

The Invisible Arrow of Abenomics: Structural Reform and Innovation

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Takeaways

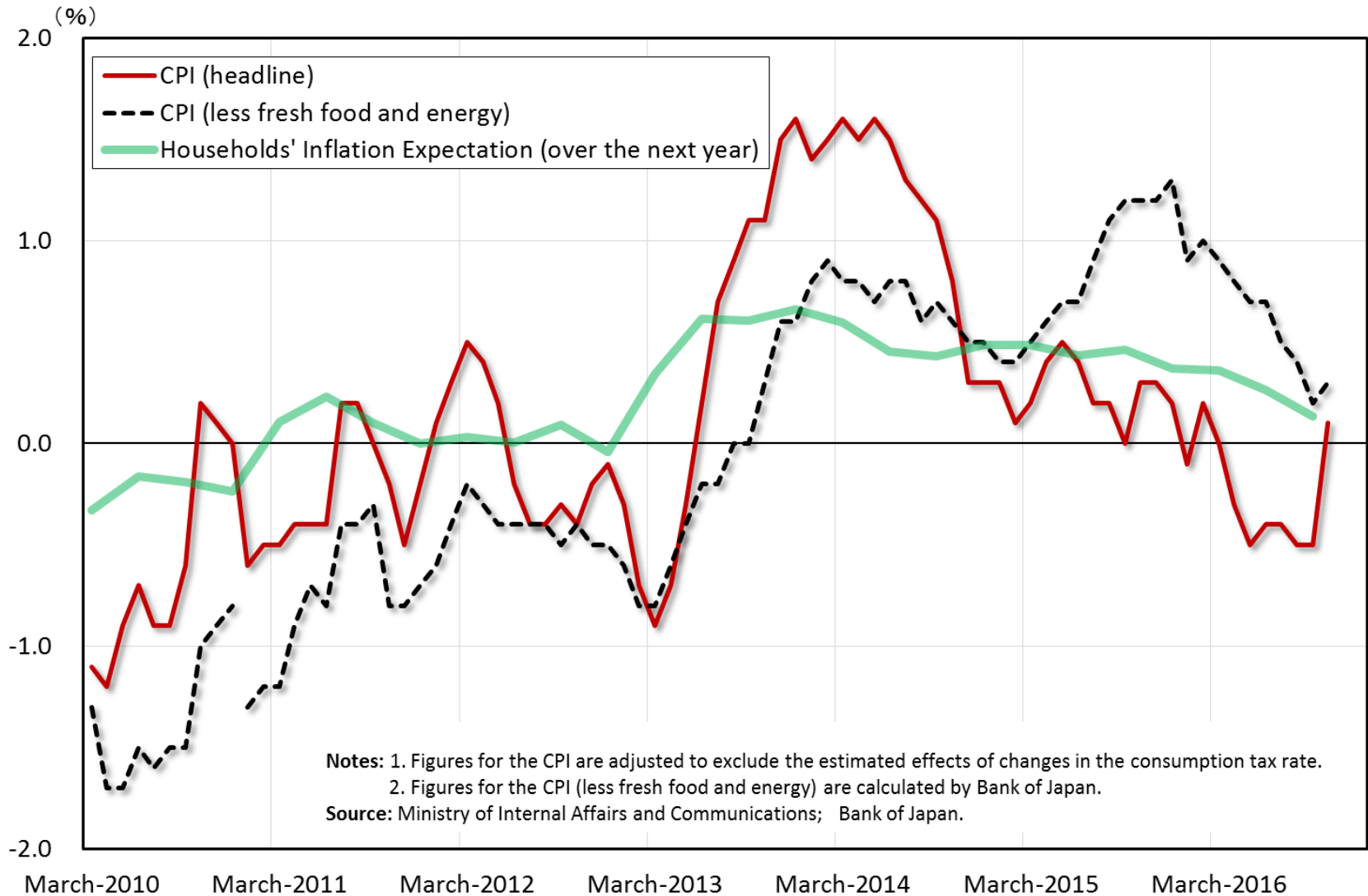
- The first arrow alone could **not** raise the inflation rate to **2%**
- The real economy is moving into **labor shortage**
- **Fiscal stimulus** as fine-tuning is **unwise** at this point
- **Third arrow** to raise the potential growth rate, labor productivity and real wage is essential: Focus on “labor” today
- Increase in **labor input** is important & Simulations show
 - If **women** wishing to work actually work, **GDP will rise by 4.7%**
 - Other scenarios: filling M => 1.2%; work as much as men => 10.5%
 - **Postponing retirement** age from 65 to 70, **GDP will rise by 3.1%**
 - **Double foreign workers**, **GDP will rise by 1.4%**
 - **Total, 9.2% increase.**
- Progress of the third arrow is more than people think, but
- Radical policy shift is needed to hit the mark by 2020

Three Arrows: Dec 2012-Nov2016

First Arrow

- Big Initial Success but stalled recently
 - Correction of Overvaluation of the yen (80 → 123 → 101 → 110)
 - Raise the stock prices (8,600 → 20,000 → 15,000 → 18,000)
 - Inflation rate (ex food & energy) (-0.5 → +1.3 → +0.2)
 - QQE (2013.04) → QQE2 (2014.10) → Yield Curve Control (2016.11) and commitment to “overshooting”
 - QQE alone could not generate inflation
- No ammunition left?
 - Hoping a virtuous cycle of inflation ↔ Wage hike
 - But, will real wage increase? That is NOT monetary policy role.

