaded area (ex. 1990);

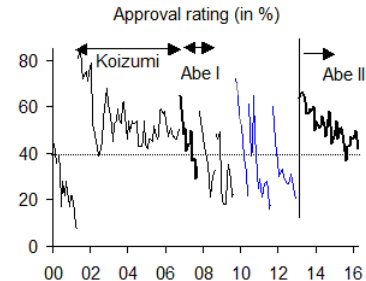
increase: dark grey (ex. from 1990 to 2005).

Sources : OECD ; IMF ; World Bank.

No inertia in terms of structural reforms. Similar roadmap over the past 15 years, "just do it!" (Takatoshi Ito).

A nationalist program? "Japan back on its feet"

Abe: grand-son of Prime Minister Kishi Nobusuke 1957-1960; intention to turn the page on the post-area peace and remove restrictions on the armed forces.



Source: NHK.

- Abe I: improved relations with China (after Koizumi); education reform; first attempt to change the constitution; economy as 2dary.
- Abe II: tensions with China before Abe II contributed to bring him back to power. Constitutional reinterpretation about the armed forces. Speech for the anniversary of the war on August 15, 2015.

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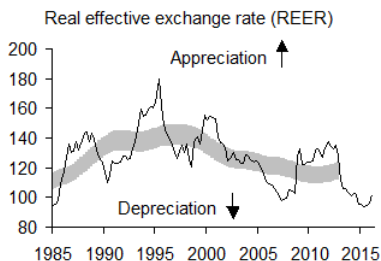
Conclusion

Macroeconomic outcome

Structural reforms

Abenomics: Has it worked?

Correcting the overvaluation of the yen ✓



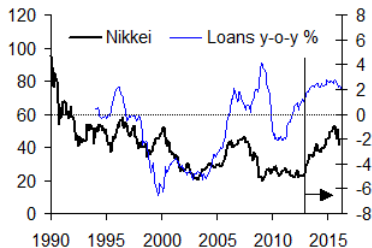
Note. The shaded area represents a band of +/-5% around the 10 year average for the REER. This does not reflect some possible changes in the equilibrium value of the REER (e.g. due to lower current account surplus, etc.)

Sources : Bruegel; authors.

- A contributing factor to the Japanese slowdown: appreciation related to the Plaza Accords (1985-1990), then at the time of recovery (from 1993 to 1995, "syndrome of ever higher yen"), and finally after the Lehman shock (2008-12); economic costs, reinforces deflation.
- Abenomics corrects the initial overvaluation of the yen...
- ...yet slow and limited impact on exports.

Boosting equity returns and increasing credit ✓ (caveats ✕)

Financial variables 1990-2016

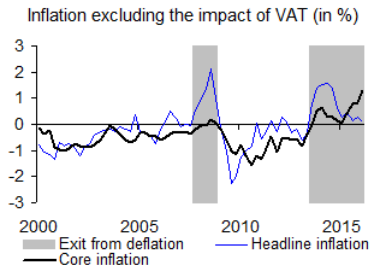


Sources : BOJ; Nikkei Index.

- Recovery of bank lending: growth of 2.0% y-o-y in March 2016 but in deceleration as compared to July 2015 (2.8%).
- Increase of the Nikkei index by 80% since the appointment of Abe as a candidate in September 2012 (Abenomics started before PM Abe).
- Occasionally, some volatility.

Exiting deflation ✓ (with some caveats ✕)

Inflation 0% in March 2016. Has Haruhiko Kuroda failed in his bid to exit deflation? No, he has failed to achieve the inflation target of 2% (set in April 2013) but...

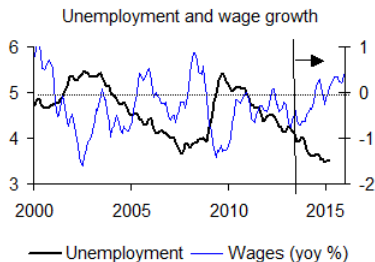


- Core inflation excluding fresh food and energy at 1.2% in March 2016.
- Clear difference between the previous exit from deflation in 2007-08, mostly due to a (positive) energy price shock.
- Underlying inflation from -0.9% to +0.3 % on average over the past three years and compared to the previous three years.

* Excluding fresh food and energy.
 Source: Statistical Office of Japan.

Reducing unemployment ✓ and raising wages ✕

Why a limited impact on the decline of unemployment on wages?



