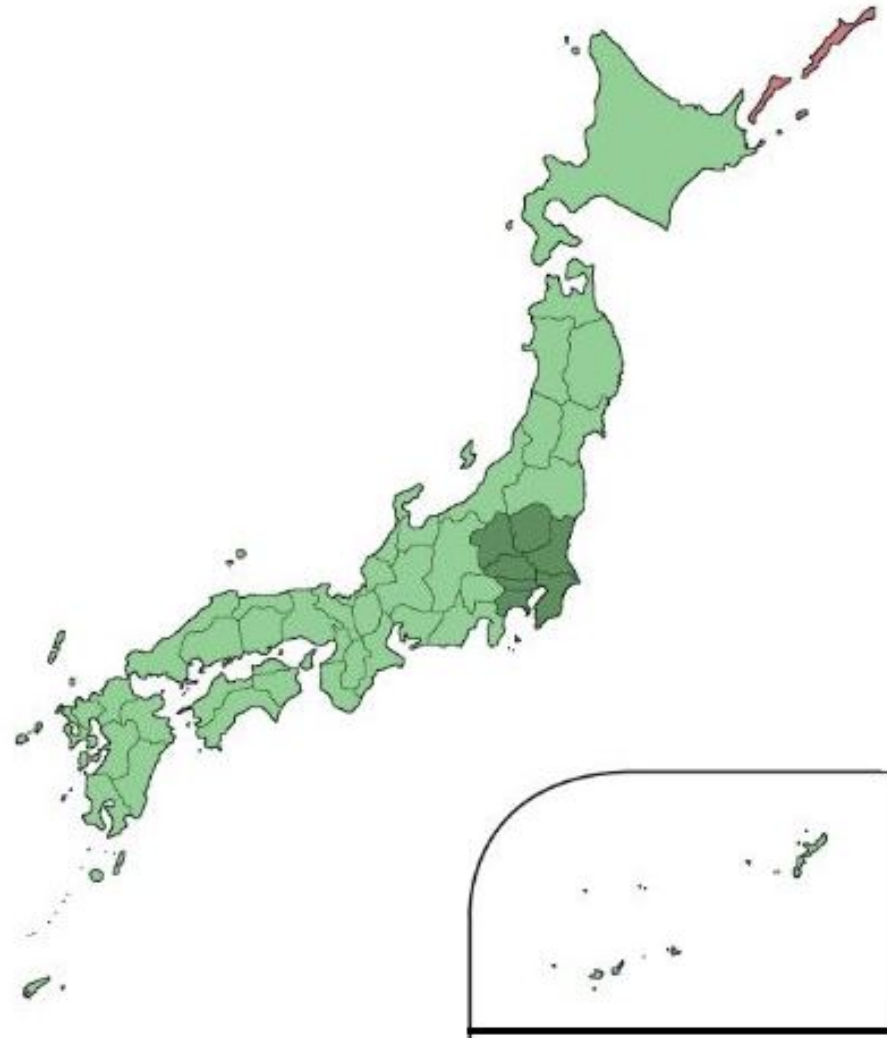


# Hour 5

## Japan – Strengths and Challenges



# Major Economic Challenges

1. Balance Sheet Recessions
2. Demographic Challenges\*
3. Energy Problems
4. Debts, Deficits, and Taxation
5. Abenomics
6. Structural Changes to the Economy

# 1. Balance Sheet Recessions

A balance sheet recession is a type of economic recession that occurs when high levels of private sector debt cause individuals or companies to collectively focus on saving by paying down debt rather than spending or investing, causing economic growth to slow or decline. The term is attributed to economist Richard Koo and is related to the debt deflation concept described by economist Irving Fisher. Recent examples include Japan's recession that began in 1990 and the U.S. recession of 2007-2009.

<https://www.youtube.com/watch?v=HaNxAzLKegU>

<https://www.youtube.com/watch?v=8YTyJzmiHGk>

## **2. Demographic Challenges\***

# 3. Energy Problems

[http://www.meti.go.jp/english/report/downloadfiles/energy\\_hakusho\\_201711.pdf](http://www.meti.go.jp/english/report/downloadfiles/energy_hakusho_201711.pdf)

