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Debating Abenomics

YEO Inman*

Abstract | This paper aims to outline and analyze the policy objectives and accomplishments of Abenomics, which has been in place for three years since the end of 2012 to restore the Japanese economy from its long-term recession. Abenomics is, in theory, a reflationist policy, and sets a specific target rate for inflation. The policy is essentially a strategy for growth, composed of the so-called "three arrows," namely bold monetary easing, expanding government expenditure, and inducing private investment. Of the three, Abenomics places most emphasis on monetary easing, which was meant to reverse the economy's deflation in a relatively short period of time. While the three years of Abenomics have been successful in raising the volume of corporate profits and asset prices, the aggregate demand figure—a composite of investment, consumption, and export levels—showed few changes, revealing the policy's limitations in bringing about a solution to Japan's long-term recession. Instead, the failure of this radical monetary policy may lead to a further breakdown of the Japanese economy.

Keywords | long-term recession, deflation, Abenomics, three arrows, reflationists

Introduction

Abe Shinzō's grip on power remains unwavering. The Abe-led Liberal Democratic Party (LDP)-Komeito (*Kōmeitō*, Clean Government Party) coalition government scored another sweeping victory in the latest Upper House Election in July 2016, resembling Koizumi's uninterrupted series of landslide victories a decade earlier. While these results may seem similar, their causes are, in fact, quite different. For Koizumi Jun'ichirō, who put forth policies to cut government expenditures and implemented neoliberal structural reforms, his sweeping victories were largely dependent on his popularity among the Japanese people. By contrast, Abe's win entailed a complex array of voices opposing Abe's political shift to the right, which was then offset by the people's hope and expectation for Abe's economic policies. There were, of course, some similarities,

* YEO Inman is a Professor at the Department of International Commerce, Gangneung-Wonju National University (inman@gwnu.ac.kr).

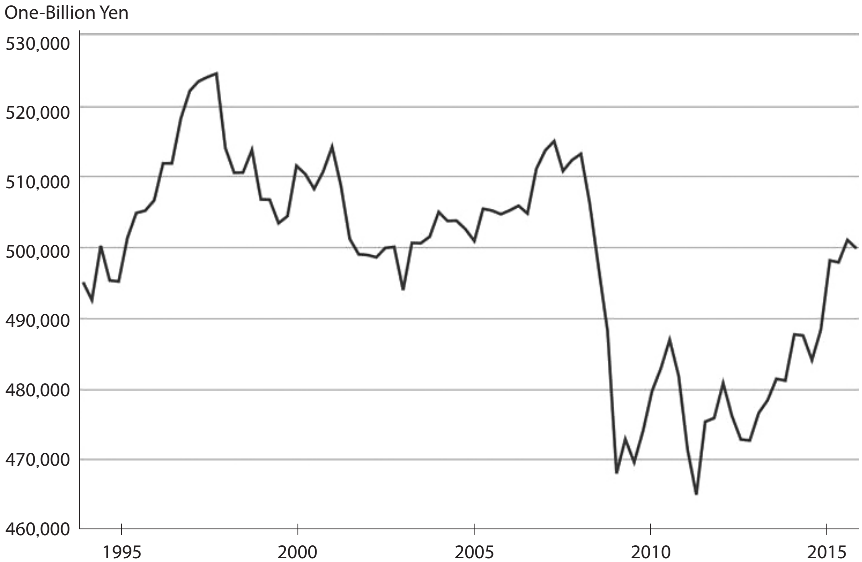

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Figure 1. Japan's GDP

such as their political strategy to appear as "responsible" politicians to the public. Yet, such strategy, as this paper argues, poses a dangerous gamble for the Japanese economy. The public often looks for responsible, trustworthy figures for their political leaders in dire economic situations. For example, Koizumi's lengthy stay in office (April 2001 to September 2006) was preceded by a series of bankruptcies of the city banks and Japanese financial reforms. The inauguration of Abe's second cabinet in late 2012 also coincided with the Japanese economy's continued suffering under the influence of the Global Financial Crisis (figure 1). Additionally, the Democratic Party of Japan's (DPJ) period in office from 2007 to 2012 was highly criticized for its "irresponsible politics."

As this article illustrates, Abenomics, Prime Minister Abe's economic policy, is a double edged sword.[1] While the introduction of the policy brought with it

1. Abenomics is a set of economic policies espoused during the second Abe cabinet. Ever since the dissolution of the Lower House in November 2012, and the *Asahi Newspaper*'s use of the term, Abenomics became widely used in Japanese public discourses. In 2013, Abenomics was listed in *The Encyclopedia of Contemporary Words* (*Gendai yōgo no kiso chishiki)*, issued by the Japanese publishing company Jiyū Kokuminsha (Free Nation Press), as one of the Top Ten Buzz Words of the year, an honor for which Abe awarded himself.

diverse symbolic and even belittling terms, such as the “three arrows,” “*Aho*[fool]nomics,” and “*Abe nomi kussu*” (Only Abe Can Smile Policy), it is hard to deny that the recent discourses on the current situation and future of Japan center around Abenomics. From the outset, Abenomics triggered contentious debates on the pros and cons of the policy. And while three years have already passed since the implementation of the policy, allowing for an overall evaluation, the polarization of views on Abenomics remain unflinching to this day.

It is against this backdrop that this paper aims to clarify and scrutinize the existing debates on Abenomics, as well as to briefly elaborate on the implications of Abenomics for the Japanese economy. Moreover, my study finds that the discussions on Abenomics within Korea have remained largely restricted to “practical” issues, such as the possible influence of Abenomics on the Korean economy. Taking this into account, this article will instead examine the theoretical foundations of the policy. I believe that these findings will help to develop a comprehensive overview and evaluation of the past three years of Abenomics and provide guidance for future directions.

