



JAPAN'S ECONOMIC PERFORMANCE: Relevance for the United States

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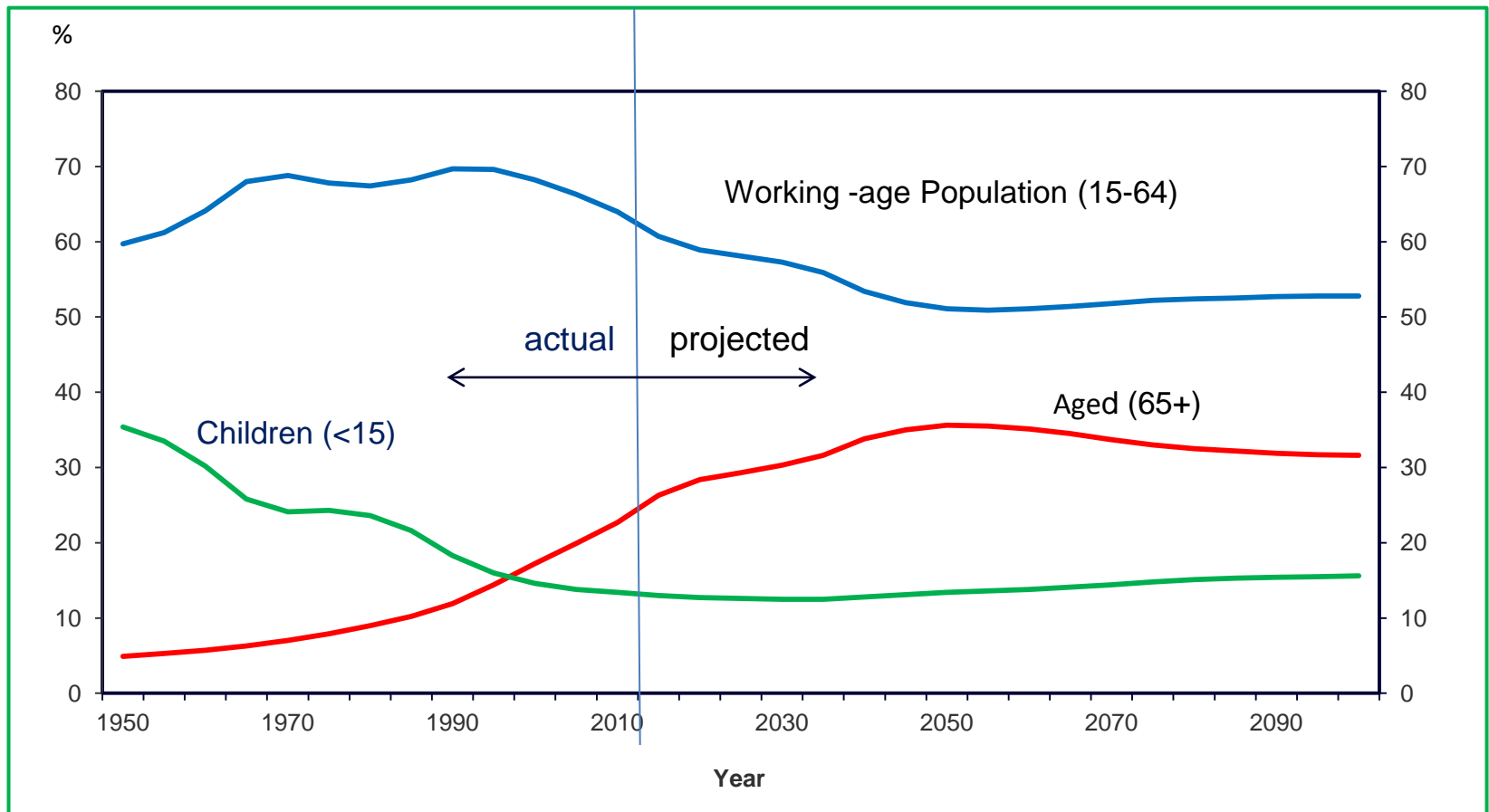
U.S. – Japan Comparison

- Since the financial crisis, the US economic situation has taken on many of the characteristics of Japan.
 - Monetary policy tool is exhausted
 - Short-term interest rate at lower bound
 - Quantitative easing largely ineffectual
 - Huge fiscal stimulus (deficits) cannot be sustained
 - Dysfunctional political system
- Are U.S.–Japan headed for stagnation?

