The Japanese Experience

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Business Economics Programme

the Japanese Economy

- Rapid growth until 1980s.
- Economic “shocks” of 1980s and 1990s.
- Is this really a “recession”?
- Can policy fix it?
- Can Japan’s economy change?

OECD macroeconomic performance

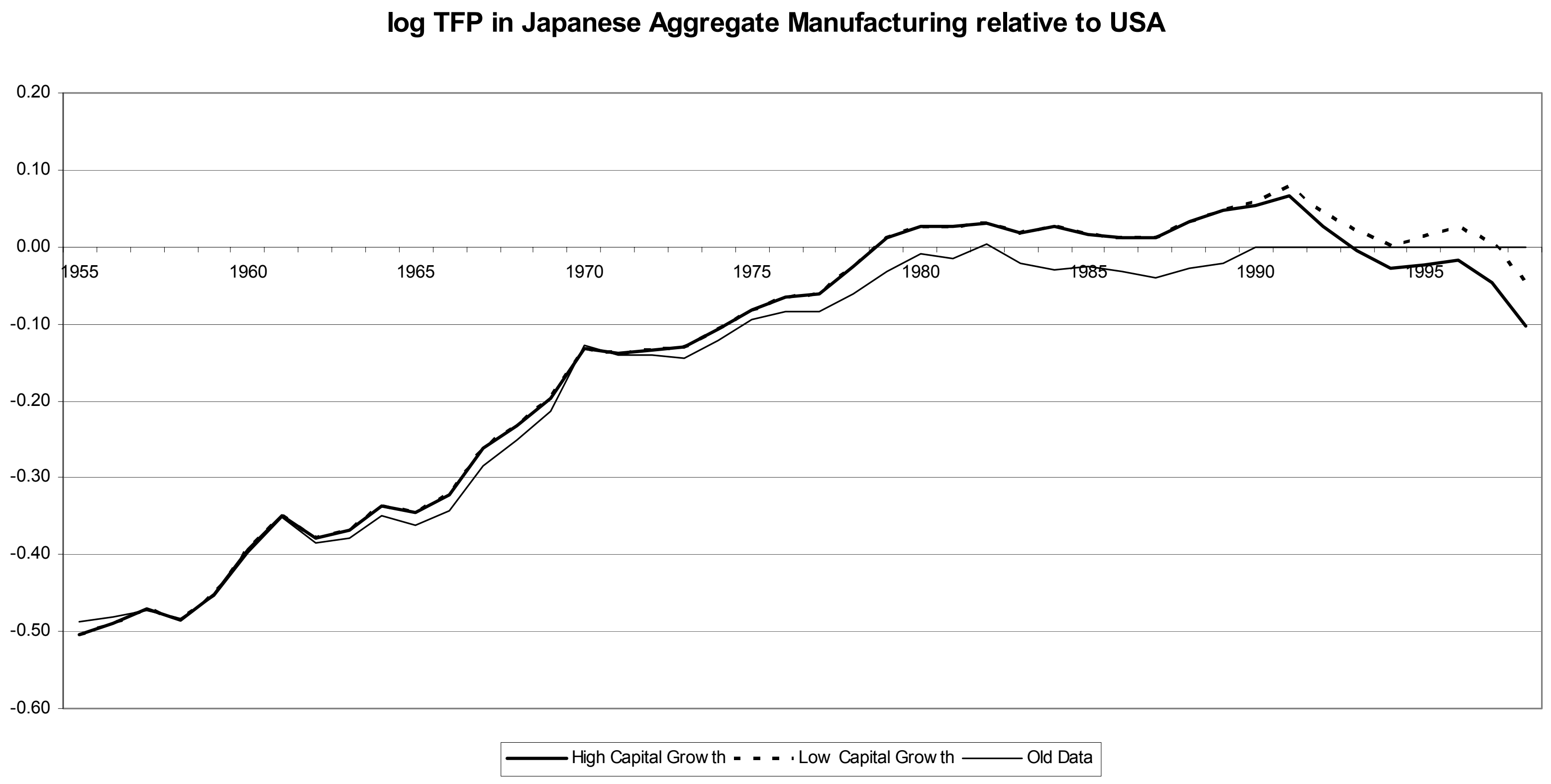
	OECD	EU	USA	JAPAN	GERMANY	FRANCE	ITALY	UK
Output Growth								
1960-1973	4.9	4.7	4.0	9.7	4.3	5.4	5.3	3.1
1973-1979	3.2	2.6	2.9	3.5	2.4	2.7	3.5	1.5
1979-1989	2.9	2.2	2.8	3.8	2.0	2.1	2.4	2.4
1989-1999	2.6	2.0	3.0	1.7	2.2	1.7	1.3	1.9
Unemployment								
1960-1973	2.9	2.6	4.8	1.2	1.0	2.6	5.7	3.3
1973-1979	5.0	4.6	6.7	1.9	3.0	4.4	6.0	4.9
1979-1989	7.3	9.4	7.3	2.5	5.8	8.8	8.2	9.8
1989-1999	7.4	9.9	5.8	3.1	7.5	11.2	10.9	8.3
Inflation								
1960-1973	3.9	4.1	3.1	6.1	3.4	4.9	4.9	4.8
1973-1979	8.8	9.6	7.8	9.5	4.6	11.1	16.7	15.6
1979-1989	5.4	6.6	5.3	2.5	2.8	7.5	11.4	7.0
1989-1999	2.7	3.4	2.4	1.0	2.4	2.1	4.6	3.8