Theoretical Debates on Abenomics

Abe’s second cabinet began at the end of 2012, and Abenomics became fully implemented around March 2013. This section of the article will focus on the theoretical background of Abenomics. To begin with, the economic indicators of the time revealed how the cycle of low growth, deflation, and strong yen, which set in during the 2008 global financial crisis, continued to persist in the Japanese economy. In numerical terms, the nominal and real rate of economic growth in 2012 were, respectively, 0.5 percent and 1.4 percent; the inflation rates of corporate and consumer prices were at about -0.9 percent and zero percent. By contrast, the unemployment rate remained at a moderate 4.3 percent and the exchange rate at around 79.8 yen per dollar. Meanwhile, the dependence on government debt finances reached 48.8 percent at the time, with almost half of the government budget running on government bonds. The central and local government’s long-term debt to GDP ratio was 218.8 percent. Japan practically had a zero-percent interest rate, as the official discount rate reached only 0.3 percent at the time. In other words, Japan did not have many monetary and fiscal policies left that could allow Japan to escape its long-term recession.

1. The Reflationists' View

Regardless of the circumstances, the pro-Abenomic theorists maintained that monetary policies would be the right remedy for the recession. Pinpointing deflation as the underlying cause of their economic problems, they argued for what they called a reflation policy,[2] with a target of two- to three-percent mild inflation per year.

This reflationist idea first emerged from an article by Paul Krugman (1998), professor of economics at Princeton University and Nobel Prize Laureate. In Japanese policy circles, the most prominent reflationists were Iwata Kikuo, professor of Gakushin University, who was Deputy Governor of the Bank of Japan, and Hamada Kōichi, emeritus professor at Yale University, who is known to have first proposed Abenomics in Japan.[3]

Professor Iwata had criticized the Bank of Japan's passive monetary easing, arguing instead for simultaneous implementation of a specific inflation target and unlimited quantitative easing as the solution to reversing deflation in Japan's economy. His perspective was opposite of the critics who purported that the decrease in Japan's working age population, and population as a whole, both inevitable factors, were the root causes of Japan's economic slump. Specifically, he argued that the strong yen phenomenon was driven by the slow increase in Japan's money supply after the 2008 global financial crisis to a level that the US and European countries could not match. Pinpointing this imbalance in the money supply, he believed that more expansive quantitative easing could bolster the weakening yen and boost price levels.

Furthermore, these reflationists argued that there were empirical cases in the past where such policies successfully freed the economy from recession (Iwata 2004). They referred to Finance Minister Takahashi Korekiyo's policy during the Shōwa Depression in 1930-32 as an example. At the time, the government actively pursued quantitative easing far above previous levels, expanded fiscal spending, and induced the Japanese banks to buy out the government bonds, which had been issued to accomplish the first two tasks. This successfully revived the Japanese economy. The specifics of Takahashi's policy are well-known among Japanese economic circles. Yet intriguingly direct references to or discussions of Takahashi's case have largely remained taboo until this time in Japanese society. While it is true that Japan was able to escape the Great

2. The term was first coined in Japan. It had not been used in existing textbooks on economics.

3. Discussions on their arguments, refer to Iwata et al. (2013); Wakatabe (2015); Kataoka (2014); Lee Ji-Pyeong and Kim Hye-gyŏng (2013).

Depression more quickly than the US and European countries on the basis of Takahashi's policy, many refrained from referring to the case after World War II, as people began to draw connections between the policies and Japan's imperialistic war. They believed that the policy provided opportunities for more state control, lowering fiscal discipline, and ultimately making Japan more vulnerable to the military's intervention and requests for expansive fiscal spending.

Regardless of this historical narrative, the reflationists, in fact, have been trying to follow Thomas Sargent's (professor at New York University and Nobel Laureate) logic that "regime change will transform the actions of the people." To elaborate, in his studies on hyperinflation among countries defeated in World War I, Sargent argued that the phenomenon was resolved by people's "recognition" of change in the policy regime, such as the founding of an autonomous central bank, a balanced budget, and a return to the gold standard, rather than reducing the actual money supply. According to the reflationists, Peter Temin, a professor at MIT, is also known to have applied this theory to the Great Depression (1989). He illustrates how people's expectations and forecasts of economic conditions play a significant role in changing the economy, as well as the central role of government in bringing about these expectations.

Hamada was the key figure who directly conveyed the background and policy implications of the reflation policy to Prime Minister Abe. Well known for his unique career and straightforward style of speech,[4] Hamada served as Special Advisor on Economic Policy in the Abe cabinet.

2. Critiques on Reflationists

These reflationist arguments are largely criticized for misinterpreting mere correlation for causation between the two economic factors. In other words, the critics believe it is unfounded to expect former successful policies to be equally effective when applied to current problems (Ikeo 2013). While other criticisms have also been put forth, the following section will focus on the causality between deflation and recession (Ikeda 2013).

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4. After graduating from the University of Tokyo, Hamada joined the Ministry of Finance, later returning to the economics department at the University of Tokyo. After working as professor at the University of Tokyo into his fifties, Hamada taught at Yale University. Since that time, he has been sharpening his criticism on the monetary policies of the Bank of Japan, for instance, asking Shirakawa, the governor of the Bank of Japan, whether "he has sold off his soul to the Bank of Japan." Regarding professor Noguchi Yukio, who opposed the reflation policy, Hamada describd him as "ignorant of macroeconomics." The first twenty pages of his 2012 paper are also filled with his personal attacks on Shirakawa (Ikeda 2013).

