



**Retrenchment or Stagnation: Lessons  
from Japan's 'Lost Decades'.**

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## **Slide 1. The Conventional Wisdom.**

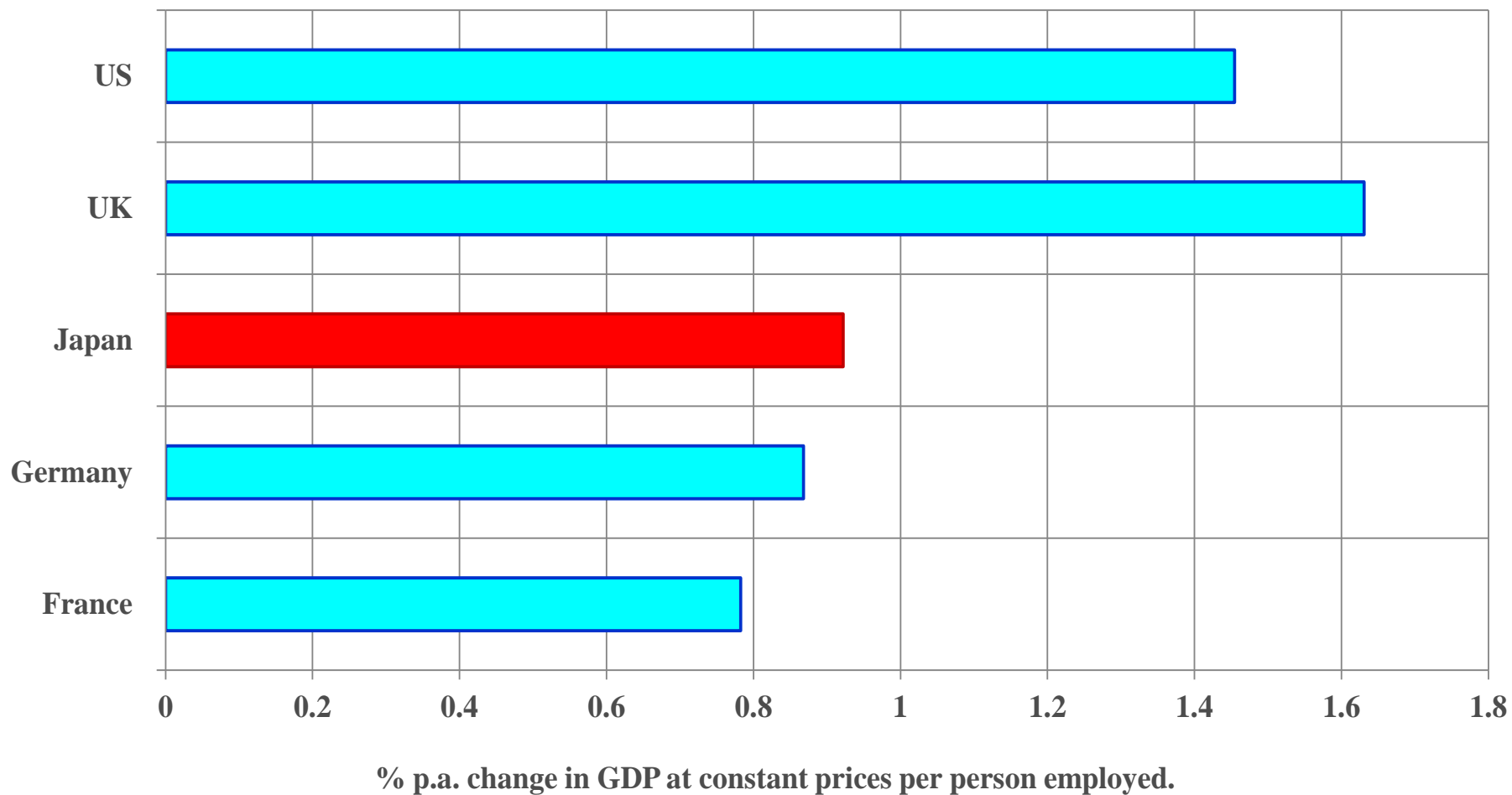
- **Japan has suffered from two “lost decades”.**
- **This is due to a failure to boost the economy sufficiently with fiscal and monetary stimuli.**
- **Deflation has depressed demand and thereby the economy.**

## **Slide 2. Reality.**

- **Growth has been slow due to demography.**
- **Deflation has been more of a help than a hindrance.**
- **Japan's productivity has improved more than France or Germany.**
- **As in all developed economies, poor policies have held back growth.**

# Slide 3. G5: Productivity 1992 - 2012.

Data Sources: National Accounts via Ecwin.



