

Comments on the Second Session : Economic Growth and Policy

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1. Growth Strategy

1. Institutions can play an important role in establishing the incentive-reward mechanism in an economy.

- We are living in global competition of institutional evolution.

2. Reforms of political, social and economic institutions can affect the difference of total factor productivity levels among different nations.

- They lead to the difference of long-term performance in growth and distribution.

3. For instance, we can identify five categories of institutions such as (1)political system stability, (2)openness of economy, (3)gender gap, (4)easiness of start-up business and (5)flexible labor market.

1.Growth Strategy

4. It is sensible to improve the Japanese institutions to achieve the “best practice” in the world, notably in the area of women’s participation on labor market and new entry of domestic and foreign firms into regulated markets and smooth exit of unprofitable firms as well as education.

5. From this perspective, it is essential for Japan to participate in the TPP negotiations process which will trigger other bilateral and regional FTA/EPA (RCEP and FTAAP) , although there remains business vested interest problems in the TPP such as the pharmaceutical industry, automobile industry, agriculture industry and insurance services (sensitivity items).

1.Growth Strategy

6. It is desirable to set the long-term national goals to establish and maintain the status of Japan as the “first-tier country” (Armitage-Nye Report(2012)) in the coming decades.

- Stop diminishing trend of population and maintain the population size in 2050.
- Double per capita GNI from about \$40 thousand to \$88 thousand(=the current per capita GNI in Norway) in 2050 (“Japan in 2050” (JCER(2013))).

2. Flexible Fiscal Policy Management

1. The three arrows of Abenomics make sense if we understand them as integrated package policy measures.
2. Achievement of 2% inflation target is throughout possible if the government achieves 2% real GDP growth target over the medium-term.
 - However, it seems difficult to achieve 2% inflation target in two years.

2. Flexible Fiscal Policy Management

3. We can implement the “growth-friendly fiscal consolidation” from the longer-run perspective.

- Strong commitments on credible fiscal target from longer-run perspective allow flexible management of fiscal policy in the short-run.
- Fundamental reform of tax and social security system serves to mitigate the trade-off between growth and fiscal consolidation (Iwata= Saruyama (2013)).

2. Flexible Management of Fiscal Policy

4. On the need to increase infrastructure investment for replacement and for the purpose of making the Japanese land more resilient against natural disasters, it is desirable to fully mobilize the private funds through the introduction of covered bonds, infrastructure investment fund and the use of PFI and PPP.

- It is impossible to finance Yen 200 trillion infrastructure investment in ten years solely by relying on public money.

3. International Coordination of Monetary Policy

1. There is no need to coordinate monetary policy, if all the countries adopt the “domestic currency pricing” (=100% pass through of exchange rate fluctuations).

- Trading partner countries can enjoy the improvement of terms of trade, lower world interest rate and possibly the inflow of FDI, due to the expansionary monetary policy adopted by home country.

2. The mixed use of the “domestic currency pricing ” and the “local currency pricing” may complicate the issue of international policy coordination (Iwata and Takenaka(2012)).

- The nature of problem resembles the issue of international coordination on capital income taxation (the source principle vs. the residence principle) pioneered by Hamada(1966).

3. International Coordination of Monetary Policy

3. However, there is a case of the “beggar-thyself effect” for home country under the “domestic currency pricing” regime, due to the terms of trade deterioration arising from combination of currency depreciation and rise in commodity and energy prices.

