
2019 JAPAN: STRUCTURAL REFORM COMEBACK

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The key issue for Japan's 2019 outlook is not the hike in the consumption tax coming October 1 but the determination of "Team Abe" to present a new, urgent and credible structural reform agenda. Herein lies the key to unlock Japanese markets out of the current "[value](#) trap" consensus.

Chances are this could happen earlier in the new year. First of all, there is global pressure. Japan is hosting next year's [G20](#) summit. Prime Minister Shinzo Abe has committed to showcase and deliver on an ambitious structural reform agenda, with a particular focus on social security and entitlement reform. Meanwhile, on the home front, Abe's Liberal Democratic Party (LDP) faces an upper-house election by July/August. To win and maintain the two-thirds supermajority required for constitutional reform, Abe will have to present a policy package that goes beyond just promising that the October tax hike won't derail his recovery.

Specifically, I am looking for two 2019 domestic policy initiatives:

1. An LDP commitment for "no more tax hikes"
2. An LDP commitment to cut social security entitlements for the "rich" by introducing means-testing

A "no more tax hikes" policy commitment from the LDP would be more than just political populism—it is good economic policy. After a tax hike takes effect, there is nothing more damaging to consumer confidence than being told that additional tax hikes will be coming. In contrast, a commitment by the ruling party to freeze taxes is likely to be a boost to confidence—no need to save more today to pay for tomorrow's tax hike. Moreover, a political commitment to stop relying on lazy tax hikes to fund runaway government spending will actually raise pressure for true structural reform of public spending and finances.

In Japan and elsewhere, the single biggest negative force against the sustainability of public finances is entitlements, with all Organisation for Economic Co-operation and Development countries de facto social welfare states being pulled deeper and deeper into deficits as the baby-boom generation retires and/or becomes increasingly unwilling or unable to participate in gainful employment. Means testing for eligibility of public entitlements, while perhaps unthinkable in the U.S., is likely to be quite popular with Japanese voters because of Japan's strong socioeconomic sense of fairness and equality. And from a policy perspective, means testing should prove a most effective way to cut into Japan's excess savings. It is a de facto tax on wealth that speeds the generational transfer of assets. The younger generation will benefit from lower taxes, and the older baby boomers will have to dig into their personal savings while still consuming services that employ the young.

In my view, the new generation of post-Abe leaders is likely to embrace means testing, not just to shore up domestic voter support and add a new sense of fairness, but also to showcase to the world Japan's true policy leadership in managing a stable super-aging society within the context of a free-market parliamentary democracy.

We'll know by April/May whether my optimism is warranted, whether Team Abe can indeed recommit to a credible and

urgent structural reform and pro-growth agenda. In my view, chances are 2019 will mark the end of Japan's "tax-and-spend" basic policy mix. If this is true, and we see a switch toward a tax freeze and entitlement cuts on the fiscal side, the Bank of Japan will find it even more difficult to escape from its current unorthodox monetary policy regime. The dominance of [fiscal policy](#) over [monetary policy](#) is likely to remain a hallmark of Japan's policy mix.

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G20 : Group of 20 of the world's largest economies that meets regularly in order to coordinate global economic policies.

Fiscal Policy : Government spending policies that influence macroeconomic conditions. These policies affect tax rates, interest rates and government spending, in an effort to control the economy.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.