First, the critics argue that the reflationists' logic is based on reversed causality: Deflation is the outcome of recession, not the other way around. Therefore, artificially created inflation would not be a viable solution to raise the consumption level. Furthermore, these critics point out that the reflationists have fallen into the "illusion" of the quantity theory of money. According to them, the reflationists' argument that the central bank's control of the money supply could determine the price level is unfounded from the outset.[5] The reflationists also believe that deflation emerges from deflation expectations and inflation arises from inflation expectations, a result of changes in stock and real estate prices (Honda 2013).[6] But critics find this to be mistreating inflation in assets and price inflation to be of equivalent phenomenon. They further argue that the reflationists' views resemble those of the former "national socialists" in Japan who emphasized the spiritualism of the Japanese army before World War II.

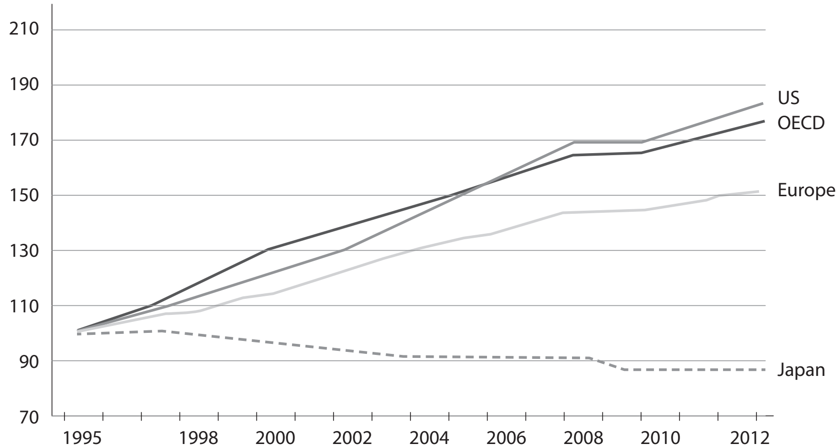
Among the critics, Yoshikawa Hiroshi (2013), professor at the University of Tokyo, made an unconventional argument that the fall in nominal wage was the cause of deflation. To him, deflation is not a monetary phenomenon but a product of real economic factors; it cannot be fixed by monetary policy. The reason that the deflation phenomenon cannot be observed in the US or Europe is not because, as reflationists argue, the central banks are increasing the money supply, but because their nominal wages are not falling (figure 2).

For the last fifteen years, the wage level in Japan has fallen by ten percent, creating an almost ninety percent gap between Japan and the US. During the same period, price levels in Japan remained almost stagnant while they increased by about forty percent in the US. In other words, the gap in the price levels can be mostly explained by the wage level differences between the two countries.

Nevertheless, as the critics of reflationists argue, the underlying factor behind Japan's decline in its nominal wages is the corporations' attempt to cut their unit labor costs to compete with China and other emerging economies. While the US and European firms also used similar strategies, the main

5. In the quantity theory of money, MV=PY is the common form of notation. M here stands for money supply, V for velocity (speed of money circulation), P for price level, and Y for income level. Namely, the amount of money supply is equal to nominal GDP. Especially when Y and V remain constant, it means that M=P. Yet this is merely an ex-post accounting derived equation and does not suggest causality in the equation. In particular, measuring V is almost impossible and M includes not only central bank-issued money supply but also the money circulating in the market; the central bank cannot be in control of it.

6. Honda (2013) is Prime Minister Abe's senior advisor to the cabinet secretary. The book was advertised as being officially recognized by Abe.



Source: Ikeda (2013, 105).

Figure 2. Nominal Wage of Major Countries (Year 1995=100)

difference was the presence of strong labor unions, which were effective in resisting their wage cuts and making it difficult for a "downward inelasticity" of wages to form. By contrast, the labor unions organized by companies in Japan allowed low paid, part-time jobs to increase rather than cutting down the number of fulltime workers, which triggered the overall fall in nominal wages. These critics also argued that Japan's steady employment rate, even during a long-term recession, is also due to this phenomenon.

3. The Essence of Abenomics and Its Underlying Logic

Abenomics is an economic policy which aims to overcome deflation through comprehensive implementation of the "three arrows." The arrows stand for bold monetary easing—the first arrow; government expenditure—the second arrow; and a private investment based growth strategy—the third arrow.

As Abenomics was founded on reflationist theory, some of the critics have argued that Abenomics was essentially about monetary easing—the first arrow—while the rest of the arrows were mostly devised for Abe's political goals. In other words, there are two sides to Abenomics, one being the outcome of intra-party politics or political compromises of the LDP and the other being an economic package. Prominent LDP figures like Asō Tarō and Amari Akira were influential in bringing Prime Minister Abe back to power, and Abenomics was forged out of a compromise among the three figures' favored economic policies. The first arrow's bold monetary easing policy was Abe's idea, the second arrow's fiscal policy was by Asō, and the third's private investment inducement strategy was by Amari. Abenomics is structured to satisfy all of the three key figures in the Abe cabinet" (Wakatabe 2015).[7]