Inflation rate is far from 2% target



Three Arrows: Dec 2012-Nov2016

Second Arrow

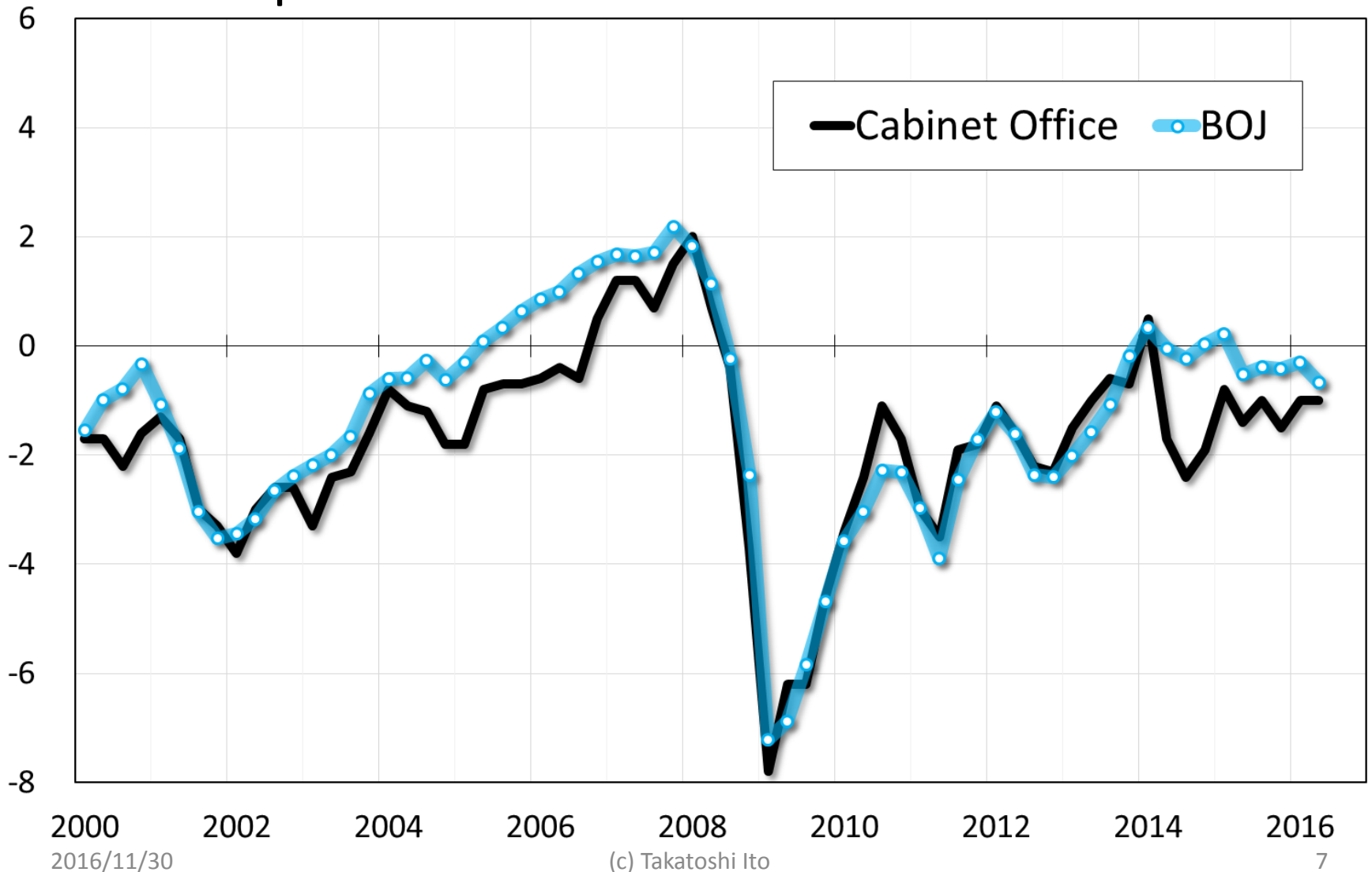
- Flexible Fiscal Policy: initial plan
 - Short-term, counter-cyclical fiscal stimulus; but
 - Medium-term, fiscal consolidation
 - On the way to make fiscal dynamics sustainable
- Consumption tax (VAT) increase of April 2014
 - Consumption and GDP declines in 2014Q2 and Q3 were worse than expected
 - Consumption expenditure has stagnated since then
 - The second increase was postponed twice
 - Currently, the VAT increase (8% to 10%) is scheduled in 2019
- Fiscal tightening and consolidation?
 - Yes, unemployment rate is low; growth rate near potential
 - No, as long as inflation $< 2\%$ and growth $<$ normal

Lack of demand or short of supply?

