

Japan's Great Stagnation; The Failure of Abenomics

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Long abstract

The Japanese economy has been stagnant since the collapse of the bubble economy in the early 1990s. Japan's GDP growth has remained low, and real wages have hardly grown most of the time. Even after the implementation of Abenomics, especially its experimental, expansionary monetary policy, the situation remains the same. After more than three decades of economic stagnation, Japan will be surpassed by Germany in GDP and fall to the fourth largest economy in the world in 2023, according to the IMF forecast (Sakakibara 2023).

Scholars have examined the causes of Japan's economic stagnation in several policy areas, such as monetary policy, fiscal policy and structural reform (Katz 1998, Maswood 2002, Blomstrom et al. 2003, Callen and Ostry 2003, Hutchison and Westermann 2006, Garside 2012, Wakatabe 2015, Yoshino and Taghizadeh-Hesary 2017, Park et al. 2018). This article conducts a critical review of the relevant literature and assesses the validity of several explanations of the causes of Japan's economic stagnation. This article shows its understanding of the causes and identifies the economic consequences of Abenomics. It examines Japan's economic stagnation by analyzing the incentives of the relevant political and economic actors to promote certain specific policies and their problems. After a few years since the end of the Abe administration and with the prospect of certain changes in the Bank of Japan's monetary policy, now is a good time to assess the effectiveness of Abenomics as an economic policy to overcome stagnation and its (unintended) consequences.

As for monetary policy, Japanese government's recent policies – Abenomics and the similar policies of the following administrations – have relied on expansionary monetary policy or monetary easing, both qualitative and quantitative, to overcome deflation and stimulate economic growth. Some economic scholars, especially those called “reflationists”, proposed monetary easing and the setting of inflation targets to create an inflationary expectation and overcome economic stagnation (Krugman 1998, Posen 1998, Bernanke, et al. 1999, Harada 2003, Iwata 2003, Ito and Mishkin 2005, Hamada and Okada 2009, Wakatabe 2015).

These scholars overestimated the effectiveness of monetary policy to achieve economic growth without understanding the essential role of structural reform in achieving economic growth through higher productivity and efficiency. In hindsight, monetary easing did not contribute to significant economic growth. Also, the BOJ's 2% inflation target was achieved only after the price increases of imported products such as raw materials caused by such incidents as the Russian invasion of Ukraine and disruptions to supply chains. It was not

inflation based on the increase in business investment and consumer spending, which the LDP government and the BOJ influenced by the reflationist idea hoped to achieve. Instead, monetary easing has had a negative impact on consumers' economic welfare and their spending by depreciating yen and raising prices of imported products, especially those of daily necessities. This had a negative impact on economic growth.

Although Abenomics was useful for increasing share prices and promoting export with depreciated yen at the beginning, it is also responsible for the currently high level of inflation and has proved to be detrimental to consumer spending and economic growth. The BOJ's monetary policy based on extremely low interest rates widened the gaps between Japanese interest rates and those of other countries and contributed to the historic low exchange rates of Japanese yen. The easy monetary policy has also enabled so-called "zombie" companies, which suffer from low levels of efficiency, productivity and competitiveness, to survive. The current estimate is that around 13 percent of Japanese companies are zombie companies (Lewis 2023). Due to the existence of many such companies, the Japanese economy has not been able to achieve sufficient economic growth and continues stagnating. Real wages have not grown either, despite the record amount of profits by some large Japanese companies. Indeed, real wages have decreased for 18 consecutive months as of September 2023 (Reuters 2023). The reflationists' assumption that (real) wages would increase with larger business profits based on the "trickle-down" theory has proved to be wrong.

As for fiscal policy, the LDP government has engaged in a large amount of public works to stimulate the economy, although the government spending for public works has been in a decreasing trend, especially during the Koizumi administration aimed at reducing public works in a neoliberal fashion. One of the main resources for the LDP to maintain political power is "interests group" politics, which has often been seen in the close and symbiotic relationship between the LDP and its supportive interest groups based on the quid pro quo – LDP's protection of and subsidies to interest groups and the votes (and donations) from interest groups to the LDP in return (bureaucrats are also part of the interest group politics).