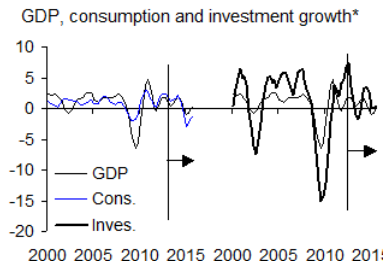
* Contractual wages excluding bonus.

Sources : Cabinet Office.

- Trend fall in unemployment (from a peak at 5.4% in mid-2009) to currently 3.3 % (not just Abe)...
- ... but weak wage growth and real wages close to zero: dual labor market (37 % of "non-regular" workers), decline in union density, demise of *shunto* (annual wage negotiations), etc.

Low real wage growth penalizes private consumption, in a context where the burden of fiscal consolidation rests on households...

Raising private investment and consumption ✖✖



* Rolling average growth over four quarters.
Sources : CAO.

- Record corporate profits and high cash ratios (ratio of 40 % of profit over market capitalization against 15-30 % elsewhere) ...
- ... but cautious investment behavior. Contrast with investment led recovery of 2002-06.
- Impact of domestic demand, slowing emerging countries ...
- Solution: corporate governance reform; taxation.

How does Shinzo Abe's record compare to Junichiro Koizumi?

Comparison of the reform outcome of Koizumi and Abe

	Koizumi / Takenaka (2000-2005)	Abe (2012 until now)	
Financial system	Reduction of NPL 2002-05	Stewardship Code 2006	Decent progress
	Core capital of banks	Reforme of GPIF 2005	Limited progress
	Privatisation of Japan Post 2005 (by 2015)	Resumption of privatisation of Japan Post	Decent progress
Labor market	Dispatched Workers Act 2003	Scheduled increase of minimum wages	Limited progress
	No measures for regular workers	Few measures for regular workers	Standstill
Free trade agreement	Some bilateral trade agreement	TPP agreement; EU - Japan	Decent progress
		Ongoing discussions RCEP (China-Korea)	Limited progress
Deregulation	Special economic zones	Special economic zones deregulation in health, electricity	Limited progress
Public finance sustainability	Trinity reform (local government) 2003	Increase of VAT 2014	Decent progress
	Pension reform 2004	Reduction of corporate tax (by 2018)	Limited progress
Agriculture	Limited reforms... then reversal after Koizumi	Within the TPP, trade liberalization with some exceptions. Reform of rural cooperatives.	Decent progress
Immigration		Limited reform on immigration	Standstill

Color code:

Decent progress

Limited progress

Standstill

Macro impact:

Major

Smaller

Is it enough? Laundry list to raise potential growth

Suggested reforms to raise potential growth in Japan*					
Measure	Impact on GDP	Objective of Abe	Implementation	Source	
Labor market					
Female labor participation	0.25	yes	limited	IMF; OECD	Decent progress
Flexibility, firing / hiring	...	no	Standstill
Immigration	0.15	yes	limited	IMF; OECD	Standstill
Agriculture and trade					
Agriculture (direct impact)	0.03	yes	gradual	Takatoshi Ito.	Decent progress
Free trade agreements **	0.30	yes	gradual	FMI ; Adam Posen ; CAO.	Decent progress
Deregulation					
Special economic zones	0.20	yes	gradual	...	Decent progress
Electricity	...	yes	limited	...	Decent progress
Financial support to SME	0.25	no	...	IMF	Standstill
Business climate, governance	...	yes	gradual	Takeo Hoshi.	Decent progress
Total	1.20				

* Converted into an annual impact: some of the estimates give an impact on GDP over 10 yrs.
 ** Free trade agreement (over 10 years) : in negotiation TPP + 0,7 % ; EU-Japan + 0,6 % ; ongoing discussion : RCEP (Asean + 6) +1,1 % and +0,75 % Tripartite Japan-Korea-China.

Color code:

Decent progress

Limited progress

Standstill

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Rebooting Abenomics

What are the risks?

Abenomics: Will it fail?

Abenomics needs a reboot

Why are the actual results short of the initial expectations?

