Blowing Up Japan’s Economy to Save it: Abenomics Two Years On
By David McNeill

The paralysis that has plagued the Japanese economy — and its policymakers — since the early 1990s has for long defied a solution, and for many it seemed the country was in unstoppable decline.

With the return of Shinzo Abe as prime minister in 2012 and the arrival of Abenomics, it looked for a while as if Japan had at last found its savior. But some now wonder whether instead it found its destroyer. David McNeill looks at the complex drama unfolding.

AFTER YEARS of uninspiring Japanese prime ministers, many observers were surprised to see the political resurrection of Shinzo Abe in December 2012. Abe, too, was widely considered as dull as dishwater when he was plucked from the ranks of the Liberal Democratic Party (LDP) by then outgoing Prime Minister Junichiro Koizumi to run the country in 2006-2007. That first attempt ended in frustration, compounded by a humiliating bowel disorder that forced Abe to spend long periods in the toilet. On his second try, Abe at least had an inspiring message: “Japan is back.” In one of his first major speeches to an international audience in 2013, Abe pledged to turn around Japan’s $5 trillion economy.

Abe’s boast to the world did not lack chutzpah. Japan had been adrift economically and politically since stock and land prices began deflating in the early 1990s. It had endured years of sputtering growth and deflation, sapping confidence and turning some of its once-shining corporate stars, notably Sony and Sharp, into basket cases. Many Japanese believed, indeed accepted, that the country was in unstoppable decline.

When Abe returned to power, with his bowel condition under control, he came bearing a memorable policy metaphor: his three “arrows” — fiscal, monetary and reform for national growth — that he would fire into the anemic economy. He quickly unleashed arrow No. 1, a fiscal stimulus package worth an eye-popping ¥10 trillion ($85 billion). Haruhiko Kuroda, the governor of the Bank of Japan, announced a huge expansion in the country’s money supply to re-inflate the economy by 2 percent: ¥60 trillion to ¥70 trillion — nearly the size of the Swiss economy. Deflation must be conquered, Abe declared; businesses don’t invest and consumers don’t spend, trapping the economy in a doomed cycle.

“If prices don’t go up, wages don’t go up,” he explained. “If people believe prices will be higher six months from now, then they will believe it’s best to buy now rather than later.”

This turbo-charging of the economy was a shock. For years, Japan’s policymakers had seemed content to manage slow economic decline, as dictated by the country’s aging, shrinking population. Now Abe was calling a halt. “Japan is not, and will never be, a tier-two country,” he said. His bold interventionism won the support of America’s liberal economic intelligentsia, who seemed content to overlook Abe’s political hawkishness and hard right-wing take on Japan’s war history. Abenomics would “give Japan a much-needed boost and the rest of us an even more-needed antidote to policy lethargy,” crooned Paul Krugman in The New York Times. In the same newspaper, Joseph Stiglitz called Abenomics a “huge step in the right direction.” Japan may have quite a lot to teach us, he wrote.

One effect of Abe’s economic chest-beating was immediate — share prices soared. At the time of this writing, Japan’s main index is up 72 percent since he took power. His bludgeoning of the yen, meanwhile, saw it sink in value against the dollar, eventually by about 30 percent. The falling currency stoked the profits of big exporters such as Toyota, but had less impact on overall export volumes, probably because so much Japanese manufacturing has moved offshore in the last two decades. It also, of course, made imports more expensive: Japan’s trade deficit for the first half of fiscal 2014 was the highest since records began in 1979 as the value of imports grew 2.5 percent. Much of the blame for that was Japan’s post-Fukushima fuel bill, said the government, plausibly. All Japan needed to do was switch back on its idled nuclear reactors.

For a while, Abe’s gamble seemed to work. The economy expanded at an annualized rate of 3.5 percent in the first quarter of 2013. Consumer sentiment brightened, exports rose and corporate bonuses grew at their fastest pace since the early 1990s. Impressed, The Economist put Abe on its cover soaring through the air and wearing a superman suit. Abe also crisscrossed the world, visiting 50 countries in a bid to boost trade, though tellingly avoiding Japan’s two closest neighbors, China and South Korea. At home, he leaned on the Keidanren, Japan’s largest business lobby, to hike base wages — the litmus test for whether his economic strategy “works or falls apart,” said Martin Schulz, one of the more optimistic Japan analysts.

