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Abenomics: A Change in the Concept

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Abstract. The article addresses recent changes in the views of the Japanese government, headed by Prime Minister Abe Shinzō, regarding the content and desired effect of its economic policy, which is presented to the public under the brand of *Abenomics*. The article highlights the major points of the economic credo proclaimed by the Japanese cabinet set up by the current leader of the ruling Liberal Democratic party after the Diet Lower House elections of late 2012. It presents the mid-term goals set by the new cabinet, as well as the principal macroeconomic tools that were meant to be mobilized by the cabinet in order to secure the achievement of these goals by means of modifying the tendencies which had solidified during the previous two decades, and bringing fresh stimulus and dynamism to the Japanese economy. The author briefly reviews the results of economic performance following several years of practicing *Abenomics* by the government and monetary authorities and possible explanations of the lack of significant progress in achieving the goals that had been initially set.

The author traces the evolution of the priorities in the economic tasks formulated by the Abe cabinets, which have been shifting from stimulating demand and reflation to promoting growth of productivity through dissemination of new technologies and ensuring an adequate supply of labor resources. The article notes the reassessment in 2015-2016 of potential effectiveness of monetary policy instruments as a means of supporting and accelerating economic growth, as well as the awareness of limited potential of additional input of public funds through government efforts as a tool for invigorating investment activity in the economy. A change in priorities is pointed out, both in the public presentation of the government's economic and social policies and, to a lesser extent, in their practical implementation, which was the logical consequence of the reevaluation of effectiveness of former tools.

Recent government documents setting larger goals, in particular the annual *Future Investment Strategy*, are analyzed as a reflection of the new vision of the economic role of the state. This vision includes less concern for current short-term macroeconomic indicators and more responsibility of the government for the fundamental characteristics and quality of the resources laying the foundation for national economic activities. The article concludes that the Japanese government's policy regarding social and business activities has been seriously adjusted to raise Japan's global competitiveness and ensure conditions for long-term sustainable growth of its economy. The said adjustment includes the abandonment of the traditional "industrial policy" concept.

Keywords**:** Japan, Abenomics, economic strategy, sustainable development, global competitiveness, post-information society

Economic policy of the Japanese government in the last decade, especially with Abe Shinzō's ascending to the post of the Prime Minister, has been subject to numerous comments with lavish use of PR cliché and labels. The most popular among them has been the term *Abenomics* launched by Japanese economists linked to the government back in 2013.

Initially it was used in the media as a convenient catchphrase, but then it gradually came to be used in government documents, and finally became an official brand-name for the economic policy of Abe's government. Its content as understood by the government economists gradually expanded with each passing year, coming to include more diverse, long-term ambitious goals and objectives, and finally became synonymous with the government's vision of the strategy of Japan's development. Nowadays, *Abenomics* as a policy concept extends to various areas far exceeding its initial scope, such as promoting considerable changes to healthcare system, innovative transport facilities, financial services and trading platforms based on new technologies, introducing digital technologies into every industry and sphere, creating an environment friendly to research and innovation, reducing carbon emission, and many others. At the same time, such a broad interpretation of this term has been accepted by the government and used by its PR service in official presentations and other public materials [Abenomics 2019].

Moreover, as the government was releasing more documents explaining the government's vision of the strategy for Japan's social and economic development, the *Abenomics* concept became more all-embracing, with its content very vague and abstract. From a plan of measures and steps to be implemented by the government, it was turning into a kind of a comprehensive vision of the desired future, often with no reference to specific dates and figures. At the same time, it became difficult to draw the line between the result of natural evolution of things and that of policy efforts of authorities, so that any growth of the size and sophistication of economic and social activity in the country could be presented by government strategists as a success of the ruling cabinet and its policy.

However, initially Abenomics had more limited tasks and was concerned primarily, if not exclusively, with accelerating long-term growth of GDP. It came against the background of two previous decades of stagnation, when obvious qualitative changes in consumption and the technological level of the economy went in parallel to nearly zero quantitative growth of GDP and real incomes. Average annual growth rates of these indicators for each decade were below 1 percent, and occasional recoveries, which sometimes lasted several quarters in a row, failed to bring about sustainable rapid growth. At first, this apparent macroeconomic slowdown did not cause much concern, as it was considered to be an inevitable consequence of the structural changes in the economy. However, by the end of the first decade of the 21st century, it came to be viewed as a serious problem.