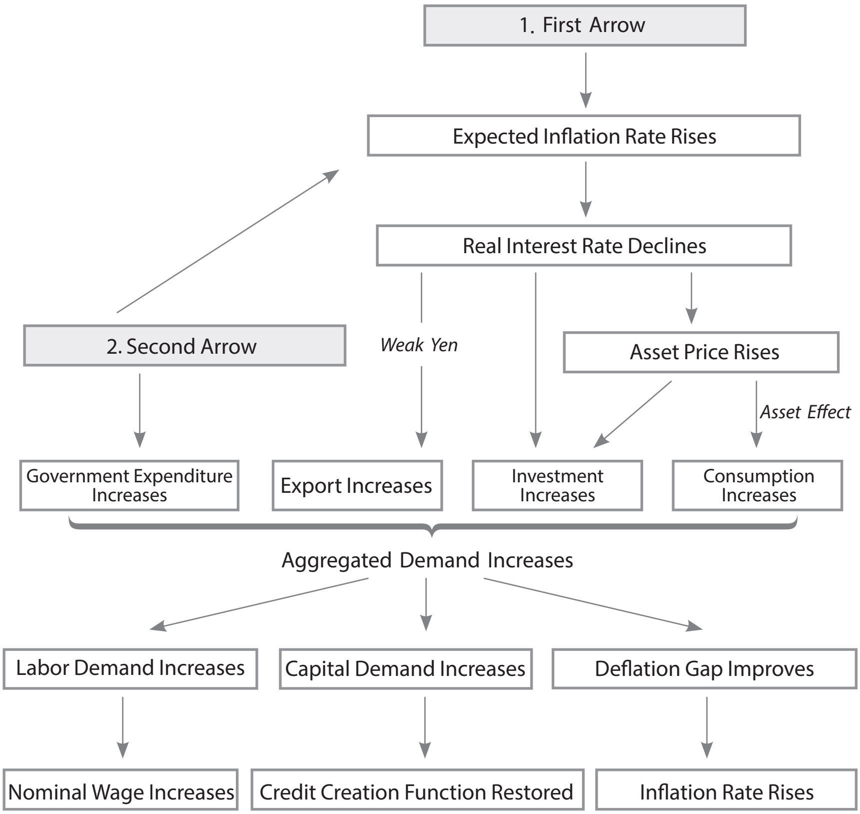
Naturally, as Abenomics is founded on three such ideologically and theoretically divergent policies, the coordination among the three arrows is limited (Shiozawa 2013). As aforementioned, the bold monetary easing policy is based on reflationist theories that stress quantitative easing as the key policy to escape deflation. The fiscal policy is traditional Keynesian policy that emphasizes public spending. Lastly, as the private investment strategy is a kind of innovation policy, the third arrow is more similar to supply-side economics. In a similar vein, French economist Robert Boyer stated that "Abenomics is an ideological Keynesianism" (Tanaka 2013, 219).

The arrows are composed of the following policies (Kataoka 2014). Regarding the first arrow, the Abe cabinet announced a two percent inflation target in January 2013, followed by an official statement in April to launch quantitative-qualitative easing under the newly structured Bank of Japan. For the second arrow, the Abe cabinet initiated the "Emergency Economic Policy for the Revival of the Japanese Economy" in February 2013 and expanded the budget. Yet they also raised the consumption tax by eight percent starting in April 2015 in order to mitigate the accumulated deficit. Lastly, for the third arrow, the Abe cabinet approved the "Japan Revitalization Strategy" through discussions with the headquarters for Japan's Economic Revitalization and Industrial Competiveness Council. Also, in June 2014, the Abe cabinet passed the "Revised Japan Revitalization Strategy 2014," which emphasized labor market reforms, increasing agricultural productivity, and transforming medical and healthcare services into Japan's new growth industries.

This three-pronged approach aimed to bring the economy out of the deflation trap in a short period of time through the first and second arrows, as illustrated in figure 3 (Wakatabe 2015, 44). In line with the reflationists' view, monetary easing with a subsidiary fiscal policy was expected to lead to the target inflation rate, which would, in turn, lower the real interest rate, raise asset prices, and result in a weak yen.

With this restoration process, the rest of the economy would then be expected to run according to the orthodox principles of economics. The

7. Additionally, Takenaka Heizō, who led the structural reforms during the Koizumi administration, and Itō Motoshige, professor at the University of Tokyo, found the third strategy as the most important arrow among the three.

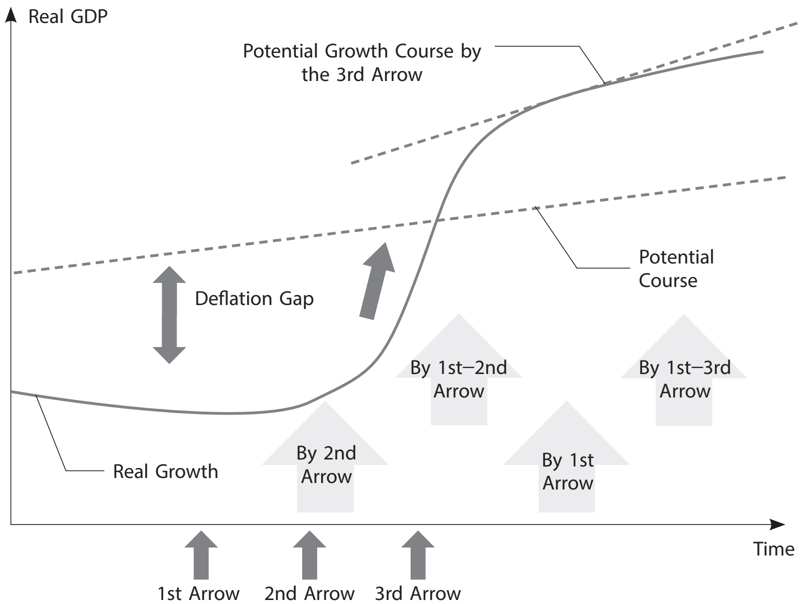


Source: Wakatabe (2015, 44).