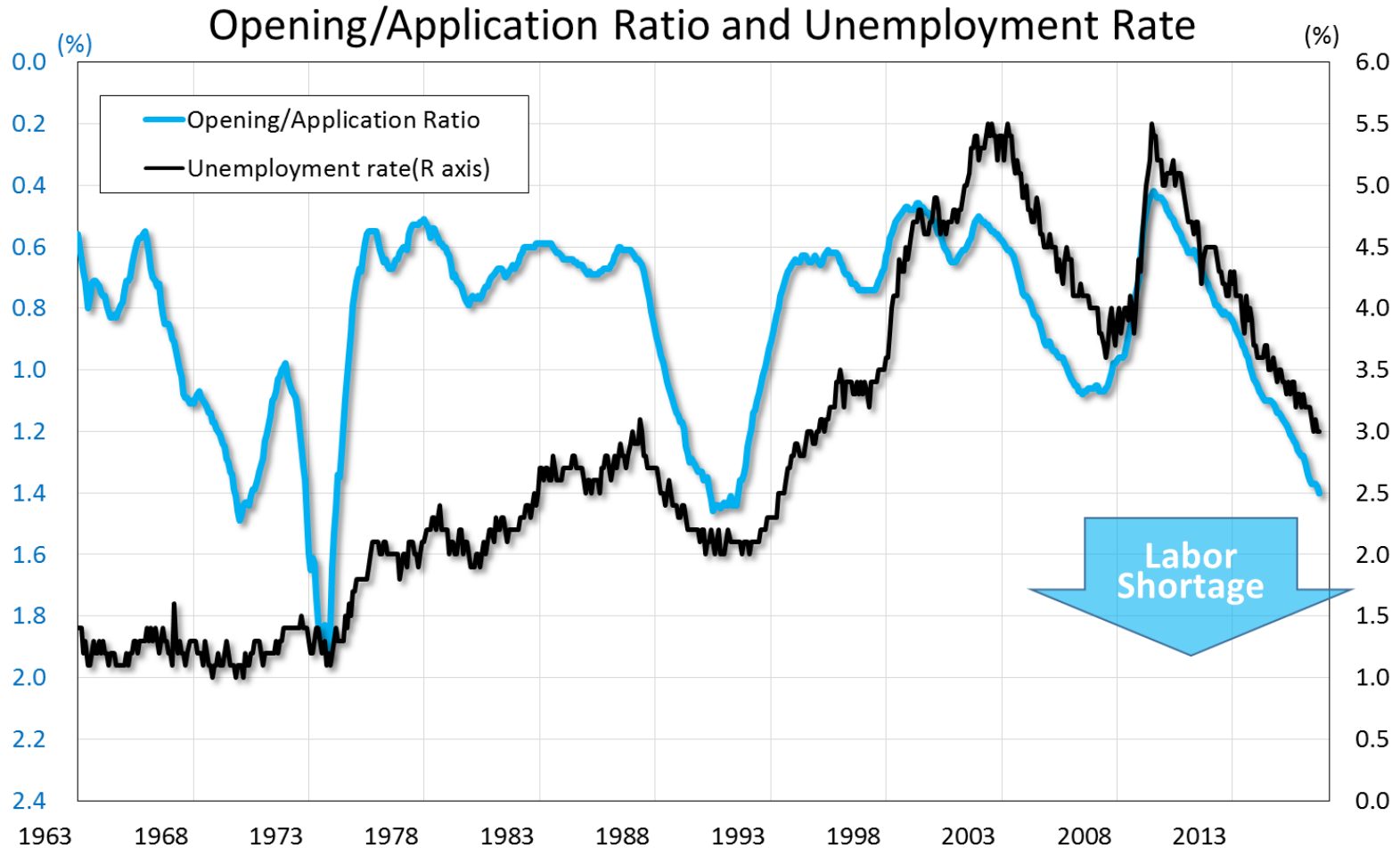
The **Third** Arrow is supply side reform

- Aggregate demand (AD) is near aggregate supply (AS)
 - The unemployment rate is 3.0% (first time since 1995)
 - The vacancy/opening rate is 1.4 (first time since 1990-91)
 - The GDP gap is small, around minus 1%
- No need to stimulate AD by monetary and fiscal policies beyond the current stance
- Wanted: to raise AS and potential growth rate
 - Efficient allocation of labor (Labor)
 - More labor input (ΔL)
 - Efficient allocation of capital (Kapital)
 - Raise productivity by innovation (Total Factor Productivity)

GDP gap is slightly negative, and has not improved since end-2013



Labor Market conditions have been improving; as tight as bubble years



出所: 労働力調査

Growth Strategy, or “Japan Revitalization Strategy”

- The most important for the long run growth (potential growth rate) is the third arrow
- Policies are announced as “Japan Revitalization Strategy” in June every year.
 - Foreigners expected a lot in Japan Revitalization Plan of 2013, but got disappointed. Drop in the Nikkei.
 - “Japan Revitalization Plan of 2014” was better
 - E.g. Corporate governance reform
 - “Japan Revitalization Plan of 2015” was a non-event (low expectation, no surprise).
 - So was 2016. What happened? No interest?
- Now let us examine Revitalization Strategy announced in June: 2013, 2014, 2015, 2016

Summary of Japan Revitalization Plan 2013, 2014, 2015, 2016

- Main pillars (common to all years)
 - Labor market reform
 - [Women] “Promoting active participation by women”
 - [Elderly] “Promoting active participation by the young/the elderly”
 - [Foreign workers] “Utilizing highly skilled overseas personnel” (foreign workers)
 - [Mobility] “from excessive employment stability to labor fluidity (realizing labor movement without unemployment)”
 - Capital Market Reform
 - Corporate Governance Reform (Corporate Governance Code)
 - Public Pension Fund Reform (Stewardship Code)
 - Emphasis on ROE
 - Infrastructure: Airport, Seaport,
 - Lower corporate income tax rate (2014 proposed → realized)