As Japan lost the status of Asia's largest economy and felt the threat of its business corporations further shifting the focus of their activities to overseas locations, the slowdown in growth rates came to be viewed as a political problem. The need to overcome chronic stagnation gradually began to occupy an increasing place in public debate and the national political agenda [Strel'tsov 2014].

Accordingly, the first edition of the program of Abe's first cabinet, which was outlined in a series of interviews and public speeches in 2013, was based on his promise to remedy unacceptably sluggish long-term growth. Part of the program that dealt with structural policy measures aimed at long-term restructuring of the Japanese economy was transformed into an official document ambitiously named *Japan Revitalization Strategy* [Nihon saikō senryaku 2013].

Despite catchy slogans designed to draw public attention (these were the widely publicized Abe's *three arrows*, which marked respectively 1) soft monetary policy, 2) government stimulus spending, and 3) structural reforms), the presented program mostly consisted of traditional tools of demand stimulus routinely practiced by every developed market economy. Namely, it included increase in money supply through injecting additional liquidity into the banking system, and additional spending on public works financed from the national budget. All other measures included in the economic policy package by the new prime minister were more of psychological nature. Indeed, they were either not backed up by effective tools that could be used by the government, or could be implemented only in the long-term perspective and accordingly could not directly and promptly affect business conditions.

Thus, structural measures aimed at increasing supply (particularly through productivity growth) were too vaguely defined and not backed up by effective measures that could yield results in the short term. Theoretically speaking, the government's determination to help mobilize and optimize available resources through small but persistent institutional changes and incentives could possibly encourage the business community to be more proactive. In practice, though, it is always checked by inertia, so even if these measures do spin the growth spiral, the process is slow and very gradual.

As for the attempt to boost competitiveness through national currency depreciation through verbal and actual interventions by the central bank, the impact of the latter on the exchange rate dynamics could naturally be short-term only. The result of this impact could be traced in the weakening of the yen in 2013-2014, but this trend changed to the opposite in the second half of 2015, and, in a little more than a year, the exchange rate returned to the 2013 year-end level (slightly more than 100 yen per 1 U.S. dollar).

Thus, leaving aside Abe's PR activity (to which he spared much more attention and effort than his predecessors), in the first two years of his premiership, *Abenomics* was, in fact, confined to several packages of additional infrastructure financing programs and measures to increase money supply and ensure moderate but stable growth of consumer prices. However, implemented measures were actually quite limited in size and scope, and that contrasted very much with the ambitious initial promises to the public.

Thus, additional spending on infrastructure projects, which was extensively discussed during the first year of *Abenomics*, actually ended with relatively modest additions to budget expenditure plans of FY 2013-2015 and failed to become a factor that even government economists believed to be a powerful boost to economic growth. Since 2014, the focus of fiscal policy has shifted towards tax relief for private companies, such as measures to reduce the effective corporate tax rate.

As for the increase in the money supply, its main tool was a Japanese equivalent of "quantitative easing" pursued by the U.S. Federal Reserve System after the recession of 2008-2009. In April 2013, the Bank of Japan, or BOJ (the central bank of Japan), headed by Kuroda Haruhiko, a known confidant of Prime Minister Abe, launched a targeted program of buying out government bonds from corporate holders, primarily private commercial banks.

In fact, regular buying of government bonds in the open market had been routinely practiced before that. Moreover, from 2009, it was steadily on the increase, nearly doubling the volume of government bonds on the central bank's balance sheet to the end of 2013. However, the newly-appointed BOJ governor boosted the volume of purchase and brought the monthly volume of such transactions to over 5 trillion yen, and in the period of a year and a half, starting from the third quarter of 2013, effectively doubled the amount of government securities on the balance sheet of the Bank of Japan, bringing it to 200 trillion yen.

