The Economics of Abenomics—A Pre-Summit Assessment

Panel 1: Needed Initiatives in Fiscal and Monetary Policy?

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Chair:
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Unedited rush transcript

Adam Posen: Getting into the substance of the matter, I'm Adam Posen, I'm President of the Peterson Institute for International Economics, and I am thrilled on many levels to welcome you to today's event on The Economics of Abenomics—a Pre-Summit Assessment. We're delighted today to be partnering with the Sasakawa Peace Foundation USA whose president will be following me to give another welcome and a more detailed one at that.

As many of the people in this room share, I and several members of the research staff here at the Institute, cut our teeth and spent a lot of time and hours working on Japanese economics and US-Japan relations through the 90s, through the 80s, through the 90s into the 2000s. And the last few years have been relatively quiescent on both fronts. Some would say deservedly, some would say undeservedly, but there is no question that there is a new wind blowing right now in Japan. I was not partisan before the election. I don't pretend to be partisan ahead of the upper house election, but I will say that in terms of economic agenda, energy, and commitment, I at least am very optimistic on what Prime Minister Abe and these governments are going forward to do.

And so to be able to have an event here in the Institute with so many friends, not just Sasakawa Peace Foundation but starting with them, with whom we've worked through the years when there is so much of economic substance to be discussed on Japan, is really an exciting thing to be doing.

In substance, so many of you are here knowing who we're having, but just let me recap and say we are very fortunate to have with us two of the leading Japanese economists, academics, and frankly, advisers directly to the Abe government, to the Prime Minster and beyond.

One of course is Koichi Hamada from Yale, who at present I think you have what, either the number one or number two bestselling nonfiction book in Japan? Except for the diet books of course. I was going to get a picture to put up, but no. And I think that many of us are old friends with Koichi and know his extensive important work in international economics, but not everybody always realizes that he played a role in the cabinet office in the Koizumi and Takenaka team a decade ago and continues to be at the forefront of economic policy debate in Japan. And so we're just delighted to have him here with us today.

Similarly, we are honored and delighted to have Motoshige Itoh from Todai, from the University of Tokyo, who worked with with Sasakawa Foundation. We're very grateful to them and him for making the effort to come over here. He is going to be speaking on our—leading of our second panel on TPP and its role for structure and reform in Japan and he too is someone who Washington needs to hear and be aware of as incredibly influential in Japan and in my opinion, in a very constructive way, and so we're just very grateful to have Professor Itoh with us.

Also speaking today, we'll go through the details, Stephan Danninger from the IMF who's been doing great work for several years on the Japan desk and is at the forefront. My colleague Jeff Schott who many of you know just wrote a, with coauthors Julia Muir and Barbara Kotschwar, a superb book on the Trans-Pacific Partnership and he did not directly address Japan as much in that and so he's going to talk about that. And also joining us thanks to the good efforts of the Sasakawa Peace Foundation USA, former USTR Clayton Yeutter will be joining us in the second panel.

Just a couple formatting things, this meeting is obviously completely on the record. We want it to be on the record and in fact, we have gone so far that this is the first ever event that the Institute is streaming live over the internet. I'm grateful that Helen Hillebrand, Ed Tureen, and our publications and technical staff made that happen and I have sent e-mails to people in Tokyo letting them know that if they can stay awake, they are welcome to join.

We're not quite yet ready to be taking questions live from abroad, but we'll get there and it's just another sign of the continuing evolution of the Institute's outreach. Of course, like all Institute events, the video, the audio, and eventually transcripts, will be up on the website, www.piie.com.

So we're going to run until 12:30. Untraditionally for the Institute perhaps, we are not offering to feed you lunch. We got a crowd without doing this so we violated Fred's first rule, which is bribe them with food. There will be a coffee break in between the two panels, but we're going to try to break this up so that there will be audience participation after each set of speakers, both for anybody here to raise a point, make a question, engage with our distinguished panelists.

So without wanting to delay things any further, let me call on Junko Chano, who is the Executive Director of the Sasakawa Peace Foundation USA who is our partner in this event. Mr. Chano.

Junko Chano: Thank you, Dr. Posen, for your kind introduction and good morning and welcome. My name is Junko Chano and a slight correction that I'm the Executive Director of the Sasakawa Peace Foundation based in Japan and also the President of Sasakawa Peace Foundation USA. They are different entities and it is complicated. So it's very easy to—no, that's quite all right.

So again, welcome to the conference and I feel very much honored to open this conference on Abenomics that we organized together with the Peterson Institute of International Economics and I'd like to express my sincere appreciation to Dr. Posen and other professional staff members at the Peterson Institute, for working with us to organize this timely conference.

Talking about Abenomics, it seems to me that it comes with many surprises. To name a few, I think it is the first time that the Prime Minister's name is used to symbolize his economic policies and has become well recognized in Japan and elsewhere.

And secondly, thanks largely to his economic policies, Mr. Abe's approval rate has gone up to 60 to 65 percent, even after his administration is up and running and that was not the case in a series of previous administrations. And also, nobody in Japan perhaps, even thought Mr. Abe would make a comeback after his resignation from the Prime Minister's seat five years ago due to his health problem and perhaps other compounded reasons.

In his recent remarks, Mr. Abe admitted that he made mistakes in his first administration, partly being too abrupt to make many changes. He even thought about retirement, but he pulled through amidst criticisms and the disappointments. He now strongly feels that he is indebted to the country and is determined to work to rebuild the nation and it somehow resonates our feelings that we must have made mistakes, but we are ready to strive for the better future and Abenomics seems to be working so far.

The Japanese stock market was recorded highest after Lehman shock. Japanese yen that had been overly appreciated now is coming to a reasonable range and Mr. Abe's message is people who work hard should be properly rewarded. That strongly appeals to the Japanese public. So, so far, so good, but Abenomics is just a month-old baby. So much remains to be seen.

And therefore, we have invited to the conference two key players in helping Mr. Abe to move forward with his economic policies. And Dr. Posen explained quite well about Dr. Hamada and Dr. Itoh, but if I echo a little bit, Dr. Koichi Hamada, he's Professor Emeritus of Yale University and he currently works as a Special Advisor to the cabinet and I understand that Mr. Abe really respects him and also trusts his advice. And Dr. Motoshige Itoh of Tokyo University, he is a leading member of The Council on Economic and Fiscal Policy right now and is quite responsible for fiscal stimulus of Abe's policy.

And speakers from the United States also, we have Dr. Garinger from IMF, and also Dr. Posen, and Dr. Marc Noland, the specialist on Japanese economy. And also Dr. Schott and also Ambassador Clayton Yeutter, they are quite knowledgeable about trade policies.

So I'd like to thank all the speakers today for kindly coming to speak at the conference. And finally, I'd like to thank all the participants today and I hope we enjoy the discussions. Thank you very much.