Source: ***Economics of the OECD 2000 exam paper data tables 1, 4 and 5.***

what happened to economic growth?

- Growth fell in two "steps": 1973 and 1991.
- Since 1997 longest post-war recession: 6 quarters of negative growth.
- Now growing slower than other OECD.
- A large part of the decline is from productivity performance.

long-run Japanese performance



Japanese industrial performance

Table 1

Relative TFP Level of Japanese Industry (US=100)

	1955	1973	1980	1989	1998
Total	**60.5**	**87.8**	**102.6**	**104.9**	**90.2**
Food	73.5	84.4	82.1	75.9	68.3
Textiles	57.2	69.4	69.6	56.4	44.7
Paper	65.0	95.4	103.4	118.7	102.7
Chemicals	76.3	89.5	119.6	134.7	125.5
Minerals	42.2	70.8	78.1	79.3	68.8
Primary Metals	57.0	98.5	123.8	123.5	109.7
Metal Products	39.3	75.7	74.0	81.9	75.9
Machinery	40.6	86.1	107.9	91.2	n/a
Electricals	50.5	100.0	125.5	132.3	n/a
Transport	40.3	85.3	98.2	104.3	97.1
Instruments	37.4	80.1	94.3	95.2	95.3

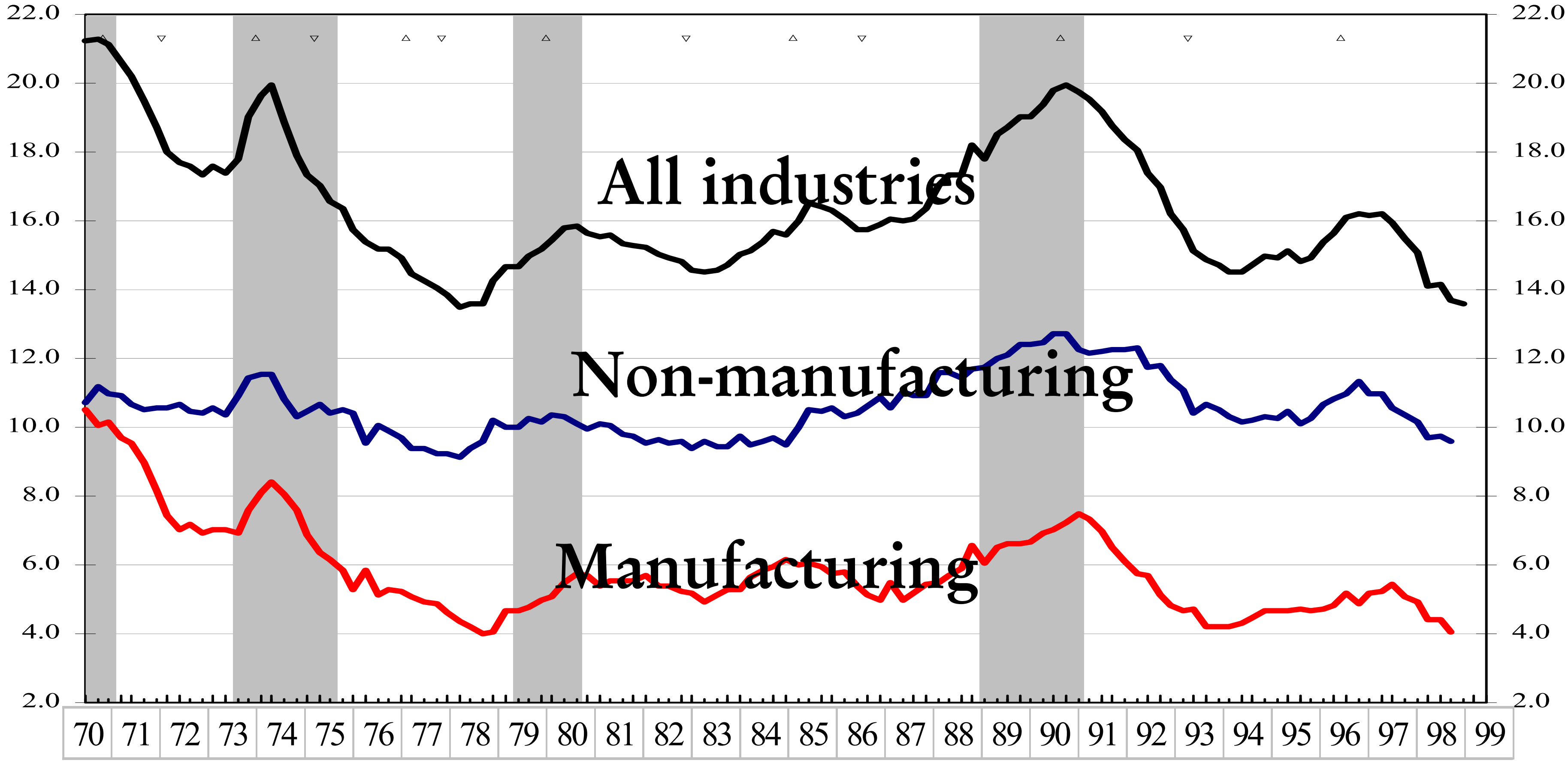
three major interpretations

- Succession of unfavourable shocks
  - Japan’s structure hasn’t changed
- Potential growth has sharply diminished
  - catch-up is over; unfavourable demography; Japan’s model can’t adapt
- Elements of both which interact
  - shocks plus pessimism and uncertainty

1980s economic shocks

- 1985-1989 the “bubble” economy.
  - investment boom (excess capacity?)
  - land and asset prices
  - policy stance - loose money, tight fiscal (low interest rates, capital outflow)
- Persistent trade surpluses; tension with the US.

