



## FINANCIAL TIMES

'Without fear and without favour'

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# Abe must fight to keep his project on track

Japan's economic woes highlight the need for more Abenomics

At the end of 2012, Shinzo Abe was returned to power in Japan on a promise to revive his country's ailing economy after a long period of stagnation. Two years on, the prime minister's ambitious mix of economic policies – often described as “Abenomics” – hangs in the balance.

Far from recovering, Japan's economy has slipped ominously into reverse. A sharp fall in gross domestic product during the summer was blamed on one-off factors, most notably an increase in consumption tax in April. But hopes that this reverse would be temporary were dashed this week when it emerged that the economy had contracted a further 2.2 per cent on an annualised basis in the third quarter. This has pushed Japan back into recession, its fourth since the collapse of Lehman Brothers in 2008.

Mr Abe's plan was always ambitious and rested on a series of shocks he proposed to administer to the moribund economy – known as “arrows”. The first was a fiscal expansion, launched within weeks of assuming office. This was followed by monetary stimulus which was aimed at dragging Japan out of its deflationary spiral – a dose that was upped two weeks ago when Bank of Japan governor Haruhiko Kuroda said he would increase the central bank's purchases of government bonds.

The third arrow has been slower to deploy. This is a package of structural reforms largely aimed at loosening the jobs market and increasing Japan's sluggish growth rate. Progress here has been slow at best.

It is too soon to talk about the failure of Abenomics. There are signs of a tentative lifting of Japan's deflationary mindset. Earnings are ticking up slightly along with consumption, suggesting that the long period of falling prices could finally end. Nor is the slide in GDP quite as awful as it at first

appears. The decline is mostly attributable to an unexpected drop in corporate inventories. Had these remained stable, the economy would have grown marginally.

Still, the task facing Mr Abe is not becoming any easier. Financial markets – ever alert to political frailty – are on the lookout for signs of weakness. Three questions are on investors' minds.

First, Mr Abe must decide by the end of this year whether to press ahead with the second planned increase in the consumption tax to 10 per cent. If there was a case for using this measure to consolidate Japan's still out-of-kilter public finances, the impact of the first round must surely have killed it. The economy remains too fragile and too dependent upon consumers recovering their animal spirits to take the risk.

The second is whether Mr Abe will now call a snap election. There is talk in Tokyo that the prime minister is tempted because of the chance to exploit the weakness of a divided opposition. But while success at the polls might give Abenomics longer to work, the risk remains that an inconclusive result would place the whole experiment in unnecessary jeopardy.

The last question concerns Mr Abe's third arrow, which he has yet to pull firmly from the quiver. It is hard to see him making structural reform the central theme of any election campaign. But the reality is that Japan's economy will only enjoy sustainable growth if the country presses on with the task. Rather than seeking short term electoral advantage, Mr Abe should throw his weight behind policies to make the labour market more flexible and to close the gap between permanent and casual workers.

The man who gave the bold policy of Abenomics its name cannot afford to be distracted now. There is no plan B.

# How bankers are paid is now everyone's business

To reform their culture banks must also become smaller and simpler

There was a time when bankers' pay was a private matter between the bank's owners and employees. Now it is everyone's business. Last week's fines for rigging currency markets have left shareholders, customers and regulators wondering how to stop banks from repeating such appalling practices. A good place to start is how bankers are rewarded.

Here, Mark Carney, governor of the Bank of England, has taken up the cudgels. Much has improved since the nadir of the financial crisis. Pay is deferred and paid in shares to a much greater extent. The bonuses of miscreants can now be clawed back. But it has clearly been insufficient to dissuade many bankers from gross misconduct. Mr Carney therefore argues for extending clawback provisions into fixed pay.

In popular perceptions, the loss of trust in banking goes beyond the actions of a few rogue traders to the very heart of its culture. An industry that is meant to serve the wider economy is regarded as greedy, irresponsible and even criminal. As the owners of banks – and the ultimate payers of fines – shareholders seem unable to deal with this problem alone. Co-ordinated international action from regulators is needed to enforce higher standards.