The result was a corresponding growth of the money supply due to politically motivated large-scale increase in the monetary base as a result of BOJ policy. Monetary expansion led to a decrease in the market borrowing costs, and commercial banks' loans to the non-financial sector steadily increased from 2013 to 2015.

However, the authorities failed to achieve the specified interim objectives of this policy, namely 1) defeating deflation, which had been characteristic of the Japanese economy since the late 1990s and was considered to be one of the main obstacles to restarting fast sustainable growth, and 2) significantly increasing propensity to consumption and consumer activity in the household sector.

Thus, the growth of consumer demand during the first three-year period of Abe's premiership was sluggish and unsustainable, and the negative impact on it of raising the rate of consumption tax in April 2014 was much stronger and longer than government economists expected. The decision to postpone the second of the two planned increases of the rate of this tax (up to 10 percent) to October 2019 did not help to accelerate demand growth.

As for the consumer prices, they hiked shortly, partly as a result of the aforementioned increase of the consumption tax rate. However, from the second half of 2014, price dynamics began to slow down and almost came to naught by mid-2015. As a result, the government failed to unwind the spiral of positive dynamics (the so-called virtuous circle) of prices, consumption, and incomes of economic actors despite strong and cheerful statements to the contrary by Prime Minister Abe and his economic advisers. Accordingly, the goal set by the *Japan Revitalization Strategy* to bring annual growth rates to the 2 percent-plus level remained unattained.[1]

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1 The "Strategy…" set a target for GDP growth of an average of 2 percent per annum in real terms over the next 10 years. In the first half of this 10-year period, an even higher growth rate was envisaged [Nihon saikō senryaku 2013, p. 2].

Nevertheless, government economists saw no reason to adjust their policies. A new version of the aforementioned basic document, approved by the Cabinet in June 2016, assessed the 2013-2015 implementation of economic strategy of the Japanese cabinet as successful [Nihon saikō senryaku 2016, p. 1]. However, specific indicators of this success, as cited in the document, were only indirectly related to the original objectives. Thus, the Abe cabinet was credited with boosting employment (more than a million new workers in three years) and presumably improved corporate governance in the private sector. The latter, as well as the stated increase in productivity in the economy, were interpreted in the document as a result of easing regulation in the electricity production, agriculture, healthcare, in particular as a result of measures aimed at liberalization that the government agreed to during the negotiations on the Trans-Pacific Partnership (TPP) agreement. Also, the document claimed that the government had succeeded in reducing the tax burden on private business and in giving it more flexibility by allowing to freely choose forms and conditions of employment.

As for the goals of reviving consumer activity and overcoming deflation, the government could not provide convincing evidence of their achievement, and the fact was used as an argument to continue the policy of stimulating demand through fiscal and monetary expansion.

Indeed, in the following period, the BOJ continued large-scale market operations of purchasing government bonds and holding them in the central bank's investment portfolio. The outstanding amount of long-term government bonds held by the BOJ showed a twofold increase over two and a half years, exceeding 400 trillion yen by mid-2017. As a result, financial institutions that were selling the bonds to the central bank accumulated an unprecedented amount of monetary liquidity. That should have led them to step up search for potential borrowers in the non-banking sector and thus indirectly pull up commodity prices.

For the same purpose, monetary authorities resorted to the policy of extremely low interest rates set by the central bank as a regulator of financial markets. Since the basic rate for financial institutions to borrow from the Bank of Japan was set at a very low level of 0.3 percent as early as 2008 and afterwards, in order to increase pressure on financial markets to further reduce the cost of borrowing, BOJ resorted to cutting the deposit rate applied to balances of commercial banks' accounts in the central bank. In 2016, the key rate applied to selected balances of accounts of credit institutions (policy-rate account balances) was set at a negative level and has been kept negative ever since.

Another tool that was used for these purposes was the indirect regulation of government bond yields on secondary market. From a certain point in time, the volume of the BOJ's purchase of government bonds came to be determined with reference to its impact on their yields at market prices. The target yield was set at zero.

So, the goal of the central bank's interest rate policy as well as its "quantitative easing" was to push the maximum amount of bank liquidity into the corporate and consumer finance markets, thus bringing about an overall increase in investment, consumer spending and commodity prices in the economy [Shvydko 2018].