## 4. Debts, Deficits, and Taxation

There are only four ways a country can resolve a large public debt: growth, repayment, default or inflation. Growth is out. Whatever prime minister Shinzo Abe says, Japan cannot outgrow its liabilities while the population shrinks, no matter how many trade deals it signs or reforms it concludes. Large-scale immigration would change everything, but debt ratios should not decide so fundamental a social choice. Repayment is almost as difficult. It would require a budget surplus over many years despite ever greater spending on healthcare, pensions and national defence. In turn, a surplus requires a corresponding deficit for consumers, companies or foreigners. Given the expectation of higher taxes and uncertain pension provision, Japanese households seem unlikely to run down their savings aggressively. That makes the two crisis outcomes — default or inflation — seem inevitable. Default, however, makes no sense at all since almost all of Japan's debt is owned by the central bank and the domestic financial system. If it did not repay, the government would simply have to recapitalise them. It would be defaulting on itself. Higher inflation — at or a bit above the 2 per cent inflation target Japan has missed for the past couple of decades — would help, not hurt, by gently eroding debt. Just possibly, in the transition to higher inflation, the Bank of Japan might lose control and let prices take off. But the government has little incentive to pursue an inflation tax. Japan is an asset-owning country full of price-conscious pensioners. There is no quicker route to political suicide than destroying their savings. All four routes to resolving the public debt seem improbable. Nor is there any obvious reason, given that Japan is the world's biggest international creditor, why investor panic and flight from the yen should force it to choose among them. That leaves a more plausible fifth option. Do not resolve the public debt. Live with it. This is surprisingly do-able. In a forthcoming update to a prescient 2005 paper casting doubt on the likelihood of a debt crisis, Columbia University economist David Weinstein and co-author Mark Greenan find three reasons why Japan has avoided a bond panic: falling interest costs, ruthless control of spending on the elderly and a big rise in taxes. The real interest rate Japan pays on its debt has fallen steadily. With short-term interest rates now negative, the country gets paid to borrow for short periods. The interest bill is even more manageable after factoring in revenues from Japan's foreign exchange reserves and other public financial assets. As a result, economic stimulus under Mr Abe has finally stabilised Japan's debt after years of relentless increase. It was 237 per cent of GDP in 2012. The International Monetary Fund forecasts 232 per cent of GDP for 2022. Low interest rates mean the existing debt simply does not matter that much for fiscal sustainability. More importantly, and belying its reputation for wasteful public works, Japan has made a series of tough decisions on healthcare and pension spending. Real per capita outlays on the elderly have fallen. Tax revenues are up by six percentage points of GDP since 2000. "If this approach continues," write Mr Weinstein and Mr Greenan, "Japan may very well avoid either a financial crisis or a major inflationary episode." Japan cannot afford to splurge. As the baby boom generation reaches old age, it will need to means test benefits and raise more revenue from wealth and consumption taxes. But Japan has shown it can do so. It is time, therefore, to drop the fears of imminent crisis and the demands for instant fiscal tightening. Mr Abe's policies have stabilised Japan's debt. It is imperative to keep them going until inflation is high enough to cut interest rates during a recession and the economy is strong enough to run a fiscal surplus during a boom. A country with Japan's demographics will always be close to the edge. With discipline on spending, however, there is no reason to fall off it. The widow-maker has plenty more victims in it yet.

## 5. Abenomics



Abenomics (アベノミクス) refers to the economic policies advocated by Shinzō Abe since the December 2012 general election, which elected Abe to his first term as Prime Minister of Japan. Abenomics is based upon "three arrows" of **monetary easing, fiscal stimulus and structural reforms**.

Let us briefly look at some macroeconomic data for the pre-Abenomics period (1997–2012) and Abenomics period (2012–2016),

- (1) average nominal GDP growth has increased from  $-0.5\%$  to  $2.1\%$  (but the objective was  $3.0\%$ ),
- (2) average real output growth has increased from  $0.6\%$  to  $1.1\%$  compared to the objective of  $2.0\%$ ,
- (3) inflation measured using the GDP deflator has risen from  $-1.1\%$  to  $0.9\%$  ( $1.0\%$ ).

## 6. Structural Changes to the Economy

- (1) Addressing the duality between regular and non-regular workers
- (2) Correcting long working hours
- (3) Advancing human resource cultivation and supporting reemployment
- (4) Promoting flexible work styles
- (5) Introducing new scholarship programs to equip children of low-income families with skills and knowledge in tertiary education before their entry into the labor market
- (6) Health (e.g., utilization of AI, IoT, big data, robots)
- (7) Transportation (e.g., unmanned travelling)
- (8) FinTech (e.g., regulatory reform)

[https://www.japan.go.jp/abenomics/userdata/abenomics/pdf/170508\\_abenomics.pdf](https://www.japan.go.jp/abenomics/userdata/abenomics/pdf/170508_abenomics.pdf)



# Summary Hour 5

1. Koo has used the concept of a balance sheet recession to explain what has happened to Japan during the 1990-2018 period. Firms have seen their assets fall but liabilities remain constant. They react by minimizing debt rather than maximizing profit. They refuse to borrow even when there are profitable opportunities. High risk premia. One problem is that Japan continues to be in economic malaise even after 25 years.
2. Discussed tomorrow by Group 3
3. Japan energy problem is massive, renewable program has not been successful – too expensive , not scaled, fossil fuels being used, including coal, 9 nuclear plants now operating (out of 42), public is divided. The issue has become politicized. Japan imports 90% of its energy
4. Japan has a national debt that is 230% of the GDP. Reductions in this require increased growth, low interest rates, some austerity, a rise in taxes, Consumption tax is scheduled for a rise Oct 1 2019 and will rise to 10% from 8%.
5. Abenomics is only partially working, arrow 1 monetary stimulus continues to be used, arrow 2 is fiscal stimulus which has not been substantial, budgets increased at first to 2.4 trillion USD but have been reduced in recent years. The 3<sup>rd</sup> arrow structural reforms are discussed below.
6. Structural reforms include development of human resources, small and medium sized enterprises, IT sector, promotion of science and tech, promotion of inward FDI, reforms in agriculture, labor, and finance. Detailed programs with kpi indicators to evaluate progress.