Figure 3. The Paths of Abenomics

underlying logic is that the rise in consumption, investment, export, and government expenditure, which are all constitutive factors of aggregated demand, will alleviate the chronic deflation gap, increase capital demand, and ultimately lead to a rise in nominal wages.

After settling the deflation gap, what becomes important was the medium to long-term growth strategies that can increase potential GDP. Perhaps the appropriate analogy in this context is to see the first arrow as the medicine to cure an illness, the second arrow as the healthy food to regain strength, and the third arrow as the exercise for better overall fitness. If the three arrows could be implemented as such, the economy would be expected to reach the next stage of its growth trajectory. Iwata, a reflationist and Deputy Governor of the Bank of



Source: Kataoka (2014, 25).

Figure 4. Transmission Mechanism in Abenomics

Japan, called this the "Transmission Mechanism," as seen in figure 4 (Kataoka 2014).

4. Opinions and Responses to Abenomics

In December 2012, Kaieda Banri, president of the DPJ, criticized Abenomics, saying that "scholars have divergent opinions" on monetary easing and that "peoples' lives should not be used as theoretical testing grounds for these opinions." Further, he argued that "the plan to implement extensive public projects is an outdated trick." He also pointed out how the fiscal policy might "infringe on the autonomy of Bank of Japan, which will disturb the integrity of the yen, and therefore causing various side-effects." In April 2013, former President of the DPJ, Noda Yoshihiko, commented that the "Abe" in Abenomics stood for Asset, Bubble, and Economy. This corresponded with severe critiques by many Japanese economists and experts against Abenomics (Lee Ji-Pyeong and Kim Hye-gyŏng 2013). Hama Noriko, professor at Dōshisha University, derided Abenomics as "Aho(Fool)nomics," arguing that while stock and asset prices may rise, this would only be a temporary bubble in which prices of daily goods remained stagnant and deflation persistent, with benefits only for those in the upper strata of the economy. Noguchi Yukio, professor at Waseda University, also expressed concerns for the high likelihood of failure for the two-percent reflation policy, making it inevitable for the Bank of Japan to take far more drastic measures, such as underwriting their government debt.

As such, the pessimists towards Abenomics viewed structural factors as foundational to the Japanese recession and deflation phenomenon. The monetary and fiscal policies were, to them, not solutions but potential problems that could have further side effects on the Japanese economy. Other critiques also considered Abenomics to be more than just a simple economic policy, but also a political strategy towards a rightward shift and militarization of Japan, calling this the "hidden fourth arrow" of Abenomics (Itō 2014; Tomoyori 2015).

Against these criticisms, the proponents of Abenomics retorted that these detractors were failing to distinguish their opposition against Abe from an objective assessment of the economic policies to revive Japan. These critics disapproved of Abenomics not because of the economic policy per se, but due to their antipathy towards Abe's political ideology. The pro-Abenomics experts called for caution about making false linkages or logical leaps, such as that Abenomics would result in the realization of Abe's nationalistic political agenda to allow the right of collective self-defense, revise the Peace Constitution, or intervene in the Japanese education system.[8]

Debate on the Achievements of Abenomics

1. Achievements

Since its implementation three years ago, what has Abenomics actually changed or accomplished? The public materials available from the Cabinet Office's homepage provide some valid reference points (www.cao.go.jp. Accessed May 25, 2016).

First, the rate of GDP growth has improved since the implementation of Abenomics in 2013, as indicated in table 1. The real rate of GDP growth in 2014

8. The proponents of Abenomics also criticize liberals for opposing Abenomics for the following three reasons: (1) Because a non-liberal figure like Prime Minister Abe implemented the policy; (2) Their acknowledgement of the success of Abenomics will weaken their criticism against Abe; and (3) While Abenomics may be successful now, they believe the success will not last (Wakatabe 2015, 21).

Table 1. Japan's GDP Rate

Year	2011	2012	2013	2014	2015 (Estimate)	2016 (Forecast)
Nominal Rate of Growth	0.4	0.9	2.0	1.5	2.7	3.1
Real Rate of Growth	-1.3	0.0	1.7	-1.0	1.2	1.7

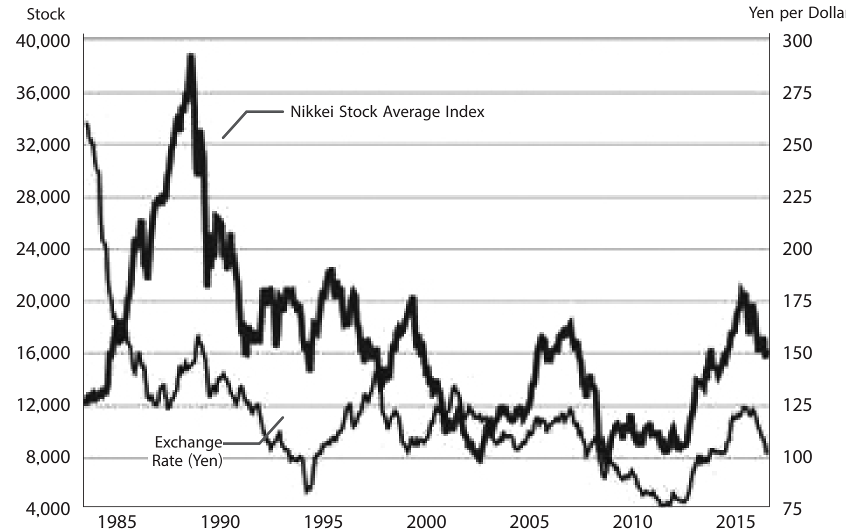
fell short of the previous year because of the consumption tax increase implemented in April of that year, which resulted in an overall rise in prices. On the basis of such empirical evidence, the Abe administration has declared that the deflation phenomenon, which has been persistent in Japan's economy over the past fifteen years, had finally come to a halt, thus signaling Japan's recovery from the recession. The Abe administration reinforced this optimistic outlook on the grounds that favorable conditions, such as a fall in oil prices and a rise in wages, continued.

