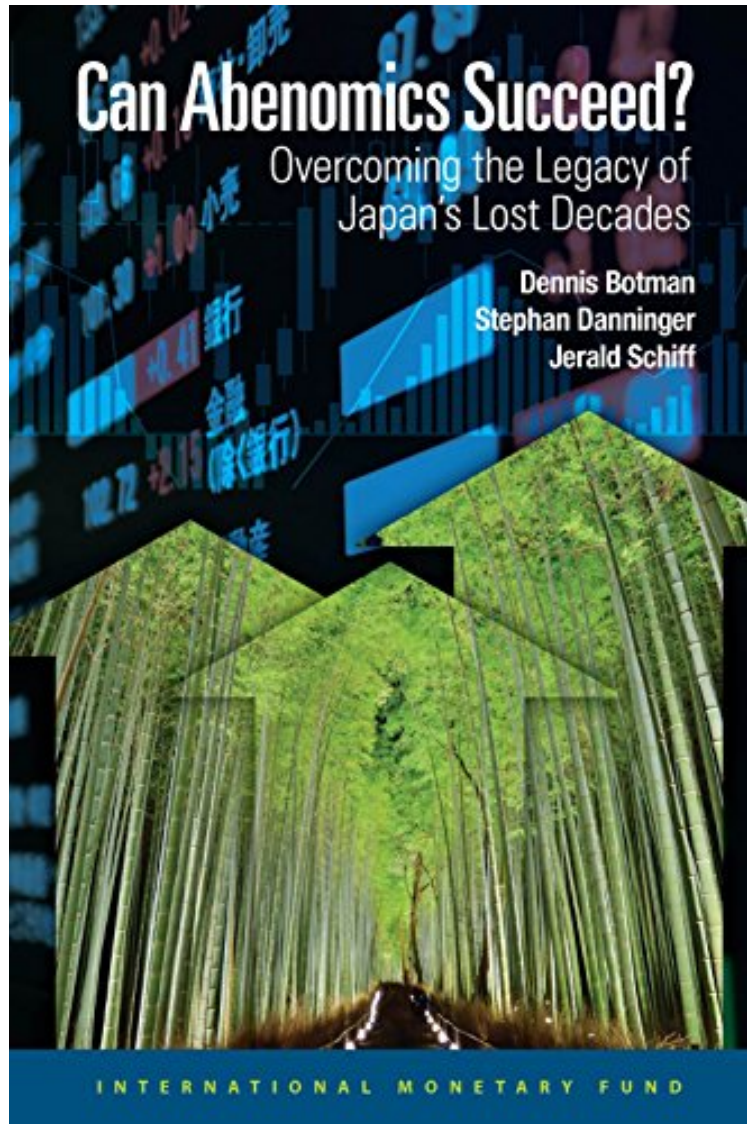


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Can Abenomics Succeed? :Overcoming the Legacy of Japan's Lost Decades

Dennis P. J. Botman, Stephan Danninger, Jerald Alan Schiff
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3 of 3 people found the following review helpful. A lot at stake for Japan and the rest of the worldBy Jeremy P. CliftWith much at stake and multiple goals, Japan clearly needs a comprehensive and coordinated set of reforms. This recognition lies at the heart of Abenomics --the set of economic policies advocated by Shinz? Abe to revive Japan--