Summary of Japan Revitalization Plan 2013, 2014, 2015, 2016

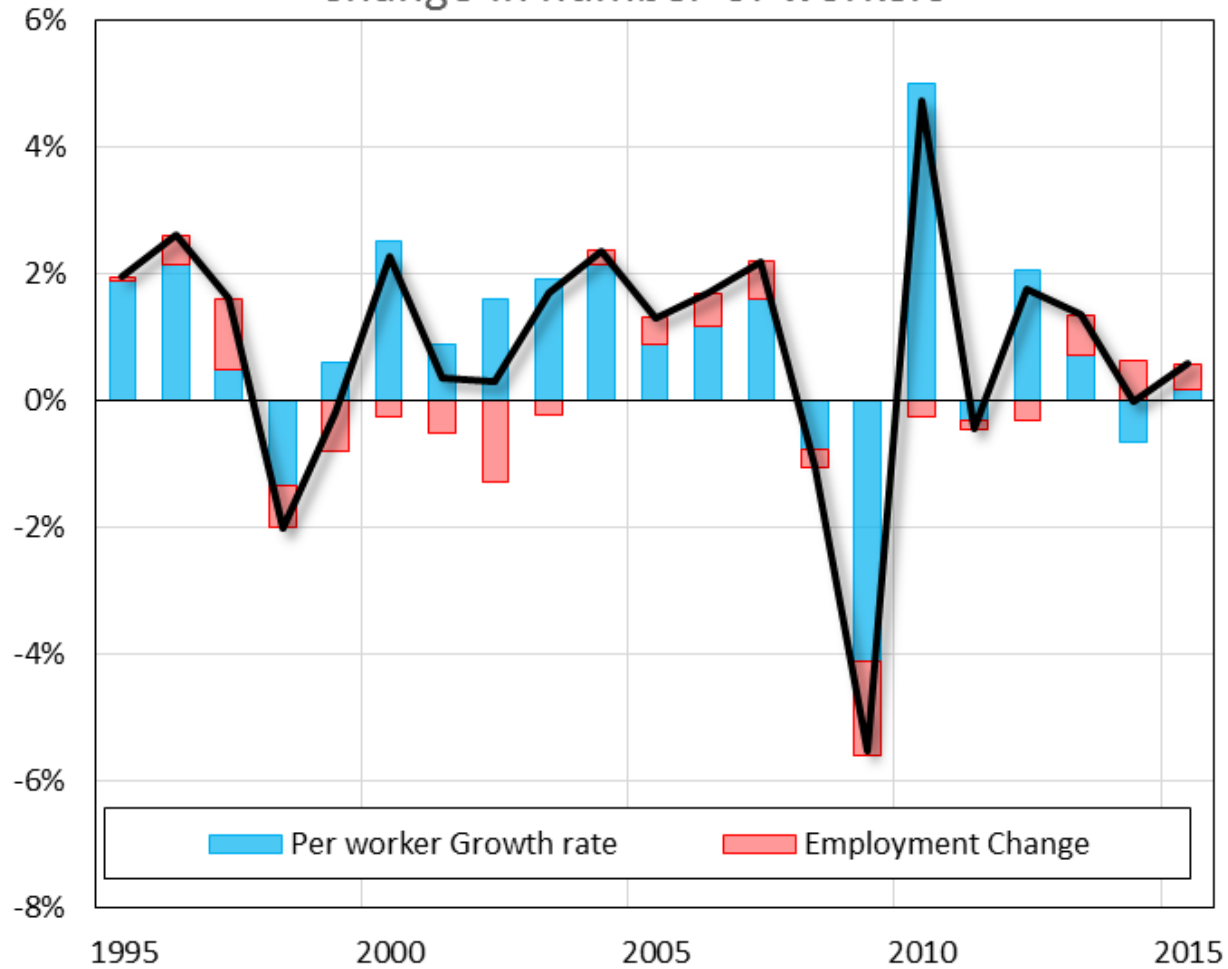
- Raise productivity and stimulate innovation
 - Agriculture
 - “Turning agriculture, forestry and fishery industries into growth industries” (2013)
 - University Reform
 - IT (Big Data)
 - Robotics
 - Fintech (2016, proposed)

Demography and Growth

- Estimate of increasing GDP from increase workers
 - Real GDP in 2015. (Chain, 2005, billion yen) = 529,120
 - Those worked in 2015 (10,000 persons) = 6,376
 - **Per (10,000) worker GDP = 83.0**
 - We will use this repeatedly.
- **If labor productivity remains the same**, adding 10,000 workers would increase GDP by 83 billion
- Or adding **1 million workers raise GDP by 8.3 trillion yen or 1.57 % point**

Growth Rate is low

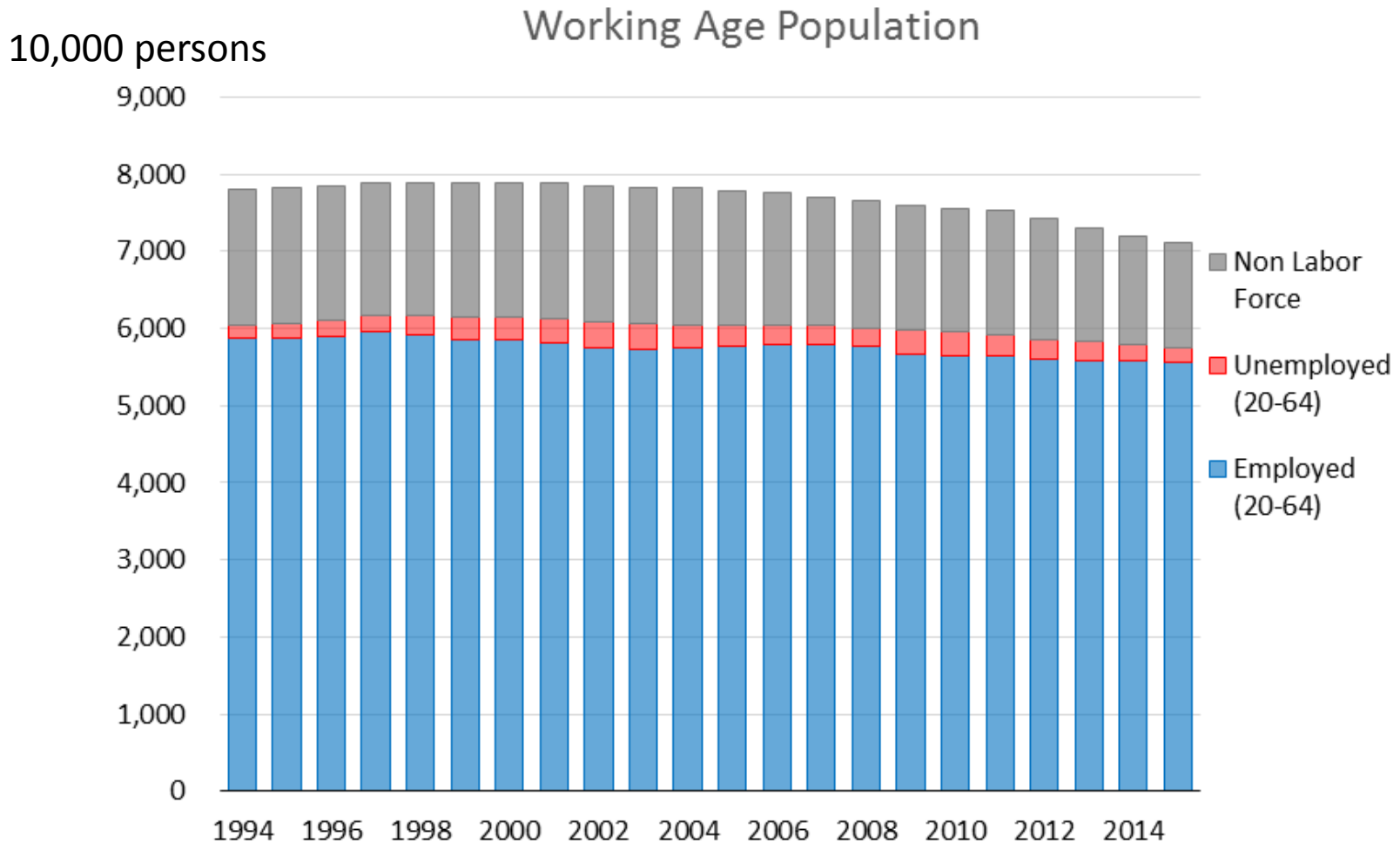
Growth Rate = Per-worker productivity growth
+ Change in number of workers