Marcus Noland: Good morning. My name is Marcus Noland. I'm Director of Studies here at the Peterson Institute. It is my pleasure to chair the first panel dealing with macroeconomic issues. We have a wonderful panel of speakers.

Our first speaker will be Professor Koichi Hamada. Koichi is the Tuntex Professor of Economics at Yale University, where he specializes in the Japanese economy and International Economics and is Professor Emeritus at Tokyo University where he taught before coming to Yale in 1986.

He is a fellow of the Econometric Society, which for people like me is a big deal. He was the President of the Japan Economic Association. He was founding President of the Japan Law and Economic Association.

In Japan, he has participated in many policy committees and advisory boards, but perhaps most significantly from January 2001 to July 2002, Koichi took leave from Yale to serve as the First President of the Economic and Social Research Institute in the cabinet office, a body created to promote administrative reform chaired by the prime minister.

For these good works, he has been awarded the Imperial Decoration, the Order of the Sacred Treasure a Gold and Silver Star, which is given to those who have accumulated distinguished achievements for Japan.

Our second speaker will be Adam Posen, the President of the Peterson Institute for International Economics. He recently returned from the United Kingdom where he spent three years as an external member of the Bank of England's Monetary Policy Committee. Adam has published numerous pieces on the Japanese economy, beginning with his 1998 book, Restoring Japan's Economic Growth. He is still trying.

Last but not least and by way of comparison, the new kid on the block, Stephan Danninger is division chief in the IMF's Asia and Pacific department and has covered Japan for the last four years. He has been at the fund since 2000, where his research has covered a variety of topics including the determinants of fiscal sustainability, the effectiveness of fiscal rules, determinants of expert competitiveness and cross country spillovers from global financial distress, all of which will be key issues in our discussions today.

So without further ado, I'd like to turn it over to Koichi and I would ask the three speakers to try to keep it around ten minutes if you can. Thank you.

Koichi Hamada: Good morning ladies and gentlemen. A kind mention about my book, but my wife says don't count the unhatched chickens yet. And I have many friends in this Institute. It was a nice place to come back to, but the late Mike Mussa developed his international economics following Mudell-Fleming type of analysis and some have different opinions about balance of payments and so forth, so it's John Williamson and Fred Bergsten about our currency war. Still, it is a very pleasant place to visit and discuss about practical policy matters, but incorporating our theoretical wisdom.

And I had the very nice fortune when I was proofreading my recent book, Mr. Abe called me. I was stand, I couldn't answer systematically. So I wrote some memos to him and he used it for the campaign. And my friends say I was looking for the year to put my opinion in, but now many people are getting their ideas into my years. And I was interested in the role of ideas in the political leadership, or political specific interest in determining the right or sometimes the wrong economic policy, like the wrong monetary policy of Japan in the past 15 years.

And other than academic, I'd like to share academic thought. Ideas are important and good understanding is the most crucial, but this event showed me that unless there are some political rights, political leaderships, even good ideas cannot be utilized.

By the way, Abenomics was named by Mr. Hidenao Nakagawa, LDP's Secretary of the first Abe cabinet, but I was pleased to find that by many advisers like Kikuo Iwata, Kozo Yamamoto, Congressman Yoichi Takahashi, and Etsuro Honda and others. Mr. Abe finally convinced that monetary policy is one of the most important things we need for recovering the Japanese economy.

And I think [inaudible 00:15:49] will talk about these more precisely, but usually people say it's a very courageous monetary policy and expedient fiscal expenditures and efficient growth strategies. Those are the three arrows to recover the Japanese economy. Printing money cannot forever increase wealth. It helps very much in the process when wages and prices are sluggish, but in the sub-stage, we have to increase our productivity to enlarge the pie and the first one is taken very effectively it seems, so I tell those who argue according to all the doctrine of the Bank of Japan (BOJ) that monetary policy cannot work, that proof of the pudding is the eating and not so many arguments that monetary policy doesn't work was disproved by the present surge of stock price as well as the weakening of the yen. Just one year and one day ago, that was Valentine in Tokyo that Valentine Day.

The BOJ itself took that ambitious monetary policy and the markets reacted very well. But then, BOJ took a policy of discounting the effect of this new economic policy so the policy stopped to encourage the economy and that is very understood by Mr. Abe's move in his start of the campaign that credible monetary policy is important. If BOJ Chief discredits the effect of monetary policy himself, then that kind of monetary policy doesn't work.

Probably this is worth mentioning that there is some division of opinions in the relationship between the first monetary policy. I am a good student of Mundell and I think under that flexible rate, the first arrow is more important. But when I interviewed many American economists too that if the interest rate is close to zero, then at some point maybe another [inaudible 00:19:04] of fiscal expenditures, that kind of stimulus may be needed and in the meeting surrounding the Prime Minister, Mr. Itoh, [inaudible 00:19:19] Itoh is leaning towards a little bit to this second view, but that my view is first try the first part, monetary policy and the exchange rate effect as much as possible and after the interest rate doesn't move, there are other channels to be in effect or credit acceleration effect, but fiscal policy or some other approach may be necessary to recover the long ailing Japanese economy.

But sometimes we have to be careful that the second part is used by the old time politicians or old time [inaudible 00:20:07] with economy I described the fiscal expenditure is the only way to recover the economy and I don't think that's true and if that path is taken, the serious, I think, also serious government, that situation will not be cured by this active monetary policy. And structure reform is very important in any type of economy and particularly in Japan where still government regulations are excessive in my opinion.

I think I will just show you some of the pictures of Japanese economy and monetary policy. If we normalize by unity, the pre-Lehman crisis [inaudible 00:21:11] money or balance its magnitude, then British—Bank of England, FRB, all increased drastically after the shock. The Japanese economy was not damaged very much by financial trouble so that was a good thing.

That is probably the only thing that Mr. [inaudible 00:21:37] should recommend, but it didn't increase and yesterday in the Financial Times, the Bank of Japan likes the other picture to look at the actual amount of money [inaudible 00:21:58] this balance sheet's balance and that looks quite different, because I carry hundred dollars in here then my wife says it's sometimes dangerous to be stolen, but in Japan, when we are going to some evening dinner with 200 cash and so forth, I may not feel very secure.

The way money is used is quite different in cash-oriented society and check-oriented society. So sometimes, Bank of Japan use this kind of thing as a rhetoric that Bank of Japan is expanding money from the beginning, but what matters is as you see, the rate of increase and the real exchange rate start in Japan.

I think it's coming down fortunately via Abenomics and this great leap of industrial production [inaudible 00:23:09] so very deep down after the Lehman shock because of the inaction of the Bank of Japan and high rate of exchange rates, Japan suffered relatively. This is relative to the economic scale, so probably the United States suffered equally in magnitude, but in relative scale, Japan had the worse relative income production and you see that and as a deep [inaudible 00:23:46] naturally because of the earthquake, unfortunate earthquake and inflation rate and so forth.

