

Japan's Economy of the Post-Abe Era. Powerless Fiscal and Monetary Policy

Yoshihide Suga Inherited Two Broken Arrows, One Arrow with No Archer and Dreadful COVID-19

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Global Research, October 06, 2020

Region: [Asia](#)

Theme: [Global Economy](#), [History](#)

New Japanese Prime Minister Yoshihide Suga has inherited from Abe Shinzo an economy in bad shape. The arrow of fiscal policy has made itself powerless, the arrow of monetary policy flooded the country with money which has lost its direction, The arrow of the structural adjustment has never left the bow. The long shadow of corona-virus is threatening the Japanese economy.

Abe Shinzo is the unique Japanese prime minister who has ruled Japan for nine years, one year in 2007-2008 and eight years, 2012-2020. This is a remarkable achievement in terms of the length of the prime minister's mandate. But, the people's expectation for national leaders is correlated with the length of the leader's being in power. So, one asks if Abe has done something which is commensurate with length of governing.

Perhaps, the most important criterion for judging Abe's policy achievements is his economic policy which may be grouped in to two policies: Abenomics and CORONA-19 policy.

What I am trying to argue in this paper is this. First, the Abenomics has not been a big success given the injection of enormous resources. This is attributable to wrong diagnosis of the problem of post-bubble Japanese economy. Second, the delayed emergency measures taken by Abe against the COVID-19 have made the recovery of the Japanese economy more difficult.

1. Abenomics



The malaise of the Japanese economy began with the real estate bubble burst of 1989. But, who made the bubble in the first place? Japan enjoyed unprecedented economic boom for three decades before the bubble. GDP increased by more than 10% a year. Such prosperity

was due to the Korean war, the Dodge Plan, the Cold War and the Japanese people's remarkable ability to import foreign know how – especially the technology of the U.S.- and japanize it.

However, the Japanese miracle was attributable primarily to the Japan Inc. led by the golden triangle composed of highly motivated and competent politicians, business leaders and the bureaucrats.

The success of the golden triangle led to the trilateral collusion, which became a powerful oligarchy and ruled the economy. Real estate speculation was the fastest way of making quick money and it is more than possible that the oligarchy and other rich people were the chief source of the asset bubble.

In 1988, a year before the drama of the bubble burst, in Ginza (Tokyo) area, one-square-meter land was worth US\$ 149,000. The territory of Japan was 37% of that of the U.S. But the value of real estate in Japan was 4 times that of the U.S. real estate. In the Tokyo stock market, the value of stocks was 69% of GDP in 1988; it jumped to 152% in 1989. It is hard to understand how such bubble is possible. One possible reason was the fact that the Japanese elite groups were little concerned with the health of the national economy; they were more interested in making quick bucks.

Then, in 1989, the bubble exploded without noise. But it was as devastating as large earthquakes. The value of real estate in Tokyo fell by 80%; the stock index in the Tokyo Stock market fell from 30,000 to 15,000. This created a panic among policy makers. The Bank of Japan (BoJ) reacted in a disturbing way; it jacked up, in 1990, the interest rate from 2% to 6%. This was too much; it created uncertainty; it reduced consumption; it slowed down production of goods and services. The recession began.

To fight the recession, the BoJ reduced the interest rate to zero per cent by 1994. This was too drastic and too late. The recession did not stop. What was more worrisome was the danger that this policy of the BoJ made the traditional monetary policy powerless in recovering the economy from recession. To recover the economy from the recession, interest rate should go down, but it could no longer go down below 0%. Here, Japan was trapped in so called the liquidity trap. Therefore, the BoJ had to use another monetary policy tool, namely the quantity easing policy (QE) in addition to two other policies comprising the fiscal policy and the structural adjustment policy.

In this way, Japan picked three policies: the QE policy, fiscal policy and the structural adjustment policy. These three sets of policies became Abenomics adopted in 2012, the year when Abe became prime minister for the second time.