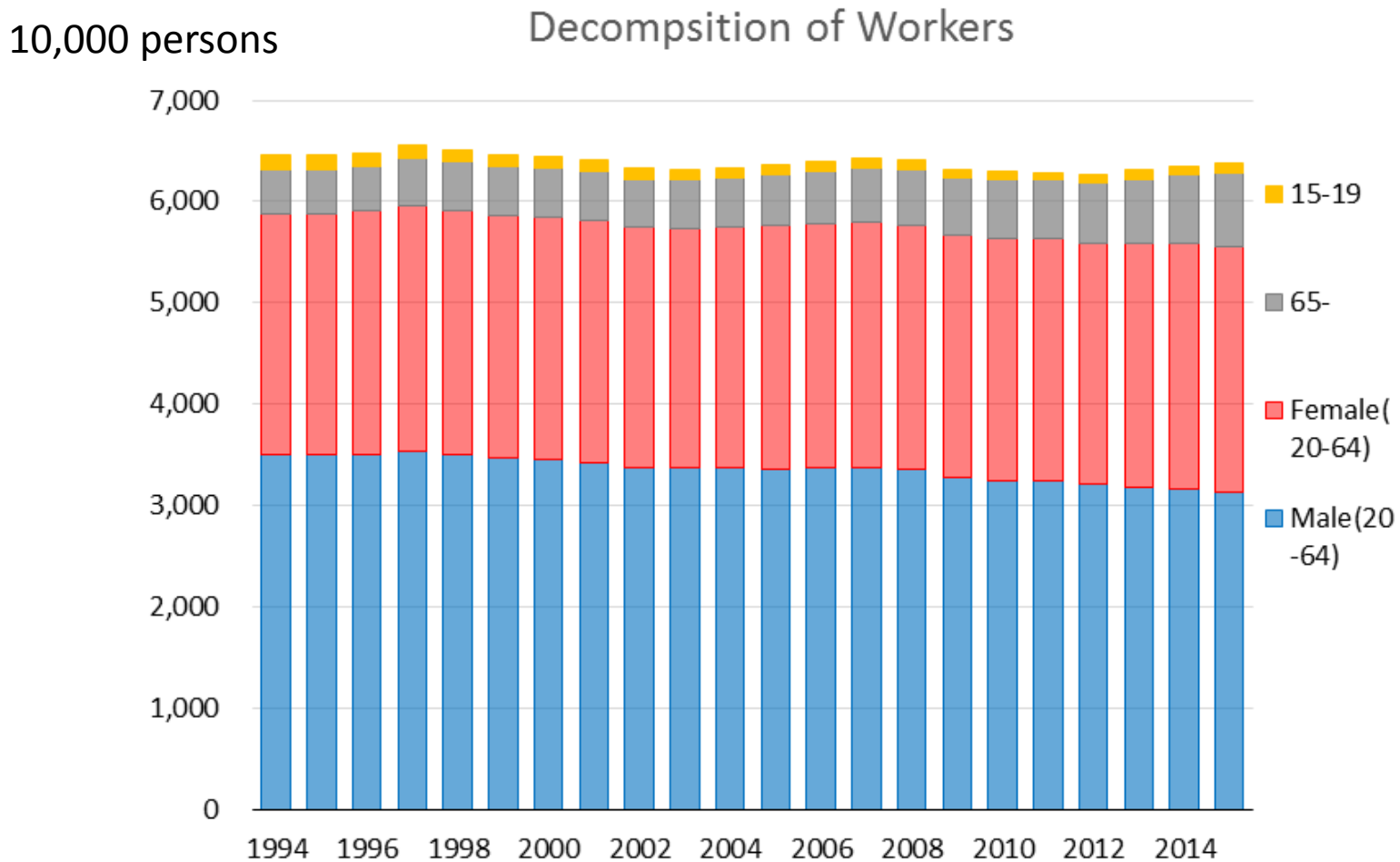
Labor input

- **Working age (20-64) population is declining**
 - In 2010, 75.6 million → in 2015, 71.1 million
 - **Declining almost 1 million every year** (baby boomers retiring)
 - **Minus 1.5% pressure on GDP**
 - Significant drag in economic growth
- Remedy
 - Increase participation rate of women
 - Increase participation rate of the elderly
 - Increase foreign workers
 - Relocation from unproductive sectors to productive

