

Philosophy of Abenomics

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Link: <http://www.daily-sun.com/home/printnews/49880>

It is often customary to attach the name of a president/prime minister who pursues an innovative set of policies that draws a roadmap in economic growth in the near future from the current poor state of the economy. Reganomics or supply side economics of Ronald Regan during 1981-1989 and Clintonomics during 1993-2001 served as classic examples. The basic tenets of Reganomics were widespread tax cuts, decreased social spending and the deregulation of domestic markets. The premise of his policy was the traditional concept of “Trickle Down” theory that a reduction of corporate tax is the best way to stimulate growth; low corporate tax rate would have dual effect; corporate savings would be translated into investment and thus more employment and growth. President Clinton advocated for more humane approach with elements of modernizing the federal government, making it more entrepreneurial and distributing more authority to state and local governments.

Japan is the second biggest economy of the world with GDP of over \$17 trillion. Recently, the Japanese economy is in the limelight for two reasons, the GDP growth drops consecutively for Q2 and Q3 and a second term premiership of Shinzo Abe with a mandate to bolster the economy with three arrows policies. Japan officially notified that its economy is experiencing recession; for Q2 the economy experienced contraction of 1.9 per cent and for Q3 GDP shrank by 0.4 percent though the first Quarter Q1 observed a GDP growth rate of 1.6 percent. The fall in growth during Q2 and Q3 is due to a hike in sales tax from 5 percent to 8 percent and fall in real wages. An economy in a state of deflation seldom recover when it experience successive recession for a few quarters and thus requires bold drives to revert the moribund economy into a growth generating process. The three pronged policies of Abe helped the economy to bounce back from trough and miraculously real GDP recorded a growth of 2.4 percent during the Q1 of 2015. It is pertinent to look into the current state of the Japanese economy to understand the policies that Prime Minister Shinzo Abe considers to stimulate the economy.

An important indicator to judge the health of an economy is its debt GDP ratio. The ideal figure is less than 50 percent of GDP, but the gross debt in Japan reached 226 percent of GDP; the highest level of debt in the OECD country. Moreover, the year to year budget deficit of around 8 percent in Japan would render the sovereign debt burden unsustainable because the safe level of budget deficit is 3 percent as per the EU standard. One of the easy ways to reduce the debt burden is to raise taxes. The two- year premiership from 2012-2014 by Abe was characterized by concerted effort to reduce national debt by tapping into new revenue through raising taxes but the very high sales tax drastically cut the consumption and accentuated the deflationary state of the economy.

Deflation in Japan is the result of the collapse of the asset price bubble in the early 1990, the stock price nosedives to 7000 from a hefty 39,000 index points. This resulted in the negative equity for many banks and for many corporate houses. Investment collapsed and in the backdrop the labor force received a wage cut or unemployment situation aggravates. The obvious way is to

pursue an expansionary fiscal policy to boost aggregate demand. The task is reasonably easy in an economy where the sovereign debt as a percentage of GDP is within the rein. The case of Japan is rather precarious. Debt GDP ratio was 60 per cent during 1990 but from 1994 the gap between the OECD and the Japan is increasing; the trend tells that convergence is a bleak possibility. The snap election in December 2014 gives a leeway for Shinzo Abe to cure the economy by a quick elevation of the mindset from deflation so that people take risk in investment through a new set of policies engineered by the new government and supported by a congenial environment both for home and abroad.

The historical review suggests that the policy set in Abenomics is just the replication of the set of policies pursued by Korekiyo Takahashi. Korekiyo Takahashi was the finance minister for several times and also a Prime Minister before John Maynard Keynes advanced the idea of demand stimulation through the concept of Aggregate Demand in his book, *The General Theory* in 1936. Abenomics has three broad economic measures to get rid of from this deflationary situation. The most obvious one is quantitative easing by the Bank of Japan. The second one is an expansionary fiscal policy to stimulate aggregate demand and the third one a sustainable growth strategy through massive deregulation and ensure a cooperative global environment.

Fixation of target inflation rate is a prerequisite for an economy in a deflationary state. The policy of quantitative easing through Bank of Japan may push the economy in the positive growth zone in tandem with fiscal prudence. On the fiscal front, the government must perform the role the spender of the last resort. The government of Japan during the fiscal year 2012 installed a large scale supplementary budget to address the poor state of infrastructure. Though in the deflationary state, interest rate is relatively low and capital investment may not cross the depreciation cost, an incentive package such as tax exemption or special depreciation benefit augur well. An incentive package in domestic investment may also increase the export GDP ratio from current 11 percent to over 20 percent as a fillip of the weak yen through the policy of quantitative easing. Another pillar is moral suasion to invigorate a sense of patriotism to the corporate world to pay more or hire more workers. The participation of more women in labor force may complement some of the problems related to an ageing and a declining population. Two important points in the stimulation program through quantitative easing and fiscal prudence deserved special consideration. One relates to the safeguard of real wage that accrues with sustainable growth; wage commensurate with rise in CPI and to rein in interest rate suitable for increased investment in the aftermath of bold program of quantitative easing.

Deflation and inflation beyond the safe level are both maladies of an economy; the ways you remedy the inflation, quite opposite are the means to address the state of deflation. The problem is more acute with a heavy debt burden nation. The Shinzo Abe dilemma was to raise the higher sales tax that may be an elixir in reducing the national debt but a lowering of the sales tax aggravates the debt situation. It is a delicate seesaw game to balance the long plank that rest on a central fulcrum. It is important to put weight in both the right and left side of the plank so that the seesaw attains an equilibrium state and ultimately the economy rest on a genuine growth track. The nice thing that Japan can bank on is that most of the debt is denominated in Yen, only a few countries in the world can boost of such facility. There should be an accommodating formula to ease the debt burden since higher sales tax in 2017 may turn to be regressive in nature when inequality persists in the face of uneven growth. There are a few shiny spots for future.

One is the Tokyo Olympics in 2020 and the ratification of Trans- Pacific Partnership [TPP] free trade agreement. Indeed, it is a daunting challenge to revert an economy that is burdened with massive sovereign debt from deflationary syndrome to a smooth growth path.

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