I didn't prepare the slides, but one thing I'd like to finish this speech is about currency war and the Japanese defense against the criticism is that Japan stood very silent when the great surge of other countries and the surge of real exchange rate hike with the yen, so why Japan should be blamed if we do relaxing monetary policy. But I worked in this field very much and probably my local fame in academics is given by this international monetary independence and under the fixed rate, I worked the doctrine that monetary coordination is necessary and useful.

But by the same analytical scheme, we can prove contrary to my first provisions and so monetary policy should be assigned to its own price level not the exchange rate, but the price level and employment and then the world will be led to a kind of better state, so if Brazilian ministers complain of currency war, Brazil itself should take its proper monetary policy. The monetary policy of one country is assigned to its own country and not for others. If we assign our monetary policy to American state of affairs, then the really the currency exchange rate will collapse into the beggar the neighbor [inaudible 00:26:18]. Thank you very much.

Adam Posen: Thank you so much, Hamada Sensei, it's a great honor and pleasure to be following you. I'm going to cover in a sense, much of the same ground and I hope that's not too repetitive, but I think it's important to pick up on two critical points that among the many that Professor Hamada made.

Point one is that mainstream macroeconomics believes that the Bank of Japan didn't do anything for the last couple decades no matter how much two out of the three past governors said. And so therefore, we should be hopeful that a new approach to monetary policy will have actual impact.

Point two, which again, I'm picking up on Professor Hamada, but I completely agree, Japan is still growing below potential. It was arguably growing at or slightly above potential in the mid-2000s, but has since regressed and that potential remains much higher than many people think and therefore it is entirely for Abenomics to set a goal of getting growth up very strongly over the next couple of years even though there are of course many structural issues to be dealt with in the long term.

Now, let me expand on each of those points with a couple of side remarks on fiscal policy and exchange rate effects most importantly on monetary policy. Koichi cited our late colleague Mike Mussa, who of course in addition to being brilliant, was the master of the quip and he at one point had said, "Putting Alan Greenspan in charge of bank supervision was like putting a conscientious objector in charge of the Marine Corps."

Governor Shirakawa or Governor Hayami as head of an expansionary monetary policy is the same thing. They both took office and insisted that they could not do anything and that any attempts they made would fail and that when they made attempts that their heart wasn't in it and it was contrary to their principles and it would only prove that their attempts would fail.

Now, monetary policy is not merely a confidence gain, but this meant that at every level throughout the BOJ and every time there was innovation—please shut that off—every time there was an innovation or an attempt at new policy, the governors themselves were undercutting it. And there is a very simple way, in addition to what the chart that Professor Hamada rightly puts up, that there was no monetary policy reaction to the downturn since 2008 on the part of BOJ except for this very brief thing since Valentine's Day a year ago which I'll discuss.

They key thing is you want to not just talk. You want to do. This is true whether it's the Bank of Japan, the Bank of England where I served, the Federal Reserve. I said this at the Jackson Hole last summer. It's not enough to merely say you're going to do something; you have to actually do something.

And in monetary policy when interest rates are at zero, the way you actually do something is you buy assets and the assets you buy, the impact is bigger, the less those assets look like cash and as has been repeatedly established including by the Japanese economist [inaudible 00:29:249] and many people since, the Bank of Japan has chosen repeatedly in its so called quantitative easing, to only buy JGBs of shorter than three year duration and short bills.

And the new innovation of this supposedly great new policy last February was to buy bills effectively six months. This is cash. You would not expect it to have any real significant impact on the economy. So there is just a simple fact that truly expansionary monetary policy in Japan under the guise of quantitative easing has not yet been tried, full stop.

Perhaps thanks to the two professors we have with us today, perhaps thanks to some things I and others have said, all of the leading candidates to become the next governor of the bank of Japan and the statements of the Abe administration make it clear that this will change, that they will buy longer duration JGBs and they will consider buying other yen denominated assets.

I believe strongly this will make a material difference to the outcomes for Japan when this starts. I am hoping that they don't do it incrementally by doing five years and seven years and ten years. There's no reason they can't, at the April meeting, immediately start buying ten-year JGBs and out. If they want to do more and constrain the balance sheet. It would be perfectly reasonable for them to sell their accumulated short bonds and bills or let them expire and just replace them with ten years, that would be in fact, operation twist in a sense, just as the Fed did. It would give an additional boost to markets.

This is all very easily doable by the Bank of Japan, they have the facilities in place. The operational expertise. They have the markets. It would require nothing but the will to do it. And I am quite hopeful that the will to do it will be there and again, as a matter of forecasting, because people have gotten so inured in Japan and in the JGB market to the idea that they can—that Bank of Japan interventions have no meaningful effect, they I think will be surprised on the upside by how much this matters when it takes place.

The yield curve is very low, but in proportional terms as for example, my colleague David Miles at the Bank of England used to say, "What matters isn't the absolute level. If you move down the yield curve by 20 percent at the long end, that's a very large effect, even if it's only a few basis points." And monetary policy is always transmitted through this cascade of relative asset prices even if you're cutting interest rates. You don't control all the interest rates in the economy. You're hoping for this cascade of decisions out to private actors.

I think it would be quite reasonable for the Bank of Japan to be ready to buy domestically denominated corporate bonds and particular bank bonds. They've already talked about this, some of the candidates. The facility is already in place. It would constructive. It could add extra power to what they're doing as well as helping the banking system when they're pulling duration out of the market and JGBs. I'm getting a little technical here but I want to get this on the record.

They key challenge for my economic policy in Japan, and in fact for all of us, in the so-called developed world, is how do you get private investor's money off the sidelines. In Japan, it seems particularly obvious that there's a huge amount of money sitting in corporate balance sheets after all the repayments of the past decade not being invested, but that of course is the case here in the United States also where you have very cash-rich companies. That is where fiscal policy as well as creating a more inflationary environment, not a hugely inflationary environment, simply a non-deflationary environment, comes in.

And there is the point where I differ slightly from where Abenomics is, although I think largely I'm in line with where Professor Hamada was. Some of you may have noticed, my friend and hero Paul Krugman and I disagreed slightly lately on Japanese fiscal policy. I don't want to make a big thing off this.

The issue for me is as long as the Abe administration has committed to raising the consumption tax significantly in 2014 and 2015, which they have done, jerking the economy around by doing a little bit stimulus this year only to take it away next year I think is a not great idea. I think the net cost and benefits are not very good.

That said, if you use the fiscal stimulus as a structural reform effort, so you treat the consumption tax increases as permanent, which they will be in all likelihood, but you create a temporary tax incentive say for investment tax credits which I know the Abe team has spoken about, but I also know is not really currently in the budget proposal as strongly as at least I would like. If you did accelerated depreciation, if you did all these things that we're well familiar with that we have on the shelf that you could do and thereby permanently shift the balance of consumption taxation versus investment taxation or corporate taxation in Japan, that would be worthwhile.