Workers are not declining as much as population



Female and Elderly are increasing

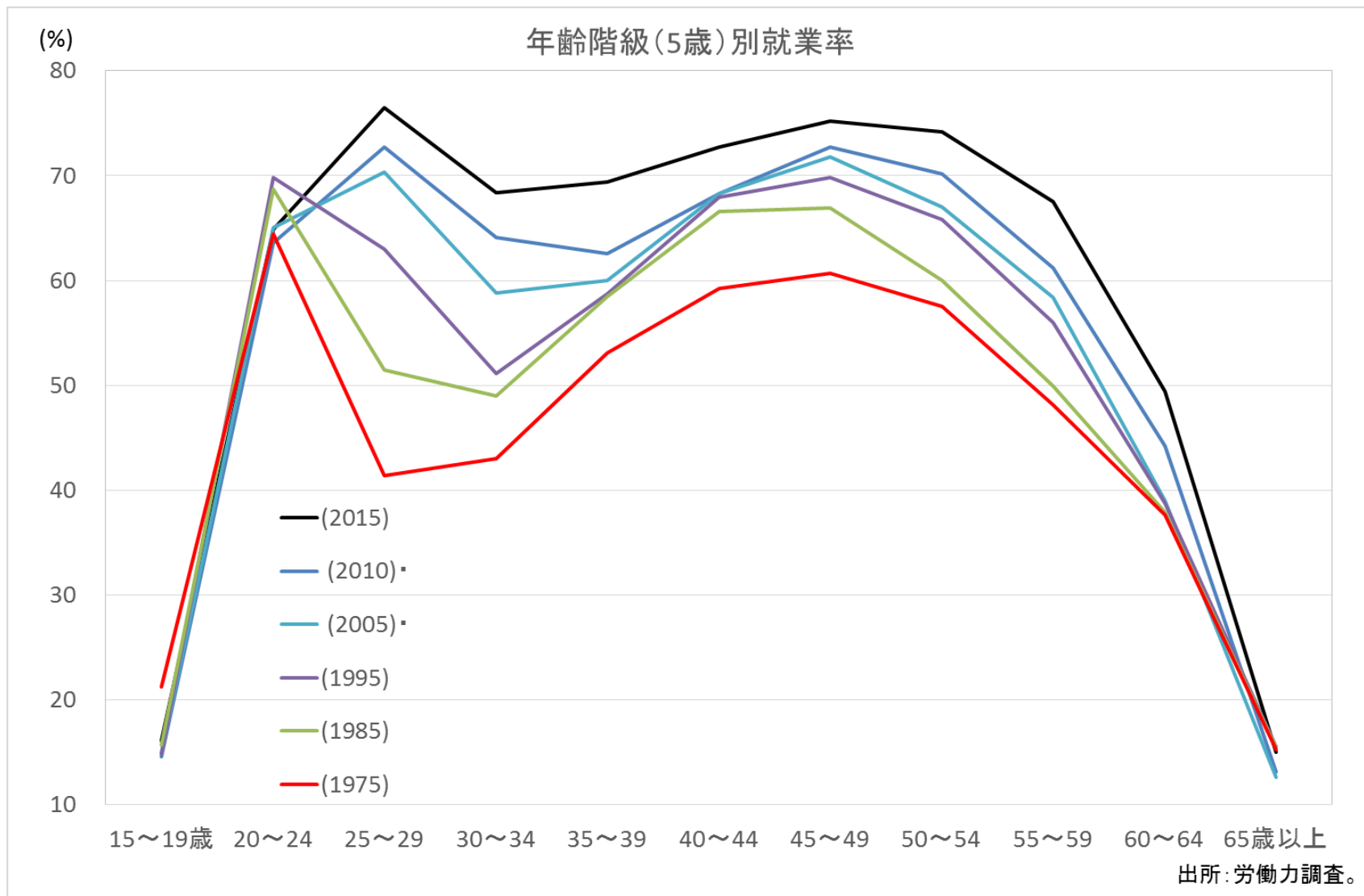


Labor participation rate

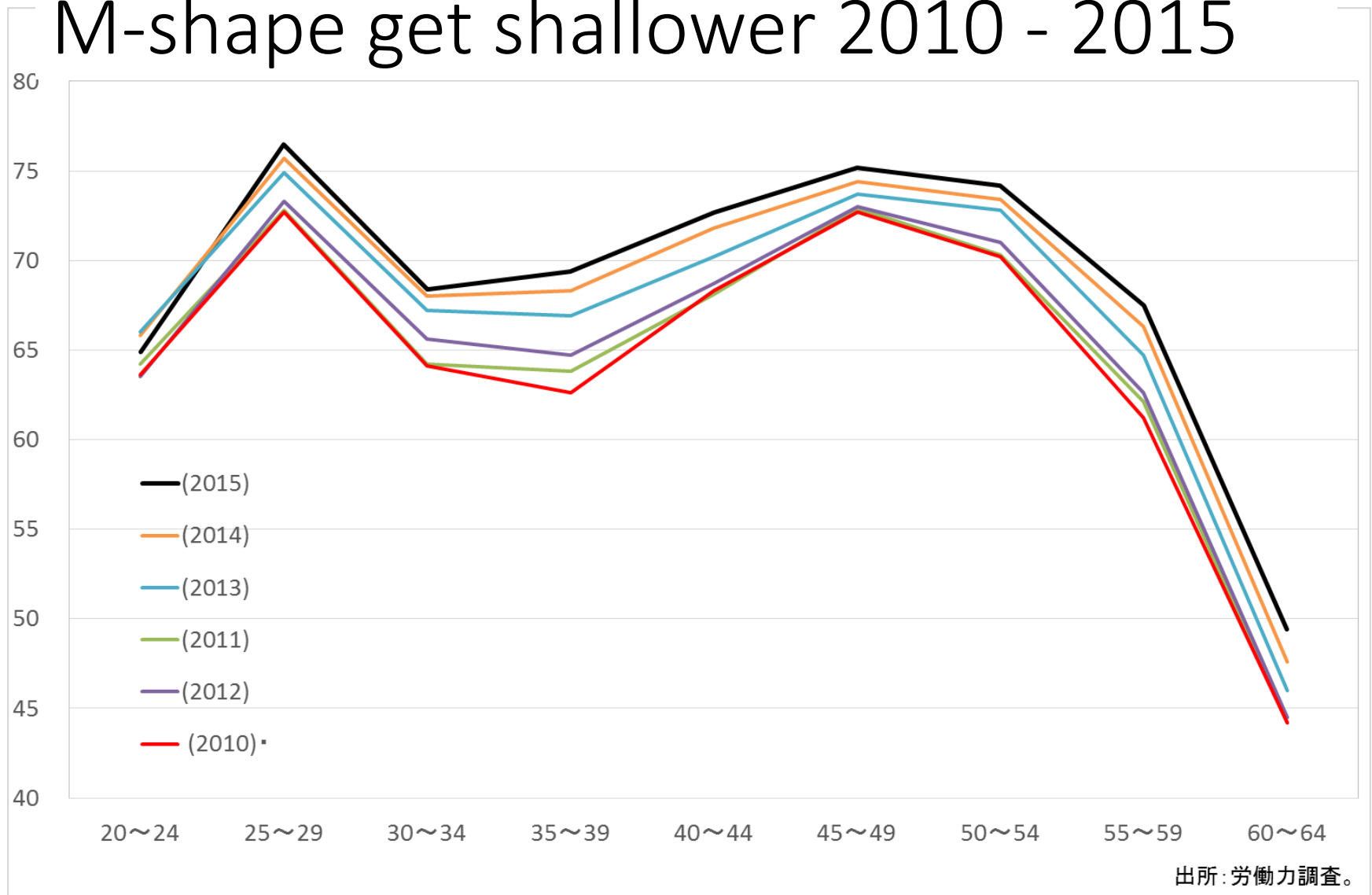
Women M-shape

- Labor participation is increasing
 - Women in the 20-64 age group, in particular 25-45
 - Participation of the Elderly (65 -)
- M-shape for the child-bearing and –rearing ages
 - But the valley of the M-shape has been quickly filled
- Still room to increase women participation rate