History may record that the wheels began to come off the Abenomics bandwagon after the government hiked the sales tax from 5 percent to 8 percent in April 2014. Abe might legitimately claim that the tax was not his idea — it had been around for some time, an orphan of the political class (the Democratic Party of Japan promised in the 2009 Lower House election campaign not to raise the consumption tax, but it switched...
2014 was the worst since Japan's 2011 tsunami. Fifths said the yen was too high. “It is clear that was back in recession. His resounding win on December 14 should help silence opposition for what is likely to be a bumpy political road ahead, dominated by divisive debates on tax, nuclear restarts and “collective defense,” which voters mostly oppose. Abe, said a fierce Asahi Shimbun editorial, “thinks he can do anything so long as he wins an election.”

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That he would win, of course, was a foregone conclusion (though it was on the lowest turnout in postwar history — millions of voters simply went on strike). The question is, with a super-majority in parliament, what will he do with a clear four-year mandate? Many are hopeful that he will pull ties with China, Japan’s biggest trading partner, out of what have appeared for most of his term to be a death dive. Direct Japanese investment into China plummeted by nearly half in 2014, and the number of Japanese living in China has fallen by more than 10 percent since 2012, according to Japan’s foreign ministry. The two countries have squared off over a clump of goat-infested rocks in the East China Sea that Japan owns but both China and Taiwan claim. Abe’s revisionist instincts and rejection of what the political right in Japan calls “apology diplomacy” for the nation’s wartime misdeeds have complicated what was already a fractious relationship. Washington bears some responsibility here. It wants the “good” Abe, the hawk who will deepen military ties with its US military partner, but not the whitewasher of history who enranges much of Asia, especially joint ally South Korea. The two Abes, however, cannot be separated. Abe also faces close scrutiny over his government’s drive to scour deflation out of the economy. To some commentators, these plans amount to nationalizing Japan’s entire bond market, a view strengthened when Bank of Japan governor Kuroda announced on October 31 that he was upping the bank’s annual purchases of government bonds to a staggering ¥80 trillion (it later emerged that four of the bank’s governors voted against the move). With annual purchases now equivalent to 15 percent of GDP, Japan is in unchartered territory, said The Economist.

Kuroda and his supporters believe that Japan can go on printing money until it hits the 2 percent inflation target. This, after all, is what he has done so far. But others warn that turning the central bank into what Bloomberg commentator William Pesek calls the Ministry of Finance’s ATM is decidedly risky. “Once the laws of finance, and gravity, reassert themselves, Japan’s debt market could crash,” said Pesek. Jim Rogers, fabled Singapore-based investment banker, was more blunt: Abe is blowing up Japan, he told national broadcaster NHK in December 2014.

Then there’s the problem of Japan’s rickety finances: public debt stands at 240 percent of GDP. Over 90 percent of that debt is domestically held, putting Japan out of harm’s way for now. But it cannot go on climbing forever: in early December, ratings agency Moody’s fired a shot across Japan’s bows by cutting its credit rating by a notch. The consumption tax hike was supposed to help start the repairs; Abe’s elusive virtuous cycle would further boost tax revenues. But the economy is stalled and the tax hike has been postponed. The 2020 Tokyo Olympics could worsen public finances: Not a single Olympics since 1960 has met its cost target and the 1964 Tokyo games triggered the beginning of Japan’s addiction to bond issuance that we live with to this day.

Abe seems likely, therefore, to push ahead with the sales tax rise and cut corporate taxes, another pledge to world markets (Japan’s effective corporate tax of 35.6 percent is roughly double the rate in Singapore and Hong Kong). But without growth and wage increases, Japan’s wealth gap will widen and his popularity may slump. His next term will be dominated by discussion about the third, and least aerodynamic, of Abe’s three arrows — his long-promised reforms. Does Abe have the stamina to boost the female workforce, lower the drawbridge to immigration and face down the Keidanren and Japan’s energy and medical lobbies? Will he really push a long-delayed trade deal with America over the Trans-Pacific Partnership (TPP) that brings him into direct conflict with the LDP’s bedrock support among farmers? Not a few have pointed to the contradiction of this great reform project being led by the head of the party that helped build up Japan’s sclerotic business structure in the first place.

Unless he challenges Japan Inc., however, Abenomics looks very much like more of the LDP’s old spend-and-pump economics, garnished by Abe’s dangerous nostalgia for Japan’s big-power status. “We must restore Japan’s honor,” Abe said in December, ahead of the election. Is there room in Abe’s definition of honor for thousands of Chinese businesses, millions of foreigners and an economy that is open and fair? Given the outcome of the December election, it’s safe to say that expectations are a lot lower than they were when we were embarking on Abe’s economic journey. Tellingly, his electoral slogan for his re-election bid was: “There is no road but this.” Unfortunately, he may be right.