Mr Carney's intervention echoed that of William Dudley of the New York Federal Reserve in proposing payment in “performance bonds” instead of straightforward cash. These instruments are held back to pay any future fines. For organisations that pride themselves on their financial sophistication, it should not be hard to design bonds that align employee interests with those of wider stakeholders.

Introducing yet another layer of complexity into an already tricky process carries risks. Staff will resent the extra uncertainty in their pay packets and either ask for higher pay or look for

ways to hedge their exposure. Regulatory initiatives often bring a slippery response from the regulated, leading to unintended consequences. Mr Carney's enthusiasm for performance bonds partly stems from the way an EU cap on bonuses has led to escalating fixed pay.

However, there are also limits to how brute incentives can ever alter a company's culture. This particularly applies to banking, where an expanding forest of regulation and their very size make many investment banks too complex to understand or manage. It took more than five years to resolve the bankrupt Lehman Brothers, by no means the largest or most complicated entity on Wall Street. Banking encompasses many varied disciplines: dealing in currencies, handling a large merger, and marketing to retail depositors require very different aptitudes.

On their websites, banks list company values such as “integrity” and “putting customers first”. But no matter how well meant, applying them to such sprawling organisations has turned out to be near-impossible. This adds weight to calls for a split between investment and retail banks. A manager from the trading desk may have no more feel for high street customers than an oil company executive would for running a supermarket. In the end, banks may regain the confidence of regulators and customers only once they have been split into smaller, more coherent units.

Regulators are right to push for reform of pay, not least because its sheer quantum outrages ordinary members of the public. How compensation is set also sends a vital message about what a company values. But it will take more to shift something as intractable as the culture of banking. A sign that things are improving will be when staff no longer need to be bribed into behaving well.

# Letters

Sir, The Financial Times (editorial, November 13) and Kevin Rudd (Comment, November 14) are among those who have welcomed the US-China agreement on CO<sub>2</sub> emissions, thinking that it shows the way forward to a global agreement in Paris next year. Unfortunately, it shows the wrong way.

The commitments made by the two countries are essentially their forecasts

of business as usual, plus some safety margin. China promises to stop increasing emissions by 2030. A few years before that, its population is expected to peak, and by 2030 the intensive phase of its industrialisation will be over. Already today, its per capita CO<sub>2</sub> emissions have surpassed those of the EU. Thus, China's promise means little. Moreover, the more it increases emissions during the coming

15 years, the more is allowed after 2030, and hence the easier it gets to meet its commitment. We surely don't want a Paris agreement that creates such perverse incentives.

The only purpose of the US-China agreement is to hide the lack of real action. The effort a country makes to decrease CO<sub>2</sub> emissions can be measured by the price it puts on them, but in both the US and China

this price is negative, since they subsidise fossil fuels. The negotiations in Paris should focus on raising this price, not in 2030 but now. Even raising it just to zero would do more to combat global warming than both the present agreement and the Kyoto protocol.

**Jonas Nycander**  
Dept of Meteorology,  
Stockholm University, Sweden

## Money multiplier is not fixed but depends on the volume of private credit

Sir, I feel compelled to respond to Fran Boait's unsupported criticism (Letters, November 17) of my letter (November 13) in response to Adair Turner's Comment.

First, Dr Boait dismisses my concern over a possible resurgence in the money multiplier by claiming the March 2014 Bank of England Quarterly Bulletin “debunked the money multiplier model”. In fact, the BoE Bulletin explains that the banking system creates deposits when it lends, and thereby determines the amount of broad money. Therefore, the money multiplier, which is the ratio of broad money to high powered money issued by the central bank, is not fixed but rather depends on the volume of private credit, which was precisely my point. To restate, when deleveraging ends and animal spirits revive, private credit creation, and hence the money multiplier, will probably rise.