Japan Faces Major Challenges

- Working-age population will fall by 20% between 2000 and 2030
- Increased pension and health care cost of aging population
- Large budget deficits
 - Budget deficit 10% of GDP in 2012
 - Net debt of 135% of GDP
- Added burden of the earthquake and tsunami – nuclear power shortages

Age Distribution of Japanese Population



Japan has addressed many of these problems

- Scaled back pension program in a series of reforms over past decade
 - Offsets most of future demographic trend
 - Large proportion of Japanese work past retirement age
- Health care costs remain low relative to GDP
 - 8% versus 15% in United States
 - Strong price controls
- Budget deficit cut to 2% of GDP prior to financial crisis, but back up in recent years

Fundamental Problem is the Economy

- After its 1990 crisis, Japan's GDP growth slowed from 5% to 1% p.a.—two lost decades.
- If growth does not improve, the burden of an aging society will be substantial
- Why has growth been so low?
- Will growth be low in the future?
- Growth is key to solving fiscal problems.

Japan's Growth Slowdown: The Supply Side

- Slower GDP growth after 1990 reflects widespread slowdown in capital and labor inputs
 - Labor force and hours worked fell substantially
 - Reduced capital accumulation
 - Slower multi-factor productivity growth
 - Extends over two decades
- Future Growth in GDP $\approx 1.5\%$
 - Labor productivity 2% (similar to United States)
 - Labor force -0.5%