You could, even if you were feeling sufficiently radical, make some of those changes permanent and promise to keep raising the consumption tax further out, keep it neutral.

Stephan Danninger from the IMF is an expert in these things and can talk more about the broad issues.

This is not, I want to note, because I think Japan is about to hit the wall. As I said in my Financial Times article some of you saw a few weeks ago, as Christian Broda and David Weinstein did in an excellent paper some seven or eight years ago, Japan's debt problem is misleading even if you look at, public debt problem that is, even if you look at the overall net rather than gross situation.

But it is costly. There's a difference between it is an immediate disaster, which is not and it is a poor use of resources and distortionary, which it is, and that to me is the difference between when I and many others were advocating fiscal stimulus in 1997 or 2000 versus now is the debt situation is having bigger cost now. So you want to balance this out, but that doesn't mean it's a disaster and it doesn't mean that you have to forswear all changes in the tax code.

Now, I'm almost out of time so let me just make two more points quickly. First, in terms of what's likely to happen, I do worry that if the fiscal package, as currently seems to be proposed, consists of the traditional types of public work spending, it will have very low multiplier, very low impact, not because it's so inherently bad, although there is that issue, but because there's so few shovel-ready projects left to go in Japan and it would make much more sense to do it through the tax code.

I also worry, as several people have raised, that if wages are not raised in the private sector, or at least kept up in the private sector heading into the wage round in April, that the offset from what I expect will be increased inflation, lower exchange rate on people's wages will put a downward pressure on the economy. So I can be quite confident about the monetary impact without being quite as confident about the immediate growth impact and I worry about that. And so I do hope as the company Lawson's chairman has just announced and some other Japanese companies have announced, they're going to make real wage gains for some Japanese workers given the additional profits with the exchange rate. Finally, the exchange rate.

Koichi mentioned our colleagues, Fred Bergsten, John Williamson and others who've spoken about the exchange rate here and particularly the yen dollar many times through the years. As Marc Noland and I both have demonstrated, there is a variety of use on these issues within the Institute. Not all of us are in the same place on this and right now, we have Bill Cline and John Williamson doing their next round of estimates on the equilibrium exchange rates and while we won't scoop them, my guess is that they will find that the yen is probably slightly undervalued by their mark.

We have Joe Gagnon who will be releasing a new study on the econometrics looking at the impact of currency manipulation in a few weeks. We'll all be invited to that event. And of course his focus is on behavior, not on the level and his focus I think rightly when you look at your pen is they have not actually manipulated or intervened in foreign currency markets as yet.

I think there was a lot of chatter going into the G-7 meeting, but I think we have a positive outcome coming out. My personal views are similar to those of Joe Gagnon's, in that what matters is are you actively manipulating the currency? In the same spirit as what I said about monetary policy. What matters is what you do and Japan's government and the BOJ have not done anything to violate the G-20 compact.

Now, there have been some excessive statements. It's a young government as our colleague from Sasakawa Peace Foundation both here and in Japan said, Abenomics is a baby. I am convinced that at least the top leadership in Japan understands that unfortunate in-your-face statements about the level of the yen will be counterproductive. I am fully confident that they will not be intervening directly into currency markets barring some very strange incident and support from their multilateral partners. And within that, monetary policy will succeed. Thank you very much.

Stephan Danninger: Thank you very much. Thank you for inviting me. Thank you for having me on this very distinguished panel. I'll speak about ten minutes and I'll use a handout that is available so I'll refer to it on and off during my presentation.

But maybe before I start out about the prospects of Abenomics, I just recently was in Japan and somebody made a nice interesting remark saying that Japan's big reforms happen in 15 year intervals. I guess I've heard the two, the arrival of the black ships in 1854 was 15 years later followed by the Meiji revolution; the peace treaty after World War II, 1952 followed with 1968, the Japan-U.S. Security Treaty; and if you'll look at the economics of the post bubble era, 1998 seems to be the trough, Asian crisis, financial sector crisis within Japan. So it led to the lowest, what we estimate, potential growth rate, so now we're 15 years later and maybe Abenomics has that magic touch.

What about Abenomics that we like? Certainly we share the goals, feeling deflation should be a top priority as well as raising growth. Japan is the country with the most prominent aging problem. Also, the comprehensive approach I think is something that is important.

If you look at my second slide, I just wanted to highlighted comprehensive is really important. There are multiple challenges. Low growth and lingering deflation is the two cornerstones I have mentioned. The most but it's really for us the large fiscal deficit and the high debt that needs to be addressed through these reforms.

If you turn one more page, you'll see a chart that outlines the contours of a comprehensive reform package, which in many ways looks similar to three arrows except for there are many more arrows. But I think two parts, or a split between the left and the right side is pretty obvious. On the left side, all these green parts referring to a growth strategy and we think raising growth is like the essential long-term ingredient in order to get out of deflation and in order to get the debt level down.

That needs to be complemented by these two arrows, which I think are now very actively in play, monetary policy and fiscal policy. I call it sound macro policies. I'll talk a little bit in the remaining few minutes about these two aspects, but mostly about the fiscal policy, which I think in the government's prescription is called this flexible fiscal policy. I would like to call it credible fiscal strategy.

Before I get into the latter one, let me talk and echo what Adam was saying about monetary policy. If you look at slide below, you'll see the easing activity by the Bank of Japan since it introduced its asset purchase program. It increased quite rapidly, but the two biggest elements of it, the purchases indeed of JGBs with three years maturity and less and financing bills, which are even shorter maturity.

So options to make monetary policy more effective is indeed going into longer maturities. There may also be options to link the duration of purchases to achieving inflation. I think with a very, very flat yield curve, you need to influence expectations and you do so by giving guidance, forward guidance on how long you'll be carrying out purchases.

The part that should also be considered is going into risky assets, I think you mentioned bonds, but I think equity is another deep market that could be touched. It is very unusual for central banks but these are unusual times. You would like to both address low growth as well as deflation and sending a strong signal in that direction may also be an option that the Bank of Japan could consider. So this is as much as I'd like to say about monetarism, but let me get into some of like the main point on a credible fiscal strategy.

So far, the government has committed or reiterated its commitments to the G-20, which are reducing the primary balance in half from its 2010 level. This would bring primary balance down to minus 3.4 percent currently projected in—we projected the primary deficit at 8.8 percent, so that's a large first step. But then in order to bring the debt ratio down, you need to get into a primary surplus and that goal has been set for 2020.

What is missing is sort of like how you get there and I think having a credible strategy is incredibly important to make short-term measures such as the current stimulus that is in place or monetary policy effective and I'll tell you why in the next few slides, why it is so important to have a credible strategy.