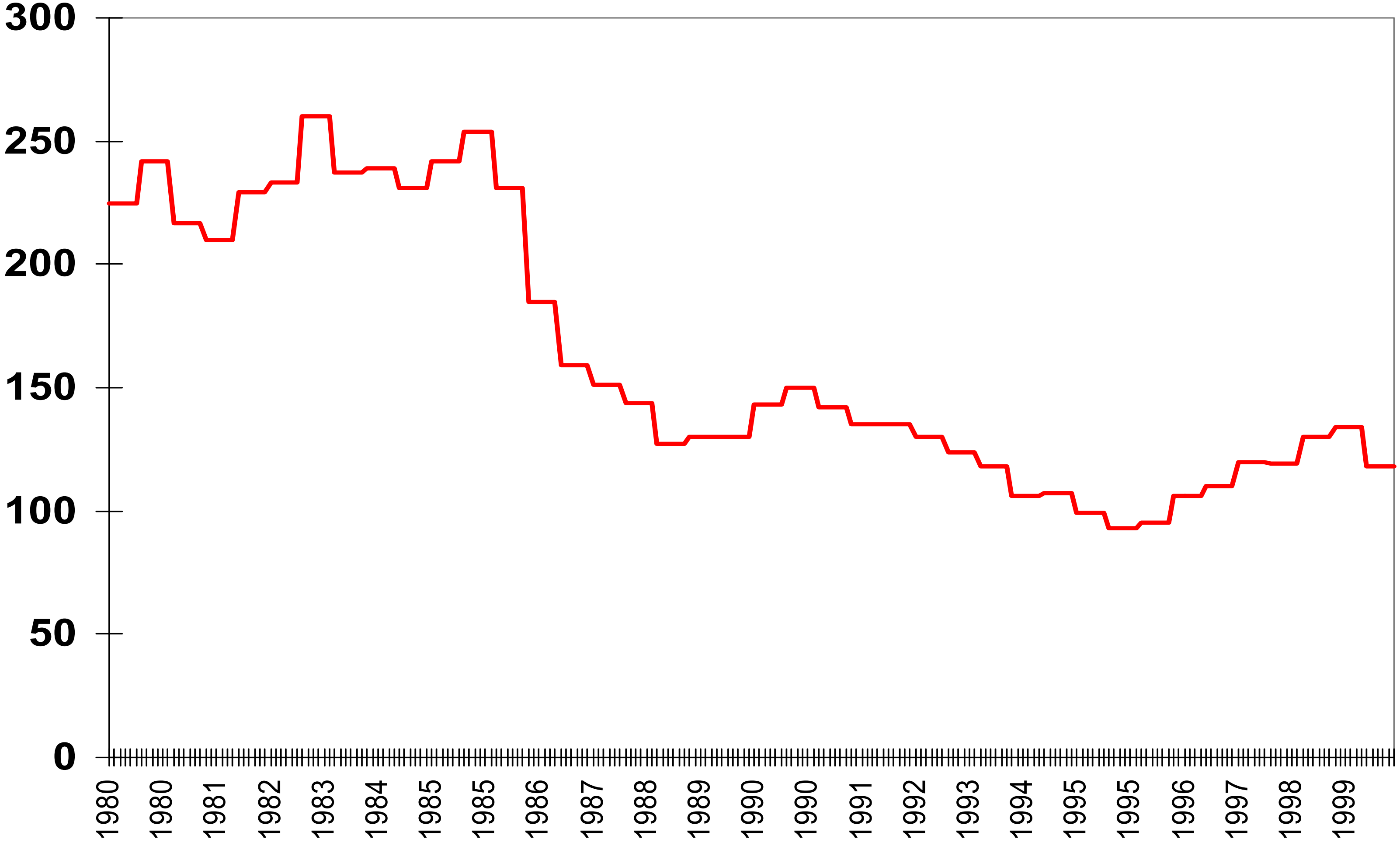
fixed Investment as % share GDP



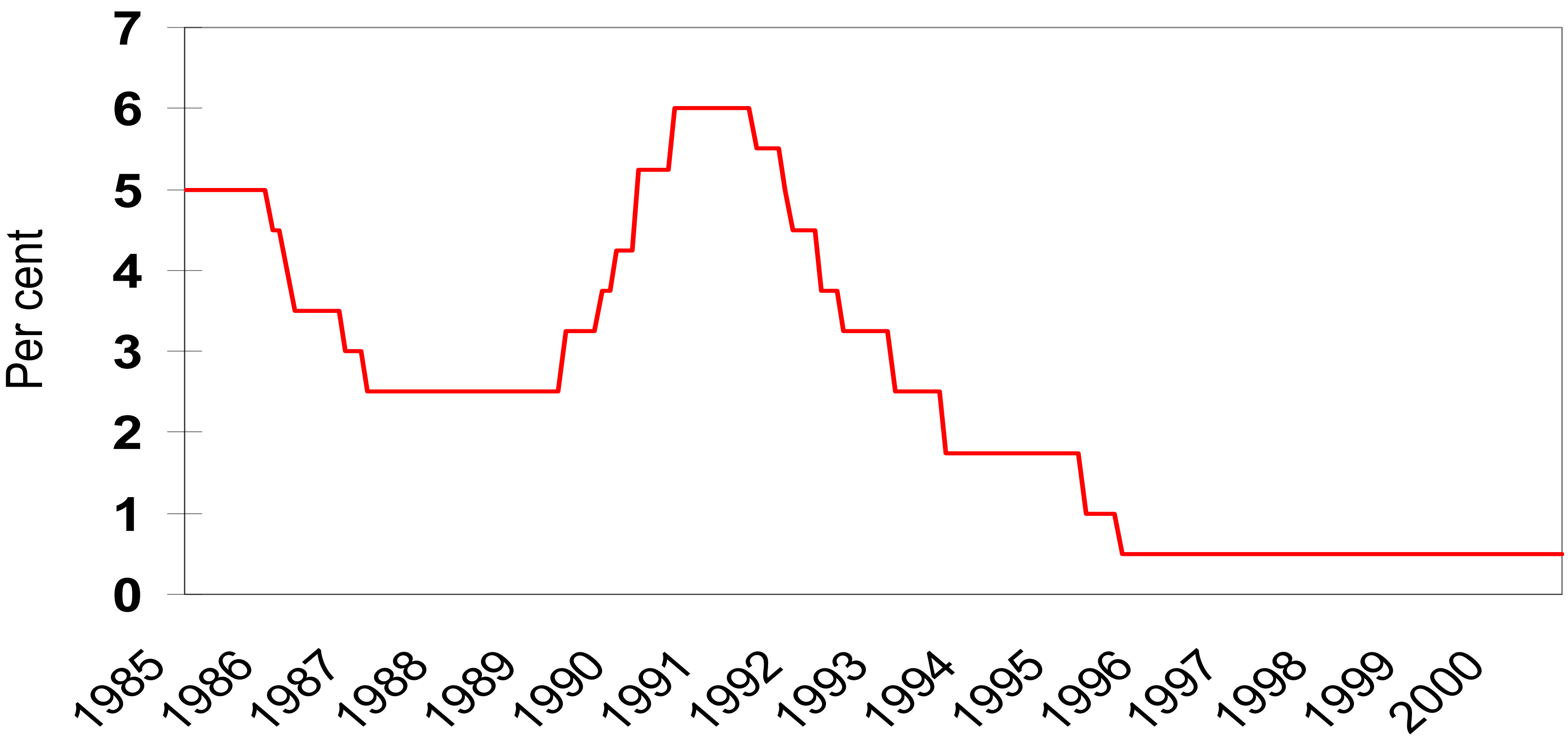
reverse shocks in 1990s

- Yen appreciation from Plaza (1985) to 1996.
- Monetary policy burst the bubble in 1991 - deliberate.
- Massive loss of wealth.
- Policy induced double-dip recession in 1991-95 and 1997-99.

Yen-Dollar Exchange Rate



Japanese Official Discount Rate



more shocks in the 1990s

- Large and rising government deficits and debt.
- Ageing population - pension problems.
- Financial market deregulation and demands for further deregulation.
- Banking “crisis”, bad loans and “credit crunch”.
- Asian crisis of 1997-98.

