Abe's Report Card

By Richard Katz

An "A" for promises and vision. A "D-minus" for developing the strategy and tactics to bring about compelling change.

If any Japanese prime minister had the political dominance to deliver on promises of structural reform of the economy, it was Shinzo Abe. He held advantages unmatched by any predecessor for decades. Following his 2012 election triumph, he faced no opposition party with any realistic chance of winning an election for years to come. His Liberal Democratic Party and its small coalition ally won more than two-thirds of the seats in the Diet's powerful Lower House not only in 2012 but again in 2014 and 2017. Unlike his predecessors, he faced no powerful opposition factions within the LDP. Finally, he achieved what forerunners had unsuccessfully sought: leverage over the bureaucracy by wresting the power to appoint the top six hundred posts in the ministries.

Instead of spending this immense political capital on structural reform, however, Abe risked it on pushing through two unpopular moves on security issues. One was changing Article 9 of the Constitution in a way that many Japanese considered illegitimate. Instead of amending the Constitution, he simply had his Cabinet "reinterpret" it, so as to legalize participation in collective defense. The second was a state secrets law that critics said would allow the government to cover up its mistakes and infringe on civil rights. Both caused big demonstrations and temporary drops in poll ratings. Yet since there was no credible alternative, neither Abe nor

---

Richard Katz, Senior Fellow at the Carnegie Council for Ethics in International Affairs, is writing a book on how to nurture new, high-growth companies in Japan.

THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
220 I Street, N.E., Suite 200
Washington, D.C. 20002
Phone: 202-861-0791 • Fax: 202-861-0790
www.international-economy.com
editor@international-economy.com

the LDP paid any penalty in subsequent elections. This suggests that Abe had the power to get what he wanted on both security and the economy, but chose not to use it.

The upshot is a tale of missed opportunities. Abe's accomplishments never came close to his promises or his potential.

Abe promised that "Abenomics" would generate 2 percent annual GDP growth, more than double the sluggish 0.9 percent pace prevailing in the "lost decades" since 1991. His tenure began with a spurt of growth, but only because Japan's economy was recovering from a six-year slump caused by the 2008 global financial meltdown. Then Abe hiked the consumption tax in April 2014 and again in October 2019. Both hikes triggered mild downturns. Had Japan been fundamentally healthy, those would have been minor interruptions. However, Abenomics had done nothing to elevate Japan's potential growth rate on any long-term basis. Consequently, during Abe's whole tenure prior to Covid-19, GDP grew just 0.8 percent a year, and from the 2014 tax hike onward, just 0.5 percent.

The whole purpose of growth is to raise living standards, but those fell further under Abe. Despite the prime minister's pleading with companies to raise wages 2 percent each year, real wages dropped another 3.5 percent during his tenure. Jobs did grow by four million, of which 3.3 million were women, and supporters of Abe said this furthered his vow to make Japan a society "where women can shine." However, for men and women alike, 75 percent of those new jobs were dead-end "non-regular" positions (mostly part-time and temporary) which pay one-third to one-half less per hour than regular jobs, even when the work is the same. Such wage discrimination is illegal but no government agency is mandated to enforce the law. Abe could have created such a mandate, but did not even try. In 2012, Abe set a target to raise the share of female managers in private companies to 30 percent by 2020. Discrimination against women in pay and promotion is also illegal, but Abe, like his predecessors, failed to enforce that law. There was some improvement in the proportion of female managers—from 11 percent in 2011 to 15 percent by 2018—but Abe pushed back the target date to 2030. On his watch, Japan's ranking on the World Economic Forum's gender equality index fell from 101st out of 136 countries in 2012 to 121st in 2019. Had Abe enforced the laws on equal pay for equal work, household income would have been higher and so would consumer spending.

Abe's accomplishments never came close to his promises or his potential.

On paper, the "three arrows" of Abenomics could have put the economy well on the way to revival. The arrows were monetary stimulus, fiscal stimulus during the recovery followed by deficit reduction, and structural reform. The problem is that none of the three arrows work without the other two. Unfortunately, the first arrow was the only one that Abe took seriously.