The QE policy is a monetary policy which does not rely in the interest rate, rather, it consists in expanding liquid funds to the financial institutions which can finance consumer expenditures and business activities including investments and exports of goods and services. The fiscal policy consists in expanding tax income or government debts in order to bail out firms in trouble or expand consumption expenditure through subsidies or tax incentive measures. Of these three policies, the structural adjustment policy was the most difficult, because to implement it, the government was forced to discipline large corporations and people and institutions which were parts of the oligarchy.

One wonders why Abe picked arrows to identify economic policies. It is unusual to name

economic policy with war weapons such as arrow. Abe took arrows to show his strong wish to carry out these policies. In fact, his policies were bulldozer policies of pushing through no matter what. Such strategy may have merits in speeding up the policies. But, it is not wise to handle in this way such a complex reality as the economy.

Anyway, we have three arrows designed to kill the enemy, the stagflation of the Japanese economy which was, once, strong enough to challenge even the American economy. In this way Abe, got himself three arrows: the monetary arrow, the fiscal arrow and the structural adjustment arrow. Unfortunately, none of the three arrows have hit the target, the recovery of the dynamism of the Japanese economy.

The fiscal arrow ended up with astronomic government debt representing 250% of GDP in 2019. This was the highest public debt rate in the developed countries. This presents serious problem. Some people say that it is not a problem, because the creditors are Japanese citizens and they do not force the government to pay back the debt. But, sooner or later, the government must honour its debt and to do so, it has to find needed funds, more taxes, which means burden on the future generation of citizens.

The more important question is whether or not the fiscal arrow has hit the target, that is, the freeing the economy from decades-long stagflation. Unfortunately, the fiscal arrow has not hit the target. Even with government debt representing 250% of GDP, it was not enough to hit the target. It could not go through the tall wall of the structural ailment of the Japanese economy. The fiscal arrow was broken.

Much of the funds generated by the public debt should have been used for enforcement of productive firms, not the bail out of insolvent large corporations which were, in fact, the source of the structural ailment of the Japanese economy.

The monetary arrow did fly far, but it was also broken before hitting the target of saving the Japanese economy. The BoJ literally flooded the financial market with US\$ 923 billion in 2013, US\$ 1,056 billion in 2014 and US\$ 656 billion in 2015 amounting to a total of US\$ 2,835 billion. There were other QE measures giving total money supply of US\$ 12 trillion representing 2.4 times the Japan's GDP of US\$ 5 trillion in 2019.

So, money supply had no limit. But, was there any demand for the money? By and large, the demand for money comes from the consumer and the businesses. The income distribution has become more and more unequal, because the income of the vast majority of the Japanese people stopped to increase for years. Under such circumstance, it is no wonder that few people went to banks to borrow money, for the simple reason that they had no means to pay back the debt. The businesses did not go to banks either, because there was no demand for their products. So, the banks ended up with mountains of money which was, in fact, a burden in a situation of zero per cent interest rate.

What banks did was to finance the bailout of firms in trouble, make loans to pay old debts of consumers and businesses and even invest in foreign countries. One thing sure was that the QE was no longer the solution to the stagflation of the Japanese economy. In this way, the monetary arrow was also broken. It could not pierce the thick wall of the structural defects of the Japanese economy.

The failure or the limited success of the fiscal and the QE arrow was, perhaps, due to a wrong diagnosis of the ailment of the Japanese economy. It is possible that the ailment of

the Japanese economy was not something that could be cured by fiscal or monetary policies. At least, there was a limit to what the two arrows could do.

The real nature of the problem was structural ailment of the economy. Therefore, what Japan needed was the structural reform of the economy. There were surely many structural problems. But, as far as the stagflation of the economy is concerned, two problems may be identified: demographic problem and the low productivity of large corporation.