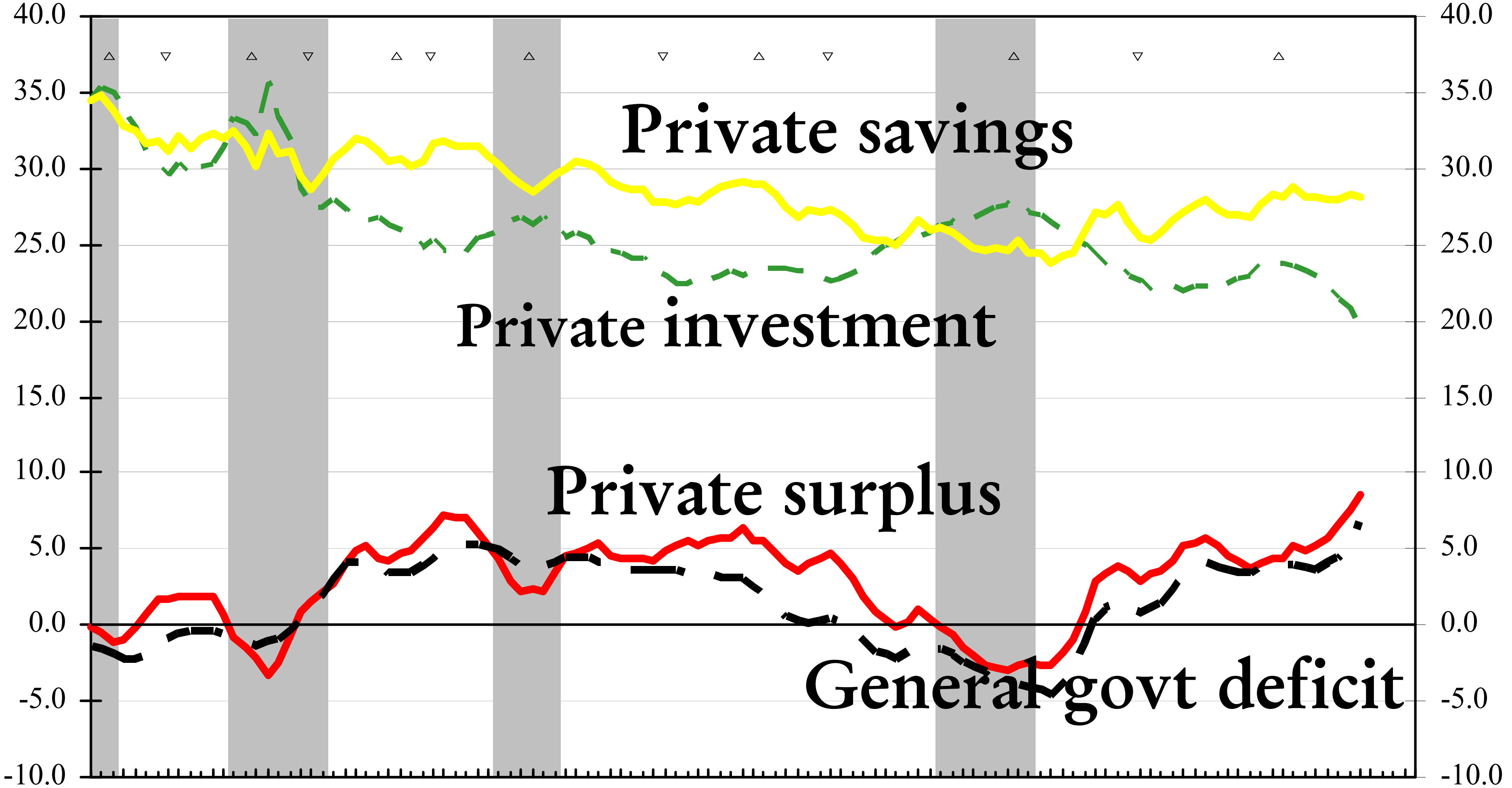
but is this really a recession?

- Where is potential growth, how bad is the recession?
- Neoclassical, “supply-siders”: it’s a natural adjustment.
- OECD and IMF: potential has fallen to 1.5%, output “gap” about 5%.
- Krugman: potential is much higher 3% so “gap” is much bigger.