Abe risked it on pushing through two unpopular moves on security issues.

During Abe's years in the political wilderness, his advisers convinced him that, to regain political power,

Abenomics' Three Arrows

On paper, the "three arrows" of Abenomics could have put the economy well on the way to revival. The arrows were monetary stimulus, fiscal stimulus during the recovery followed by deficit reduction, and structural reform. The problem is that none of the three arrows work without the other two. Unfortunately, the first arrow was the only one that Abe took seriously.

—R. Katz

Shinzo Abe, *Japan's longest-serving prime minister, held office from 2006 to 2007 and again from 2012 to 2020.*

he had to talk about economic recovery. Unfortunately, most of his economic tutors fed him the illusion that the root of the country's economic sluggishness was lack of confidence as manifested in, and worsened by, deflation. Conquering deflation would thus be sufficient restore confidence and growth. In other words, he could revitalize Japan on the cheap, without stepping on any toes.

The man Abe appointed as Governor of the Bank of Japan, Haruhiko Kuroda, contended that defeating deflation was a matter of public faith in the Bank of Japan compounded by running the money-printing press full speed. He claimed he could create 2 percent inflation in just two years on the basis of his Peter Pan theory: "the moment you doubt whether you can fly, you cease forever to be able to do it." Alas, outside of Neverland, "happy thoughts" lift neither lost boys nor lost decades. From April 2015 (Kuroda's original target date for hitting 2 percent) through June 2020, core inflation (excluding food, energy, and consumption tax hikes) averaged a negligible 0.2 percent. While that's an improvement, the fact is that the mild -0.5 percent deflation rate prior Abe's rise was not the cause of Japan's problems, but a reflection of them. The Abe-Kuroda argument is akin to saying one can cure a patient's fever by putting ice on the thermometer.

Abe had the power to get what he wanted on both security and the economy, but chose not to use it.

The most potent use of monetary stimulus would have been to finance fiscal stimulus since the government could borrow at a zero interest rate. Moreover, debt owed to private investors dropped by a third since the Bank of Japan was buying government bonds *en masse,* thereby reducing any chance of a government debt crisis. Unfortunately, Abe's fiscal measures entailed both the gas pedal and the brake, but with a heavier foot on the brake. While the government increased its spending, taxes lowered domestic demand by an even greater amount. On net, Abe tightened the structural deficit (what the deficit would be at full employment) by a very large 3.5 percent of GDP.

Even if Abe had implemented the monetary and fiscal arrows correctly, that alone would not have yielded a sustained revival. Rather, it would have provided the economy with a cushion enabling it to go through the delicate surgery of structural reform. The whole point of structural reform is to create a productivity revolution. GDP growth is the sum of growth in the total hours worked by all laborers combined plus growth in output per workhour. Workhours have been falling since 1990, leaving productivity growth as the sole source of growth. For GDP to grow faster, productivity growth must accelerate. The key to the latter is "creative destruction," that is, the entry of new, high-productivity activities and companies, and the exit of older, low-productivity ones. Since there are many of the latter in Japan, the transition would be difficult and that's why a fiscal-monetary cushion was so vital. Unfortunately, Abe's "third arrow" reforms consisted of a lot of great-sounding goals with little strategy or action to turn them into reality. As a result, productivity continued to sag. During the first twenty-two years of the "lost decades"—1990 to 2012—GDP per workhour rose 1.6 percent per year; under Abe the rise was lower: just 1 percent per year.

