How did the Japanese economy really adjust?
Lessons for Europe

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“Is the world following Japan’s long and winding road?” (M. Shirakawa, 2012)
Issues at stake for Europe (and the US)

1. Growth: economic stagnation as during Japanese lost decade?

2. After the collapse of bubbles: how to deal with (sovereign, corporate, households, international) debts? Which underlying mechanisms (deleveraging)? (See for example Reinhart & Rogoff, 2009)

3. Which economic policy?
   - Any degree of liberty on the side of monetary policy?
   - Is fiscal consolidation the only horizon?
Balance-sheet recessions: toward a new consensus regarding the understanding of the aftermath of financial crises?

- After a financial crisis (such as the one that Japan experienced in the early 1990s and the world around 2007-2008), drop of asset prices and deceleration of growth may lead to a special type of recession: balance-sheet recession.

- Economic agents engage in balance sheet consolidation: reduction of debt ratios (deleveraging) and accumulation of liquidity.

- This is done through increased saving and reduced spending → lower demand.

- In this context, monetary policy become impotent (as agents accumulate liquidity and are not ready to borrow) and fiscal policy is problematic (as governments may “be forced” to engage in fiscal consolidation).

- It may lead to a vicious circle marked by long lasting stagnation.
Japan: a textbook case? (Koo, 2011)

- Collapse of the Bubbles
- Deleveraging by economic agents
- Negative impact on investment, consumption, and therefore on demand
- (Surplus of current account)
- Helplessness of monetary policy (liquidity trap) but positive role of government’s spending that has mitigated the negative consequences of declining investment
- Lasting economic stagnation and (mild) deflation
Japan in balance-sheet recession (Koo, 2011, fig 5)

**Fig. 1:** Financial asset and liability flows at nonfinancial companies in Japan

(Note: (1) Adjusted for impact of taking on liabilities related to the JNR Settlement Corporation and the National Forest Service (FY98), privatization of the Japan Highway Public Corporation (FY02), and postal service privatization (FY07). (2) The FY11 figure is the four-quarter moving average through Q3-Dec 2011. Source: BOJ’s Flow of Funds, and Cabinet Office’s National Account Statistics.)
Eurozone in balance sheet recession (Koo, 2011, fig 14)
Today’s presentation: what did really happen in Japan? Which lessons for Europe? A view from industrial and labor economics

- Focus on the corporate sector and more particularly the non-financial firms

- Taking seriously:
  1. The impact of the financial system on the nature of the financial constraints faced by firms
  2. The investment issue
  3. The employment system and its evolution (income channel)
  4. The evolution of wage/profit and rising inequalities
  5. Firms’ heterogeneity (importance of micro data)
A methodological note

- More technically, it means rephrasing the question: Which adjustments at the corporate level under financial constraints?
- Research program with N. Canry (U. Paris 1), H. Teruyama (Kyoto U.), H. Mizobata (Kyoto U.):
  1. Model of joint labor and capital adjustment (Yashiv, 2011) with financial constraints
  2. Micro level dataset
  3. Deleveraging interpreted as a form of financial constraints, itself determined by the financial environment defined by the characteristics of the financial institutions (Bond et al., 2003) and economic policy variables
Today’s presentation: what did really happen in Japan? Which lessons for Europe? A view from industrial and labor economics

- While focusing on the corporate sector (capital and labor), we have to keep in mind:
  1. The nature and the size of the initial shock: burst of bubble and side consequences (e.g. Ueda, 2012)
  2. The background of rising public debt
  3. Households’ saving and consumption
  4. The international background (current account surplus)
  5. Price dynamics (deflation)
Today’s presentation: what did really happen in Japan? Which lessons for Europe? A view from industrial and labor economics

- Do not overlook the following facts:
  1. (Gradual) Changes on the institutional environment (= as a result of structural reform = liberalization): a great transformation of Japanese capitalism (Lechevalier, 2014; research project with T. Hoshi, H. Miyajima, and M. Sako)
  2. Decomposition of the balance-sheet recession – the lost decade (1992-2005) into two sub-periods

  **The end of 1990s is a turning point** from the viewpoint of the severity of the crisis (Hamada & al., 2010), Wage flexibility (Kuroda & Yamamoto, 2014), deflation (Yoshikawa, 2013), the increasing heterogeneity of firms (Ito & Lechevalier, 2009), liberalization (Lechevalier, 2014), etc.
Increasing diversity of Japanese firms

● 2 stylized facts:
  1. Increasing performance dispersion (Ito & Lechevalier, 2009: see appendix)
  2. Corporate diversity (in terms of organization, corporate governance, employment practices) and institutional change (Aoki et al., 2007)

● Why does it matter?
  1. Impact on investment (Ito & Lechevalier, 2010)
  2. Sluggish adjustment at the macro level but substantial differences across firms (Lechevalier et al., 2013)
  3. More generally, source of micro/macro paradox
Investment and growth