Second, she incorrectly ascribes to me the view that debt monetisation automatically leads to hyperinflation. I said it carried a risk, not a certainty. In addition, her citation of the Cato study on hyperinflation by Steve Hanke and Nicholas Krus lends no support to her criticism. Hyperinflation itself is a bad situation and Hanke's statement that hyperinflations occur in “extreme conditions” is not an attribution of causality. My reference to the central European hyperinflations in the 1920s, which are cited (for Germany and Austria) in the study, are generally believed to have been the cause, and not the effect, of a collapse in the “productive capacity” of those economies. That is why FA Hayek, who lived through the Austrian hyperinflation, was so adamantly opposed throughout his career to inflationary policies.

**Daniel J Aronoff**  
President, The Landon Companies,  
Birmingham, MI, US

## The real battle is about broadband neutrality

Sir, Your editorial “Obama is only half right about net neutrality” (November 12) is also only partially correct, beginning with its headline.

The real battle is about broadband neutrality, which extends beyond net neutrality. The US broadband providers, notably the oligopoly Comcast, AT&T and Verizon, operate broadband channels that are not Internet-connected and can be used for example to deliver video services, including Netflix's, in conditions that effectively circumvent the intent and reach of rules applied only to access to the Internet. Local loop unbundling is



'Let's hope the warning lights of global economic instability are replaced by the Christmas lights of global rampant consumerism'

one tool that can be used to stimulate competition in the broadband market but not the only one. It would probably face even fiercer opposition in the US than limits on so-called “fast lane prioritisation”. Fast lanes can be constructed in conditions that allow companies of all sizes to gain comparable access to fast lanes to points of interconnection with broadband access networks, while allowing customers themselves to choose, as they do now, which fast lane, ie speed of service, they subscribe to within the access networks. The broadband providers should be responsible stewards of substantial public resources to which they have been awarded access in franchises that protect them from competition to a significant degree.

They are not entrepreneurial ventures that have to succeed on their own merits against multiple competitors, unlike the companies that became today's, or aspire to become tomorrow's web giants. It is particularly egregious to consider allowing Comcast, to all intents and purposes a family-run firm, to decide the conditions of access to and use of infrastructure that is vital to the social and economic lives of all Americans and US residents.

**Martyn Roetter**  
Independent Telecommunications  
Consultant,  
Boston, MA, US

## Impressive poring rate of Fifa's ethics adviser

Sir, You report (November 15) that Michael Garcia “spent two years at Fifa's behest poring over 200,000 documents”. That's a poring rate of about 275 a day, assuming that he didn't stop poring at weekends. And he also “travelled the globe to conduct scores of interviews”. Quite a guy!

**Adrian Williams**  
Headington, Oxford, UK

## When the wheels of India's justice system stick

It was back in 1973 that Delhi bus conductor Ranbir Singh was accused of defrauding his state-owned employer by charging a passenger only 10 paise (one-tenth of a rupee) instead of the 15-paise fare for the journey. He was fired but acquitted. Yet the case continues 41 years later, with the next hearing set for January. The smallest coin today is 50 paise.

Forget the proud man's contumely and the pangs of despised love: in India, legal delays rank first among the reasons listed by Shakespeare's Hamlet for finding life unbearable.

Mr Singh's experience is by no means unique. A year ago, former postman Umakant Mishra was finally acquitted by a court in Kanpur of stealing Rs57.60 in 1984. He had been suspended for 26 years before reaching retirement age.

Even the fictional Jarndyce and Jarndyce case in Charles Dickens's *Bleak House* (in which the inheritance in dispute is entirely consumed by legal fees) is no match for the realities of Indian litigation. Sunni and Shia Muslim families have been locked in a legal tussle over a plot of land in Varanasi since 1878, and the Indian Supreme Court has been involved in the case for the past 38 years.