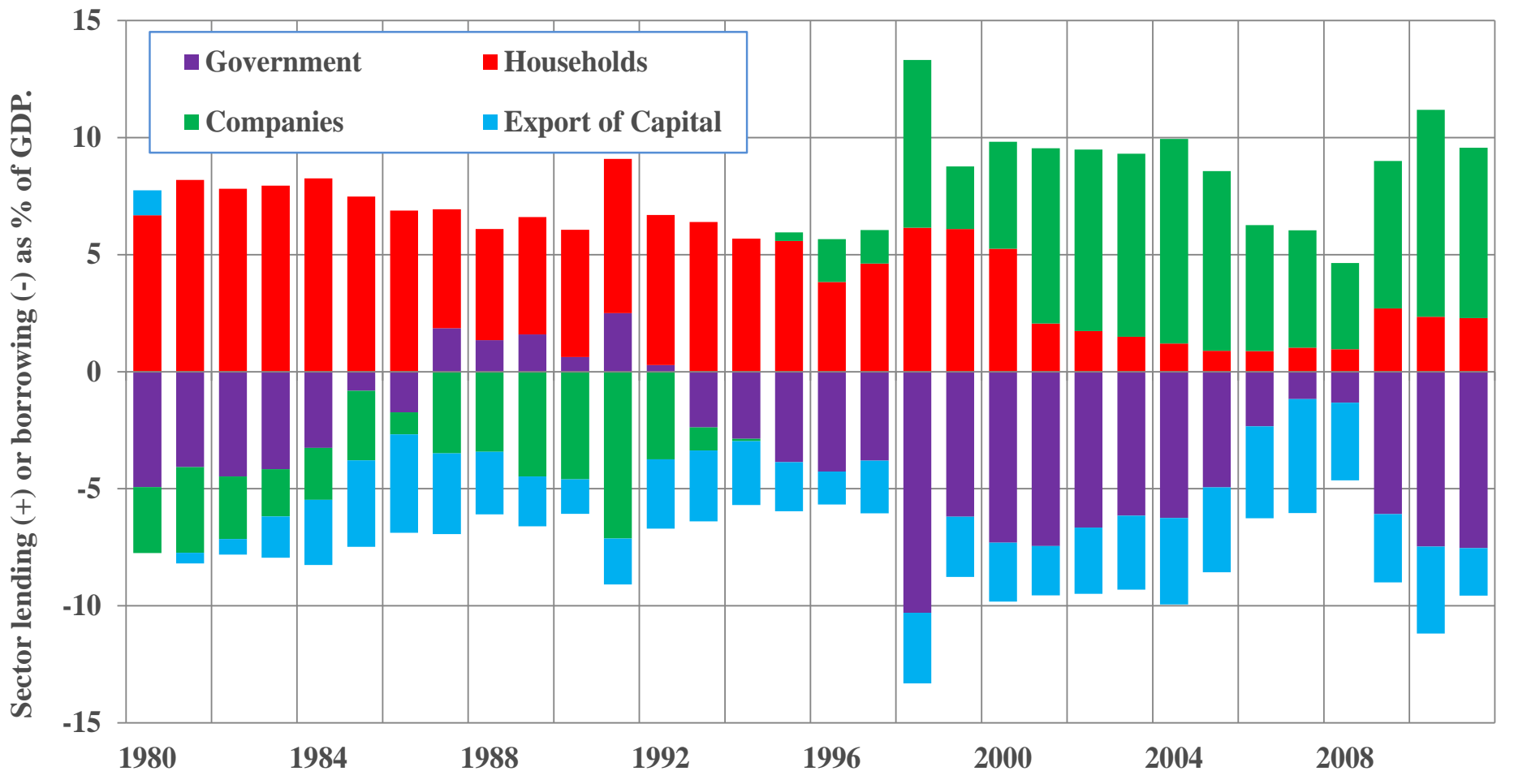
## **Slide 4. Policy Failure.**

- **Neither fiscal policy nor monetary stimuli have been insufficient.**
- **The problem has been the wrong policies.**
- **Ignoring Japan's key problem is the cause of bad policies.**

## **Slide 5. Japan's Key Problem.**

- **Japan has a structural corporate cash flow surplus.**
- **This comes from excessive past investment and**
- **Current excessive depreciation allowances.**

# Slide 6. Fiscal Deficits = Other Sectors' Surplus.



Data Sources: Cabinet Office Website National Accounts 2003 and 2011.