- The lost decade as a demand-led slump and private investment as its main driver (Yoshikawa, 2002)
- Lasting adjustment to the over-accumulation of capital
- Financial constraints and deleveraging
- Debt and Corporate restructuring (Hoshi et al., 2010)
Labor market adjustments

- Labor adjustment in Japan in historical perspective: internal flexibility (R. Dore). The apparent adjustment is therefore low by comparison to the US for example (Hashimoto, 1993)
- The case of the post-bubble: these practices have play a role in the 1990s until the turning point of the late 1990s
- Sign of a turning point: End of downward nominal wage rigidity; wage flexibility as the primary source of deflation (Kuroda & Yamamoto, 2014). From income effect to deflation (Canry et al., 2011)
At macro level, price ran parallel with nominal wage, suggesting that nominal wage cuts is the reason for deflation in Japan.
To summarize...

- The cost of the adjustment has been paid by the firms in a first step in a context of sluggish labor adjustment...

- The situation has been durably reversed from the late 1990s at the expense of employees

- See the following figures
Personnel cost, dividends, cash & liquid financial assets and operating profit of all industries in Japan (% change, 3-year moving average)

Companies enjoyed better financial health from the 2000s

Capital adequacy ratio (%) * by capitalized amount group (yen), all industries

*Capital adequacy ratio (%) in this case was calculated as follows: 
\[
\frac{(\text{shareholders' equity} - \text{stock warrant})}{\text{total assets}} \times 100
\]

This is not the case for employees...

Real wage, year-on-year growth (%)*

* Establishments with 5 employees or more

Lessons for Europe?

- Preliminary remark: despite general similar patterns, varieties of experiences in Europe
- Example: labor markets adjustments (Bakker & Zeng, 2013) – Ireland, Spain vs. Germany, Poland
- More generally, differences in:
  1. The initial conditions – the “structure” which will affect the mode of adjustment (e.g. labor markets) and the nature of financial constraint
  2. The nature and the size of the initial shock
  3. The political environment that may conditions the pace and the direction of change (through reforms)
Comparison Japan-Europe

- Overall, which European country’s trajectory does seem the most similar to the Japanese one? **A composite picture:**
  1. From the viewpoint of the “structure”: **Germany**
  2. From the viewpoint of the nature and the relative size of the shock, **Spain** may be considered as more similar.
  3. From the viewpoint of the political environment (and the process of reform), **Italy** is relatively close.
Final remark: What does Abenomics change?

- Allows introducing a discussion on the ceiling of public debt and the rhythm of fiscal consolidation
- More volatility
- Nothing regarding wages and labor situation, which is nonetheless the most problematic at this stage
References

References

- Hoshi T., S. Koibuchi & U. Schaede (2010), Corporate restructuring in Japan during the Lost Decade in Hamada et al. (2010)
- Koo Richard C. (2011), The world in balance sheet recession: causes, cure and politics, Real-world economics review, issue no.58
References

- Shirakawa M. (2012), Deleveraging and Growth: is the developed world following Japan’s long and winding road, Lecture at the London School of Economics and Political Science
Thank you for your attention

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Appendix: The issue of debt

- Decomposition
- International comparison
- Debt, deleveraging and the nature of financial constraints for firms
Appendix: Private savings surplus or deficit (source: McKinsey)
Appendix : General government fiscal balances

(Note) Japan and the United States: General government financial balances excluding social security

<table>
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<th>Year</th>
<th>Japan</th>
<th>France</th>
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(Note 1) FY2010 budget is not reflected in the above data.
(Note 2) Figures for Japan are adjusted to exclude special factors.
(Source) OECD "Economic Outlook 86" (December, 2009)
Appendix: Evolution of the labor productivity dispersion in the manufacturing sector (Ito & Lechevalier, 2009; BSBSA, 10,000 firms)
Increase of non-regular (part-time) worker pushed nominal wage downward.

Regular (full-time) worker’s wage also dropped since 98.
Appendix: Labor market adjustments – diversity and inequalities

- **Increasing corporate diversity and labor adjustment**: Lechevalier et al. (2013) shows a slower adjustment (speed of downsizing: from 0.245 in the 1990s to 0.22 in the 2000s) but increasing dispersion of individual speeds (SD from 0.354 to 0.386 for a panel of 410 listed manuf. firms)

- **Rising wage inequalities**: to be connected to increasing firms’ heterogeneity (Kalantzis et al., 2012); a peculiar form of labor market segmentation, which is superposed to intra firm dualism (e.g. regular vs. non regular workers)
Appendix: Implications for Europe

- Current situation in Europe: Negative domestic credit growth, Shrinking household income, **Corporations holding onto their cash**

![Graph showing nonfinancial corporations' holdings of cash as a percentage of each country's gross domestic product.](image)

**Sock It Away**
Nonfinancial corporations’ holdings of cash as a percentage of each country’s gross domestic product

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Sources: Bank of England; European Central Bank; Eurostat; U.S. Commerce Department; U.K. Office for National Statistics

*The Wall Street Journal*