- **Some factors are not directly controlled by Abe ...**

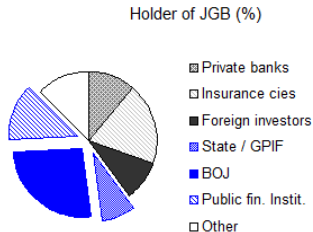
- Slower global growth, particularly in Asia.
- Heavy focus on trade agreements as a catalyst for change (the technique of external pressure: *gaiatsu*) ... but delay of two years compared to the original timetable and some results no longer depend on Japan (TPP and Obama-Trump-Clinton).
- Private corporate behaviors (reaction of exports, wage dynamics, business investment)...

- **... but other are:**

- "Actions speak louder than words" (closing the gap between the rhetorics and policy actions: women labor force participation, wage growth, structural reforms...).
- No initial focus on households or on inequality.
- Some policy tools (ex. tax) are still available.

How will the fiscal endgame look like?

Three red lines and three calendars for a sovereign debt crisis:



Source: BOJ, FOF.

- Total private savings (households and firms). Public debt exceeds domestic savings. = 10-20 years?
- Foreign investors demanding higher yields. = 5-10 years?
- Confidence crisis. Domestic investors demand higher yields. = Now?

Large BOJ buying at different maturities reduces the risk of a confidence crisis. Half of foreign investors are central banks holding JGB for diversification purpose. Still some years before a crisis.

What are the risks in terms of debt sustainability?

The fiscal performance is of course worrying but it is less so that suggested by gross debt statistics:

- A measure of **gross debt** using the Maastricht criteria would reduce debt by about 50 points about GDP. Still very high, even from 250% to 200%.
- Despite demographic aging, the **implicit debt** may actually be lower than in Europe: relatively lower health spending, "macro slide" for pensions...
- **Expenditures**. More efficient public spending ... but conversely also less ability to cut spending during a crisis. Still, after the 2011 earthquake, civil servant wages were cut by 10% for two years.
- **Revenues** Some leeway in terms of taxation (VAT, broadening the tax base...).

Should VAT be increased in 2017?

Opposition of some experts conveyed by Abe in March 2016:
Stiglitz, Krugman, Hamada (Yale professor and Abe senior adviser)
... contrasts with the position of the MOF or the IMF.

Three ways of considering the tax increase:

- A structural (tax) reform: reduce the imbalances between generations. ✓
- A fiscal consolidation measure: 2 pts of VAT = 1% point of GDP of additional revenue. ✓
- Cyclical impact: +0.4% in 2016 but -0.6% in 2017 (BOJ). ✘

How to get the benefits without the cost? Need to compensate in part the negative GDP impact (social safety net, buffer for lower income households...)

How high is the risk of hyperinflation / high inflation?

High inflation scenario:

- Temptation to inflate away the high debt level.
- Risk of monetization of public debt i.e. direct purchase of government bonds in primary instead of secondary market; de facto loss of central bank independence.
- Impact: high interest rate, higher debt service and lower growth; undermine confidence in the yen, currency crash...

Our views:

- Focus of the BOJ on exiting deflation, with 2% target in medium-term. Setting higher household and corporate inflation expectation, overcoming weak wage-price nexus, etc.
- Will take time to unwind current QE policies.

Nb. Semantics: hyperinflation, 20% every 2 wks; inflation 1970s: 20% per year.

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A multidimensional crisis

A decade of financial crises

Countercyclical policies

In search of lost growth

What lessons for Europe from the "lost decade"?

"Don't do Japan": the fear of the ogre...

- The fear of a "lost decade" cf. "We don't want to do Japan" (President Obama, as quoted by Geithner, *Stress Test*, 2014, with some kind of caveat: "Although it wasn't entirely fair to Japan [...] the President was right.")
- If you do such policy just as Japan, you will experience one or two lost decade(s) !
- If you do not finish your soup, the ogre will come and eat you !

"Don't do Japan": the fear of the ogre...

- The fear of a "lost decade" cf. "We don't want to do Japan" (President Obama, as quoted by Geithner, *Stress Test*, 2014, with some kind of caveat: "Although it wasn't entirely fair to Japan [...] the President was right.")
- If you do such policy just as Japan, you will experience one or two lost decade(s) !
- If you do not finish your soup, the ogre will come and eat you !
- Japanese fairy tales : no need to fear the ogre ! (Hokusai, setsubun, 1816)



The limitation of one-sided explanations

Understanding the crisis in its duration and the lack of solid return to growth. Limitation of approaches focusing on a single factor or only on structural factors:

- Paralysis of the Japanese model and lack of reforms. = No, some blocking points indeed, but also many reforms.
- Demographic aging, would explain everything from the lower growth and deflation to the worsening of public finances (BOJ before 2012). = No, only one of the factors of the slowdown.
- A series of macroeconomic policy mistakes. = Partly, but not a single factor.