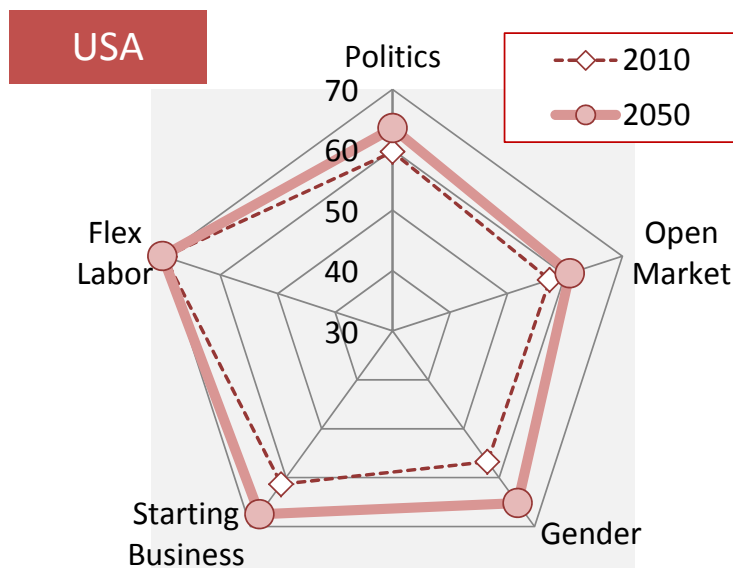
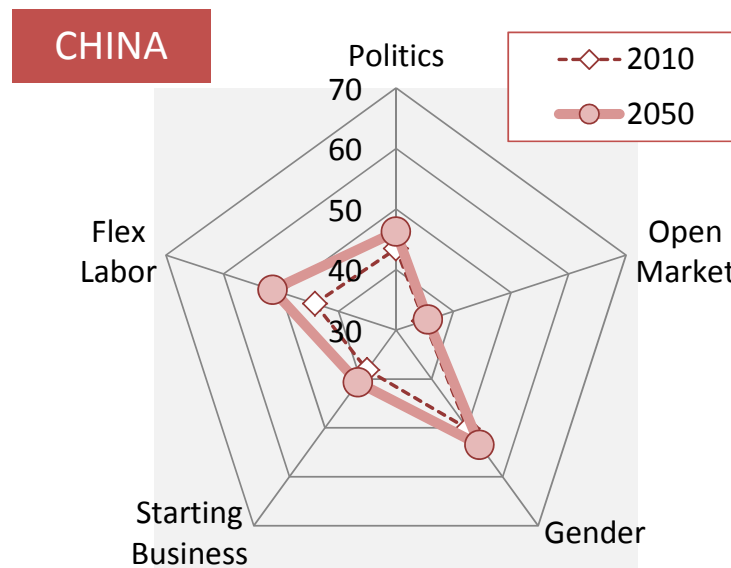
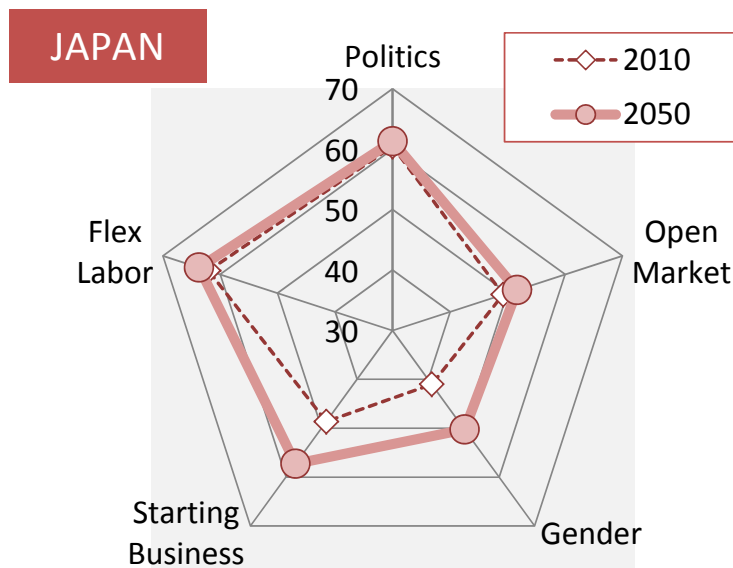
- This happened in early-2008 before the Lehman shock when Japan entered the recession coupled with the rise of core CPI more than 1%.
- Given the heavy reliance on imported LNG and oil after the Fukushima accident on March 11, 2011, Japan will face a risk of stagflation, if the Yen rate depreciates excessively.

4. Illustrations by the Use of Macroeconometric Exercise

1. Medium-term forecast in February 2013: the case of “Aggressive Fiscal and Monetary Policy”

2. Fundamental reform of tax and public pension system: the case of partial privatization of public pension system(=16% cut of wage tax) and 10% cut in corporate tax rate. Both of them are financed by 15% consumption tax increase.

Fig.1 Institutional Factors



(Note) 5 factors which determine long-run productivity growth.

(Unit) Standard deviations with the mean across 64 countries in 2010 as 50, and 1 standard deviation as 10.

Table 1 Per Capita Gross National Income in 2050

(Nominal, 10 thousand US\$)

	1990		2010		2050	
Rank						
1	Switzerland	3.5	Norway	8.7	Norway	14.2
2	Japan	2.8	Switzerland	7.5	Switzerland	11.4
3	Sweden	2.6	Denmark	6.0	Japan(Growth scenario)	8.8
4	Norway	2.6	Sweden	5.1	Sweden	8.7
5	Finland	2.5	Netherlands	4.9	Denmark	8.1
6	Denmark	2.4	United States	4.7	Canada	8.0
7	United States	2.3	Finland	4.7	Australia	7.9
8	Germany	2.1	Austria	4.7	United States	7.7
9	France	2.1	Belgium	4.7	Belgium	7.5
10	Canada	2.0	Australia	4.6	Finland	7.4
11	Austria	2.0	France	4.4	Ireland	7.4
12	Belgium	1.9	Canada	4.3	Netherlands	7.3
13	Netherlands	1.9	Germany	4.3	France	7.1
14	Italy	1.8	Ireland	4.2	Austria	7.0
15	Australia	1.7	Japan	4.2	United Kingdom	6.6
17	.		.		Japan(Stagnation scenario)	5.4
29	.		.		Japan(Bankrupt scenario)	3.9
45	.		.		China	1.2
47	China	0.03	China	0.4		

