Is Uncertainty a Friend to Business?

By Kazumasa Kusaka

The good news first: while the Japanese economy struggles to identify a growth strategy under a declining and aging population, some positive outcomes have been seen with "Abenomics". The bad news is that the Chinese economy also seems to be heading into a transitional period where it is not fully ready to address future demographic shifts and burdens. The two economies contrast greatly to the American and Indian economies where economic growth is maintained with an increasing population.

In Tokyo, having passed the legislation to enable Japan Self-Defense Forces to participate in collective self-defense actions, the Cabinet's top priority comes back to "economics". Prime Minister Shinzo Abe has spent considerable political capital on security issues and now with lower support ratings his team has to tackle the more difficult part of Abenomics, which is the third arrow — structural reform initiatives.

It is repeatedly pointed out that the main player in the third arrow is the private sector, but the question is whether this only applies to structural reforms. The key question often asked not only in Tokyo but also in other capitals is "Why has business, regardless of nationality, not responded to global quantitative easing of monetary policy with substantial investment?" In Japan, Abenomics' first arrow — an easy money policy — seems to have resulted in an increase in investments in the pipeline.

Recently in Washington, the Japan Economic Foundation had the opportunity to hold a US-Japan Forum which dates back 1984, this time with the Brookings Institution. The growth strategies of the United States, Japan, China and India were on the agenda. The timing was perfect to discuss how we can safely exit from QE, starting with the US and then the others, without a severe impact on emerging economies.

The policy makers design policy measures, but that is only part of the game. The real players are in the private sector, either businesses or households. Then the question is how business has responded to the changing macroeconomic environment. More precisely, with these low rates of interest and abundant money available, why do businesses not respond to the seemingly favorable and inviting circumstances by investing big? And how will they react, once the trend changes?

Some of the views we heard suggested that investment in the form of M&A is very expensive due to surplus liquidity making costs very high when calculated in terms of expected earnings. The logical question then is how about greenfield investment, because equipment and construction costs have been suppressed in recent years. But businesses seem to be cautious because the project period needed to recover initial expenditure and register decent returns would be long, during which time interest rates would rise, in addition to the recent uncertainties surrounding the global economy and geopolitics.

So should we be pessimistic over the post-QE period? Harvard professor Clayton Christensen's "disruptive innovation" episode came to my mind. It is a difficult choice for an established company to face between holding on to a successful market through *kaizen* ("continuous and incremental improvement") and daring to venture into a new market with innovative technology, products and new business model. Even if it were true that uncertainty discourages the realization of optimal levels of investment, those who are not the established but outsiders might find this uncertainty to be an opportunity. When applied to the Japanese scene, the focus and targeted recipients of Abenomics should not mainly be big business but SMEs with a venture business-like entrepreneur mindset. A pool of professionals in finance, technology and marketing could help them.

Coming back to "uncertainty", the Chinese economy, which has been a major driver of the global economy since the Lehman Shock, is starting to lose pace, and especially the lack of credibility in its data sets has resulted in suspension of many investment plans by the regional and global private sector. Global communities including governments, private sector and academia can help increase the transparency and credibility of what is happening in China and the interpretation of these developments. These efforts would in turn help reduce the level of uncertainty.

The international difficulties and challenges of achieving economic policy coordination to deal with China and other areas stem from, and lie deep within, domestic difficulties and challenges. Perhaps the elements of Game Theory, as illustrated by John Nash, are making it difficult to reach that ideal solution, with each nation having a different set of goals under its own constraints.

All leaders only have limited political capital in choosing unpopular policies under the constraints of elections and other factors. The economic policies pursued by Germany over the Greek problem have shown how domestic politics and public opinion can act as constraints on policy making.

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