## **Slide 7. It's Not A Cyclical Problem.**

- **Advocates of fiscal and monetary stimuli assume that companies' cash surplus is a cyclical problem.**
- **Hence the nonsense about deflation.**
- **Inflation advocates assume that negative real interest rates would boost investment.**
- **If they did, it would make things worse!**

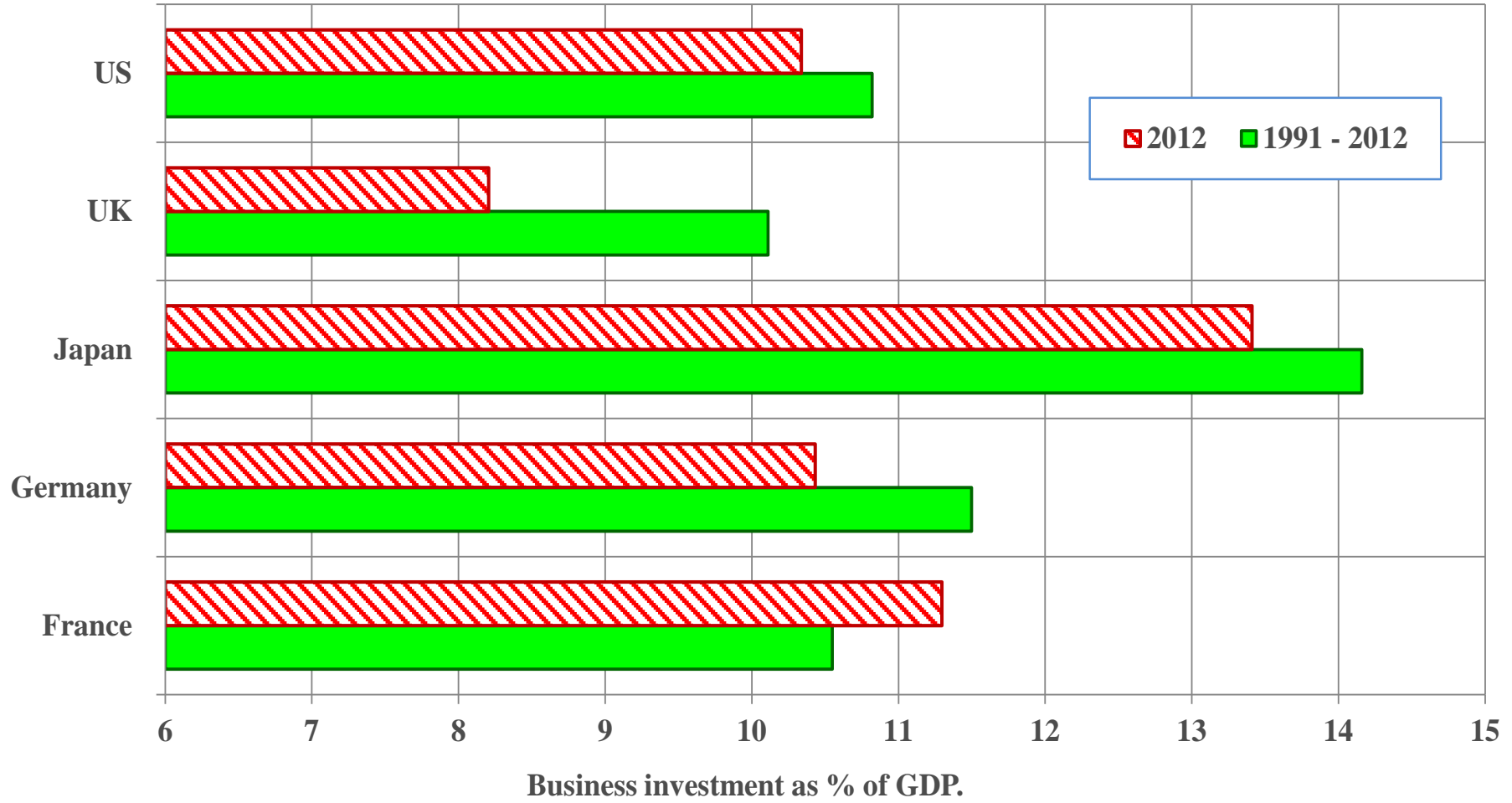


## **Slide 8. Japan Overinvests.**

- **Japan invests more than other G5 countries both business (Slide 9) and total.**
- **Through demography, not poor productivity, it grows slowly (Slide 10).**
- **It wastes investment (Slide 11).**