(Source) Estimated by JCER based on World Bank statistics

Fig.2-1 Aggressive Fiscal and Monetary Policy

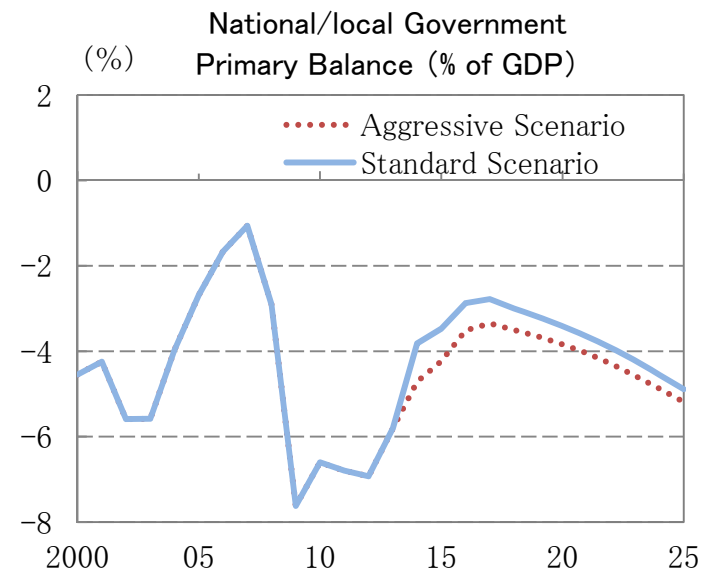
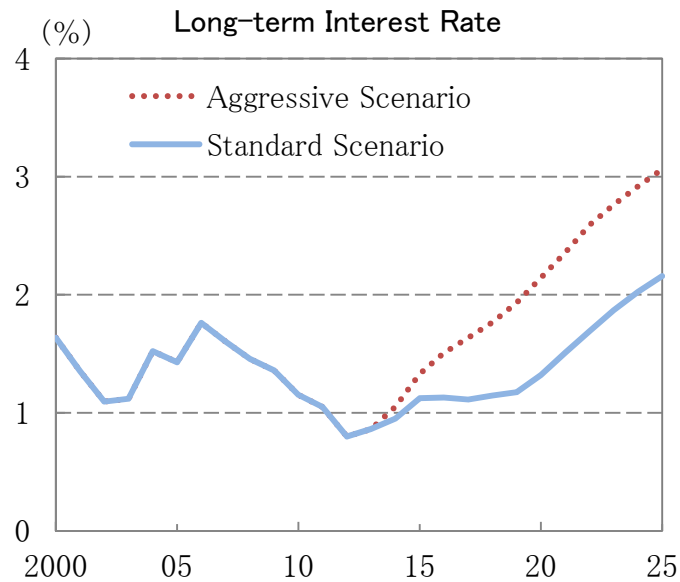
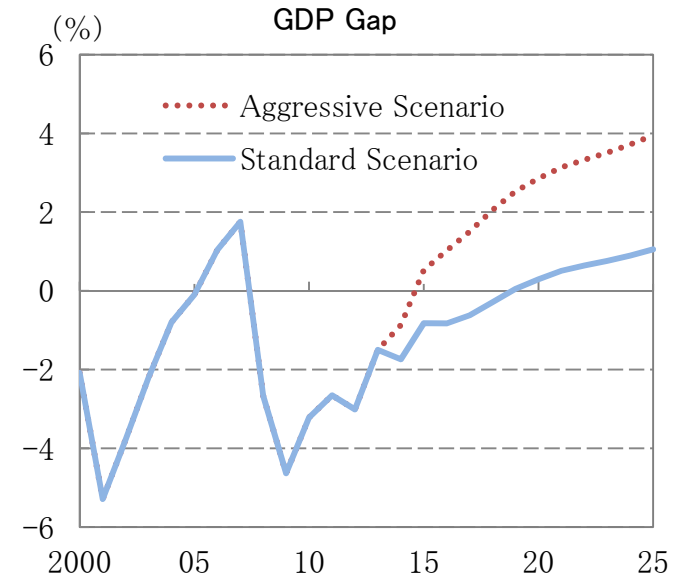