And I have three risks, fiscal risks, outlined. The first one is, given the high level of debt, even a small 100 basis point increase in yields has a substantial impact on the debt ratio. We have done some simulations and you can see that the debt ratio, this is net public debt, can go up in a matter of 10 to 20 years by another—my eyes are getting old, 30 to 50 percent of GDP. So that obviously makes it more difficult to bring debt down.

The second risk is while people say Japan has a very stable domestic investor base and that's true, that is helped domestically, helped by institutional investors, but part of the investors are banks and banks would suffer from an increase in interest rates through the valuation loses of their bonds. Estimates by the Bank of Japan on page five and you can see that at least for regional banks, these are the smaller banks, the impact on tier capital from 100 basis point increase in interest rates will be quite substantial. So that's sort of like the risk number two.

And I think the risk number three is the interaction between stimulus that aims to sort of jump start the economy and at the same time monetary policy that needs to pursue achieving a 2 percent inflation guide, which means loosening. So you have on page six, [inaudible 00:47:09] proposed that stimulus, which we estimate in effective terms about being 1.4 percent of GDP of additional spending that mostly is debt financed and at the same time if you start to ease more aggressively, it could be perceived—not saying it does, but it could perceived that there's some monetization happening and I haven't seen anybody who hasn't seen through this and seems to believe that, but this is sort of just one step that who knows if there's a next stimulus that needs to be supported. So one need to be careful and have a plan in place for medium term fiscal reforms.

So let me just make three points on concluding with that so what are the elements of credible fiscal policy? Well, first actually, there needs to be a firm commitment to the consumption tax rate. It is not yet fully approved. There is a legislation in place, but the government needs to decide on implementation, which we understand will happen in the summer, August, or September.

Why VAT and I think that the reasons are amply known, but let me just reiterate it. Japan has the lowest VAT rate among advanced economies. There's a nice chart on page seven, but overall revenue ratio, that is, the yield in percent of GDP is also low. So there is room to—this is really sort of like the area where adjustment happens and obviously VAT or the consumption tax, I should say, is a very efficient way relative to other ways to raise revenue.

But what about beyond 2015, and here I've copied our famous menu of options table into my presentation and I'll leave it to you to read it through. Let me just explain briefly the left column is what currently is roughly in place. That achieves roughly 4 to 5 percent of adjustments, only half way towards the goal of lowering the debt ratio.

So what is needed next? And I'll point out two things, I think I agree with Adam that what should be taken seriously is raising the consumption tax further. There's no specific one number that's the right number, but I think there are also important expenditure-side reforms. One to point out is longevity and health is tremendously better in Japan than in other countries, so raising the retirement age from 65 to 67 for instance, creates both savings for the pension system, but also keeps very productive, very healthy, and very efficient people in the labor force and as you know, the shrinking labor force is one of the factors drawing down growth.

So let me stop with these two points and make sort of like a plea of how does Abenomics stack up. Well, I think it's an ambitious program, but in order to be successful, it needs to be complemented with medium-term policies. It's not that these policies are not on the table, they haven't been announced so we don't know whether they're going to be effective enough or not, but I think it's important to act very soon to make sure that the credible fiscal strategy is in place as soon as possible to make it easier for monetary policy to ease, but as well as the growth strategy, to raise growth, which implies a difficult structural reform some of which I think were discussed in the second panel.

Marcus Noland: Thank you very much. I'm not sure we actually need the name tags, since I don't think any of us look particularly alike.

Adam Posen: You and me, Marc.

Marcus Noland: It's about as close as it gets. So we've had three very stimulating discussions. We have about 40 minutes. There is a microphone in the center aisle and there is a roving microphone, so please just raise your hand or go back to the center microphone. Please identify yourself when you ask a question and if possible indicate to whom on the panel it is addressed. So any questions? Arthur Alexander.

Arthur Alexander: Thank you. Yeah, Arthur Alexander at Georgetown. I have a question for Professor Hamada or perhaps Professor Itoh. One of the curious things is how Mr. Abe came out of the gates running, he was ready and I'm curious about what you might know about his kind of years in the wilderness where he was not Prime Minister, coming out with a leadership style very different from the previous five or six prime ministers and very different from his own previous behavior where he actually is showing leadership with ideas, with strategies, approaches, and so on. Very different from everybody since Mr. Koizumi some years ago. I'm curious whether you have any ideas about where did this all come from?

Marcus Noland: And I thought I was about to ask a politically sensitive question.

Koichi Hamada: Actually, I am also curious about the same program. Mr. Abe has been very understanding that monetary policy or monetary stimulus is a necessary ingredient, an important ingredient of recovery and when I saw him at various intervals, he was supportive to the idea, but he was not really convinced like the present that first arrow will start the Japanese economy.

Last June, June last year, I'm doing research on the determinants of economic policy and I asked him in an interview several questions and at that time he completely—he was convinced that the present type of Abenomics is necessary and useful. So even between that one year, I met before last June, he must have been convinced by other advisers. He also mentioned that he was at the turn of Bank of Japan policy like the abolishment, stopping of the zero interest rate in 2000 and so forth and recent 2006 [inaudible 00:55:01] his promise to keep monetary policy enough expensive and he told me, Mr. Abe told me, he was thinking of the possibility of that Bank of Japan view was wrong, but he was convinced by that kind of [inaudible 00:55:25].

Marcus Noland: Yes, sir.

Andrew Hodge: Thanks. Andrew Hodge, US Government. This is a question both for Adam and Steven. You both suggested obviously, there's a vulnerability to high levels of Japanese government debt, Adam I guess in particular in your Financial Times article. It strikes me however that maybe I mean looking at history, the main vulnerability of debtors are who pulls the plug is related to total debt or foreign debt and actually on both those two scores, if you're looking at total debt or foreign debt, Japan actually ranks fairly well with a lot of the debt problem being the government debt.

So I mean, in particular for example Stephan cited a number where Japan gets in trouble over 20 years or so on because of excessive interest burden or interest service in the government debt. On the other hand in the United States, the net interest on total debt is right now 11 percent of GDP. If US interest doubled, that would be a fairly significant shock to the income share and GDP. So I wondered if you can talk about whether Japan's relatively good scores on total debt and foreign debt imply maybe a more room potentially on the fiscal side?

Adam Posen: Thanks, I'll go first and Stephan just went. I have to take issue at that number about 11 percent of GDP to me sounds wrong. If we've got 90 percent debt level and we're paying 2 percent interest on most of it, that doesn't get you to 11 percent of GDP.

Andrew Hodge: Total net debt [inaudible 00:57:18].

Adam Posen: Total net—anyway, that's not a meaningful concept. So we're working on the fiscal side. I think you're right that Japan has room and I think that's why both Stephan and arguably the IMF and I and a bunch of other people, have said we don't expect the blow up. We're not worried about the yield curve suddenly spiking for largely the reasons you said, the net debt level is much lower than the gross debt. A lot of the holdings are by somewhat degree captured savers and captured institutions and there's very little foreign debt and most of the foreign debt is held by central banks or other official institutions.