Sources of Growth

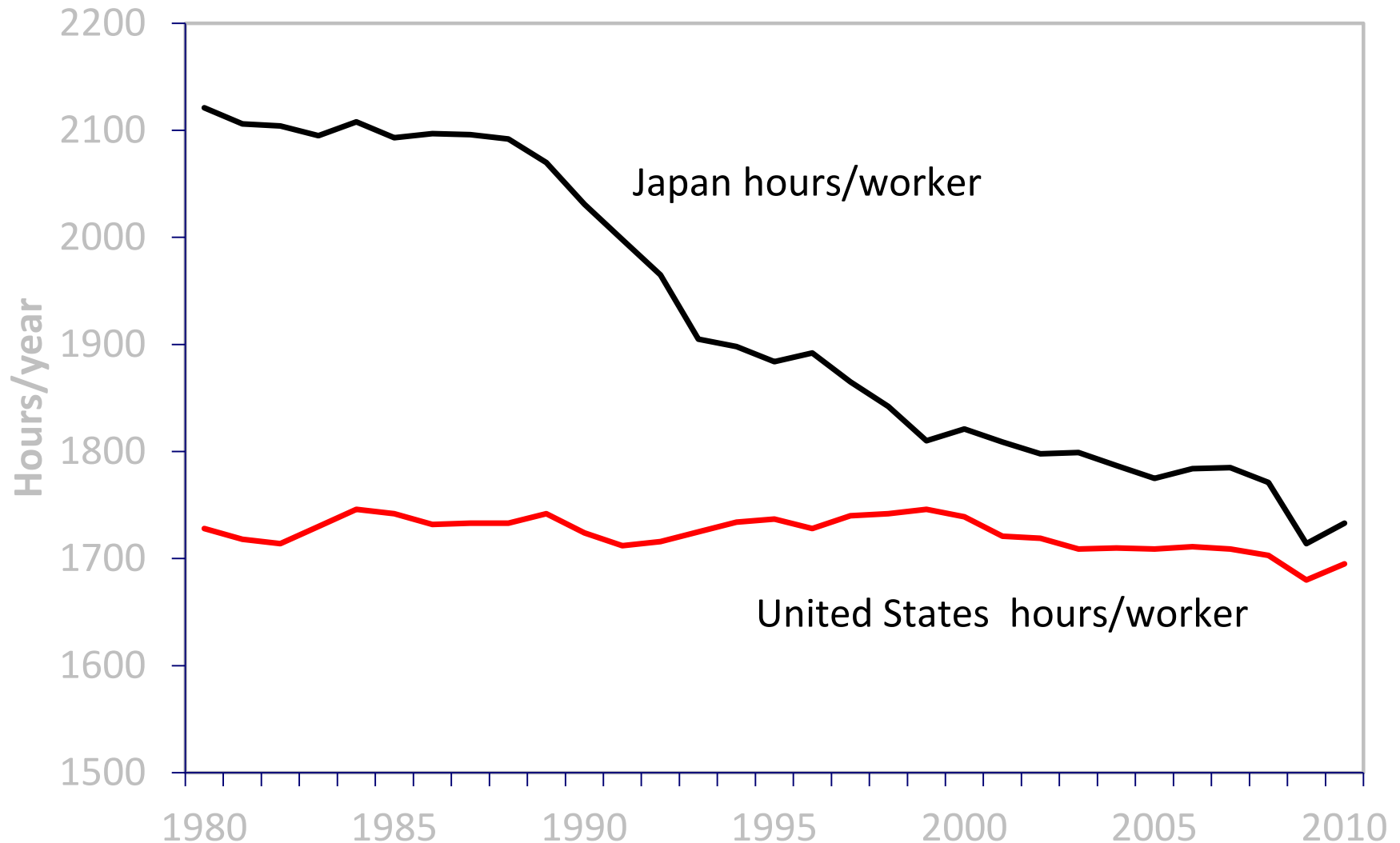
Japan and the US

	Japan				United States	
Annual percent change						
	1980-90	1990-2000	2000-08		1990-2000	2000-08
GDP Growth	4.9	0.7	1.2		3.9	2.2
Contribution of:						
Labor Hours	0.4	-0.8	-0.7		1.2	-0.2
Capital	1.9	1.0	0.5		1.4	1.0
Multi-factor Productivity	2.7	0.5	1.5		1.3	1.4

Adjusting to Slower Growth

- Slower growth offset by shorter workweek.
 - Avoided large increases in unemployment.
 - Workweek now comparable to the United States.
- Japanese income inequality has increased significantly since 1990, but it is still below the United States.

Japan and US hours/worker, 1980-2010



Japan's Growth Slowdown: The Demand-Side

- Major collapse of domestic investment
 - Net investment (adjusted for depreciation) is negative.
 - Sharp declines in household and government saving.
 - corporate saving exceeds corporate investment
- Japan has shifted from high-saving, high-investment (pre-1990) to low-saving low-investment.

Japan Saving-Investment

	1980-89	1990-99	2000-09	2010-11
% of national income				
Saving	16.6	13.2	5.9	1.3
Corporate	3.6	2.7	9.0	10.0
Household	10.9	8.9	2.0	1.7
Government	2.1	1.6	-5.0	-10.4
Investment	14.1	10.8	2.5	-2.1
Current account	2.5	2.8	3.9	3.5
Statistical discrepancy	0.0	0.6	0.6	0.1

Wealth Losses

- Asset price bubbles in equities and housing during late 1980s.
- Nikkei index fell to half of its 1989 peak by 1995.
 - Currently, about $1/3^{\text{rd}}$ of 1989 value.
- Housing prices have fallen to 60% of 1991 peak value.

Japan - Competitiveness

- Historical strength has been in manufacturing exports
 - Export industries have had highest rate of productivity growth
 - Rapid innovation
- Domestic manufacturing and service industries lagged behind
- In 1990s,
 - Manufacturing productivity slowed
 - Service sector productivity accelerated