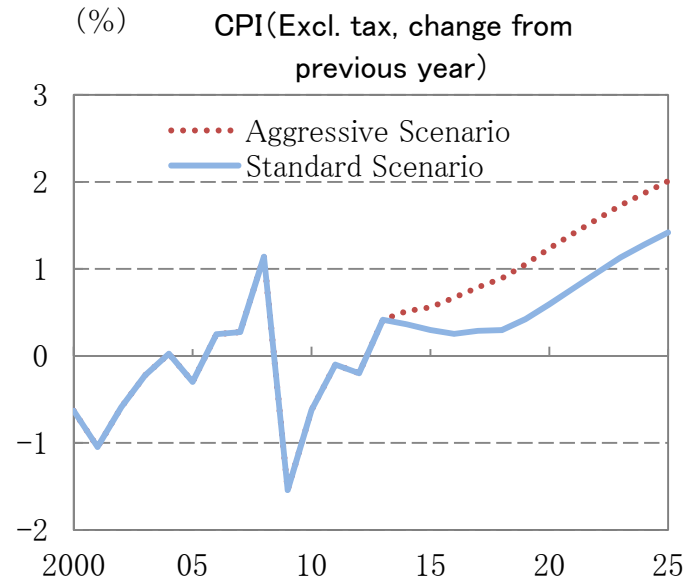
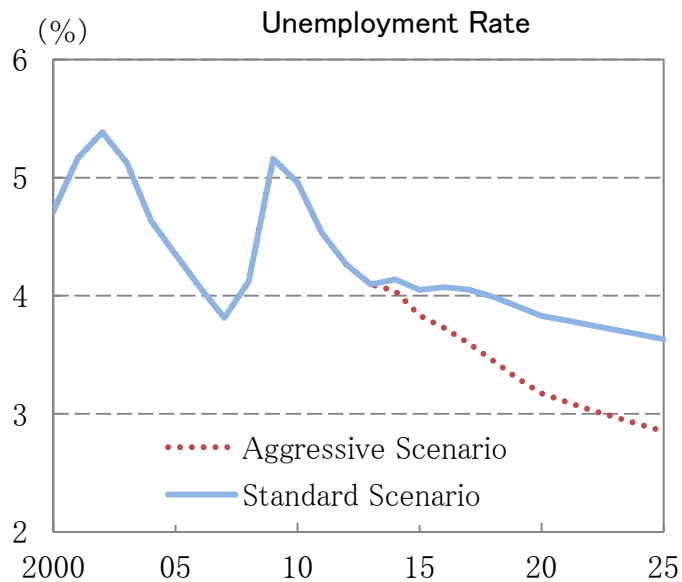
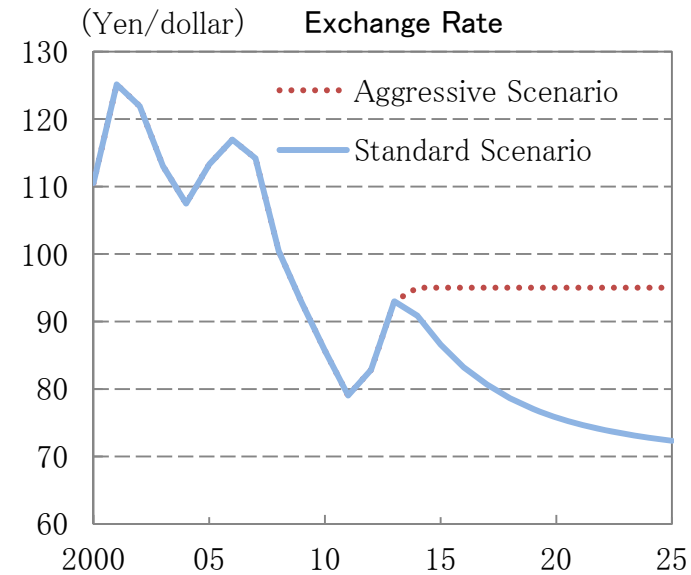
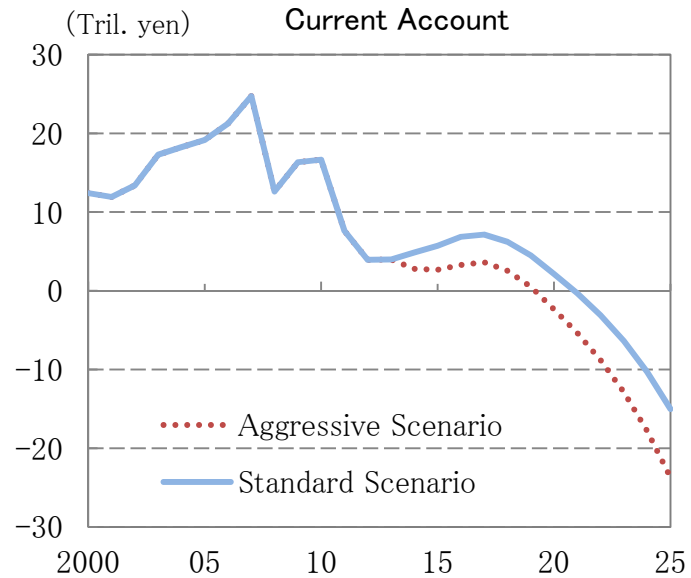
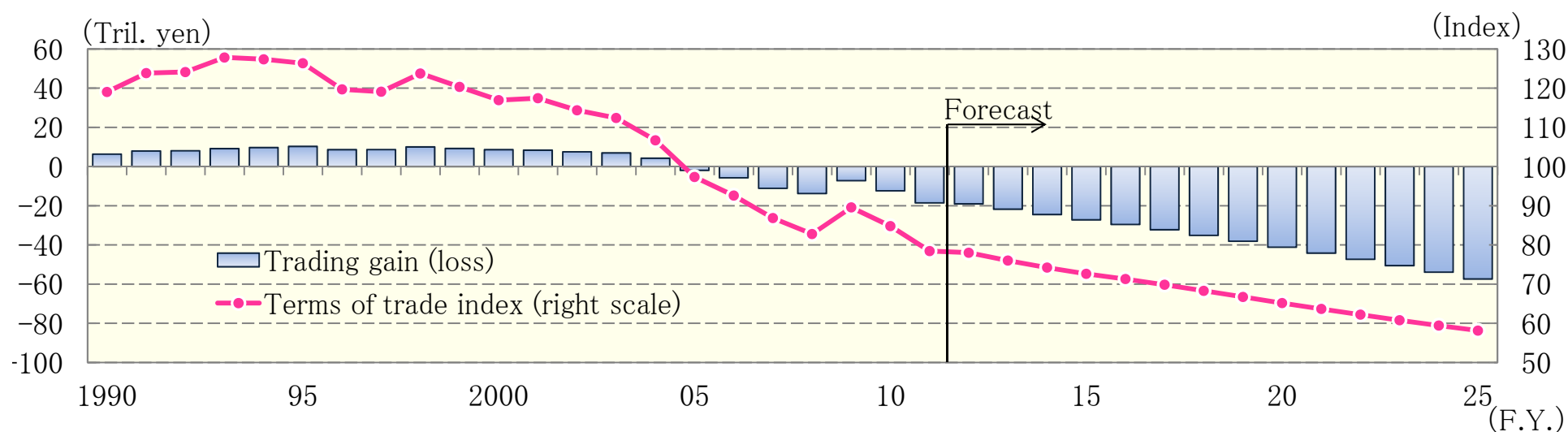