So on all those grounds, that's why you have room. However, I want to strongly agree with the two—the first two of the three costs that Stephan had in his very nice presentation. Number one being that simply the running cost of rolling that over if the interest rates go up is very high and that's what I tried to refer to perhaps unclearly on my FT article and subsequent statements is that's what I mean by crowding out that realistically, Japanese public spending isn't going to go up from where it is on a steady state basis and private investment needs to go up and if a big chunk of money is going to just straight out interest payments, it crowds out public investment and other public spending. So it is a bad distortion, it is a cost even though it doesn't mean they couldn't do it.

And then the second point that Stephan raised, which is the vulnerability of the banking system, particularly some of the smaller banks, our former colleague Carmen Reinhart, among others, and people in this building as well have pointed out about the issue of financial repression that when as we've seen very much in Europe, we talk about the negative cycle between sovereigns and banks holding sovereign debt.

And so the issue in Japan is not that you're going to have some Greek-like crisis, but that you are effectively engaged in financial repression by forcing all these public debt into these banks and so that they don't want to do anything else. That has a cost to productivity, a cost to investment, and leaves these banks vulnerable in the same sense although to a much lesser degree, that we've been worrying about the European banks and that's why I personally think it would not be a bad idea to combine longer duration JGB purchases with some purchases of Japanese bank debt. Stephan?

Stephan Danninger: Thank you. Maybe not that much to add. One point that's maybe different in Japan and in other countries is that the adjustment time that is projected to bring debt down is very, very low. So we're talking about ten years. Maybe after the stimulus, we might need to think a little bit even longer to get debt down on a downward path. So during this time period, this 100 basis point increase for example, that was shown as an example, that can sort of like act like—it's quite as a break so it may not sort of like derail the economy in sort of like putting it into debt crisis, but it makes it so much harder to bring debt down and put so much more onus on raising growth, finding reforms that can increase growth and also to bring sort of like investment back.

Marcus Noland: So I would like to, before turning to John Williamson, I would like to apologize to my colleague to the left. I think there's something wrong when the IMF is to my left, but it is Stephan Danninger. I am particularly sensitive to this since I frequently with Stephan Haggard, who often has his name mispronounced. So John Williamson and then John [01:01:02].

John Williamson: Thank you very much. The question is directed at, probably the [inaudible 01:01:05] Koichi Hamada, but maybe would apply to the others speakers as well. It's about the difference you declared with the balance of payments and real exchange rate objectives of myself and Bergsten, Fred Bergsten, and also Bill Cline was mentioned.

Based on our estimates of the overvaluation is whether—or undervaluation—is whether a country has current account deficit greater than 3 percent. So presumably, you are envisaging that there's logically—there are two possible bases on which you could have a difficult, one is if you disagree with the type of model we use to translate exchange rates into current account surpluses, which let me assume it's not that.

And in fact, that you are differing instead on the current account surplus and whether you should worry about those that if they are offset by a capital outflow on [inaudible 01:02:21] account, that I think would be the alternative [inaudible 01:02:23] view that really, there is nothing to worry about as long as current account surpluses are offset by an outflow on private capital account.

If that is in fact the basis of your defense, then the logical implication is that you would favor, or you would react with equanimity, if there were a current account surplus of 5 percent provided it was offset by a capital outflow and you know that maybe fine for Japan. It's not totally fine for the rest of the world.

Koichi Hamada: Thank you for pointing out some of my opinion's difference to his and so forth. I think if we take the fourth world economy, sometimes a country can be a capital exporter, another time a capital importer. If the population is expected to be declining, then it would be natural for a nation to build more assets by having current account surplus, and later on, probably various countries had to rebound accumulated assets and having current account deficit.

And last time I was invited by John here, I read the paper how the rate of time preference affects the long run state of current account balance. If a country is more patient and takes care of hereditaries more, I don't say it's good or not. Then that kind of country can accumulate current account surplus for some time. And therefore, there is no norm. It's not the norm that current account should be equalized to zero. If you enforce by monetary by measures like surpluses [inaudible 01:04:46], then it will create a lot of problems later.

So my point is that a more patient country may accumulate some current account surpluses and so forth and monetary policy and exchange rate should be governed in order to have reasonable price stability and employment level. That's maybe a little out of the standard [inaudible 01:05:20].

Adam Posen: Let me just for the sake of diversity of Institute views give a quick answer that is not set in what John believes is the limits of what's a logical, acceptable response. My issue with the fundamental equilibrium exchange rates argument, even though it is a very valuable tool for us to do and we will be proudly rolling out the next iteration in time for the spring fund bank meetings, is that it is neither an achievable policy objective nor an attractor in markets. The whole point of the exercise seems to be pointing out that you have divergences from these fears for long periods and so neither markets nor governments successfully drive you back to these fears. So the question is how useful is it to then try to frame policy recommendations or judgments based on them.

Now, you can say based on the very transparent and consistent set of assumptions that John, Bill, and others who have worked on this have, that okay, this tells you where you are. But for me, I think it misses a lot of both context, in that it matters a lot more when countries are manipulating their exchange rates and running trade surpluses during a global recession then averaging it over moderate fluctuations of the cycle, then you really are stealing people's lunch and it matters a lot more in policy terms the actions than the levels.

Now, none of this disagrees with the fundamental insight John had, in my opinion, which Keynes and everyone pointed out, we didn't have a way of sanctioning surplus countries in the Bretton Wood system and we need some way of doing that and he's one way of thinking about it, which I think was a very big contribution.

But moving forward, in my personal opinion and only my personal opinion, I think the idea of speaking about what is an acceptable form of behavior, rather than judging what's an acceptable for of exchange rate level, is more likely to prove good just as we did in the trade arena and just as we do in the national security arena.

John Lipsky: John Lipsky, Johns Hopkins SAIS. This is two quick questions inspired by Adam's remark regarding financial repression. One is first of all, as we all know, nominal long-term interest rates in Japan remain very low. What is the basis for your optimism that expansion, monetary expansion will have a substantial impact or significant impact on economic activity?

Secondly, the most politically successful prime ministerial figure of recent times has been Prime Minister Koizumi and we recall that his second election was centered entirely around the notion that privatization of the postal savings system was the critical element in achieving structural reform in the Japanese economy and he won overwhelming support, but he was followed by Prime Minister Abe in his first term who effectively abandoned that goal under various pressures. Was the Koizumi analysis wrong that postal savings, privatization was a critical element in structural reform for Japan or is that a missing element of importance in the current set of policy proposals? Thank you.

Adam Posen: I thank you John for the very pointed questions. I have a feeling both my colleagues will want to get on this as well so I'll give very clipped answers, if Marc will allow. First on the monetary side, as I tried to express this earlier, I think the effect on nominal variables is likely to be much more significant than the effect on real variables.