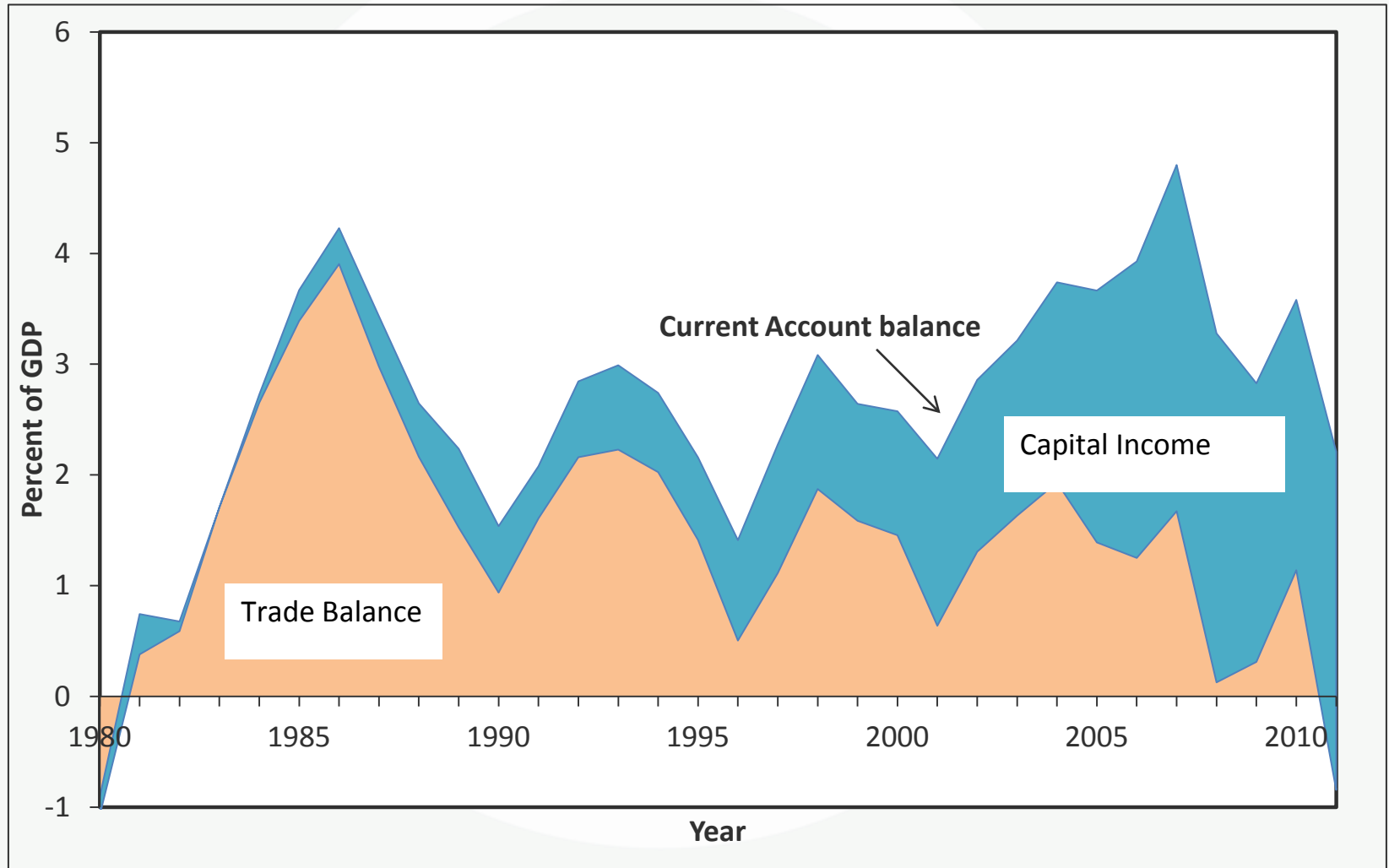
Japan - Competitiveness

- Japan faces increased international competition in manufacturing
 - China and Korea
 - Improvements in information technologies make it easier to outsource production
- Declining labor force in Japan
 - Without immigration, capital and technology will move to areas of available labor
 - Japanese firms will continue to be global leaders, but they will produce abroad.

Future Strengths

- Japan (3.3%) is third behind Finland (4%) and Sweden (3.6%) and above the U.S. (2.9%) in share of GDP devoted to R&D.
- Japanese education system ranks high in international tests on science and math.
- Japan is world's largest creditor nation.
 - \$3 trillion net investment position
 - Compare to -\$2.5 trillion (debt) for United States.
 - Large net earnings on foreign investments.

Japan's External Balance



Changing Trade Structure

- Shift away from Europe and North America toward Asia.
 - Asia trade is in intermediate goods that are ultimately embodied in exports to the United States and Europe.
 - Shift of assembly work to China
- Negative effects from Japan-China political disputes.