Interest group politics was also seen in the second arrow of Abenomics aimed at economic growth through fiscal expansion. While the creation of jobs based on public works is a quintessential Keynesian policy and may be useful for stimulating economic growth to some extent, especially at the time of economic crises, the LDP government's reliance on public works for economic stimulation has wasted a huge amount of taxpayers' money and contributed to the worst situation in the world of the accumulated debt of the Japanese government – currently higher than 260 percent of GDP. Many companies engaging in public works are small- and medium sized enterprises that lack productivity and efficiency such as those in the construction sector. In this way, LDP's reliance on public works for both

economic stimulation and its maintenance of power has contributed to the survival of non-competitive companies with low productivity. This further contributed to the lackluster performance of the Japanese economy on average in terms of GDP growth. The effectiveness of fiscal policy in achieving economic growth, especially the one through often unnecessary public works a la the LDP interest group politics, has proved to be limited after the creation of a large number of public works for decades.

As for structural reform, the LDP government has shown its intention to implement structural reform since the 1990s, but reforms were implemented insufficiently in many cases. As mentioned above, one of the power resources for the LDP (and bureaucrats) to maintain power has been interest group politics. This has restricted the degree of reforms aimed at enhancing labor productivity and economic efficiency. For example, the delay in the reform of financial supervision based on the “convoy” system enabled financial institutions lacking productivity, efficiency and competitiveness to survive longer than necessary (Amyx 2004). This exacerbated the problem of non-performing loans and contributed to economic stagnation in the 1990s.

The failure to reform regular employment in the form of easier dismissal may have deterred interfirm labor mobility from declining to promising industries although easier dismissal has no guarantee to increase employment or promote labor mobility, as seen in several European countries such as Italy that relaxed dismissal regulation (Cirillo et al, 2016). The content of Japanese labor market reform was mostly deregulation of non-regular employment, but this contributed to the increase in low-paid workers in precarious conditions (Watanabe 2014). The introduction of the “equal pay for equal work” principle in the Work-style Reform in 2018 was an appropriate measure in this context, but this principle has several loopholes in its implementation as it was introduced as a policy measure to promote economic growth rather than a measure to improve working conditions and enhance worker protection (Watanabe 2020). The increase in such workers who lack spending power is likely to have contributed to lower growth. The neoliberal deregulation of non-regular employment may be considered a bad example of structural reform as it has contributed to economic stagnation.

However, the above case does not negate the overall necessity of structural reform in certain industrial sectors. Many Japanese companies in the service sector suffer from low labor productivity and business inefficiency due to government regulation, anti-competitive business customs, a lack of digitalization, inefficient human resource management, inflexible business style, and so on. While structural reform implemented by the government may not solve all these problems, there are several things the government can and should do to promote economic growth, such as reducing government regulations to protect inefficient businesses. This is an essential measure to enhance productivity of Japanese businesses and

promote economic growth. However, we probably cannot expect much from the governing party that depends on interest group politics.

While the implementation of appropriate structural reforms aimed at enhancing labor productivity and business efficiency is essential to overcome economic stagnation and promote economic growth, the over-reliance on macroeconomic policy (monetary and fiscal policy) in the ways proposed by reflationists of Abenomics has proved to be not only useless but also detrimental. The implementation of fiscal policy mostly based on the creation of public works is not as effective as it used to be in the past and should not be relied easily, given the increasing amount of social welfare spending despite the already very high level of the government debt-to-GDP ratio. The implementation of expansionary monetary policy could not achieve the 2% inflation target in the way the Abe administration and reflationists hoped – a virtuous cycle of the increase in corporate profits, the increase in workers' salaries and the increase in consumer spending. Instead, the 2% inflation target was achieved only because of the price hikes caused by external factors such as the disruption to global supply chains.

Abenomics failed to raise real wages that have stagnated since the collapse of the bubble economy, partly due to the lack of a mechanism in which a sufficient portion of corporate profits can be converted to workers' salaries. Instead, the expansionary monetary policy of Abenomics contributed to the significant depreciation of Japanese yen and has had a negative impact on consumer spending, thus contributing to economic stagnation. This monetary easing also contributed to the survival of inefficient businesses lacking productivity and competitiveness. This has also made it more difficult for Japan to overcome economic stagnation. The Japanese economy needs structural reform to achieve growth. Easy monetary policy and fiscal policy based on public works are convenient policy tools for the LDP government, but their usefulness for economic growth has proved to be limited. Instead, they are more likely to enable economic stagnation to continue.

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