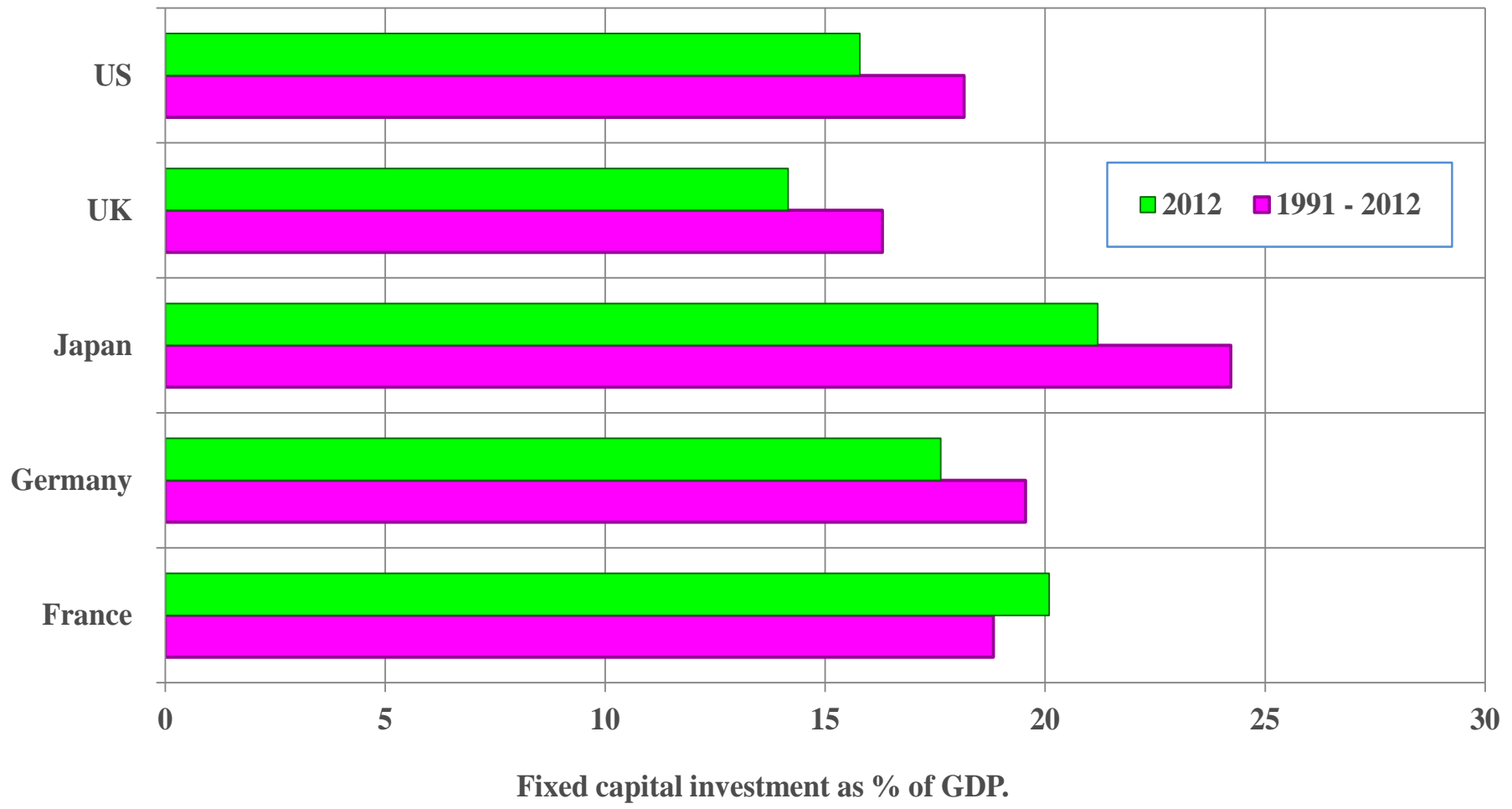
# Slide 9. G5: Business Investment as % of GDP.