Japan is one of the countries which suffer much from demographic problem. The absolute number of the population of Japan will decrease from 126.5 million habitants in 2019 to 100 million in 2050. The speed of aging of the population is such that the population of 65 years old plus which counted for 17.4 % in 2000 now represents 28% of the population. On the other hand, the active population of age group of 15-64 years old which represented 67.5% in 2013 now represents 59.3%.

The demography is perhaps one of the most important determinant factors of the potential growth of the economy. It determines the quantity and the quality of the labour force; it determines the size of the domestic market. The declining population is the common challenge of all the developed countries. The obvious solution is immigration. But Japan is the most anti-immigration country among the developed countries. In average, in OECD countries, immigrants account for 12.2 % of total population against 1.2 % in Japan.

The main reason for the absence of immigrants in Japan is obviously the racism. Under the centuries-old Shintoism, the Japanese believe that they are the Yamato-race meaning the emperor's race, hence superior to all other races. Even now, discrimination against foreigners is a common phenomenon in Japan. There are about one million Koreans most of whom still remain Korean citizens poorly integrated into the labour market. Suga, the new prime minister, has to assure massive immigration to survive economically. But, to do so, Japanese must stop thinking that they are superior to all other races.

There is another factor which is responsible for the stagflation in Japan. It was the loss of global competitiveness of large corporations, members of the Keiretsu (assembly of big corporations). These corporations were once the pride of Japan and the envy of the world. However, since the bubble burst followed by stagflation, they lost the support of the domestic market as well as the global market.

In the period, 1995-2011, the global share of Toyota car production fell from 51% to 41%. The world share of Honda car production went down from 39% to 29%. In the period from 1995 to 2007, the global share of DRAM memory chip production dropped from 42% to 9.2%. This is incredible. The global share of Japanese production of navigator had free fall from 100% to 0 %. As for the profit of Japanese firms, in the period, 2001-2011, the profit of the Mazda decreased from 4.3% to 2.5%, while that of Toyota dropped down from 9.5% to 1.9%.

The implication of these figures is that the real cause of the Japanese stagflation was the losing competitiveness of Japanese large corporations in the global market. Therefore, the real structural adjustment policy was not the balling out of these corporations. The priority should have been given to SMEs. True, large corporations have made great contribution to the Japanese economic development by making GDP grow. However, as labour-saving technology developed further, the capacity of large corporations to create jobs became marginal.

The large corporations were also responsible for the concentration of income and assets in the hands of a small group of people. This has invited unequal income distribution leading to shrinking consumer demand and declining GDP growth.

In fact, Abe's third arrow of the structural reform should have consisted in not bailing out non-viable large firms; it should have helped competitive large corporation; it should have allocated more resources to the development of SMEs. But there was no one to promote and pursue such policy. In other word, the third arrow did not have its archer.

Abenomics has failed. If it is a success, it was surely very limited success. It is true that since 2012, the minus GDP growth became relatively rare; the jobs increased in number, mainly low paid jobs; the stagflation was dealt with some success. But this cannot be regarded as success, given the injection of fiscal resources and quantity easing which amount to almost 5 times GDP. The failure of Abenomics is largely due to the lack of Abe's political will to impose structural reform of Japan's industrial structure on the one hand and, on the other, the absence of effective immigration policy.

2. Haunting COVID-19 Crisis

Thus, Suga has inherited the economy which was still facing the danger of stagflation. To make the matter worse, Suga is given the economy further devastated by Abe's poor management of corona-virus crisis. The Japanese economy had barely survived the decades-long stagflation. Now, the shadow of the corona-virus is cast over the sky. Nobody knows the degree of devastation created by the virus crisis. However, Abe's poor management of the virus crisis could have worsened the negative impact on the Japanese economy. Abe lost the golden time in stopping the virus propagation so that he could protect his friends' investments in the Summer Olympics.