One of the biggest obstacles to productivity is Japan's low rate of entry and exit of companies. Each year, the number of new companies and the number of exiting companies each amount to about 5 percent of existing firms. That's just half the rate of a typical OECD country. If old companies won't get off the stage, innovative new companies don't have room to get on; they can't recruit workers, get financing, or find sites. Abe pledged to double the turnover rate. It never happened. The reason is that Japan continued the practice of shoring up moribund companies so as to prevent job losses. Today, a fifth of all loans charge an interest rate under 0.25 percent, and nearly two-fifths charge less than 0.5 percent. On a loan of a $1 million, the annual interest bill would be just $2,500, making even the most zombified

Abe's "third arrow" reforms consisted of a lot of great-sounding goals with little strategy or action to turn them into reality.

firm seem creditworthy. Moreover, the government not only pressures banks to keep rolling over loans to troubled firms—a practice known as evergreening—it also provides government loan guarantees to 40 percent of small- and medium-sized enterprises every year, more than any other OECD country.

Some might argue that Abe should not blamed because, even under the best of circumstances, the transition to more creative destruction would be extremely difficult. That would be understandable if this were a rare case where the politician who called himself "the drill bit" breaking through the "bedrock of special interests" instead surrendered to those very interests. However, from the get-go, he repeatedly yielded even in cases where reform would have been easier politically and economically. One of the most harmful was his capitulation to big business' demand for corporate income tax cuts. In a country plagued by low consumer spending, he raised taxes on consumers while lowering them on companies. The government echoed the business lobby's sales pitch that this would raise investment. In reality, companies were so financially flush that they were chronically unable to find enough profitable investments to use all the cash flowing into their coffers. Throughout the last decade, the surplus of cash flow over investment amounted to 5–6 percent of GDP each year. The "excess savings" of the corporate sector is one of the biggest causes of Japan's chronically anemic private domestic demand.

This pattern began early on, in the 2013 cave-in to the 100,000-member pharmacy lobby. In 2013, Rakuten chieftain Hiroshi Mikitani, a member of a blue-ribbon "advisory council," recommended that online sales of prescription drugs be permitted in Japan, as they are in some other OECD countries. The proposal had merit. Not only can e-commerce boost productivity, it can also lower costs to consumers, and spare less mobile old people the need to visit a pharmacy. Nonetheless, the Abe administration rejected Mikitani's recommendation, prompting him to walk out from the panel. He told the press, "Abe's growth strategy was about bringing down regulatory barriers and cultivating new businesses and services. It's disheartening to see that now going in the opposite direction … I'm fed up."

Abe's fiscal measures entailed both the gas pedal and the brake, but with a heavier foot on the brake.

One of the biggest hits to household budgets is the high cost of food. That, in turn results not only from tariffs on imports, but also the monopoly of the gargantuan farm cooperative known as JA (Japan Agriculture).

In a country plagued by low consumer spending, Abe raised taxes on consumers while lowering them on companies.

JA is like an octopus with hundreds of tentacles in a myriad of fields. It has 250,000 employees. It runs one of Japan's biggest trading companies, banks, and insurance firms. Yet because it supports the LDP in Japan's rural areas, it has long been exempted from the Anti-Monopoly Law. An advisory council recommended big reforms. Instead, Abe worked out a deal with JA that Abe claimed cut its political lobbying power, but did not even touch its exemption from the anti-monopoly law. When JA President Akira Banzai spoke at the Foreign Correspondents Club, the moderator asked him, "So, you agreed [to the deal with Abe] because there won't be much, if any, change. Is that accurate?" Banzai replied: "It's premature to lead to any conclusion about whether there will be any change or not."

In a sop to the big machinery companies still making coal-fired electricity plants, the government still promotes them. Since the 2011 nuclear crisis in Fukushima, forty new coal-fired plants are either being built or have already been built. Japan's governmental finance agencies pumped US$16.7 billion to promote exports of coal plants to developing countries during 2013–2019. Worse yet, if a Greenpeace report is correct, these overseas plants emit not just carbon emissions, but up to forty times as much pollution as plants built for use in Japan.

The argument here is not that Abe's concessions to vested interests are worse than those of his predecessors. It's that, aside from rhetoric, he was more of the same. When it comes to fundamentals, it's hard to maintain that Abe left Japan's economy any better off than when he arrived. ◆