Three interconnected factors

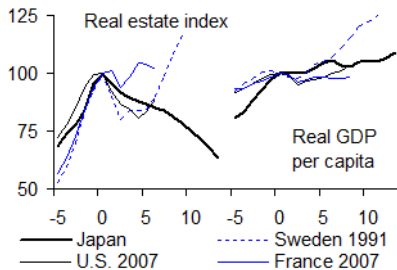
An analysis of the Japanese slowdown that focuses on the impact of three interconnected factors:

- A **financial crisis** that is recognized and resolved with delays.
- A succession of exogenous or endogenous **shocks**, to which countercyclical **policies** responded imperfectly.
- A slowdown in **trend growth**. On the demand side: cumulative impact of the first two factors (lower investment). On the supply side: impact of demographic factors (lower labor force); end of economic catchup period; at the micro level, coordination problems between actors with increasing heterogeneity (lower productivity growth).

How do these factors affect European economies today?

Factor #1: A decade of financial crises

From a traditional financial crisis to a protracted economic slowdown. Two crises: bursting of the bubble in 1990-91 (equity and real estate), systemic financial crisis in 1997.



Index = 100 peak of real estate at date t

Source: OECD; authors.

- A real estate bubble finally very close to that of Sweden (1991) or the US (2007) including the first five years after the crisis ...
- ... but a growth slowdown later much stronger than Sweden.
- Japan is the exception when compared to the examples of the 1990s but less of an exception after 2008.

Why did it take fifteen years to solve the financial crisis?

Eight years from the end of the bubble to the systemic crisis; four years of incomplete measures; only three years to finally clean up the banking system.

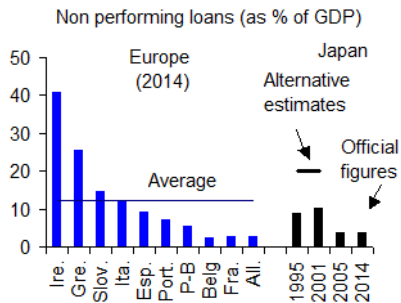
Chronology of the financial crisis

1985	Plaza Agreement
1986-90	Real estate and financial bubble
1990-91	Bursting of the bubble
1992	First slowdown
1993	First published data on NPL
1997	Systemic financial crisis (Yamaichi, Sanyo, HT, LTCB...)
1998	First rescue plan: partial recapitalization (1.5 pt of GDP)
2002	Takenaka plan: reduction of NPL and limits to differed tax assets
2005	NPL at 1.8% (8.6% in 2002)
2008	Lehman shock

- 1990-1993 gradual deterioration of macroeconomic indicators;
- 1993-1997 illusion that growth will solve the situation;
- 1998-2002 half-measures and incomplete recapitalization;
- 2002-05 rapid reduction in NPL and transparency on the measure of core capital.

A decade of financial crises

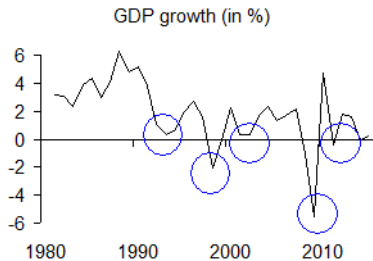
A high cost on growth (increased by deflation, "zombie" lending, or balance sheet effects ...).



- For example, growth slowdown of 0.7-2.0 percentage point of GDP over five years for countries affected by a systemic financial crisis.
- On average, NPL are lower in Europe ...
- ... but not for all countries. Lesson for Europe: do not delay the resolution of the crisis for too long.

Factor #2: an accumulation of shocks and the policy mix

Not "two lost decades" but recoveries and relapses:



Sources : Cabinet Office.

