

Turning Japanese or Returning to Reality?

Adam S. Posen, PIIE

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Turning Japanese or Returning to Reality?

- There are really two periods to Japan's 'lost decades'
 - Idiosyncratic shocks and recurrent by policy mistakes 1990-2002
 - International shocks and long-term trends 2002-present
 - Growth including productivity growth decent compared to comparable economies in the second period
- Big issue # 1: Does Japan still demonstrate undergrad textbook macro circa 1990 applies?
- Big issue # 2: How relevant to growth and welfare are the puzzles of the apparent inability to raise inflation?
- Big issue # 3: What is the political economy of raising the growth rate, and how applicable is that to Asia generally?

Assessment of Abenomics to date

- **Juxtaposition of very high real impact of 2014 fiscal tightening with relatively low impact of monetary expansion – how weird? How important?**
 - Yen pass through to inflation is not high, as expected by non-academics
 - Multiplier on VAT hike is not high vs. prior arguments by Krugman/Summers or Kuttner and Posen (2001)
 - Most of all, unlike in the 1990s, many of the observed phenomena are simultaneously global patterns
 - low wage growth,
 - low pass through, low response of imports to depreciation
 - no SR stable Phillips curve,
 - low long rates despite fiscal weakening

Assessment of Abenomics to date

- **Have to think harder about the labor market dynamics**
 - Try to unpack the impact of increased part-time worker share and of hours
 - But the evidence on labor market reform (from EU) is that it is deflationary in the SR and expansionary benefits only come with a lag conditional on expansion
 - Japan seems to be doing relatively well on productivity growth, not just per capita growth
 - Listen to the next presentation by Fukao – very important
- **Two and a half large structural reforms have been undertaken**
 - Womenomics raised overall LFP by >1.5% in 2 years, is affecting Boards/wage differentials slowly, but huge growth boost
 - Corporate governance reforms are increasing two-way flow of FDI (may explain the rise in services imports)
 - Agricultural consolidation and breakdown of price supports awaits TPP for full implementation

Does Abenomics support or discredit standard macro approach to growth?

- **The forward-looking expectations/credibility centered view of monetary policy comes off poorly**
 - We really need real growth and wage increases to get inflation up
 - Combo of exchange rate movement and the BOJ program should have been “credible” by any standard
 - Combination of labor market changes and global forces can account for a rather large share of the ‘shortfall’ in inflation (i.e., core targeting was more successful)
- **Fiscal policy comes closer to being as expected, at least in the short-run, and ignores the long-run without harm**
 - Multipliers on fiscal policy not unexpectedly large, but persistence of shock was as surprise
 - Much more troubling with respect to fiscal theories of price level, debt-sustainability, and distinctions of permanent/temporary tax impacts

Does Abenomics support or discredit standard macro?

- **Four surprises and challenges with respect to overall policy assessment**
 - Big overlooked surprise is that unlike 1990s/early 2000s, clean banks and balance sheets, still limited effect
 - Should we stop talking about credibility? – if forward-looking matters, shouldn't there be Ricardian effects of fiscal policy and/or a stock market response to VAT hike?
 - If labor flexibility and shareholder rights enhancing reforms don't work when tried, does this mean that structural reform is overrated?
 - Public capital accumulation over private capital accumulation seems to work (a remnant of the old Asian growth model that deserves to stay?)

What are the challenges Japan presents to macro?

- Remember, the message of Japan 1990-2003 is that policy worked as expected
 - Has something changed?
 - Japan is more open and more market now than in 2003 which goes other way
- Underscores the misleading emphasis on (simple? or just flexible?) forward-looking expectations – even amongst well-informed businesses and investors
- Challenges us to further examine the global forces (still tbd) behind inflation levels and consumption/savings trends – especially since not simple RBC looking either
- Highlight the puzzles in trade balance and exchange rate pass-through –
 - How can depreciation have large effects on exports volumes but not imports?
 - How can depreciaton affect a huge chunk of the economy and not (first-round) affect general inflation?
- Why is low inflation so inertial not just sticky?
- Are we having to take more literally falling in and out of two states of the world between recession-land and boom-world?

The Political Economy of Reform and Growth

- If you start to look around, this is everywhere
 - Not so much ‘turning Japanese’ as ‘new normal’ is ‘old normal’
 - It was the 1990s US that was aberrant (Blanchard Gali 2005)
 - Look at Italy, look at UK, and so on
- Political economy of stagnation
 - (“Is Germany turning Japanese?” Posen 2003)
 - Incomplete financial liberalization
 - Macro policy division and deflation bias
 - Financially and politically passive households
 - Lack of openness to trade/cap flows AND foreigners
- Germany saved by EU, can Asia integrate?

The Political Economy of Reform and Growth

- The point of openness isn't just economic, but in terms of challenge to the status quo incumbents
- Also throwback that this is about political economy
 - Old school – interest groups in civil society, ethno-nationalist identity, financial institutions capture
 - Not the Italo-Swedish school of institutionalism and incentives
 - Openness matters a great deal
 - Anti-immigrant what it says about society (Noland Pack 2004)
 - Close mindedness