Fig.2-2 Aggressive Fiscal and Monetary Policy



(Source) Estimated by Japan Center for Economic Research

Fig.2-3 Terms of trade, Trading gains and losses

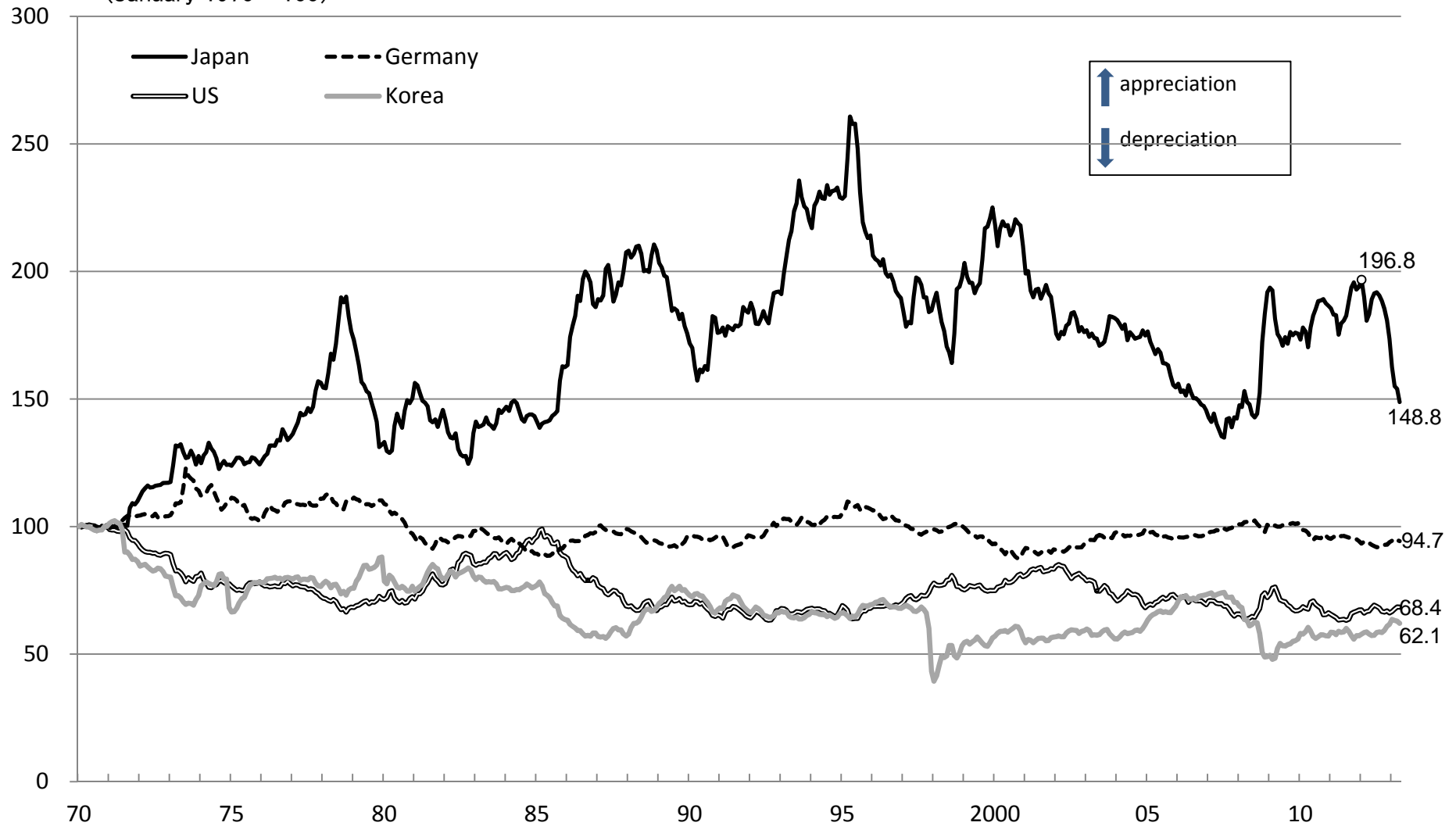


- (Note) 1. Trading gain(loss) = { (Nominal exports-Nominal imports) / Numeraire deflator} - (Real exports - Real imports)
 2. Numeraire deflator = (Nominal exports+Nominal imports) / (Real exports+Real imports)
 3. Terms of trade index = Export deflator / Import deflator x 100

(Source) Cabinet Office, "System of National Accounts"