Second, corporate profits, which are important preconditions for investment, also showed signs of improvements. Corporate profits, which were 48.5 trillion yen in 2012, increased by more than thirty percent over the past two years to 59.6 trillion yen in 2013 and 64.6 trillion yen in 2014. In addition, business forecasts (measuring market sentiment) for companies were -9 points in December 2012, but improved to +9 points in December 2015. In fact, the number of bankruptcies in 2015 totaled 8,812, the lowest level in the past twenty-five years—the second consecutive year of bankruptcies below 10,000 cases.

With restoration of corporate profits, the employment rate is also improving. As of October 2015, employment has increased by 1.1 million people since the fourth quarter of 2012. The ratio of valid job openings in February 2016 was 1.28, the highest level in the last twenty-four years. The unemployment rate also remained low, at 3.3 percent in February 2016. The wage increase rate of 2015 also exceeded the 2014 level, reaching the highest point in the past seventeen years. Moreover, Japan's budget deficit was also alleviated, achieving the targeted reduction level (-3.3 percent) for the ratio of primary balance to GDP in 2015. And by 2020, the level is expected to turn positive.

Based on these accomplishments, on January 4, 2016, Prime Minister Abe announced his optimistic outlook for Abenomics, claiming that the influence and effectiveness of the policy will reach every corner of Japanese society.

While the abovementioned statistics reflect Abe cabinet's official evaluation of Abenomics, as listed on the homepage, they exclude economic indicators more widely used in economic circles. Two examples of these indicators are the



Source: fred.stlouisfed.org.

Figure 5. Japan's Stock Index and Exchange Rate

rise in stock prices and yen depreciation. This discrepancy in the choice of indicators to assess Abenomics, the critics argue, is the fundamental reason for Japan's improving rate of corporate profits. It also explains why the improvement in economic indicators remains unfelt by Japanese consumers. In any case, it is notable that the government does not emphasize yen depreciation and rise in stock prices in their publicity materials.

Taking this into account, when we observe the stock price and exchange rate trends (figure 5), we can see that both have largely moved in the same direction since the 1990s. We can find that a strong yen (a fall in the exchange rate) and fall in stock prices, and a weak yen (a rise in the exchange rate) and rise in stock prices occurred simultaneously. In particular, the years between 2013 and 2015 showed a rapid rise in stock prices and exchange rates (weak yen). Exchange rates and stock prices began to rise with the dissolution of the Lower House on November 16, 2012 and a decision to call for a general election in December of that year, as the LDP's return to power was expected. By March 8, 2013, the Nikkei Stock Average Index returned to the level before the Lehman Brothers' collapse. And by March 10, the exchange rate reached 100 yen per dollar for the first time in over four years. By April 10, 2015, the Nikkei Stock Average Index exceeded 20,000 yen for the first time in fifteen years. Also in May 2015, the market price levels of the Tokyo Stock Exchange were nearly restored to levels of the bubble economy period. The exchange rates had also entered the range of 120 yen since March. By the end of 2015, the stock prices and exchange rates maintained the level of 19,000 yen and 120 yen, respectively.

While Abenomics was quite successful in the realms of stock prices, exchange rates, corporate profits, growth rate, and employment level, there were also a few areas where Abenomics failed to meet its initial targets. First, the inflation target that the reflationists prioritized was not met. The inflation rate of consumer prices, which was 0.1 percent in 2012, rose steadily to 0.4 percent in 2013, 1.1 percent in 2014 (excluding the consumption tax impact), and 0.1 percent in 2015, but did not reach the target level of two percent. Second, while the businesses' profits have increased sharply due to the low yen, mainly for large export companies, these profits did not lead to an increase in investments. While the corporations' earnings were seemingly boosted by the low yen, these increases were largely due to the price effect—the rise in the yen's conversion rate. The quantity effect, an increase in export value due to better price competitiveness, was not very large. Although cases of Japanese companies returning to Japan after prospering overseas became a hot topic, as the macroeconomic indicators reveal, the actual number of such incidents was, in fact, very small. Nevertheless, from the second half of 2015 when the exchange rate was restored to the level of 120 yen per dollar, the growth rate of capital investment began to outperform the record of the previous year.

Other than the investment rates, the private consumption level showed a more sluggish performance than expected. The increases in consumption through rises in stock and asset prices have not led to improvements in the overall consumption rate. In fact, household spending has been on a downward trend for the eighth consecutive quarter since the second quarter of 2014. The real wage index, which is most closely related to real income, also fell to -0.9 percent in 2015, marking the fourth consecutive year of negative growth. While the nominal wage has increased, due to the government-led rate of increase for base level salaries, the influence of the low yen and subsequent rise in import prices exceeded the increase in the nominal wage. It can also be pointed out that, while the unemployment rate is falling, the quality of employment is also deteriorating. Comparing the number of workers between January-February 2013 and January-February 2016, the number of non-regular workers increased by 8.6 percent, while that of regular workers increased by only 0.8 percent.

In conclusion, among the planned trajectories of Abenomics, actual realization of the policies were limited to rises in asset prices (rise in stock prices) and low yen, refuting the policymakers' expectations that "orthodox economic principles will follow." The existing empirical evidence provided the basis for both the pro- and anti-Abenomics views that were present at the launch of Abenomics.