That said, there is a great deal of monetary history, monetary theory, that suggests that you do get trapped in the certain sets of expectation regimes and monetary regimes. The Japanese situation as I think Professor Hamada has pointed out, among many others, has really been trapped in a deflation encouraging monetary regime and so getting out of that regime will make a material difference.

But I do admit that it is that as just as I found with QE at the Bank of England, the Fed finds your direct mapping from positive monetary actions, even if you can get to the asset prices, the exchange rates doesn't necessarily get you on that, a huge bang on the wheel side and that's why I want to be a little careful.

Just quickly on the postal savings privatization, I agree. I mean, structural reform in the financial sector is very important in Japan. I think we've all got our laundry list. I think former Prime Minister Koizumi, former Prime Minister Takanaka were entirely right to target postal savings as one good way to do it. It's neither necessary nor sufficient, but I think it does point to the fact that you do have to make change there as well.

Stephan Danninger: Maybe stepping into the growth aspect of your question about financial sector repression. True that the low interest rates narrows net interest margins and makes banks less profitable and less willing to take risks. At the same time, businesses that are not viable can survive and can have [inaudible 01:10:42] and that suppresses and innovation and activity, especially in the small- and medium-sized sector.

This on top of it I think, this sluggishness is on top of it, enhanced by government support measures, which have been in place for some time and I'm talking about the credit guarantee schemes that allow banks to get up to 100 percent. Now it's about [inaudible 01:11:15] emergency measure and come down to 80 percent but it gets them to rely on the government to take on some of the risk. And I think measures like these that have been sort of like meant to be sort of like painkillers during the very deep recession after the Lehman shock are now turning into sleeping pills sort of like the blanket, the innovation and the cover ups of like initiatives.

And I think maybe part of the Abenomics, the third part, the growth strategy, should be a rethinking on how do we get risk capital into the private sector. Does that involve banks? They need to have proper credit information. This involves SMEs that may not be able to rely as much on these credit guarantees. Yes, and maybe at some point, you get some growth despite the slow interest rate environment.

Koichi Hamada: Like [inaudible 01:12:25] real thought by James [inaudible 01:12:31] type of general equilibrium approach to asset market and if you use sufficient, different weapons, not just short time JGB, but variety of government bond and also other assets, the [inaudible 01:12:55] effect will work and it is already demonstrated by some scientific work that [inaudible 01:13:02] worked and the regime of quantity easing in Japan.

And also [inaudible 01:13:09] deviated credit channel, acceleration of a credit channel would work if we have higher stock market values and so many people worry about reduction of bond value or asset values, but they don't count the other effect that equity market [inaudible 01:13:34] realized.

For the second question, I'd like to shift to Professor Itoh about [inaudible 01:13:43].

Adam Posen: He's right there, Michael.

Marcus Noland: Why don't we just move on to Matthew Goodman who's been waiting patiently?

Matthew Goodman: Thank you, Marcus. Matthew Goodman of CSIS. Interesting discussion. Since this is billed as a pre-summit assessment, if you were drafting talking points for President Obama to use with Prime Minister Abe and you wanted to say the following four things, in what order would you order these four things and would you agree these are the right four things to say? (A) Keep it up on the stimulus arrows of Abenomics; (B) be careful about the exchange rate; (C) be careful about debt; and (D) get started on the growth strategy, on structural reform.

Adam Posen: If I'm allowed since I've actually not directly been in that position or sort of close to it, I would have a slightly different four in a different order. One, (A) You got the message not to let your people talk about the exchange rate that way, right? That's A. (B) Keep it up with the stimulus, domestic monetary policy. It's good as our treasury already said go for it. (C) Join TPP, as we're about to talk about in the next panel. You need it for structural reform, you need it for national security. We need you in there. Let's get that done. (D) Here's some nice natural we can sell you. Those would be my four talking points. Obviously the national security talking points in which Marcus and several people from Sasakawa can talk better than I can might dominate, but that would be my order of economic talking points.

Marcus Noland: Steve Beckman.

Steve Beckman: Steve Beckman. I know that the title of this session is Abenomics and I'm just struck by how incredibly narrowly focused the presentations have been and the discussion has been. I've worked for the electrical workers and the auto workers for 30 years, so I've been involved in discussions of Japanese economic policy for all of that time. And the presumption seems to be that economic policy in Japan works sort of like the way it does in the United States and the kind of measures that are adopted are in an institutional structure that's kind of like ours and everybody else's in the West and the reality is obviously quite different. The institutional structure in Japan is very different.

Adam says you judge the exchange rate issues by what they do rather than what they say. I've watched exchange rate changes between United States and Japan for a long time and it's very hard to identify the specific actions that affect exchange rates, but somehow the exchange rate seems to go in the direction that would be in the interest of Japan's institutional structural growth model. So that's the issue that I really want to-

Adam Posen: Sorry, just to interrupt, what do you think happened to the yen up until six months ago over the past three years and how was that in the interest of Japan's structural growth model? How is the-

Steve Beckman: It wasn't in the interest of Japan's structural growth model and it must be a political debate within Japan that it has some influence over this policy and I think the United States' pressing may have had something to do with Japan exchange rate policy and there are certainly other economic factors that influenced Japan's decisions in this area. But it seems to me that what you're proposing is that an export-led growth strategy is what Japan ought to be pursuing and I don't—there's been no discussion of where the investment might go if investment in Japan grows, what industries would be the focus of that investment. That tradition is it goes to the big companies that are big exporters.

What in the way you've presented Abenomics changes that dynamic and creates different opportunities? And what are the political pressures within Japan that are pushing for reforms of the institutions and changes in the structural distribution of income? Aren't these issues that need to be discussed in economic policy? Certainly in the United States, the political dynamics of who benefits and who doesn't from economic growth is a huge issue and yet, no one has talked about that at all. Thank you.

Stephan Danninger: Maybe I can just add to what has been left out, because we have a second session on this, is a detailed discussion of what should be on top of the growth strategy. I think TPP we have supported for some time that has distribution, but also has very powerful growth implications. One aspect of TPP that maybe overlooked is that it might require an opening up of domestic markets, so bringing investment in and creating a catalyst for domestic reforms. That's one aspect.

Another aspect that's extremely important is tapping into available labor resources or employment for underutilized groups and we had a very nice paper a colleague of mine wrote, Can Women Save Japan. The labor force participation rate of women is significantly lower than in other G-7 economies and there are both structural barriers, there are cultural barriers but there are also legislative, meaning fiscal barriers, the disincentives for example for dual household earners.

So this can be addressed. This has powerful effect on growth. We made some estimates. It could raise growth over a ten-year period by a ¼ percent. It doesn't seem a lot, but if potential growth is estimated at 1 percent, it's not such a small amount.