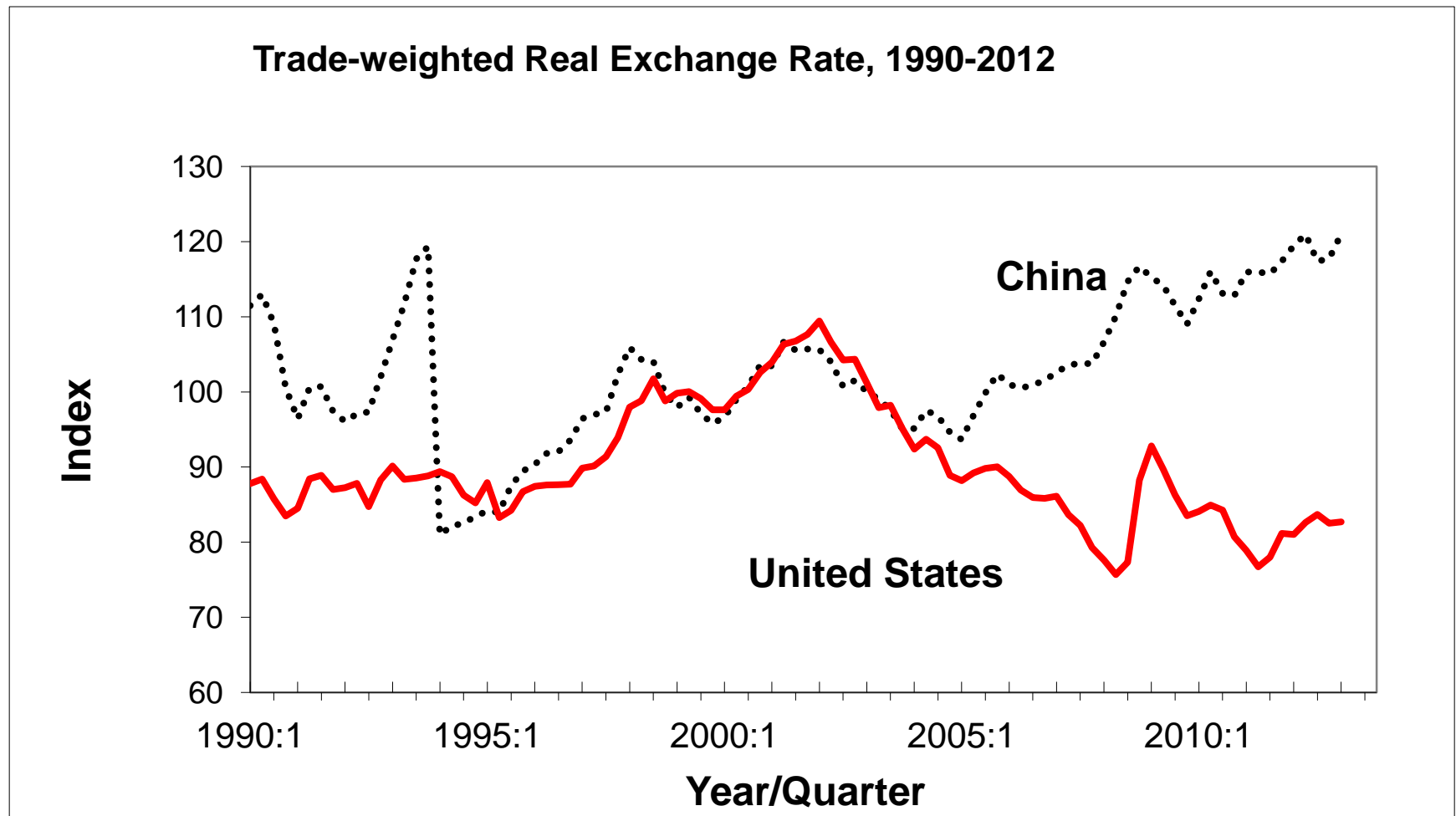
Hollowing Out

- Alternative definitions
 - Decline in industry share of GDP
 - Evident in Japan and G-7
 - Decline in industry share of employment
 - Evident in Japan and G-7
 - Loss mid-skill jobs
 - Less evidence
 - Offshoring of jobs
 - Evident in Japan and G-7
- Process is part of normal transition of high income economies out of manufacturing

