
Japan's Comfortable Stagnation

Remarks for National Bank of Poland conference:

“Successes and Failures in Catching Up”

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Background (1)

- Drivers of Japan's success in 1970s, '80s also responsible for stagnation/slow down in '90s and beyond
 - high savings rates
 - “industrial policy”, managed by central bureaucracies: “known” industries, products, technologies, production functions
 - export-led growth, competition in international markets to assure quality
 - massive lending by favored (5-6) banks to favored borrowers: in '80s, 6 of world's 10 largest banks (by assets) were Japanese!
 - “dual economy”, disfavored SMEs
 - focus on scale and market-share, rather than innovation and profitability
- Mercantilist legacy, export emphasis
 - but high domestic investment demand limited ($S > I$) gap

Background (2)

- Stagnation in '90s characterized by:
 - rapidly changing sectoral/industrial demands
 - new technologies, new and shifting production functions, IT, and “services” versus “goods”
 - growing ($S > I$) gap, investment abroad more profitable than at home, anemic domestic demand, sustained mercantilism
 - Japan and U.S. have similar export exposures (10.5%, 10.3%), but domestic demand in U.S. much stronger
 - decreased TFP



Background (3) (cont'd)

- **Other characteristics of post-bubble economy**
 - NPLs and banks near insolvency
 - huge bank “assets” of 1980s are NPLs of ‘90s and ‘00s!
 - some recent improvement: public funds, monetary policy, sale of some assets
 - but, Japan has “overbanked” capital market, while other parts of capital market underdeveloped (see below)
 - public debt 140% of GDP, large additional unfunded gov’t liabilities
 - continued burden of regulatory bureaucracy

Foreground (1)

- **Nevertheless, Japan is not in crisis:**
 - some recent improvement in banks' balance sheets (see previous chart)
 - some increase in profits' share of GNI, and rise in domestic investment
- **Among world's highest GNI/P**
 - male and female longevity 5-years above that of U.S.!
- **Highest CA surpluses, FX reserves**
- **Second highest foreign aid, substantial Afghan reconstruction funding, support for OIF**
- **Cities, health, safety, law and order exceed U.S. standards (despite Yakuza and some recent setbacks)**

Foreground (2) (cont'd)

- Improved recent performance: annualized 3rd q't'r growth 3.9%!
 - significantly based on domestic demand, C and I
 - CA surplus flat, or diminished
 - so, neo-mercantilist dependence reduced
 - but 3.9%/yr not sustainable, 2%/yr optimistic forecast
 - reasons: uncertainty concerning banks “best” practices, enforcement of corp. governance, continued excessive reliance on credit part of capital market, demographics



Foreground (3) (cont'd)

- **Japan's economy exemplifies “high-level equilibrium trap” (HLET):**
 - capital deepening, but technological progress can at least sustain slow GDP growth
 - continued, selective international competitiveness
 - declining, as well as aging population
 - so, zero growth = rising GDP/P

Outlook and Prognosis (1)

- Without sustained structural reform, 1-2%/yr growth is optimistic forecast
 - politics, Koizumi, LDP, DP, etc.
- Needed reforms include:
 - B of J permissive, anti-deflationary monetary policy (“inflation targeting”)
 - further cleansing of banks’ balance sheets, some borrowers’ bankruptcies

Outlook and Prognosis (2)

- **Needed reforms (cont'd)**
 - development of non-bank segments of capital market: equities market, VC industry, start-ups, IPOs, entrepreneurship, innovation
 - households' resistance: reasons and how to mitigate (comparison with U.S.)
 - improved corporate governance
 - deregulation
 - erosion of mercantilist legacy, economic opening to both domestic and foreign entrepreneurship
- **Political resistance perhaps more likely to be overcome by external shocks (e.g., China, North Korea) than internal pressures?**