Undoubtedly, it is rather early to assess the impact of the virus crisis on the economy, because even the first wave of the pandemic is not over. It is possible to have, soon, a second wave. But, already some of available data suggest that the damage of the economy caused by the pandemic seems very grave. For instance, in the second quarter of 2020, the Japanese GDP has fallen by almost 28 % compared to the same period of 2019. For the entire year of 2020, the GDP is expected to decrease by 6%. This is serious. For the entire period of Abe's rule from 2012 to 2020, the annual growth rate of the Japanese GDP was, in general, a little, below 1 %. The fall of 6% in 2020 is indeed a big blow.

There are already 500 bankruptcies of small- and medium-sized enterprises (SMEs) of which 69 were food and beverage business; 53, hotel business; 54, apparel business. The consumer spending has shrunk by 14% as of July 2020. The major fall of consumer spending took place for travel (-58%), entertainment (-38), department stores sales (-29%) and transport (-28%) There is no doubt that they were the SMEs which suffer the most from the pandemics. This is the problem, because, in Japan, 70% of all jobs are created by the SMEs. Moreover, we should not forget that the vast majority of Japanese earn their butter and bread from working for the SMEs.

Abe has provided a set of emergency funds to cope with the devastating outcome of the lockdown. His government has provided as much as US\$ 2 trillion, which may look like a large amount. It is. In addition, Abe has provided a series of fiscal and monetary incentives for the production and the consumption of goods and services as well the exports of goods and services.

Perhaps, the most important policy measure taken by Abe is the access to bank loans. However, the trouble is this. In all probability, the bulk of benefits of these measures will go to large corporations for two reasons. First, the trilateral collusion of politics-corporations-bureaucracy has always favoured large corporations in policy making. Second, what counts in the long run is bank loans, but they are difficult for SMEs to have access because of prejudice and weak collaterals.

It is a well known fact that the global economy had hard time to recover from the global financial crisis of 2007-2008. The main reason was the fact that the QE money was spent for the survival of unhealthy large banks and corporations at the expense of the development of the SMEs. Don't forget. The results of the anti-SMEs policy is rising jobless and shrinking consumer demand. In Japan, the consumer spending accounts for 60% of GDP.

To sum up, Abenomics has done some good to the Japanese economy. But, Abe Shinzo has injected more than US\$ 20 trillion of money and fiscal funds to free the Japanese economy for persistent stagflation. So, one would have expected better results, given the amount of money spent to save the economy of the country of rising sun. This is an amount of money large enough to expect a victory over the ailing Japanese economy.

But, we cannot say that it is a success. It has failed to put new breath into the economy; it has failed to attenuate the suffering of ordinary Japanese people. In fact, according to a survey, 70% of the respondents said that they had received no or little benefits from Abenomics.

The huge negative impact of the corona-virus crisis on the Japanese economy is difficult to estimate at this moment. However, it could hurt severely the economy which had barely survived the decades-long stagflation. Thus, Suga is facing very challenging task of saving the economy he has inherited. We all wish him good luck, but it is hoped that he would consider the following policies.

First, the government should not rule the people. it should serve the people. The master of the country is not the government but the people.

Second, the government should stop its decades-long pro-large corporation policy and, instead, invest heavily in SMEs which are the center of economy.

Third, the new government of Suga should find the archer of the third arrow; Suga must become himself the archer. He should boldly undertake the structural adjustment of large companies. If history says anything, Korea could have had stagflation, if President Kim Dae-jung did not go through the extensive structural adjustment of large corporations during the Asian Financial Crisis of 1997-1998. President Kim closed insolvent Chaebols; he forced healthy Chabols to specialize; he forced to make their accounting system more transparent; he induced hem to cooperate with SMEs to create productive value chain.

Fourth, this is difficult. Japan should stop thinking that they are superior to other races. The demographic problem and the problem of shrinking labour force can be solved only through immigration. Immigrants will not come, unless the racial discrimination is solved in Japan. But, it should be pointed out that the immigration policy is one of the most difficult government policies. Japan should learn much from Canada which has a very successful immigration policy.

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Featured image: Suga announcing the new imperial era name "Reiwa" on 1 April 2019 (CC BY 4.0)

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