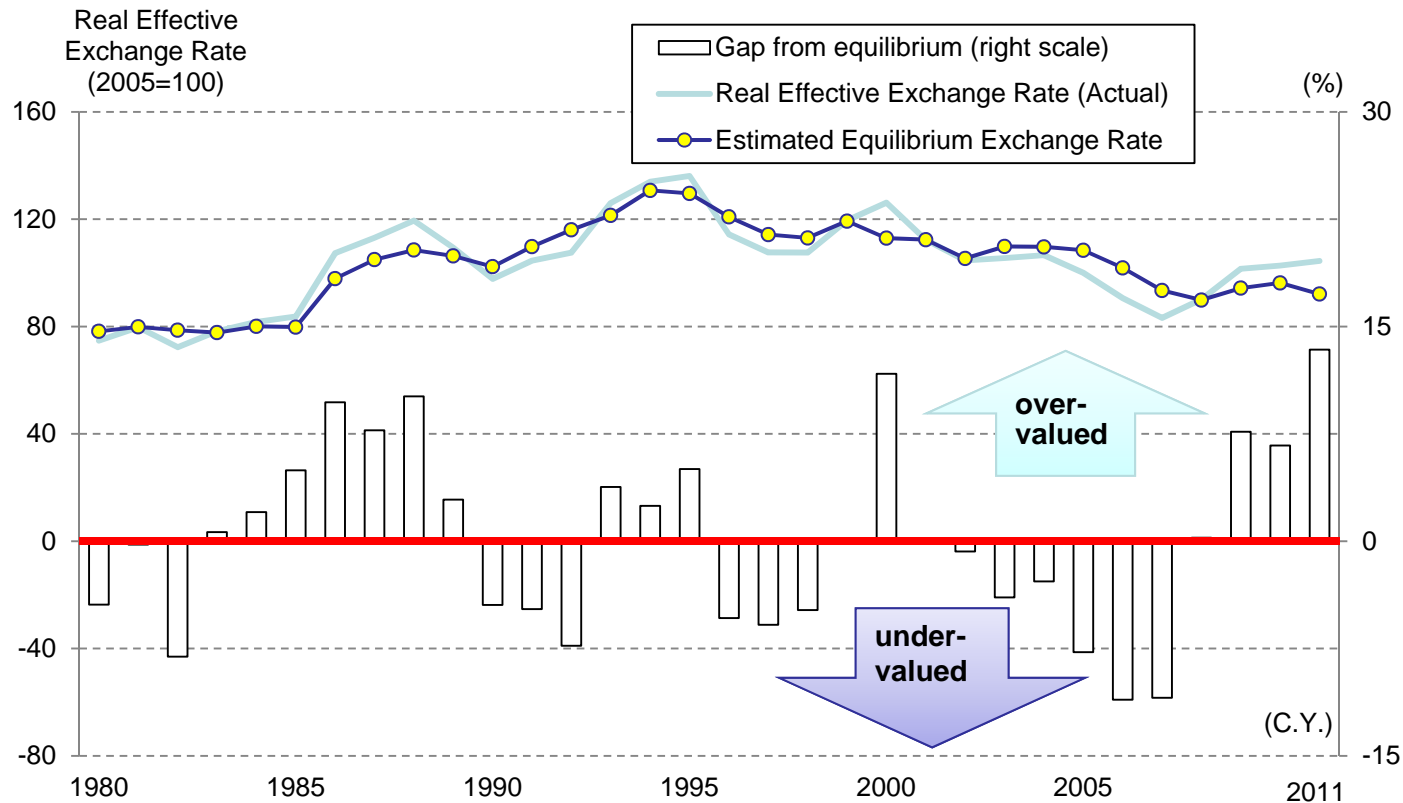
Fig.3 Real Effective Exchange Rate

(January 1970 = 100)



(Source) Bank of International Settlement, *The BIS Effective Exchange Rate Indices*

Fig.4 Strong Yen: Deviation from “Behavioral Equilibrium Exchange Rate”



