

## **Making Real a Growth Agenda for Japan**

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*Speaking Outline*

### **1. Using trade to reform agriculture and governance in Japan**

- The pursuit of deep regional free trade agendas is motivated by two largely complementary forces: 1) reform-minded governments broadly for reasons relating to either domestic competitiveness or geostrategic security; and 2) multinational corporations looking to secure global supply chains, market access, and uniform regulatory regimes.
- These forces have been countered often by emerging economies who are unwilling to make necessary reforms, and by policymakers in developed countries skeptical of the efficacy of free trade agreements.
- A major shift in global trade negotiations in the past decade has been the emergence of China.
- In Japan, there still exist very distortionary policies regarding staple food products such as pork and rice, principal problem of which is pork.
- President Obama’s trip to Japan to secure an agreement from the Japanese government was premature given that the TPA has yet to receive approval. The approval prospects for TPA and thus TPP will likely be better under a Republican-controlled Senate.
- Inclusion of a currency clause in the TPP agreement would likely delay negotiations for several years. However, under current conditions, it may need to be either implicitly or indirectly addressed if TPP is meant to eventually include China.
- From Japanese point of view, Japan (along with Korea) should be in RCEP to help maintain a relatively high standard. From the US perspective, RCEP is not a competitive agreement to TPP but rather could help countries take necessary steps towards the TPP standard.

### **2. Confronting the widespread slowdown in productivity growth**

- There has been a slow-down in productivity that has been observed in many parts of the developed world. Various explanations have been proffered from Summers’ secular stagnation, or the impaired banking system and monetary transmission, and others.
- In Japan, there has been no shortage of investment over the past 10-15 years since the Asian financial crisis, but their productivity has not increased. This could be due to the protections afforded to smaller businesses in that, in the US, a large part of the IT productivity boom was due to large firms (e.g. Walmart) integrating into their logistical network.

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- Another, complementary view was that since the structure of the Japanese economy has changed since the 70's and 80's, the large firms have been doing most of the innovating, but that innovation is of the incremental, additive variety (as opposed to the Schumpeterian variety a la Apple).
- Alternatively, in extended periods of low rates, allocation of credit may not be as productive because it is so cheap to obtain by anyone, irrespective of productivity. Further, following financial crises, credit markets can become segmented and only firms of scale or investors can obtain the low rates on offer. Therefore relatively unproductive investment is made. This may partially explain the high levels of investment in Japan coupled with low and/or declining levels of productivity.

### **3. A realistic approach to achieving fiscal sustainability**

- Debt-to-GDP ratios in Japan the US do not appear set to decline in either the US or Japan. In the US, current projections may overstate future revenues. However, the secular decline in medical costs could lead lower long-term debt-to-GDP estimates.
- For Japan, fiscal reform is critical for Japan's ability to halt the increase in their debt-to-GDP and avoid a fiscal crisis. If the reforms under Abenomics fail to be implemented, a fiscal crisis could occur within ten years.
- A fiscal crisis is when there is concern about the marginal buyer. At the moment, the marginal buyer of JGB's is the BOJ. For the US, a fiscal crisis could occur if there is a demand shock. However, that seems unlikely for some time. Reserve currency status certainly helps ameliorate that concern.
- In Japan, for the first time in many years the BOJ and Ministry of Finance are working in the same direction. In recent years, much government investment has been wasted, however.
- Currently, fiscal spending in Japan is focused on offsetting the tax increase. However, beyond that, more investigation in fiscal multipliers should be done, if that is to be the purpose.
- In the US, there are plenty of potential infrastructure projects that could be undertaken, however the political ability to get those projects funded is more difficult.

### **4. Monetary policy in the face of an extended slowdown**

- The BOJ has been very successful thus far at generating positive inflation expectations without causing a large disruption in the Japanese bond markets.
- While the effect of the new monetary regime on the exchange rate has been dramatic, this can be thought of as a reversion to a pre-2008 financial crisis depreciating trend due to, among other things, sustained low levels of relative productivity growth.
- Kuroda has made a clear in his communication that, while the BOJ will make "necessary adjustments" to its QQE program, it is only one part of a three-part strategy to generate positive inflation and real economic growth.
- In the US, the prospect of a rise median wages is uncertain. This is reflected in workers' expectations of their own prospect for increases in wages, which has remained stagnant since the crisis. However, in terms of wage share of income, that share has remained unchanged outside the manufacturing sector for 25 years.

## 5. Getting the reforms going despite opposition

- The image of limited political capital for reform is misleading. Success in breaking through with reform increases political capital going forward if you take advantage of it. Meanwhile, timidity in approaching reform increases opposition
- Often it is best to take a “Nixon goes to China” approach – look at Clinton doing welfare reform, Schroeder doing unemployment benefits reform, Reagan raising some taxes, Samaras increasing tax compliance on the Greek oligarchs.
- At the same time, it is useful to have a visible defeat of a well-defined special interest group from the other side: Reagan and PATCO, Thatcher and the coal miners, Obama and the mileage standards for autos, Ireland and the bust bankers.
- The most difficult part is have public targets that make sense and are visible, but inherently cannot be as simple for structural reform as they are for fiscal and monetary policy.
- Focusing on the labor market and wage outcomes is a fruitful path.
- The bureaucratic problems of Japan as seen in the Fukushima disaster – turf battles, lack of transparency and accountability, insufficient political power over business or bureaucrats, refusal to accept international benchmarking, desire to paper over problems – also apply to economic policy in Japan.