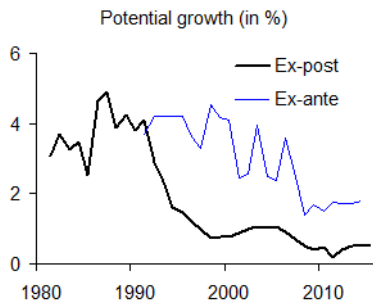
- Financial shocks: bursting of the bubble 1990-1991, systemic crisis 1997, financial stress 2003 ...
- Regional or global shocks: yen appreciation 1993-95, Asian crisis 1997-98, Internet bubble 2001, Lehman shock 2008-09 (trade and exchange rates) ...
- Tohoku Earthquake in 2011.

Weakness of automatic stabilizers in Japan. Repeated shocks in Europe: 2008-09, 2011-12... Lesson: need a buffer.

A widespread optimistic bias

The cost of the optimistic bias: waiting for the recovery and under-calibrating economic policy responses.

= Same initial bias in Europe. Lesson: avoid cheerleading.



Sources : authors based on IMF / WEO.

- An almost systematic optimistic bias (both on short-term forecasts and on medium-term forecasts: this is not just the classic difficulty in predicting crises) ...
- ... shared by many agents (government, private sector / Takan survey, international institutions / Federal Reserve ...)

Other factors related to cyclical policies

As a reminder Cf. slides above on Abenomics.

- Poor coordination between fiscal and monetary policy.
= Likely an issue in Europe. Coordination of fiscal policies with 19 or 28 countries. Lesson: need to coordinate.
- Domestic debt market. = An issue for Greece, never an issue for Japan.
- "Self inflicted paralysis" (Ben Bernanke) in monetary policy for some years, or very prudent monetary policy.
= Sometimes tempting to read the debate between governors Shirakawa and Kuroda as a debate between the Bundesbank and the ECB (ex. the "revolt" of German savers asking for higher return on bank deposits), still greater awareness.

The monetary policy debate in Japan and the euro area

Comparison of the monetary policy debate in the euro area and Japan

<u>Objections to QE policies (strong)</u>	Germany / ECB *	Japan / BOJ
Blurring the boundaries between monetary and fiscal policies.	Weidmann	Shirakawa
A financial risk to the balance sheet of the central bank.	Weidmann	Shirakawa
Remove an incentive to adopt strict fiscal and structural programs.	Weidmann	Shirakawa
Entail a shift of national sovereignty, a move toward a fiscal union.	Karlsruhe / Weid.	(Not relevant)
May lead to high inflation / hyperinflation	(1970s not 1920s)	Shirakawa
<u>Limits of QE policies / Other policies (mild)</u>		
Fiscal concern: frustration that the debt rules are being sidelined; deficit	Draghi/ Weidmann	Kuroda
Need of convincing program of structural reforms	Draghi	Kuroda
Need to study the effectiveness of monetary policy measures.		Kuroda

* Discussion about OMT (Outright Monetary Transactions, Sept. 2012) and QE (March 2015)

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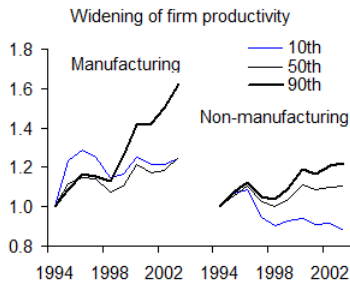
Strong objection

Mild caution

Jens Weidmann (Bundesbank president since 2011); Mario Draghi (ECB president since 2011); Masaaki Shirakawa (BOJ governor 2008-13); Haruhiko Kuroda (BOJ governor since 2013).

Factor #3: growth; less spillovers, weaker coordination

Productivity growth declined at the aggregate level. This is not just a contrast between industry vs. services.



90th: most productive 10% of firms

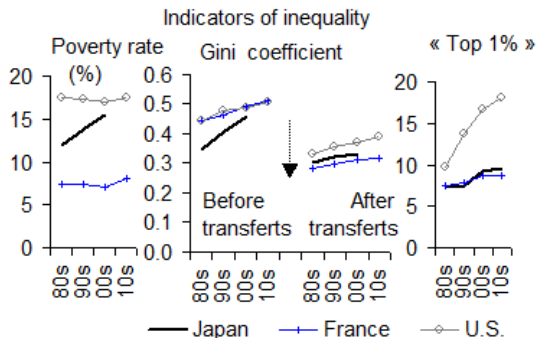
10th: least productive 10% of firms

Sources : Ito et Lechevalier, 2009.

- Increasing dispersion of productivity at the micro level that reflects internationalization or the development of competition but not technical progress.
- One major reason of the decline: reduced organizational and technological spillovers (e.g. large companies to SMEs, *shunto* for wage negotiation, etc.)

