

# Abe's success hinges on wages, investment

**A**benomics will mark its fifth anniversary in several months' time. Over that period, the Japanese economy has undergone major changes, but many people appear to feel that Prime Minister Shinzo Abe's signature economic policy package has not sufficiently lived up to expectations.

His stimulus program has fallen short of expectations on two main points. First, it has not helped adequately lift in-



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flation and wages. The most important purpose of Abenomics is an exit from deflation. In January 2013, the Bank of Japan set an inflation target of 2 percent to be achieved within two years, but it has missed the target for more than four years now.

Another important point that has fallen short of expectations is the ongoing absence of an increase in the country's potential growth rate, which reflects the real strength of our economy. If the potential growth rate remains low, it is hard to foresee the Japanese economy's recovery in the medium to long term. As a result, people continue to feel gloomy about the future of the economy.

The fact that Abenomics has not realized the desired results points to some developments that should be reflected upon. First, the Abe administration has placed too much confidence in monetary policy.

In the beginning, the public was led to expect the central bank's bold monetary easing program to halt deflation. Nonetheless, it has become evident that it is not so easy to raise inflation and wages.

As the Bank of Japan has admitted, Japanese people's deflationary mind-set has been more persistent than expected and, therefore, remains little affected by the central bank's aggressive monetary easing policy. Given the current state of the economy, it is beyond question that the central bank will maintain its existing policy, but it should be careful not to lead society to unwarranted optimism about a rise in inflation and wages.

The potential growth rate remains low because the country's economic growth strategy has not been adequately working. I do not think there are problems with the content of the strategy. What is essential is to accelerate

the speed of effective structural reforms. But, even more importantly, businesses ought to actively increase investment.

## Rise in nominal GDP

Although I mentioned earlier that Abenomics has failed to live up to expectations, I did not mean that Abe's stimulus program has been ineffective. Japan's economic conditions have greatly changed over the past 4½ years. In fact, there has been a conspicuous improvement in the economy's nominal gross domestic product scale.

Japan's nominal GDP peaked at about ¥533 trillion, a figure measured on a new basis, in fiscal 1997, when Japan got into a financial crisis. For nearly two decades since then, the nominal GDP remained below that level — the comparable annual numbers even fell below the ¥500 trillion mark from fiscal 2009 to 2012 due to the 2008 Lehman Brothers shock and the Great East Japan Earthquake of 2011. There is no doubt that the GDP shrinkage resulted from deflation.

The decrease in the GDP inflicted immense damage to the Japanese economy, leading to a significant deterioration in fiscal conditions in the wake of a decrease in tax revenues. If Japan continued to be plagued with such a deflationary trap, it would have found itself in more and more dire straits.

However, thanks to Abenomics, Japan's nominal GDP began picking up again in and after fiscal 2013 — in fiscal 2016, the nominal GDP stood at about ¥537 trillion, surpassing the previous high set in 1997.

As such, when we look at Japan's nominal GDP, its economy seems to be escaping from deflation. Indeed, trends of recovery are noticeable in various sectors in parallel with the GDP upturn.

For instance, tax revenues have sharply risen, enabling the government to deliver on its policy pledge to halve the ratio of the primary balance deficit to the country's GDP by fiscal 2015 from fiscal 2010 — an important step toward fiscal rehabilitation.

The labor market continues to improve dramatically. The ratio of effective job openings to job seekers is currently at a 30-year high, exceeding the peak seen during the bubble economy period. This means business corporations tend to suffer labor shortages. As far as the employment environment is concerned, the economy has recovered remarkably. Businesses, for their part, have recently generated un-

precedentedly high profits.

## No wage hike, no future

Oddly enough, while the labor market has improved and businesses posted record profits, inflation and wages have not surged enough and the economy as a whole has not grown sufficiently. Considering such asymmetric developments, there is no denying that there are some points of Abenomics that should be reflected on. As for the growth strategy, in particular, the government should carry out more dynamic reforms that will contribute to lifting potential growth.

I think business corporations should hold themselves responsible for the stagnant state of the economy — the slow rise in inflation and wages amid the recovery of the employment environment and corporate earnings.

Whereas the ratio of effective job offers to job seekers has considerably improved, as mentioned above, the labor income share or labor share — which indicates the extent to which corporations allocate their added value to labor compensation — has hit a 30-year low. In this regard, the extent to which corporations will unlock their huge cash reserves to increase investment and wages holds the key to realizing the Japanese economy's recovery. In other words, it is up to Japanese businesses whether they will make or break the Japanese economy.

Then, let's take a look at a certain part of the GDP statistics — the ratio to GDP of the excess of gross corporate saving over fixed investment (i.e. net lending). The net lending ratios are less than 1 percent for the United States, about 2 percent for Germany and more than 5 percent for Japan. This is a testament to the fact that Japanese businesses have built up enormous cash holdings.

By the way, has there really been no increase in wages in Japan? The answer to this question has a lot to do with the country's employment framework, known as Japanese-style employment practices. Employees of large-scale companies are protected by the seniority wage system and the lifelong employment system. Under such systems, it is difficult for employers to offer a sharp increase in wages year after year. This is a bottleneck of the Japanese employment practices.

But it must be noted that more than half of workers in Japan are non-regular workers, full-time employees of small and medium enterprises, self-employed people and so on. Their wages tend to fluctuate quite sensitively in response to labor market conditions. In recent years, there

has been a steep continuous rise in labor costs in the food-service, retail and logistics industries, reflecting serious labor shortages.

The Tokyo metropolitan government and each of the prefectures have recently raised their respective minimum wages. The government has recently decided to raise minimum hourly wages in the country's 47 prefectures. This is a meaningful measure to give momentum to the tendency toward an increase in wages in general. The government's work style reform agenda has the same-job-same-pay principle as its key feature. This is the government's message to corporate chief executives that those companies that follow a management pattern of using cheap labor and disposing of it after a limited period of time cannot survive. After all, wage growth is the most important element for the success of Abenomics.

Companies that have to be sensitive to changes in the employment environment have been actively working on steps to improve the treatment of part-time workers and students doing part-time jobs. A new wave of higher wages has finally begun gathering momentum in the non-regular workers sector of the labor market. If such a wave becomes widespread across the labor market, the average worker's disposal income is likely to go up. Wages through increased to cause upward pressure on inflation through increased labor costs, among other factors.

Above all, if the environment in which wages tend to keep rising is sustained, businesses will have no choice but to raise labor productivity for survival. In such a situation, there is likely to be an accelerated exodus of workers out of companies with lower labor productivity to those with higher labor productivity.

Yamato Holdings Co, the largest door-to-door parcel delivery operator in Japan, has recently decided to hire nearly 10,000 new workers. Just imagine what kind of companies workers applying for Yamato jobs are from. Presumably, there must be many companies that cannot afford to compete with the logistics giant in terms of wages. Those businesses that cannot raise productivity, and therefore wages, will likely find it increasingly difficult to survive. As such, the supply side of the economy is now being required to make necessary adjustments to a spate of wage hikes.

An increase in corporate investment and such wage-triggered adjustments are exactly what is necessary to raise Japan's potential growth rate.

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