M-shape gets shallow, 1975 -> 2015

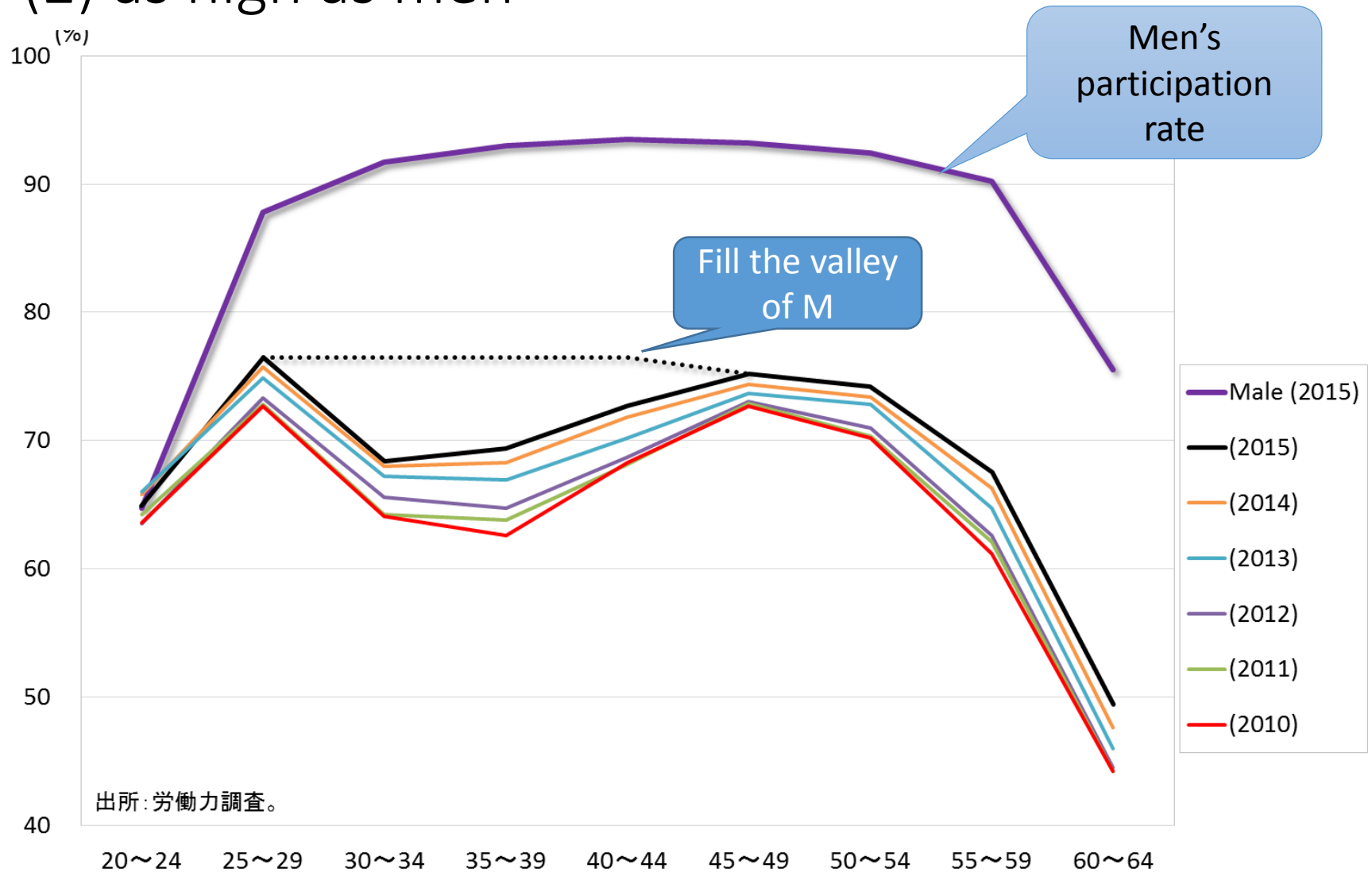


Women participation rate increase & M-shape get shallower 2010 - 2015



出所: 労働力調査。

Simulations (1) no M, or fill the valley; (2) as high as men



Simulations, Womanomics on GDP

- [No M-shape dent]
 - Increase of 770,000 women
 - Increase in GDP, by 6.4 trillion yen or 1.2% over 2015 level
- [Women participate as much as men]
 - Increase of 6,690,000 women
 - Increase in GDP, by 55.5 trillion yen or 10.5% over 2015 level
- [Those women who wish to work]
 - Increase of 3,010,000 women
 - Increase in GDP, by 25 trillion yen or 4.7% over 2015 level

Well-known policy measures to help women to participate more to work

plus some radical proposals

- Short working hours and work from home for regular workers
- Allow foreigners to work as household help, nanny and long-term care workers
- Guarantee no waiting for nursery and kindergarten
 - Government offices and large corporations should be required to build nursery/kindergarten on site
- Extended hours for nursery, kindergarten and elementary schools
- Discourage long hour working condition
 - Double over-time premium
 - Punish corporations to hide unpaid overtime work
- Eliminate tax/social security advantage of no/little work of dependent spouses

Simulation, Postpone the retirement age from 65 to 70

- Assume retirement age will become 70. Then those in the age bracket of 65-69 would work as much as those in age bracket 60-64.
 - Participation rate of age 65-69 will rise from 42% to 62%
 - This means to additional 2 million workers
 - This amounts to an increase in GDP by 16.5 trillion, or 3.1% over the 2015 level

Foreign workers

- Foreign workers in Japan 907,896 in 2015
- Doubling the foreign workers add 907,896 workers
- Increase in GDP = 7.5 trillion yen or 1.4%
 - 90.8×83 (per 10,000 worker GDP in billion)
- This can be an overestimate, as the productivity (wage level) of foreign workers may not be as high as an average workers
- This can be an underestimate, as those existing workers can increase their productivity with help of foreign workers (in trainee positions and relatively low skill jobs)
 - For example, if foreign workers work for household help, long-term health care, then women job participation rate (in high paying jobs) will increase

Flexible labor market

- Reallocation of workers from unproductive field/industry to productive field/industry had been done within a company or a corporate group
 - Eg. Textile companies became high-tech companies
 - But, no longer. Domestic markets will be shrinking