Another item was what I referred to as the breaking up of this small businesses sector. These are businesses that serve the domestic economy. So it's not necessarily we're talking about an export-led recovery. One has to remind one's self that only 15 percent of GDP is exports in Japan, so there's a large domestic economy that needs to be revived and I think that's a more difficult task, a more complex task with many elements that we'll discuss in the second panel.

Adam Posen: Just to pick up on that just very briefly. There is a second panel. It's focusing primarily on TPP. As market economists, most of us believe that if you have four straight integration at a high quality level and you have growing economy, which doesn't have the distortions of deflation, many of the other issues that were raised will be addressed or at least it will be more conducive to addressing those. Certainly 15 years of stagnation has not seemed to generate structural reform.

I do just want to personally align myself with the idea that Japan can solve many of its demographic problems by getting over its institutionalized sexism and making use of their highly educated female workforce and though I forget the author's name, I do commend you the paper by Stephan's colleague.

Stephan Danninger: Chad, Chad Steinberg.

Adam Posen: Thank you.

Ben Hancock: Hi, thank you. Ben Hancock, I'm a reporter for Inside U.S. Trade here in town. I had a question for Dr. Hamada and also Dr. Posen as well if you'd like to follow up.

Dr. Hamada, following up on monetary policy and its relationship to currency exchange rates, you made a remark about Brazil that if they're going to complain about currency war then they ought to take their own steps. I wondered if you could elaborate on what you meant by that?

And also just talk a little bit about whether you agree that these steps and measures that you are posing are not indeed intended to manipulate currency, but that's really a side effect.

And then also Dr. Posen, if you want to follow up on this. I know we're going to talk about TPP more in the next panel, but there have been proposals by Sharie Brown for example to put disciplines on currency policy and exchange rates. What do you think about those proposals would those limit, really, the ability to take the kind of necessary actions that you all are talking about right now? Thank you.

Koichi Hamada: Thank you. The Greek situation exemplifies that if you cannot aim any flexible exchange rate, then all the adjustment comes on other policies, particularly fiscal policy. So Japan is under flexible exchange rate and as long as Japan is trying to aim its own domestic goal of a certain price level and employment level and so forth, that will result to some particular exchange level. I don't think it is a manipulation. Japan actually did not in fact, adjust to the Lehman shock by expanding money supply. And now, Japan is trying to recover that kind of flexibility in policies and our ministers are saying that we did not complain to the Bank of England or Federal Reserve when the United States tried to cope with the Lehman shock by expensive monetary policy. So they say we are not to be criticized for taking aggressive monetary policy.

Currency war, it really happens if you are in different two countries and different level of exchanges, that is a conflict, but as long as the modern international finance theory, there's—and the flexible exchange rates as long as you aim for the proper domestic economic level and the price inflation level, then there would not be serious conflict in the flexible exchange rate. So it's a mis-currency war.

Stephan Danninger: I can just reiterate what the IMF has said, I think yesterday in a press briefing by our external relations department, that generally we think that the current talk of currency wars is overblown, but it's true that we've seen the euro strengthen and the yen depreciate. This is the result of better policies and a notable reduction of risks in Europe and more easing in Japan. Overall, these developments are welcome and there's really no evidence that we can point to that countries are targeting exchange rate or manipulating them. Rather, there's adoption of policies, domestic policies, that are appropriate to their circumstances.

We have our own multilateral exchange rate assessment and our preliminary reassessment says that no significant deviations from fair value assessments for the relevant currencies. So that said, we're obviously monitoring these developments and with an eye on cooperative approach if necessary and if the IMF is asked, would do its part if needed to be part of this cooperation.

Adam Posen: Just to add, I think the statement from the IMF, as you know people in this building are very happy to criticize the IMF when we disagree with our friends there and in fact, we hosted an event yesterday in which they heard some very strong criticisms, the IMF, on something else. In this case, speaking for myself, I think this statement Stephan just made is entirely reasonable.

I just want to plug rather than to address this issue, just plug that we are of course doing work, Joe Gagnon, Gary Hufbauer and others in this building are continuing to look at the issue of legally in policy terms; can you link the trade regime and the exchange rate regime? When we do do this event probably in early April with Joe Gagnon's new work, we will also be having Gary and some lawyers talk international law, people talking about that issue.

It is worthy of consideration and debate, whether you can do that or not, and it is understandable that Brazil and others that I would call the mid majors are sort of in the firing line as currencies adjust but the simple reality is in line with what Koichi said. Life, it's no different than it always was. If a country cuts interest rates because it's doing badly, that usually has an exchange rate effect and usually someone whines about it. The fact that it's taking place under these circumstances is no different as long as it is an appropriate domestic policy.

Marcus Noland: Okay. We're running up against our closing time and I know there are a number of people with questions, but I can't leave the bride standing at the aisle so.

Mireya Solis: Thank you so much. Mireya Solis from Brookings and I want to go back to fiscal policy, because it seems to me that a lot really hinges on the quality of the spending decisions. And Chano started these panels saying that Prime Minister Abe had learned from his past mistakes and my question is what is the level of confidence from the panelist that the LDP has learned from its past mistakes and it will target differently its fiscal policy to really go for a growth projects?

And I also would like to point out that we are in an electoral year and the central priority, political priority of the Abe government seems to be of course to secure that upper house majority. So can we expect in this climate that the right spending decisions will be made? Thank you.

Marcus Noland: I'm really glad you asked that question because that's been the question that's been in my head for the last hour and a half. If I understood the presentations correctly, at least from Koichi and Adam, I'm not sure if I want to attribute these views to Stephan, that at least on the fiscal component, what Japan needs in the short run is stimulus and then the long run consolidation and there's this question about the quality of these expenditures and Adam wants to go to a more tax and less pork barrel oriented fiscal policy and it seems to me that that is the question that's just been asked is the question. Is this a political system capable of delivering that outcome? And it's certainly not unique to Japan. I mean, giving someone candy and then taking it away is tough as anybody living here in Washington knows. So please, I think that's the perfect question to end this session.

Adam Posen: Marc said it all beautifully. Koichi?

Koichi Hamada: We hear that sometimes, panels break and the recovery from [inaudible 01:29:06] area is very strong. So qualitatively, there are many places to make Japan safer and more appropriate [inaudible 01:29:18] and I quite agree in this [inaudible 01:29:25] auxiliary project will help to solve those questions. But at the same time, if LDP politicians would like to use this as a good electorate gathering device, then Japan's budget deficit will not end forever. So I think quality rather than the effect of enhancing the economic activity is the most important aim for immediate fiscal policy.

Marcus Noland: Well, I think you can all agree with me that we have had three excellent presentations. I think that they have clearly demonstrated both the importance and the analytical complexity of the issues that Japan is grappling with on the macroeconomic side and as I think this ending discussion is indicated, it goes beyond the straight textbook economics to some naughty political economy questions as well. So please join me in thanking our panelists. We'll break for coffee and then return for the second panel on TPP and structural reform. Session adjourned.