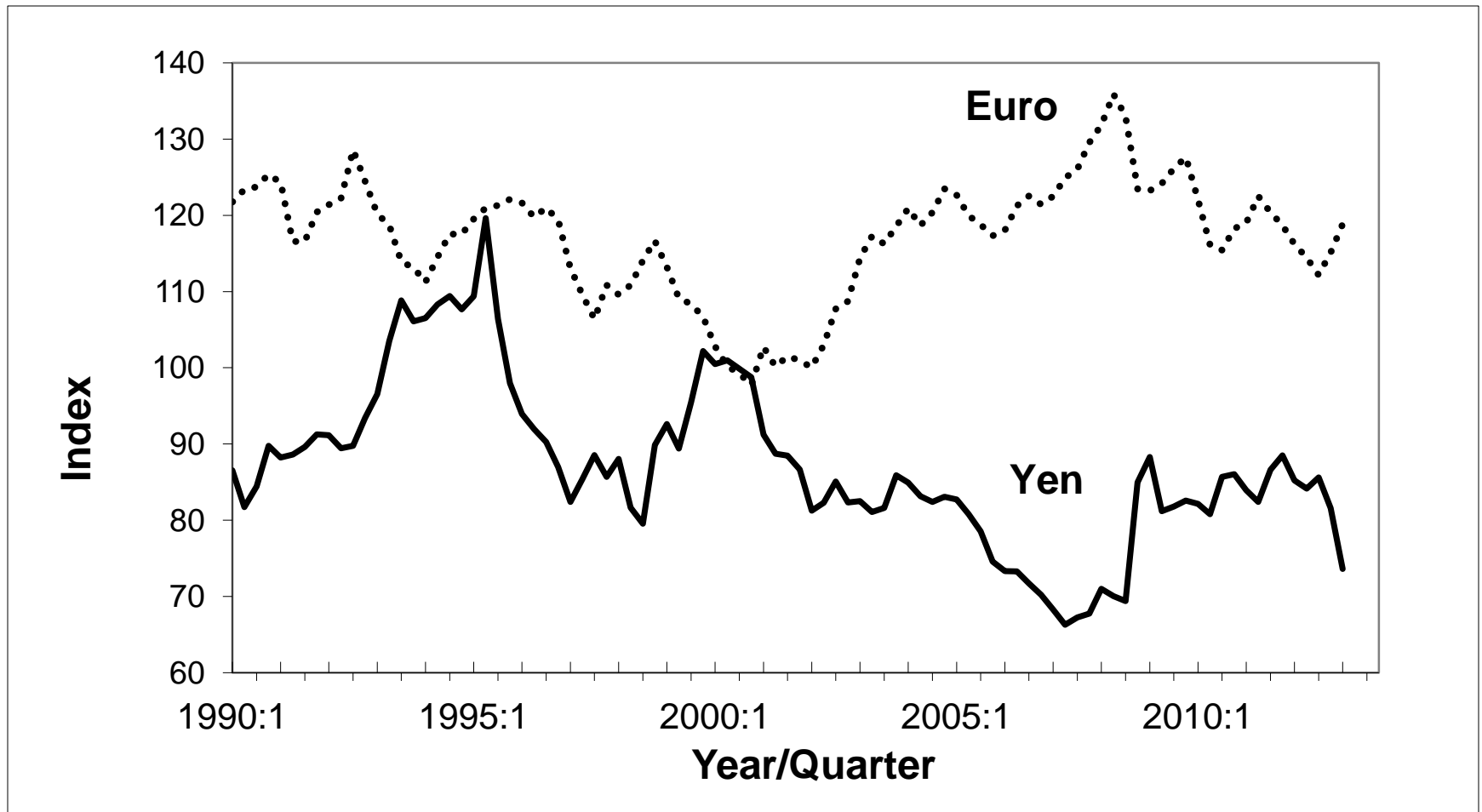
Percent of Total Employment in Manufacturing

Country	1971	2001	2011	1971-2011	2001-2011
United States	24.7	13.5	10.2	-14.5	-3.3
Canada	21.8	15.0	10.2	-11.6	-4.8
France	28.5	17.8	13.4	-15.1	-4.4
Germany	37.4	23.7	20.0	-17.4	-3.7
Italy	28.0	22.4	19.0	-9.0	-3.4
United Kingdom	33.9	14.2	9.8	-24.1	-4.4
Japan	27.4	20.2	16.8	-10.6	-3.4
G-7	27.5	16.7	13.1	-14.4	-3.6

Trade-weighted Real Exchange Rate, 1990-2012



Trade-weighted Real Exchange Rate, 1990-2012



Abe Economics

- Fiscal Stimulus
 - \$110 billion
 - Mostly infrastructure
 - Raise GDP by $\approx 2\text{-}2\frac{1}{2}\%$.
- Monetary Policy
 - Another round of quantitative easing
 - Raise inflation target to 2%
- Strong feeling of déjà vu
 - Repeating measures of past 20 years
 - Fiscal measures not sustainable, and
 - Fluctuate between stimulus and restraint.
 - Economic growth versus budget balance
 - Same conflict in the United States

Abe Economics (2)

- Policy measures do not address long-term structural problems in Japan's economy.
 - Still a dual economy with very efficient tradable goods sector and inefficient nontradables.
 - Needs regulatory reforms that have been blocked for years.
 - Large surplus of corporate saving over investment
- Export promotion is not a viable policy for Japan
 - Weak global economy
 - Japan already has a large current account surplus.
 - Real exchange rate is near historical low.
 - Borders on beggar-thy-neighbor policy.