Such delays are not mere judicial curiosities. The glacial pace of the justice system undermines India's claim that it is superior to China in at least one respect – in that it is a democratic country under the rule of law – and frustrates everyone from the humblest bus conductor to senior

## While Japan and China compete politically, they co-operate economically

Sir, Diana Choyleva observes that the depreciation of the Japanese yen will pressure China to join the currency wars (“Boj's misguided policies to revive growth risks igniting currency wars”, November 13). She also notes that Korea will respond by weakening the won.

While Japan and China compete politically, they co-operate economically. Japan provides the parts and components that go into China's exports of smart phones, tablet computers and office equipment.

Korea is also a key supplier to China. Depreciations of the yen and won will reduce the dollar cost of the imported inputs and a depreciation of the renminbi will reduce the dollar cost of China's value added in electronics goods. Concerted depreciations in Japan, Korea and China will cause the dollar price of China's final goods exports to the US to tumble.

Given the intense price competition in the global economy, China's exports to the US will thus accelerate. China's trade surplus with the US equalled \$320bn in 2013 and will equal about \$340bn in 2014. Even larger imbalances will not benefit either region.

**Willem Thorbecke**  
Research Institute of Economy, Trade and  
Industry,  
Tokyo, Japan

## Modern Tunisia's founder gave women equal rights

Sir, Saadia Zahidi is quite right to argue that “Womenomics is starting to transform the Muslim world” (November 14). But credit where credit is due: the founder of modern Tunisia, Habib Bourguiba, gave women equal rights, except where inheritance was concerned, when he enacted the *Statut du Code Personnel*, the year his country gained independence from France in 1956. Family planning followed a few years later, decades before French, Italian, Spanish and many other European women enjoyed the same rights.

Women in Tunisia have long been active in business, often at the highest level. Ouided Bouchamaoui, the chair of the employers federation, has played a key economic role since the fall of President Zein al-Abidine Ben Ali. The active part played by three generations of educated women helps to explain why popular resistance to the Islamist Ennahda government's attempt to turn back the clock was so fierce. It also explains why Ennahda lost votes to the more secular coalition led by Nida Tunes, whose veteran leader is a politician of the Bourguiba school, Beji

Caid Essebsi, in the second free general elections since the end of the dictatorship.

Tunisia will most likely be the first Arab country where democracy takes root, not least because of the contribution educated women enjoying equal rights with their menfolk have made to the public debate about the country's future. If Mr Essebsi is elected president in the presidential elections due before the end of the year, Tunisia will deserve all the financial and political support the west can muster. Will Europe in particular, for once, put its money where its mouth is?

**Francis Ghilès**  
Senior Research Fellow, CIDOB,  
Barcelona, Spain

## Native American people bore the greatest burden

Sir, Niccolò Caldararo (Letters, November 13) lists the timeline of the period of the American Revolution from 1776-1789. In fact, the period of political upheaval was from 1765-1783, while the shooting war itself – the American War of Independence – lasted from 1775 until 1783, ending with the signing of the Treaty of Paris.

I have often heard the war referred to as the First American Civil War because of the sectarian, racial and political struggles taking place during this period. One-third of the populace could be described as “patriots” opposed to parliamentary interests and controls; one-third were “loyalists” – supportive of the king's policies; and one-third were not committed either way.

Although the loyalist segment were ultimately driven from their homes and resettled in Upper Canada, it was the Native American population that bore the greatest impact in defeat.

In particular, George Washington commanded that a “scorched earth” policy be used to break the power of the largely pro-British Iroquois Confederacy. John Sullivan's campaign of 1779 devastated the Iroquois heartland, destroying dozens of villages, burning cornfields, and inducing a wintertime famine that led to thousands of deaths by disease and hunger. However cruel the guerrilla war fought between fellow American neighbours, it was far worse and more merciless when directed against the indigenous peoples.

Washington became known among the “people of the longhouse” (Iroquois) as “burner of towns”.

**Ted Gaffney**  
Waterford, CT, US

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Victor Mallet

[victor.mallet@ft.com](mailto:victor.mallet@ft.com)