and the chapters in this book offer detailed recommendations in the areas of monetary policy, fiscal adjustment, and structural and financial sector reforms to make Abenomics a success for Japan and the rest of the world. The various recommendations in this book are presented as a package and, ideally, one would like to see progress on all three arrows of Abenomics equally and simultaneously, not least because they create mutual synergies. However, there is a clear recognition that the amount of emphasis on each policy area needs to be state-dependent. This was evident, for example, around the time of the consumption tax increase to 8 percent in April 2014. Faced with weak demand and a possible reversal of actual and expected inflation, the Bank of Japan significantly further scaled up its asset-purchase program in October 2014. The authorities also decided to delay the second consumption tax increase to 10 percent and adopt further fiscal stimulus while placing greater emphasis on formulating a medium-term consolidation plan to maintain fiscal credibility. The key take away from this experience is that most, if not all, of the agenda for Abenomics laid out in this book will likely have to be implemented for Japan's efforts to be successful, but the reader should remain mindful that priorities need to be recalibrated at times depending on how economic conditions unfold. Four interrelated issues lie at the heart of Japan's economic challenge: ending deflation, raising growth, securing fiscal sustainability, and maintaining financial stability. These objectives need to be achieved against the background of Japan's rapidly aging society, entrenched deflationary expectations, and a global economy that remains mired in subdued growth. Most readers will be familiar with the following striking statistic: in 2013, Japan's level of nominal GDP was about 6 percent lower than it was in the mid-1990s. There can be little doubt that this in part is caused by persistent deflation. Nonetheless, it remains a challenge to quantify exactly how much of the slow growth was due to deflation rather than the typical post-bubble blues, population aging, and the waning effects of technological convergence. As a result, it is also difficult to measure how much living standards will improve from a successful reflationary effort and whether these potential gains are lower now than they would have been in the 1990s. Compared to other advanced countries, Japan has fared relatively well in terms of productivity growth, suggesting that the biggest bang for the buck will likely come from greater capital accumulation (domestic investment rather than outsourcing) and providing additional, high-quality, employment opportunities (rather than increasing part-time work with lower wages and less investment in human capital). The Bank of Japan's quantitative and qualitative easing measures should lead to greater portfolio rebalancing and financial risk taking, raise inflation expectations, and support aggregate demand, which, together with complementary fiscal and structural measures, should help greatly to revive Japan's economy and decisively end deflation. Another striking statistic—unprecedented among advanced economies—is the debt-to-GDP ratio, which now tops 240 percent and has risen by 50 percentage points in the last five years. Restoring fiscal sustainability by putting the debt ratio on a firm downward path is a priority for Japan's future. Although bond yields in Japan have remained very low despite ever increasing government debt, this is partly due to special factors, including a marked home bias of Japanese investors. None of these special factors can be taken for granted in the future especially with the prospect of higher yields as the Bank of Japan exits from its quantitative easing policies after achieving its two percent inflation target. Indeed, managing the normalization of interest rates along all asset classes and maturities in a way that maintains economic and financial stability will depend, in no small part, on the credibility of the government's fiscal adjustment strategy. Ambitious structural reforms are pivotal for lasting success of Abenomics. Ending deflation and eliminating the government debt overhang will be good for potential growth, but these efforts themselves depend a great deal on the economy's expected growth rate in the future. Specifically, ambitious labor market reforms would strengthen the monetary policy transmission channel and accelerate the attainment of the Bank of Japan's inflation target by enhancing the pass through of rising inflation expectations into higher wages. Ambitious structural reforms will support demand in the near term as expectations of permanent income rise. As we have seen recently in Europe, fiscal consolidation without faster growth is unlikely to succeed. A more dynamic Japan is also key from a multilateral perspective, by preventing excessive reliance on monetary and fiscal easing and an undue weakening of the exchange rate. As David Lipton says in his Foreword: "This is not just a book about Japan. The main message that policymakers should use all policy levers at their disposal in a coordinated manner when faced with persistently weak demand and high public and private balance sheet vulnerabilities extends to other important parts of today's global economic landscape. As such, policymakers around the world have much to learn from Japan's experience and from the analyses presented in this volume."

Japan's revitalization plan, dubbed the "three arrows of Abenomics," devises a three-pronged strategy—combining fiscal, monetary, and structural policies—to overcome that country's apparent inability to sustain economic recovery. This book is the first comprehensive assessment of Abenomics and the reforms needed to make it a success, including aggressive monetary easing, growth-friendly fiscal consolidation, and structural and financial sector reforms.