As for the government's fiscal policy in 2015-2017, no significant innovations could be traced, including traces of any new significant packages to infuse large amounts of public money into the economy. There was, however, no overall cut in spending to balance the budget, which was originally stated in 2013-2014 as a strategic goal for the medium and long term. Moreover, achieving the interim goal of securing zero primary deficit of consolidated budget (i.e. cleared of revenues and expenditures linked to government debt, or "primary balance") was postponed from 2020 to 2025. Fiscal policy generally remained rather soft and subordinated to the task of maintaining economic growth rather than consolidating public finances.

However, it has become increasingly apparent that measures from the original version of Abenomics as a policy to promote growth through stimulation of demand and fighting deflation had only limited potential effect. A boom in consumer spending, as well as in domestic investment, could not be achieved precisely because of the limited potential effect of monetary stimulus in the actual conditions of the Japanese economy in the 2010s.

Indeed, the decreased cost of borrowing did not automatically lead to an increase in demand for money from non-bank corporations and the population, and possibilities for further decrease of these costs were next to nil, as interest rates applied by financial regulators were close to zero. In such a situation, the traditional textbook methods of "fine-tuning" the demand for loans prove to be ineffective, as was noted, for example, by Paul Krugman in his paper on the Japanese economy [Krugman 2015, p. 178].

Moreover, the low cost of borrowing slows down natural selection of companies based on their efficiency, allowing trouble-ridden enterprises to remain "afloat" for a long time while having no prospects for growth and development. At the same time, negative rates of the regulator worsen already troubled financial situation of the banking sector, and zero or even negative yields of government bonds destroy their markets. In the long run, they are beneficial to no one except the government. As Japanese economist Yumoto Kenji, who served as economic adviser to former Prime Minister Obuchi Keizō, justly remarked, "monetary policy can buy time, but it does not solve all the problems" [Miller, Fujioka 2019].

What makes it worse, economic actors get used to monetary expansion when it is practiced continuously. They no longer react positively to incentives inherent in monetary expansion but are prepared to react negatively when authorities abandon it and turn to restrictive measures. As a result, monetary authorities, speaking figuratively, continue to press the accelerator to no effect, while they are afraid to apply breaks. While understanding that reflation (bringing consumer inflation to the target level of 2 percent) and higher propensity of households to consume could not be possibly attained, the BOJ policy-makers have been keeping all basic parameters of its policy unchanged for many years and refuse to discuss the need to change them in the near future. The fact that maintaining this line is financially beneficial to the government only adds to the doubts that BOJ's clinging to the course once set by the Abe government may not be possibly justified.

Against this background, since mid-2010s, the concept of *Abenomics* and its official interpretation have been undergoing gradual but visible change. Firstly, while the final goal of achieving sustainable long-term growth remains more or less unchanged, the government has begun abandoning specific quantitative targets, such as GDP growth rates, prices, budget indicators, etc. Thus, the documents issued in 2017-2018 fail to mention specific rates of GDP growth as short- and medium-term targets, while the goal of bringing nominal GDP to 600 trillion yen is not linked to any specific timeframe.

While the task of finally getting away with deflation remains unchanged, early benchmark in the form of 2 percent inflation rate is mentioned less frequently and is not linked to specific time horizons. The goal of achieving a zero primary deficit of consolidated budget has been postponed to times far beyond the expected end of Abe's tenure as Prime Minister. As for the additional budgetary expenditures serving economic policy goals, they may be definitely set for certain directions, but their terms and amounts are not specified.

Secondly (and this is even more important), in the contents of the future policies, the emphasis is shifted to measures that foster producers' capacities, or from "economy of demand" to "economy of supply", if we put it in familiar terms. Official documents, which are meant to set out the government's economic and social strategy, focus on productivity, competitiveness, investment, and innovation, on the quality and availability of economic resources. The government's focus shifts from stimulating demand for manufactured goods and services towards improving the quality of resources – human, intellectual, and entrepreneurial, including the quality of management, as well as to encouraging an increase in their supply. In particular, these measures include encouraging economic activity in certain age groups, improving the quality of education and training, easy access to information, better protection of intellectual property rights, etc.