Inequality on the rise and its impact on growth

Japan is no longer the egalitarian society of the 1960s-1970s.
= Stronger welfare state and automatic stabilizer in Europe.



Sources : OECD; Paris School of Economics.

- Labor dynamics rather than capital dynamics (diff. Piketty).
- Flat wages (due to the rise of "non-regular" workers).
- Depressive impact of low income workers on domestic demand.

Summing up: can Europe experience a slowdown as Japan?

No for Europe as a whole; yes for some individual countries.

- **Financial crisis.** The financial problem has been recognized much earlier and average NPL are much lower in Europe... but with some exceptions at the periphery of the euro area.
- **Countercyclical policies.** Europe has much stronger countercyclical buffers... but fiscal policy coordination is actually worst within the EU. Some similarity of policy debates between Japan and Europe... but a larger sensitivity to the deflation risk.
- **Lost growth.** Some similar factors like the demographic slowdown. In terms of structural reforms, less a cause of the slowdown as a source of potential boost in growth.

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Abenomics: Will it fail?

What lessons for Europe from the "lost decade"?

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Lessons from Abenomics

Lessons from the Japanese experience

Japan's influence on macroeconomic policies

Conclusion

Lessons from Abenomics

- **Broadly the right design.** Abenomics embody an appropriate attempt to use in a consistent way different economic policy instruments. They correct some past policy mistakes.
- **Adopting the new normal.** Despite their innovative aspect in the Japanese context, Abenomics mainly correspond to the new norm of economic policy since the financial crisis: (1) the new activism of central banks, (2) a stronger coordination of policies in favor of growth.
- **A reboot is needed for Abenomics.** After three years, Abenomics has also shown some limitations. The political calendar is almost clear: Upper House elections in June 2016 (current voting intentions: 39 % LDP, 9 % DP, 35 % w/o opinion), Lower House elections of December 2018.

Lessons from the Japanese experience

- **An optimistic bias.** One of the major mistakes of the Japanese authorities has been to overestimate the strength of the economic recovery, presumed to be the solution to all problems (financial crisis, public debt, or deflation).
= Don't wait for Godot! Risk of being unprepared for the next crisis...
- **Need of a policy buffer.** The extent of the slowdown was underestimated and the economic policy response below what would have been required, contributing to the deterioration of the economic situation.
- **The cost of procrastination.** Resolving problems that have contributed to a crisis takes time. It makes sense not to delay potentially costly decisions in the short term, otherwise there is a risk of an endogenous development of the crisis.

What is the influence of the Japanese economic experience over the past 25 years on economic policies?

- **In Japan.** Abenomics is difficult to understand without reference to economic history (ex. the VAT debate in 1997, assessment on the effectiveness of QE...).
- **In the United States.** The Japanese economy was closely followed by economic policymakers cf. recent biographies of Ben Bernanke (2015) or Tim Geithner (2016).
- **In Europe.** A smaller influence. Jean-Paul Trichet (2014)'s quip on what should be the focus of Abenomics, "structural reforms, structural reforms, structural reforms."
By contrast, comments by Mario Draghi (2016) who compares Kuroda to Volcker, both have shown that monetary policy is not powerless.

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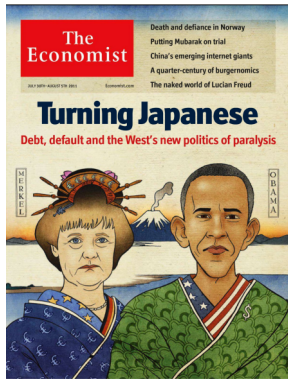
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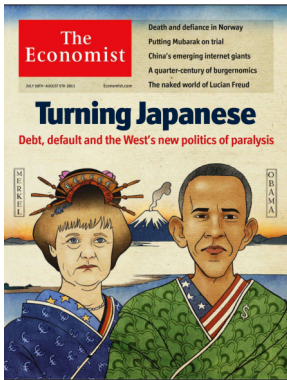
Playing with fear. Is Japanization the most scary outcome?



July 30, 2011

Turning Japanese...

Playing with fear. Is Japonization the most scary outcome?



July 30, 2011
Turning Japanese...



Jan. 5, 2013
... or turning French ?

Thank you for your attention !

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