The Japan News *by The Yomiuri Shimbun* Friday, February 4, 2022

Can ‘new capitalism’ end economic woes?

Prime Minister Fumio Kishida’s pledge to implement a “new form of capitalism” has aroused political debate about a variety of topics such as what will have to change and what policies should be introduced for that purpose.

His use of the word “new” implies that he believes the way capitalism has been practiced to date is problematic.

Since the collapse of the asset bubble in the 1990s, the Japanese economy has been in the doldrums, now known as the “three lost decades.” Three enervating factors — low growth, low interest rates and low inflation (or even deflation) — have been entrenched over the period.

INSIGHTS into the WORLD

By Motoshige Itoh

Also, the country faces the triple plight of sluggish wage growth, a weakening of the middle class, and widening income inequality. All of these conditions are implicated in the country’s long-lasting recession. In a nutshell, the ongoing Japanese situation points to the existence of a structural problem plaguing the economy as a whole rather than simply an economic deterioration.

Proponents of a capitalist economy used to emphasize the importance of market economy mechanisms as drivers for rational resource allocation and economic growth. Based on such a macroeconomic theory, Japan was among the nations to press ahead with deregulation and implement many reforms aimed at making market economy mechanisms function more effectively. Certainly, those reforms were not without meaning. Yet they resulted in the three lost decades.

It is particularly because of this that there are some who maintain that reforms should be expedited to further accelerate dynamic capitalism. However, society as a whole is now increasingly skeptical that such a push alone will go well.

Keynesian economics, which stemmed from the lessons of the Great Depression, is still of great significance in terms of identifying the shortcomings of the capitalist economic system. Capitalism’s major flaw is that it can cause massive unemployment.

Keynesian economics justifies drastic government action through fiscal policy. In fact, John Maynard Keynes’ doctrines had a significant influence on economic policy management in major countries in the years after World War II.

However, in the 1970s, as major economies suffered serious inflation, the neoclassical school of economic thought began criticizing the Keynesian approach, describing excessive government intervention as an inappropriate policy choice. The neoclassical and Keynesian schools remained at odds while the neoclassicists propagated their ideology of market fundamentalism.

But, as Japan and other major economies in the world plunged one after another into serious structural recessions, Keynesian thought regained ground. In Japan, Abenomics successfully stimulated demand. Since the outbreak of the novel coronavirus pandemic, many countries have been resorting to Keynesian economic packages to spur demand.

Structural change needed

It should be pointed out that fiscal and monetary measures for boosting demand are likely to be effective as a shot in the arm, but they are not powerful enough to change the underlying structure of the economy. This is corroborated by the fact that Japan’s long-term potential growth rate remains low.

Unless the structure of Japan’s economy is changed, it will be impossible for it to grow as much as people hope. Eventually, as growth remains low, deflation persists, the number of people in poverty rises, and the middle class declines further, Japan will be compelled to fundamentally transform.

If the basics of Keynesian policy are the injection of stimulus measures through the fiscal and monetary policies of governments and central banks, they stop short of what is actually necessary now. To change the economy’s structure, supply-side measures are indispensable.

There are many critiques of neoclassical economics for simply leaving everything to the market. When the structure of the supply side has to be changed, such an endeavor requires a certain level of government intervention.

The key aspect of the supply side of an economy is the potential growth rate, which measures an economy’s long-term potential to produce goods and services. Only three factors — an increase in labor input, an increase in capital and an increase in productivity — can improve the potential growth rate. Some people may disagree that the country should pursue high growth. However, if the Japanese economy cannot lift its growth rate, neither wage increases nor a secure social security system will be feasible.

Invest in human capital

Therefore, I would like to think about special steps for changing supply-side trends in the three areas of labor, capital and productivity.

First, for the labor force, it is difficult to increase the workforce in Japan, given the chronically low birth rate and the aging of the population. Still, it is possible to effectively expand the overall labor force by improving everyone’s abilities.

During the three lost decades, investment in human capital — the stock of knowledge, skills and other characteristics held by individuals — has been lackluster and the quality of education has deteriorated. Now that digital technology has evolved, it is increasingly important to improve workers’ access to further learning and training opportunities.

A desirable allocation of resources has not been realized as everything has been left to the market to decide

Capitalism up to now has regrettably failed to invest in human capital to bring forth sufficient results. A desirable allocation of resources has not been realized as everything has been left to the market to decide. In other words, the market has failed. As a result, the government now needs to become more active on the pathway toward enhanced investment in human capital and realizing desirable allocation of resources.

When workers are given greater access to further learning and training opportunities, and there is an increase in human capital, wages are more likely to be raised. No matter how much the government calls on businesses to raise wages, it is hard to expect wages to be continuously raised without an improvement in labor productivity.

To me, increased investment in human capital seems to be the only way for Japan’s middle class to grow. The most important path extending to a new form of capitalism is definitely investment in education and human capital.

Second, I would like to focus on increasing capital. It is apparent that lack of investment by businesses is mostly to blame for the stagnant level of Japan’s potential growth rate.

Slow growth of the stock of capital has constrained the improvement of productivity.

This area, too, has witnessed a market failure. The theory of leaving everything up to the market to decide has failed to induce investment as much as hoped.

Major countries such as China and those in the West think that encouraging private-sector investment can trigger a breakthrough in facilitating post-COVID economic recovery.

To that end, they have already adopted large-scale industrial policies to stimulate private-sector investment in the acceleration of digitization, climate change-related solutions, and other areas.

Western governments are now deploying a combination of traditional Keynesian policies and supply-side ones, with the former using fiscal resources to provide their economies with demand-side stimuli and the latter generating supply-side stimuli.

Market, governments often fail

It is obvious that economic recovery depends largely on digitization and green investments. As in the past, no desired outcomes can be possible if everything is simply left to the market to decide.

The market often fails. Governments also fail. Exorbitant government intervention tends to end up realizing no desired achievements.

Excessive fiscal appropriations can lead to the loss of trust in a government. Countries facing such challenges may put themselves on the path to sovereign fiscal bankruptcy.

What we should expect of a new form of capitalism is not excessive government intervention but a situation in which sound capitalist functions are in place again. This point has much to do with the third factor — productivity. Japan’s productivity has been low for many years now, owing largely to the badly low level of its economic metabolism. In this connection, we should reaffirm the importance of reforms that can contribute to activating market mechanisms.

Climate change is a typical case of market failure. Nonetheless, market mechanisms are being effectively used, as seen in cases of green finance — investment in businesses or projects that help advance environmentally friendly measures — and carbon pricing, which requires greenhouse gas emitters, including businesses, to bear financial costs commensurate with their amounts of emissions. Ultimately, capitalism can only be saved by capitalism.

(Special to The Yomiuri Shimbun)

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