Comments on Session III: Economic Policy under the Abe Administration
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What Happened: Regime Shift from Deflationary to Reflationary One

- Policy Regime Shift (Romer 2013)
- Deflationary Regime: The old LDP, DPJ, and the BOJ
- Reflationary Regime: The LDP under Shizo Abe and the new BOJ
How Abenomics Works

First Arrow
- Expected Inflation ↑
- Real Interest Rate ↓
- Asset Prices ↑
- Yen Depreciation

Second Arrow
- Government Expenditure

Real Interest Rate
- Consumption
- Investment
- Export

Output Gap ↓
- Inflation
- Loan ↑
- Demand for Loan
- Demand for Labor
- Wage growth

AD ↑
Increased Inflationary Expectation
Mandel and Burns 2013
http://libertystreeteconomics.newyorkfed.org/2013/04/japanese-inflation-expectations-revisited.html
Risks to Nascent Reflationary Regime

1. “Never was so much owed by so many to so few.”
   Institutional Instability
   - What happens after Kuroda?
   - Central Bank Independence is not the goal
   - Needs for the revision of the BOJ act of 1998

2. Adequacy of Inflation Targeting
   - Price level or NGDP level targeting?

3. Premature fiscal consolidation
Premature Fiscal Consolidation

- **Facts**
  1. 1997 tax hike: preceded by tax reduction
  2. After 1997, Japan experienced a full-fledged deflation
  3. 3% consumption tax hike $\Rightarrow$ reduction of real GDP growth 0.45% (Short-term macroeconomics model of ESRI, 2011)

- **Issue**: Will the nascent reflationary regime survive?

- **Plans**
  A: postponement until Japan gets back to normal nominal growth rate
  B: countermeasures: reduction in corporate and R & D investment taxes
  C: strengthening inflation expectation: introduction of NGDP level targeting
The Mistake of 1937
Stock price behavior

[Graph showing stock price behavior from 1930 to 1936, with key events such as the Great Depression and the New Deal highlighted, and a Japanese label which translates to '1930s Dow Jones Industrial Average (DJIA) chart, indicated by shaded areas representing US recessions. Source: Dow Jones & Company. 2013 research.stlouisfed.org.]

図1：1930年代ダウ工業株平均株価指数（アメリカ）
Inflation and Wage growth

Wage growth to Inflation

Money to Inflation and Wage growth

Wage growth

Inflation

Money growth

Inflation

Wage growth
Several correlations: thanks to Yoichi Takahashi
The Next Regime?

- Reflationary regime transitory by definition
- No “silver bullet” for growth policy
- The Third Arrow matters in influencing the formation of the next regime
- Two policy philosophies
  - A) government-led: industrial policy-like target policy, government fund
  - B) market-enhancing: competition policy, deregulation
- Industrial policy rarely works, but deregulation needs careful design