

U.S. and EU Can Learn Much From Abenomics

By [Joseph Stiglitz](#)

April 22, 2013



Japanese Prime Minister Shinzo Abe's program for his country's economic recovery has led to a surge in domestic confidence. But to what extent can "Abenomics" claim credit?

Interestingly, a closer look at Japan's performance over the past decade suggests little reason for persistent bearish sentiment. Indeed, in terms of growth of output per employed worker, Japan has done quite well since the turn of the century. With a shrinking labor force, the standard estimate for Japan in 2012 — that is, before Abenomics — had output per employed worker growing by 3 percent year on year. That is considerably more robust than in the U.S., where output per worker grew by just 0.37 percent last year, and much stronger than in Germany, where it shrank by 0.25 percent.

But as many Japanese rightly sense, Abenomics can only help the country's recovery. Abe is doing what many economists have been calling for in the U.S. and Europe: a comprehensive program entailing monetary, fiscal and structural policies. Abe likens this approach to holding three arrows — taken alone, each can be bent; taken together, none can.

The new governor of the Bank of Japan, [Haruhiko Kuroda](#), comes with a wealth of experience gained in the finance ministry and then as President of the Asian Development Bank. During the East Asia crisis of the late 1990s, he saw firsthand the failure of the conventional wisdom pushed by the U.S. Treasury and the International Monetary Fund. Not wedded to central bankers' obsolete doctrines, he has made a commitment to reverse Japan's chronic deflation, setting an inflation target of 2 percent.

Abe has implemented a thorough program of monetary, fiscal and structural policies.

Deflation increases the real (inflation-adjusted) debt burden, as well as the real interest rate. Though there is little evidence of the importance of small changes in real interest rates, the effect of even mild deflation on real debt, year after year, can be significant.

Kuroda's stance has already weakened the yen's exchange rate, making Japanese goods more competitive. This simply reflects the reality of monetary-policy interdependence. If the U.S. Federal Reserve's policy of "quantitative easing" weakens the dollar, others have to respond to prevent undue appreciation of their currencies. Someday, we might achieve closer global monetary-policy coordination. But for now, it made sense for Japan to respond, albeit belatedly, to developments elsewhere.

Monetary policy would have been more effective in the U.S. had more attention been devoted to credit blockages — for example, many homeowners' refinancing problems, even at lower interest rates, or small and medium-size enterprises' lack of access to financing. Japan's monetary policy, one hopes, will focus on such critical issues.

But Abe has two more arrows in his policy quiver. Critics who argue that fiscal stimulus in Japan failed in the past, leading only to squandered investment in useless infrastructure, make two mistakes. First, there is the counterfactual case. How would Japan's economy have performed in the absence of fiscal stimulus?

Given the magnitude of the contraction in credit supply following the financial crisis of the late 1990s, it is no surprise that government spending failed to restore growth. Matters would have been much worse without the spending. As it was, unemployment never surpassed 5.8 percent, and in the throes of the global financial crisis it peaked at 5.5 percent. Second, anyone visiting Japan can see the benefits of its infrastructure investments.

The real challenge will be in designing the third arrow, what Abe refers to as "growth." This includes policies aimed at restructuring the economy, improving productivity and increasing labor-force participation, especially by women.

Some talk about "deregulation," a word that has rightly fallen into disrepute following

the global financial crisis. It would be a mistake for Japan to roll back its environmental regulations or its health and safety regulations.

What is needed is the right regulation. In some areas, more active government involvement will be needed to ensure more effective competition. But many areas in which reform is needed, such as hiring practices, require change in private sector conventions, not government regulations. Abe can only set the tone, not dictate outcomes. For example, he has asked firms to increase their workers' wages, and many firms are planning to provide a larger bonus than usual at the end of the fiscal year in March.

Government efforts to increase productivity in the service sector probably will be particularly important. For example, Japan is in a good position to exploit synergies between an improved health care sector and its world-class manufacturing capabilities, in the development of medical instrumentation.

Family policies, together with changes in corporate labor practices, can reinforce changing mores, leading to greater and more effective female labor force participation. While Japanese students rank high in international comparisons, a widespread lack of command of English, the lingua franca of international commerce and science, puts Japan at a disadvantage in the global marketplace. Further investments in research and education are likely to pay high dividends.

There is every reason to believe that Japan's strategy for rejuvenating its economy will succeed. The country benefits from strong institutions, has a well-educated labor force with superb technical skills and design sensibilities and is located in the world's most dynamic region. It suffers from less inequality than many advanced industrial countries, and it has had a longstanding commitment to environment preservation.

If the comprehensive agenda that Abe has laid out is executed well, today's growing confidence will be vindicated. Indeed, Japan could become one of the few rays of light in an otherwise gloomy advanced-country landscape.

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