Also, the time horizon of this policy broadens: measures envisaged by the documents could bring positive results in 5-10 years or even later. On the one hand, it requires better arguments based on sound calculations and well-founded forecasts. On the other hand, it largely frees the government from responsibility for poor progress of growth parameters in the short term. The latter gives the government considerable leeway to choose its priorities and goals that are increasingly postulated in most general terms, thus moving the government away from the zone of possible criticism and accusations of inefficiency.

Thirdly (and perhaps most importantly), the economic philosophy and practical activities of the government led by Abe are moving further away from the government-led regulatory approach to the management of national economy, which had been typical of Japan's development after World War II. Although this policy U-turn is not always postulated clearly and unambiguously, careful reading of government statements reveals definite and significant policy change.

On the one hand, Abe and his cabinets broke with the tradition of so-called "industrial policy", when the government singled out priority sectors of the economy and used the means at its disposal, which changed over time, to ensure a more intensive inflow of various resources, such as finance, labor, and entrepreneurship, into designated industries. In recent documents, the government has avoided naming specific industries or sectors which are treated as prioritized in its economic policy and which are to receive administrative advantages over others. Instead, it spells out the most promising directions of innovations designated by experts, and these directions are expected to greatly impact the competitiveness of Japanese companies in international and domestic markets. Most of these directions are centered around certain technological or social phenomena and have functional rather than industry-specific nature.

On the other hand, the government's activities in these directions are limited to assurances of full support for the efforts of the private sector and specialized public corporations in these areas. No quantitative targets are set to secure allocation of public resources, such as finance, for these purposes. Funding for specific programs or projects relevant to prospective directions of innovation is allocated by relevant institutions and departments. The forms and volumes of such funding are determined within the framework of the national budget and do not take the form of political megaprojects with separate large-scale budgets.

A typical example of the new approach to economic strategy formulated by the Japanese government as a new interpretation of the *Abenomics* concept is the so-called *Future Investment Strategy*, a document that replaced *The Strategy of Japan's Revitalization* as an annually updated manifesto that articulates the government's vision of the country's medium- and long-term future and thus defines the context for evaluating concrete steps and initiatives of the government and its head.

Two annual reports under this title have been published and presented as 2017 and 2018 versions. The first of them, [Mirai tōshi senryaku 2017] has the subtitle: *Reforms for Realization of Society 5.0*, the second [Mirai tōshi senryaku 2018] – *Change towards Society 5.0 – Society Driven by Data*. With some nuances in the details, both are essentially based on the premise that society in Japan is undergoing a profound transformation associated with fundamentally new role of technologies based on the use of huge and rapidly growing volume of data. This transformation will affect all aspects of life and will continue for several decades, forming a new way of life (*Society 5.0*), different from both industrial society (*Society 3.0*) and information society (*Society 4.0*).

Authors of these documents believe that the changes introduced by this process into society are so great that they require a fundamental change in the methods and directions of government policy, reorienting it from the traditional policy of regulating business cycles to frontal promotion by state of structural changes in society, regardless of its impact on the short-term dynamics of particular macroeconomic indicators.

Having admitted that the four preceding years failed to change fundamentally the environment for the private sector through creating a new and powerful source of demand and did not significantly accelerate productivity growth despite the government's efforts, the 2017 document makes the following fundamental conclusion.

In order to overcome the prolonged stagnation and meet the challenge of securing sustainable growth in the medium and long term, Japan needs to implement the concept of a post-information society (*New Generation society*, *Society 5.0*), based on the use of the achievements of the

Fourth Industrial Revolution (mainly the *Internet of Things*, big data analysis, artificial intelligence, robotics) in all sectors of the economy and social life. In other words, this new understanding insists that the path to sustainable growth and development is not the use of traditional tools to stimulate consumer and investment demand, but changes in the quantity, quality, and nature of economic resources available to society, and interaction between these various resources.

For this purpose, it is believed necessary to focus efforts on promoting interpenetration, interaction, and mutual stimulation of activities in different sectors and spheres of public life. Examples of such efforts include compatibility of software and hardware and their integration in combined systems; formation of integrated databases; easy access to and use of large databases by business units in various industries; promoting research and innovation in relevant areas, including facilitating contacts and connections between business and the academic community, as well as between business and independent research organizations.