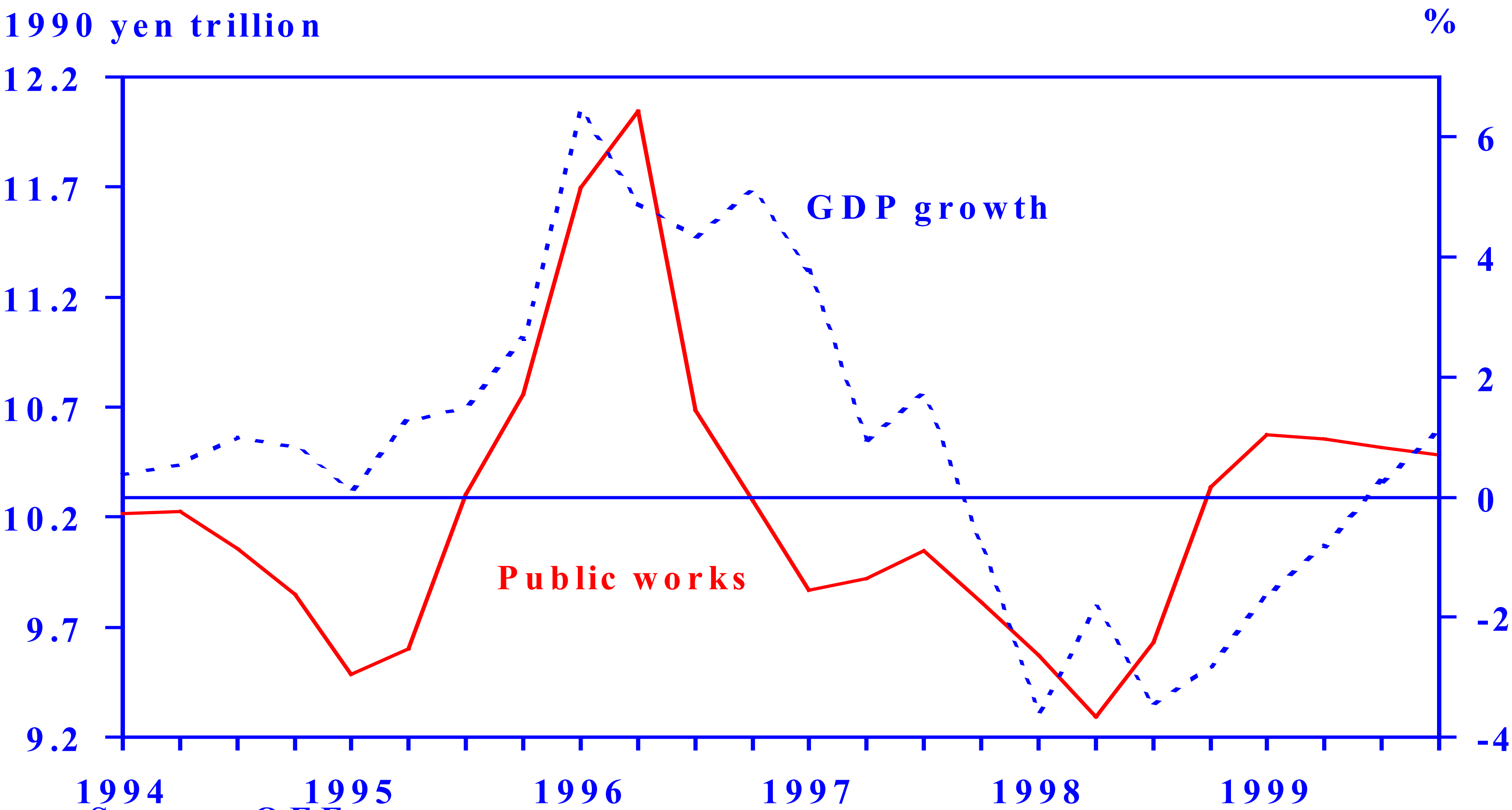
what should be done?

