

Fate of 'Abenomics 2.0' hangs in the balance

REBOOT: If the Japanese PM'S latest policy fails to embrace structural reforms, it will be no better than the first

JAPANESE Prime Minister Shinzo Abe's recent policy decisions — to increase monetary stimulus dramatically, to postpone a consumption-tax increase and to call a snap election in mid-December — have returned his country to the forefront of an intense policy debate. The problem is simple: How can aging advanced economies revive growth after a financial crisis? The solution is not.

It is now clear that the first round of Abe's reforms — known as "Abenomics" — has failed to generate sustained inflation. Hopes for continued recovery have now given way to two consecutive quarters of negative growth. The question is whether Abenomics 2.0 will put Japan's economy back on the path to renewed prosperity.



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My own view is that the "three arrows" of Abenomics 1.0 basically had it right: "whatever it takes" monetary policy to restore inflation, supportive fiscal policy and structural reforms to boost long-run growth.

But, though the central bank, under Governor Haruhiko Kuroda, has been delivering on its side of the bargain, the other two "arrows" of Abenomics have fallen far short.

There has been no significant progress on supply-side reforms, especially on the core issue of how to expand the labour

force. With an aging and shrinking population, Japan's government must find ways to encourage more women to work, entice older Japanese to remain in the labour force and develop more family-friendly labour policies. Above all,



A man walking by an electronic stock board at a securities firm in Tokyo. While the monetary policy of **Abenomics 1.0** is being delivered, the fiscal policy and structural reforms have fallen short. AP pic

Japan needs to create a more welcoming environment for immigrant workers.

There has been some movement on immigration. Panicked by deadlines for the 2020 Summer Olympics in Tokyo, the government managed to clear the import of foreign construction workers (though the decision had to make its way through a half-dozen ministries).

But overall progress has been slow. Japan desperately needs more nurses and hospice workers to care for its

aging population, but bureaucratic and political resistance to immigration is deeply entrenched.

When I first started asking my Japanese academic friends about Abe's supply-side reforms, they said, "Don't worry, they're coming".

Then, after a while, they would say, "Don't worry, they're coming — but slowly". Recently, the mantra has changed to, "Don't worry, we still think they're coming".

One can only hope so. Without structural reforms, especially of the

labour market, Abenomics cannot succeed in the long run.

The timing of the April consumption-tax hike (from five to eight percent) was also unfortunate. It would not have been easy for Abe to postpone the move, given that it had been locked in place by broad-based political agreement before he took office. But the government could have engaged in aggressive fiscal stimulus to counteract the hike's short-term effects. Instead, two successive quarters of negative growth have had a dispiriting psychological impact.

True, the slump is partly an illusion: the earlier boom was fuelled by Japanese households' effort to beat the tax by front-loading purchases of consumer durables — a nuance that seems to have been lost in the public debate. But the big picture remains: Abenomics, so far, has failed to turn around a deflationary mindset.

Mind you, Japan's outside government debt and undersize pension assets are a huge problem, and only the most reckless and crude Keynesian will advise the authorities to ignore it. For the moment, the risks are notional, with interest rates on 10-year government debt below 0.5 percent.

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But saying that Japan's debt is irrelevant is like saying that a highly-leveraged hedge fund is completely safe; the risks may be remote but they are not trivial.

Think about what would happen if the Bank of Japan actually managed to convince the public that inflation will average two percent on a sustained basis. Would 10-year interest

rates still be 0.5 percent?

What if other factors — say, a sharp decline in emerging-market growth — led to a sharp rise in global real interest rates or a rise in risk premia on Japanese debt?

In principle, Japan could weather such shocks without high inflation or other extreme measures, but it is folly to deny the country's vulnerability. A hedge fund can simply go out of business; that is not an option

for a great nation.

Fiscal sustainability requires an eventual rise in the consumption tax, and of course, Japan should not wait until international investors start doubting its willpower. The problem is in the timing and tactics. Postponing the second consumption-tax increase seems like a good compromise between pushing Abenomics to escape velocity and maintaining long-run credibility.

But this brings us back to Japan's deeper problems. Demand policies alone will not alone prevent two more lost decades, much less guarantee two golden ones. Demographic decline was a key factor in setting off Japan's 1992 financial crisis and the long malaise that followed.

Japan is still a rich country, but its ranking in terms of real per capita income has now slipped below that of many other advanced economies,

including the United Kingdom, by some measures, and far below that of the United States.

Japan's experience holds important lessons for Europe, the main one being that stimulus policies, though necessary in the short run to support demand, cannot address long-term structural deficiencies. If Abenomics 2.0 fails to embrace deep structural reform, it will fare no better than the original. **Project Syndicate**