(Source) IMF,OECD, Ministry of Finance Japan; and other national statistics

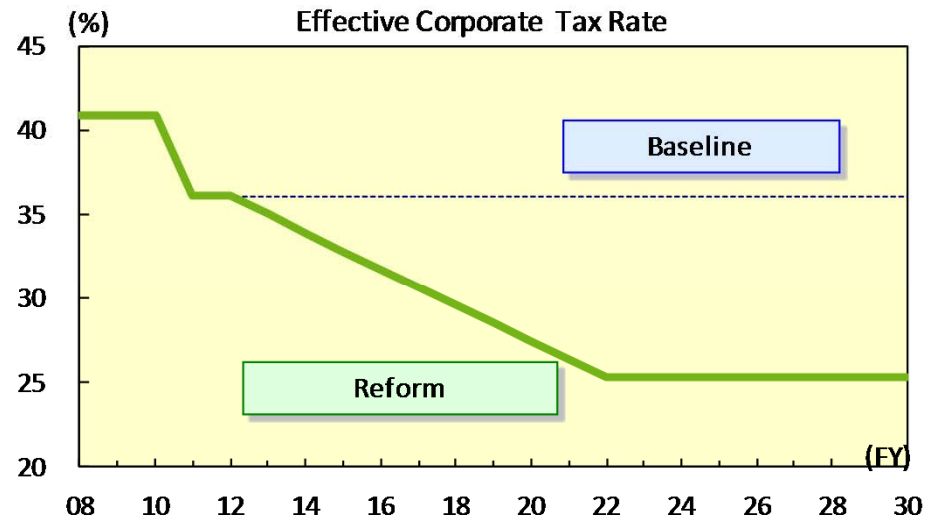
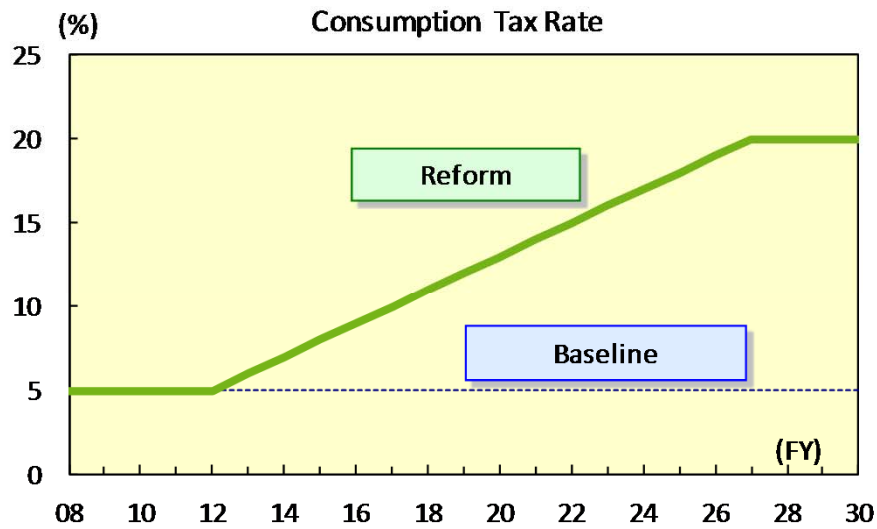
Table 2 Scheme of Public Pension Reform Plans

			Plan A Immediate abolition of pension premium	Plan B Gradual abolition of pension premium	Plan C Switching to Tax- Funded pension
Obligation of premium payment	First level portion		Immediate abolition		
	Second level portion	Past	Immediate abolition	Abolition within 10 years	Continuation
		New		Immediate abolition	
How pension benefits are paid	First level portion		Funded by tax revenue		
	Second level portion	Past	Employee's pension is responsible		Employee's pension is responsible
		New	Optional private pension		
Who bears the double burden			Young and unborn generations	Working generations and young and unborn generations during transition	—

(Note) Past means pension benefit related to pension payments already paid before reform. Initially, pension benefit will be financed by reduction of reserve. The sum of 20 trillion yen is supposed to be kept as reserve fund. After that, Government is assumed to make up for the revenue by issuing super long-term government bond or perpetual government bond.

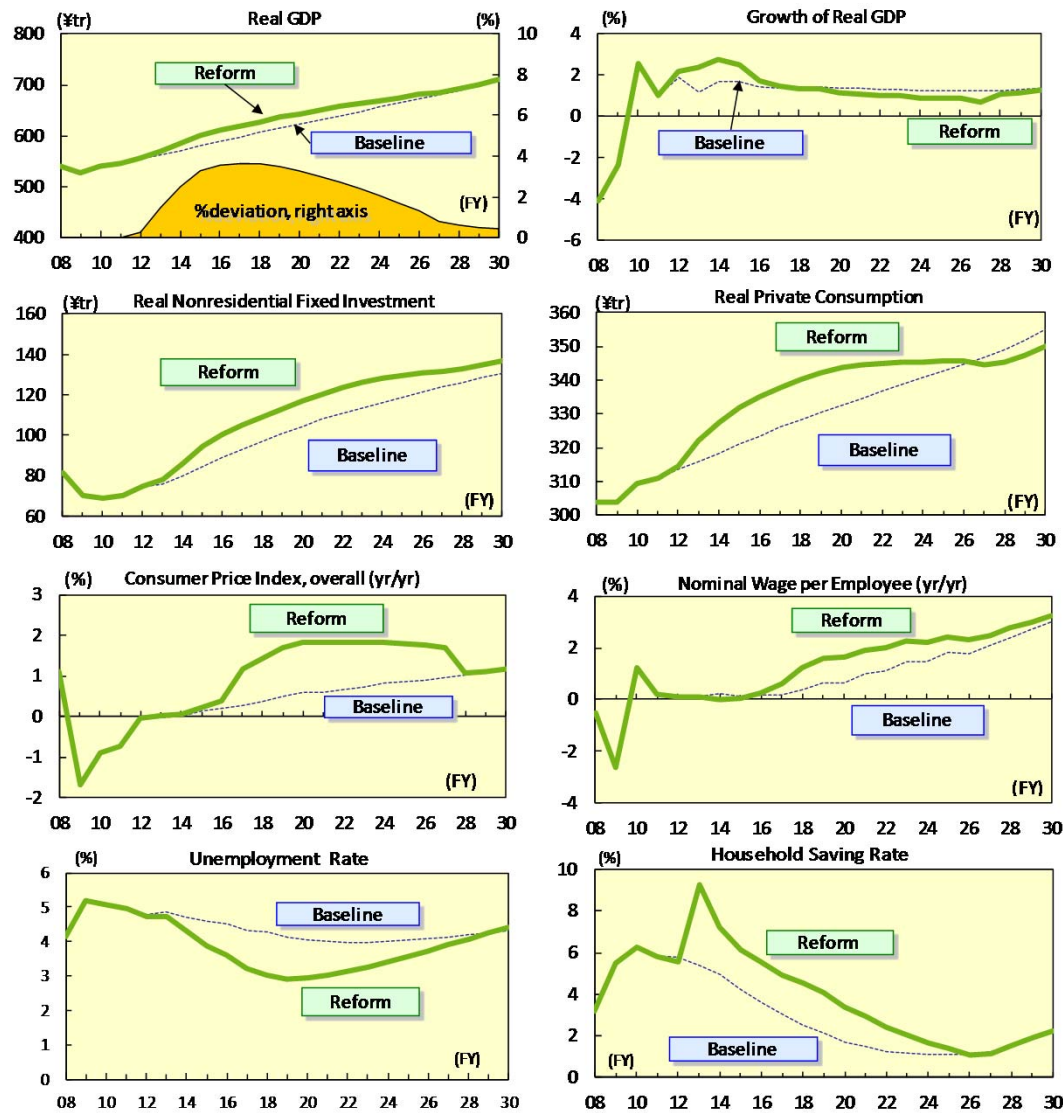
(Source) Macro-econometric model simulations by JCER.