2. Debates on the Evaluation and Interpretation of Abenomics

The reflationists who supported Abenomics on theoretical grounds claimed that the first two years of Abenomics allowed the "Japanese economy to become an empirical case to prove this international mainstream economic theory" (Wakatabe 2015, 44). Most of all, they argued that the quantitative/qualitative easing that they emphasized was particularly effective.[9]

This evaluation received varied criticism, which can be divided into two main strands. The first cluster of critiques focused on the limitations of alleged accomplishments of Abenomics. They claimed that, while corporate profits and asset prices rose under Abenomics, the changes in the levels of investment, consumption, and exports that constitute aggregated demand remained largely stagnant, limiting Japan's ultimate break from its chronic recession. Furthermore, the income gap was found to have widened between exporters/asset owners and home producers, small and medium sized businesses, and low income level groups.

These criticisms are nothing new, as they were already put forth in the initial phase of Abenomics. The enforcers of the policy themselves have also already acknowledged the limitations. Thus, a possible counterargument to the Abe's cabinet would be that a longer timeframe is necessary to accomplish the intended effect of Abenomics on the wage level. Abe's 2016 declaration that his administration would work for Abenomics to "reach every corner" of the Japanese economy can be interpreted as a response to this criticism. To challenge the logic of Abenomics, it is necessary to show that the trickle-down effect from the rise in asset prices and stock prices to higher consumption and investment would be fundamentally limited. However, it seems that, so far, there are no direct empirical data to prove this point.

The second strand of criticism was founded on the idea that the alleged improvements in the economy were not the outcome of Abenomics but other

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9. Hamada Kōichi, special advisor to Abe cabinet, stated during his interview with Reuters in November 2013, that the first arrow, monetary easing, would get a grade A, using the metaphor of college transcripts; the second arrow, fiscal policy, B; and the third arrow, the growth strategy, E. While E for the third arrow was a rhetorical joke to spell ABE, this also reflected the government's overall indifference to the third arrow. Other critics of Abenomics shared similar views to Hamada. In other words, "looking back on the three years of Abenomics, monetary easing was successful, fiscal policy ambiguous, and growth strategy less of an arrow than a small 'needle'" (Hamada 2016).

factors. These critiques especially focused on how Abenomics failed to reach its intended inflation rate, emphasized by the reflationist theorists, but instead overachieved in other areas, such as stock prices and weak yen. There is some convincing research arguing that the weak yen phenomenon began before the inauguration of Abe's administration. According to these studies, the initial changes in the weak yen had already begun around October-November of 2012, as the Europe's credit crisis subsided and the US economy showed signs of recovery. These were changes in the international economic environment, rather than the success of Abenomics (Ikeo 2013; Itō 2014). Moreover, the first half of 2013 produced an unexpectedly weak yen, depreciating to about 120 yen per dollar by 2015, which is almost equivalent to the effective exchange rate right before the 1985 Plaza Accord. Following this logic, the alleged improvements in the economic indicators were possible not because of Abenomics per se, but due to changes in the international economic environment. These criticisms are also connected to claims that these improvements would have occurred under the DPJ government. If Prime Minister Noda had stayed in office without dissolving the Diet and calling for a general election, the DPJ's economic record could have been evaluated differently.

Of course, this argument is refutable in that it is merely an ex-post interpretation of the phenomenon. Other critiques can be found that place more significance on the changes in domestic conditions rather than the international environment. In this view, the success of Abenomics was possible as it coincided with Japan's domestic economic cycle that transitioned towards economic expansion at the time (Hamada 2016). According to these internalists (emphasizing domestic factors), Abenomics began when the *Dankai* generation (the first baby bomber generation), born in the years 1947-49, reached the ages of sixty-five to seventy. This *Dankai* generation was fit, energetic, finished with parenting, and relatively well-off with their retirement funds and pensions. According to the internalists, this lead to increased demand in the service industry (e.g. travel) and expensive consumer goods such as cars. As this generation entered their seventies by the summer of 2015, their purchasing power began to decrease, a phenomenon that they expect to worsen by 2020. Due to the demographic structure of Japan, when the *Dankai* generation reaches seventy to seventy-five years of age, their purchasing power will fall, and the generations below the *Dankai* are smaller in number, with weaker purchasing power. In other words, the first three years of Abenomics were the last opportunity to recover the growth cycle of the Japanese economy by restoring domestic demand.

Regardless of the various criticisms described above, it is undeniable that

Abenomics has improved Japanese economy to some degree. Yet, the problem is that these accomplishments have been successful only to the extent of preventing further deterioration of the Japanese economy, while failing to restore the pre-1990 or even pre-2007 levels of economic growth. The Abe cabinet, as it is also well aware of this problem, seeks to focus on the third arrow, which has received less attention. The specifics of the strategy are embedded in the "Japan Revitalization Strategy 2015,"[10] in which the deflation gap rapidly narrows due to improvements in business performance, followed by an increase in the employment rate. Nevertheless, given the future trajectory of population decline and decreasing working population, supply constraints could emerge as a new challenge, despite increases in consumption. This would make productivity growth an indispensable task for the next stage of Japan's growth strategy. Thus, the Abe cabinet has recently put forth the government agenda to bring about a productivity revolution via long-term investments, as well as through the so-called "local-Abenomics."