- Life time employment (and court decision against dismissal of workers) becomes severe constraint in efficient allocation of workers
- Radical policies to solve the problem (so far resisted)
 - Expand an “annual salary” system to more job ranks
 - Introduce “cash settlement” for a disputed dismissal case
 - Pay “retirement severance pay” in installment pay over the career

Labor Market summary

- If reforms are introduced, demographic transition can be dealt with and the growth rate can be maintained high.
- **Women, the elderly and foreign workers will rescue Japan from labor shortage and low growth**

Briefly on three other areas

- Capital Markets reform
- GPIF reform
- Agricultural reform

Capital Markets Reform

- Raise ROE; Raise wage payout, or else
- Corporate Governance Reform
- Pressure from outside if necessary
 - Public pension fund to engage in dialogue, if not exercise voting
- Reward excellent companies
 - JPX Nikkei 400 was a success
 - Create more indices: Why not JPX 100? Why not JPX ESG 100? JPX small cap 200?
 - Create more ETFs so that GPIF and other pension funds (and BOJ) can pick and choose excellent (in expected long term performance) companies

Government Pension Investment Fund (GPIF) reform is nearly done

- GPIF reform started in 2013 as a part of Abenomics third arrow
- Portfolio reform has progressed
 - JGB weight was lowered from 66% to 60%, to 35%
 - Domestic equities 25% and foreign equities 25%
- GPIF Governance reform will be possible when the current pension bill passes in the House of Councilors in next month (by mid-December)
 - There will be an independent Board of Trustees established
- Program on Public Pension and Sovereign Fund (PPPSF) at CJEB will study a global trend and the progress of GPIF reform

Innovation

Agricultural reform moving!

- Agriculture cooperatives
 - Agricultural cooperative central → abolish their right for supervision of all 700 agricultural cooperatives
 - Prefectural federations → possible to be corporatized
 - Unit (local) cooperatives → increase freedom
 - Break monopoly in fertilizer and other inputs (2016)
- Rice, production quota was abolished
 - This year is the last year to set the quota
- Dairy industry reform → radical reform of breaking monopoly of Agri coop decided at LDP (Nov 2016)
- Further reform: Promote exports → distribution and trade sectors should be encouraged to enter the agricultural sector
- **Scale economies** are the key: Fail/merge low-productivity, small-scale farms and create large-scale farms. Eg. Rice, dairy, beef, pork