Fig.5 Assumption on Tax Rates



(Source) Macro Econometric Model Simulations by JCER, without the effects of the Great Earthquake incorporated.

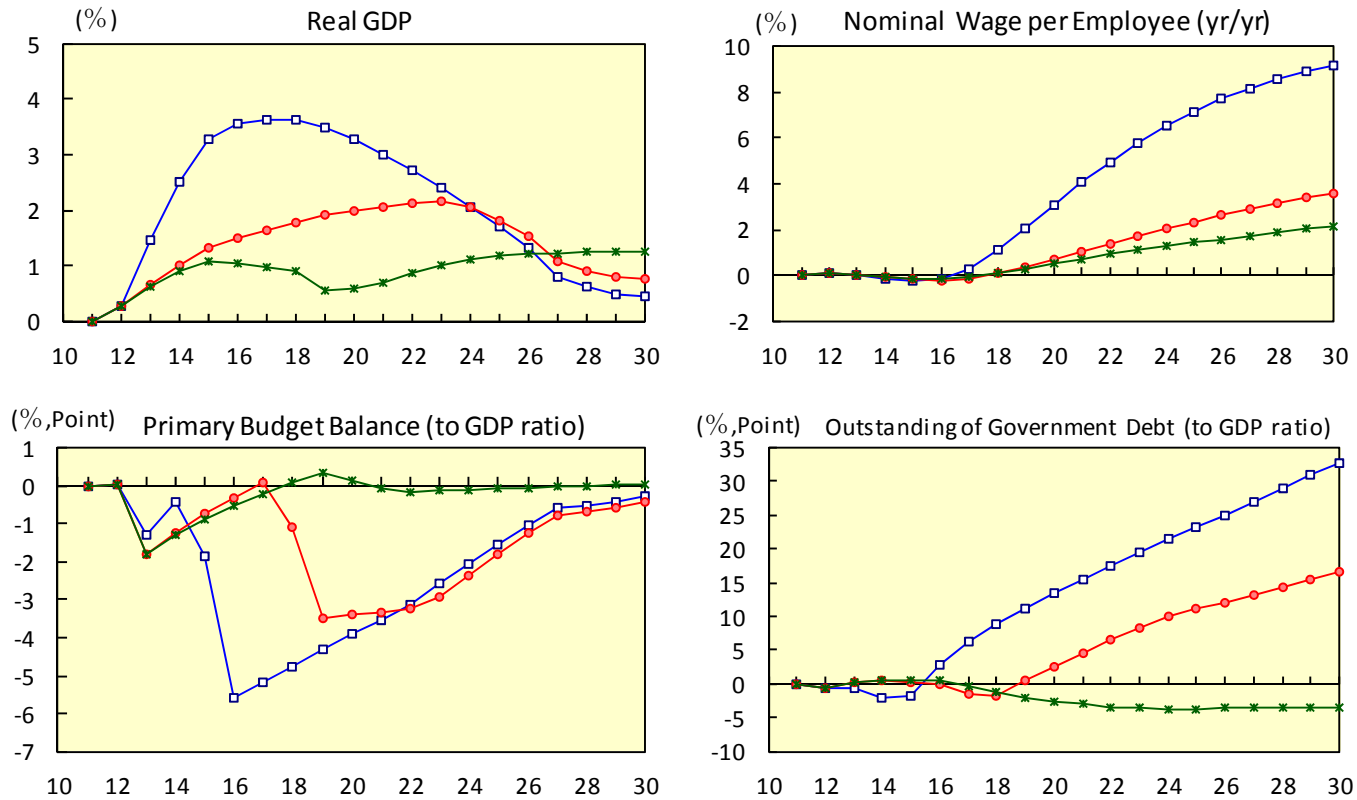
Fig.6 Impact on Macro Economy (Plan A)



(Note) The effects of the Great Earthquake are not incorporated.
 (Source) Macro-econometric model simulations by JCER.

Fig.7 Economic Effect(Plan A,B,C) (Divergence from Baseline Scenario)

- Immediate abolition of pension premium
- Gradual abolition of pension premium
- *— Switching to Tax-Funded Pension



(Note) Each line denotes discrepancy from the baseline, %.
 (Source) Macro-economic models by JCER.

Reference

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