- First decide what the problem is
  - Supply side: an economy with low potential?
  - Or demand side?
- If supply side ...
  - main policy tool is deregulation
  - flexibility, restructuring, corporate governance
  - these are happening...slowly
- If demand side ...
  - Savings rate high, for last 10 years higher than domestic investment
  - Keynesian economy with insufficient demand
  - Macro policy is the conventional remedy
  - Can it work? Ricardian Equivalence and the liquidity trap

Saving-Investment Balance



Public works and GDP growth cycle



Source: OEF

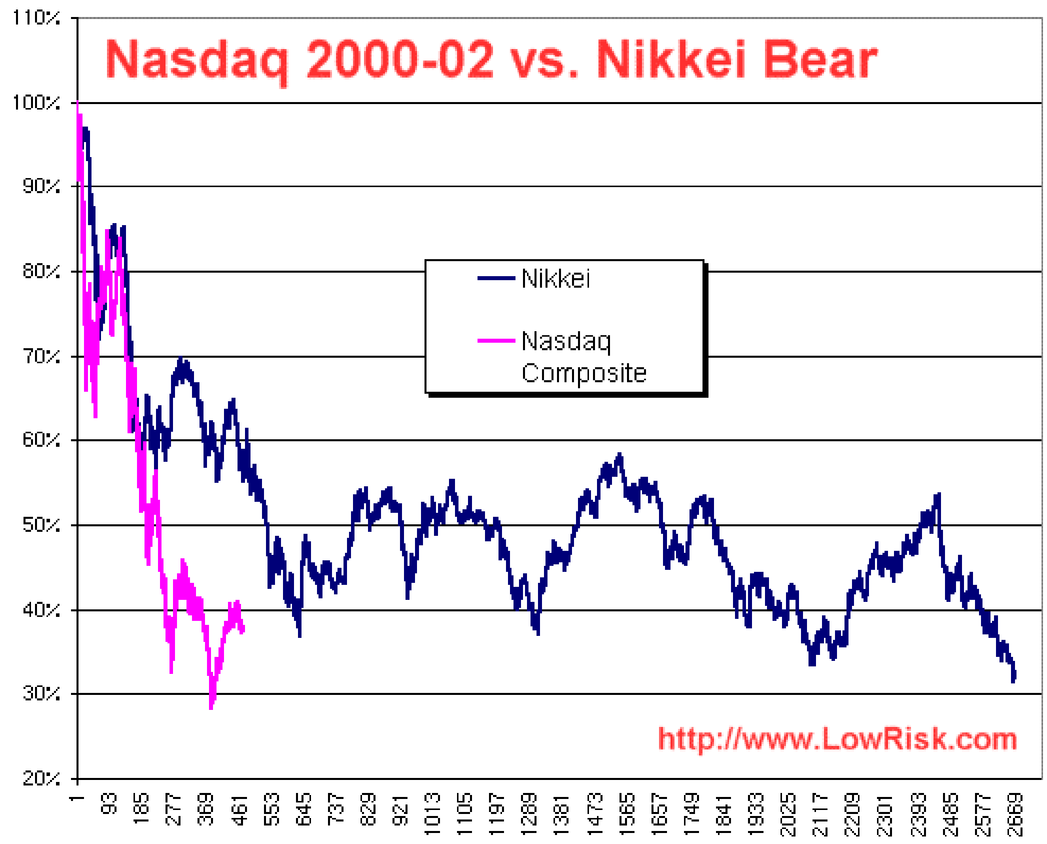
what about Monetary Policy?

- Nominal interest rates close to zero: what more?
- Japan may be in “liquidity trap”
- And worse, real interest rates are still positive
- Crazy suggestions?
  - Krugman wants positive inflation targets
  - McKinnon wants Yen depreciation
  - Bank of Japan has raised interest rates to stimulate (i.e. to make banks lend money they need to be able to make profits on loans).

summary

- The traditional Japanese model had advantages.
- But may have slowed down adjustment.
- Labour system and corporate governance are particularly slow to change.
- This is not a coincidence.
- And lack of dynamism in a major economy has effects:
  - confidence
  - fear of policy impotence
- Could it happen to the US?

what next?



Nasdaq 2000-02 vs. Nikkei Bear
110%
100%
90%
80%
70%
60%
50%
40%
30%
20%
Nikkei
Nasdaq Composite
http://www.LowRisk.com
1
93
185
277
369
461
553
645
737
829
921
1013
1105
1197
1289
1381
1473
1565
1657
1749
1841
1933
2025
2117
2209
2301
2393
2485
2577
2669