These efforts, according to government strategists, will help to create a system allowing to "optimize economic activity and increase added value, to create a vital society-economy. (...) If the reaction to the innovations of the *Fourth Industrial Revolution* is delayed, and bold reforms are held off with indecision, we run the risk of becoming subcontractors of the world's leading corporations and of accompanying erosion of our middle class" [Mirai tōshi senryaku 2017, p. 2].

Given Japan's conditions and potential advantages in the global economy, the authors of the strategy propose to replace the previous approach based on prioritizing specific industries with a new one focusing on organizational and financial assistance of the government in five directions, which, in their view, could become the engine of the Japanese economy in the medium and long term. These directions are as follows:

1. Increasing longevity of active and healthy life.
2. Innovations that increase population mobility.
3. Creating next-generation distribution systems.
4. Infrastructure and urban innovation.
5. New financial technologies.

Although the new economic policy priorities are vaguely worded, and may be subject to different interpretations, it certainly is a fundamental change compared to everything that was said (and, to a large extent, practiced) during the previous decades. Leaving aside the rather intricate forms in which the new approach is expressed in official documents, its essence is that the government abandons short-term indicators of success of economic policy and focuses on institutional reforms designed to make the Japanese economy and hence the Japanese society more competitive in the global context.

In the context stated above, the term *reforms* is somewhat misleading. Although it is frequently and deliberately used in the documents, it seems obvious that the talk is not so much about reforms in the original meaning of the word, but rather about relatively small changes in regulatory documents and their implementation, intended to serve as a kind of signal to business actors. It is these actors from whom decisive efforts are expected, which will improve the productivity and global competitiveness of the Japanese economy.

This approach can be observed not only in the "Strategy…" documents, which are of general nature by definition, but also in a more practical document, positioned as a roadmap for the new stage of *Abenomics*. This document, entitled *New economic policy package* [Atarashii keizai seisaku pakkēji 2017] and enacted by the Cabinet's decision in December 2017, displays exactly this approach.

Although the text mentions some specific measures planned for implementation in FY 2018-2020, they are only indirectly related to economic policy in its traditional understanding. These include, for example, additional coverage for low-income groups of the cost of pre-school and university education; raising the wages of social workers caring for the elderly and disabled and facilitating the obtaining of long-term visas for foreign nationals working in this area. They include supporting the use of digital and information technologies in small and medium-sized companies, providing advice and logistic assistance to such companies, and changing regulation of subcontracting. There is also a promise of educational, information, and advertising support for regional businesses in order to increase their efficiency and dynamism, etc.

At the same time, the topics in the document which directly relate to economic policy (changes in tax rates and exemptions from tax base for businesses, creation of investment funds and funds that use public money to support small and medium-sized regional businesses, etc.), are dealt with in a rather general mode, looking more like a proclamation of intentions rather than specific commitments.

Nevertheless, the document clearly spells out the general line towards abandoning the ideology and policy of strong regulation and selective support of leading companies, which was typical for Japan in the second half of the last century, in favor of general promotion of self-supporting efforts by business to improve its productivity, of raising both the number and quality of national economic actors. It would be fair to say that this is exactly the new interpretation of the economic role of the state as the essence of the concept of *Abenomics* in its present form.

The expected result in quantitative terms of the said promotional efforts, according to the government version, is a 10 percent increase of the annual volume of investment by FY2020 compared to the results of FY2016; wage increases of at least 3 percent per annum and an increase in productivity of up to 2 percent per annum, which is roughly two times more than the actual performance of the first half of the 2010s [Atarashii keizai seisaku pakkēji 2017, p. 16]. Also, the government expects the growth of employment in the economy and better adaptation of workforce to changing labor requirements despite unfavorable demographic trends (caused by the decreasing birth rate in the preceding period and "ageing" of the population).

The coming years will probably make it possible to judge the effectiveness of the Japanese government's efforts outlined in recent strategic instruments and see whether its optimistic forecasts are justified in the changing global situation.

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