Recent Trends and Forecasts

While the above assessments convey a rather optimistic outlook for the Japanese economy, the 2016 indicators reveal that three years of Abenomics have been inadequate to completely remove the deflation gap. As shown in the previous figure 5, in 2016, the strength of the yen increased and the stock prices began to fall. The exchange rate of 120.1 yen per dollar at the end of 2015 fell to 109.8 yen by April 20, 2016; similarly, the stock price also dropped during the same period, from 19,033 to 16,906.

Until January 2016, the strong yen appeared to be caused by the slowing down of China's economic growth, which induced a plunge in the price of raw materials. This was followed by a rise in the US' and other countries' interest rates, which increased the value of the yen as a lower risk asset in the midst of growing financial instability in the global economy. As a countermeasure, the Bank of Japan introduced a negative interest rate policy at the end of January. However, while the yen was no longer preferred as a risk-free asset in the months after February, the strong yen phenomenon, along with a fall in stock prices, persisted. These days the strong yen is seen to be caused by both exogenous and endogenous influences: The slowing down of interest rate

10. In April 2016, some parts were revised. The following materials are available at the Cabinet Office's homepage: www.cao.go.jp. Accessed May 25, 2016.

increases in the US and Japan's trade surplus (increase in current account surplus).

Moreover, it is becoming ever more challenging to achieve the two percent inflation target. The rate of increase in consumer prices (excluding the effect of the consumption tax) gradually declined from 1.1 percent in 2014, to 0.1 percent in 2015, to zero percent in February 2016, which is the pre-Abenomics level. Another remaining hurdle is the increase in the consumption tax from eight to ten percent, which was originally planned for April 2017, but has been postponed until October 2019.

Above all, policy makers are most concerned with the continuous rise in the yen's value and the persistent decline in stock prices, despite establishing negative interest rates. Also, people are voicing their concerns on how the negative interest rates may exacerbate the profits of commercial banks and thereby nullify the effectiveness of their monetary easing policy.

Regarding these circumstances, the Abe cabinet once again confirmed their commitment to maintain the existing policy ("Abenomiksŭ nŭn silp'aehaen-nŭn'ga?," 2016). Kuroda, current governor of the Bank of Japan maintains the position that the reason that banks cannot incur profits from their loan-deposit margin is not due to the negative interest but deflation. During his talks with Paul Krugman on March 22, Kuroda once again clarified his decision to reinforce Abenomics. It thus seems more probable that there will be no changes to the policy. Rather, the Abe cabinet will seek to use the election to regain the public's support, which has been faltering since the economic slump following the consumption tax hike in 2014. The July 2016 Upper House election result was a clear example of this. All in all, what lies beneath the Japanese public's support for Abenomics is a largely psychological factor, their traumatic experience of severe deflation when the Bank of Japan raised the interest rates in 2000 and 2007.

Interestingly, Abenomics is not very different from the mainstream economists' approach to the global economic recession after the 2008 financial crisis. Abenomics is a leader in putting these mainstream economic theories into practice. In a similar vein, Krugman (2013) expressed his support for Abenomics, stating that "the really remarkable thing about "Abenomics" is that nobody else in the advanced world is trying anything similar" and that "if Abenomics works, it will serve a dual purpose, giving Japan itself a much-needed boost and the rest of us an even more-needed antidote to policy lethargy."

Former US Secretary of the Treasury Lawrence H. Summers also perceived the current global slowdown to be caused by households and corporations' tendency to save rather than consume and invest. And while negative interest rates may be a method to induce consumption and restoration of the economic equilibrium, the advanced economies' difficulty in actually implementing the policy is the reason that they remain in a recession. To Summers, state intervention seemed to be the only remaining solution, where the state itself draws excess funds to increase spending on areas such as constructing new infrastructure (roads and bridges), or redistributing wealth to the poor (Schieritz 2016).

This was the case for Japan, which faced a dire fiscal deficit and was forced to turn to monetary easing, making the role of the Bank of Japan more influential in resolving Japan's long-term recession.

By the 1980s, the role of the Federal Reserve Board (FRB) in the economy was more like a party spoiler, "taking away glasses when the party has just begun." Yet, the FRB became more market-friendly when Alan Greenspan served as its chairman (August 1987 to January 2006). In other words, while the FRB continued to refrain from intervening in private economic activities, it opened up opportunities for private actors to take risks by providing full support in times of difficulties. Recently, however, the central banks seem to be becoming far more encouraging in this respect; as Ikeo humously stated, they seem to be inducing these private actors to "drink-up, as [they] will take care of [the] hangovers" (Ikeo 2013).

Japan's slow response to the bubble economy and its aftermath has provided important lessons to the world economy. Now, with Abenomics at the forefront, Japan has begun to apply some of the most advanced economic theories to combat the Japanese long-term recession. Because it is experimental, Abenomics is also highly risky, pushing the Japanese economy to the brink (Tomoyori 2015). The first possible emergency may be severe stagflation that could kick in if there is a further fall in the real economy. The second emergency may arise via a financial crisis that results from the bursting of the mini-bubble which formed due to the rise in asset prices. The third emergency would be the worst-case scenario, a Japanese version of the "Three Twin-Deficits" (fiscal balance, current account, household saving). This could trigger a fall in the credibility of the Japanese economy, a collapse in the value of the yen, government bonds, and stock prices, followed by soaring long-term interest rates. Simply put, this would be a total breakdown of the Japanese economy. Lastly, the fourth emergency scenario is the isolation of Japan and its economy from the world caused by the Abe cabinet's continuous rightward political shift.

As illustrated, Abenomics is a gamble. As long as Abe stays in power, a change in the policy direction seems highly unlikely. As with the issue of constitutional revision, Japan's economic problems and Abenomics seem to share the same destiny with Abe's administration.

• *Translated by JO Bee Yun*

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