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# Does Abenomics Rescue Corporations and Revitalize the Industries of Japan?

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## Economic Background: Deflationary Spiral and Lost Fiscal Discipline

The "Three Arrows" policies adopted by the current Abe administration are a combination of macroeconomic (monetary as well as fiscal) and microeconomic policies. Abe came up with the policy-mix in order to resolve two serious economic troubles that his administration faced when it assumed the top executive role in December 2012. First, since Japan's asset bubble burst in 1990, the economy suffered from a nagging recession for more than twenty years, namely "Lost Decades" in which deflationary spiral became a serious concern for policy makers. Second, because of the prolonged recession, income, corporate as well as household, declined to lower tax revenue. As long as fiscal expenditure continued to rise thanks to social welfare costs especially for elderly care and medical purposes, the government had to rely on bond issue to finance the ever expanding social programs. Consequently, in a long run, the fiscal discipline was lost. In sum, the Japanese economy was facing two basic macroeconomic troubles that had not been effectively tackled upon by the previous conservative administrations of the Liberal Democratic Party.

## Abe's "Three Arrows": Monetary Policy as the "First Arrow"

Abe's policies eventually prioritize taking Japanese economy out of the recession by the "Three Arrow" policy mix of macroeconomic and microeconomic instruments. Once this goal is achieved, the administration claimed, fiscal discipline will be eventually restored thanks to increasing tax revenue generated by higher corporate and personal income. The "First Arrow" of monetary policy executed by Haruhiko Kuroda whom Abe-appointed as governor of the Bank of Japan has almost achieved the goal of inflation targeting at 2%. This outcome became possible through five measures. First, the Bank of Japan makes call rate (short-term prime rate) negative. Second, in order to increase money supply the central

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bank committed to "unlimited" quantitative easing. Third, the bank loosened its conventional conservative policies to purchase short-term government bonds. Fourth, the bank also attempted to "correct" overvalued yen to help out struggling domestic industries. Lastly, the administration aimed to revise the legislation regarding the Bank of Japan that may function as an obstacle for pursuing the four instruments.

While Kuroda's new monetary policy resulted in moderate inflation and thus temporarily eased deflationary pressure on the economy, the overall shifts in the domestic macro-economy has not worked as a stimulus for encouraging firms to invest more and hire more with higher salaries or consumers to start spending more, though. The low level of inflation as well as increased money supply have certainly depreciated the value of yen, which invigorated stock markets. Ultimately, however, the expected rise in international demand and domestic disposable income has not universally encouraged more active economic activities by Japanese firms especially in domestic markets.

## The "Second Arrow": Fiscal Policy with "Prime the Pump" Mechanism

The mixed outcome of the monetary policies as the "First Arrow" necessitated short-term stimulus packages that should take the form of fiscal policies as the "Second Arrow." They included such fiscal expenditure on infrastructure projects on the large-scale such as roads, tunnels and bridges and investment in clean energy and earthquake-resistant infrastructure. For this purpose, the government issued "construction bonds" that the Bank of Japan bought.

The outcome of the "Second Arrow" of fiscal policy commitments into various infrastructure projects still remains uncertain as that policy is assumed to function as a classic Keynesian "prime the pump" instrument to "crowed in" private investment that will generate economic growth momentum. Because of varied results that economic growth performance illustrated in the short run and the consequential turmoil of tax revenues that hovered around, the Abe administration had to yield to the domestic and international voice demanding fiscal discipline. Contrary to its growth-oriented philosophy the administration raised the level of consumption tax from 5% to 8% in April 2014. With consumption going down, this tax hike further delayed economic recovery, which would eventually force the administration to postpone the second round of raising tax rate to 10% that had been originally scheduled in April 2015.

## The "Third Arrow": Growth Strategy with Structural Reform

The success or failure of Abe's overall policy agendas ultimately depends on the "Third Arrow" of growth strategy as long as the quantitative easing in monetary policy pulled Japanese economy out of deflation, and the infrastructure investment by fiscal mobilization laid out the groundwork for private enterprises to start committing to extensive investments of their own. This microeconomic policy of growth strategy was planned to induce private investments and contained the element of industrial competition policy, although its instruments critically differ from conventional activist approaches that Japan had adopted before the 1980s.

Growth strategy with structural reform was meant to create a firm-friendly market environment in which the corporate sector is expected to play the major and active role. Structural reform policy adopted by the Abe administration thus remains the organizer of institutional infrastructure to allow private businesses to operate most effectively without strict regulations, or direct governmental support, for that matter. Actually the policy includes such broad and extensive targets as lowering corporate income tax; opening up strategic industries like agriculture, energy, health care to international firms; corporate governance reform in introducing global standards to entice foreign investors to buy into Japanese corporations; and regulatory reforms in labor markets to utilize previously underutilized resources such as female professionals to achieve “Japan with Shining Women”.

## Virtuous Cycle of Structural Reform and Corporate Investment?

As long as the first two arrows of Abenomics played their expected functions, the Abe administration has claimed, a virtuous cycle of corporate investment and employment expansion should kick in to create a self-perpetuating mechanism of economic recovery and growth. As business performance improves, corporate investment should go up, which should create more and better employment opportunities. That will encourage more consumption of the household sector, which will support the corporate sector from the demand side to bring in higher profitability of corporate enterprises.

This mechanism of healthy economic growth has not been quite achieved. Surely many corporations, especially large ones, have attained record-breaking profits, but they have not yet committed themselves to extensive investment in facilities and employment particularly in domestic markets. Note that those profits did not necessarily originate in business activities within Japan. They rather come from past investment in international activities. Facing rapidly appreciating yen since the mid-1980s, many Japanese corporations that had adopted the principle of export-orientation started shifting their production sites to overseas locations. As production moved away, corporations lowered incremental investment in domestic facilities to result in the “hollowing” of Japanese economy. As a consequence, competitiveness of Japan-made products in overseas markets relatively declined. Japan’s productive investment further lost momentum since the 1990s, because market growth struggled thanks to lasting recession and ageing and shrinking population

This overseas investment since the 1980s has paid off by now generating much profit. Depreciating Japanese yen further inflates the profit in yen terms. In this dynamic context of domestic and international markets, the reluctance of Japanese corporations to extensively invest within Japan is rational as long as international markets invites more opportunities for profits. After all, the size of domestic markets is expected to shrink in future thanks to both low birth rate and struggling employee compensation. Actually, the compensation in real terms has continued to decline despite all the macroeconomic and microeconomic measures that the Abe administration adopted. Understandably, then, consumers in general are not quite spending given the uncertainty surrounding their future employment and compensation.

## Conclusion: Abenomics, Success or Failure?

Abenomics was a calculated gamble into which Japanese people bought, not necessarily because they comprehended its substance and decided to cooperate in terms of their economic behavior. They rather adored Abe's combative style with nationalist agendas that distanced him from most of his predecessors. For all of his political messages aside, the outcome of his policy mix of macroeconomic and microeconomic measures remain mixed.

Abe's policies ultimately depend on the positive response that corporations exhibit to the structural reform measures to arrange business-friendly competitive markets environments. Certainly, the profitability of Japan's large corporations rose sharply and the earning power of the financial sector has been enhanced within the broad Abenomics settings. But companies are not quite investing extensively in Japanese operations, as it was the overseas shifts of production committed by Japanese businesses since the 1980sthat basically bring in renewed opportunities and higher profitability. Because of the expected limitations of domestic markets, furthermore, they rather commit to strategic activities, including M&A's, in growing international markets.

For the competitiveness of Japan's domestic industries and the welfare of average households, thus, Abenomics may not have positively worked. Households are not quite spending enough because of lowering earnings, consumption tax hike and uneasiness about economic future. This household behavior is discouraging as long as the success of Abenomics depends on the consumption by households as well as the domestic investment by corporations.

It remains unclear if and when there will be positive spillovers from the profitable corporate sector to the struggling domestic industrial sector that should create more employment with higher compensation, as the Abe administration has been preaching. It thus remains still too early to predict the ultimate success or failure of the Abenomics policy as a whole.