Data Sources: National Accounts via Ecwin.



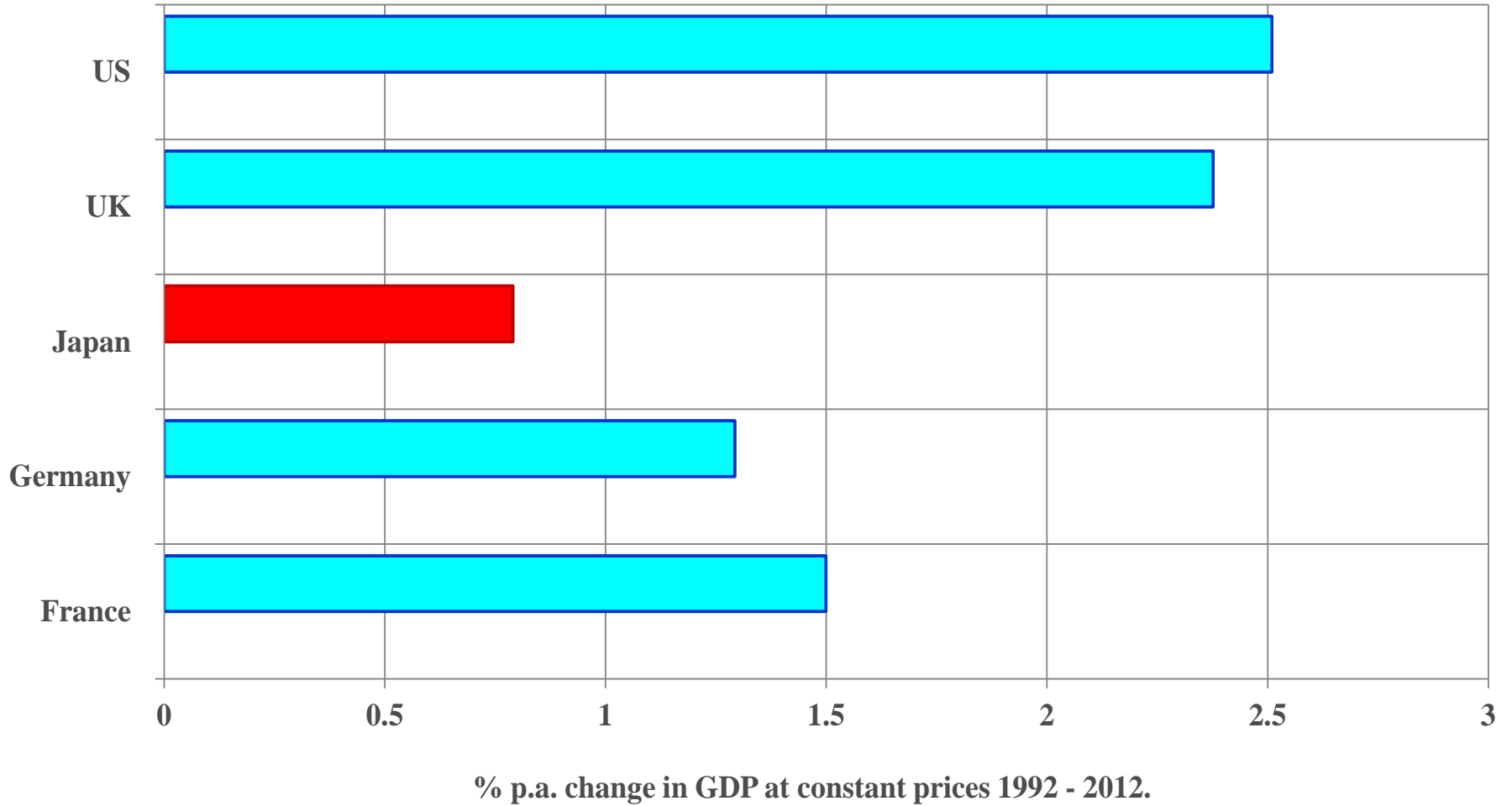
# Slide 10. G5: Total Investment as % of GDP.

Data Sources: National Accounts via Ecwin.



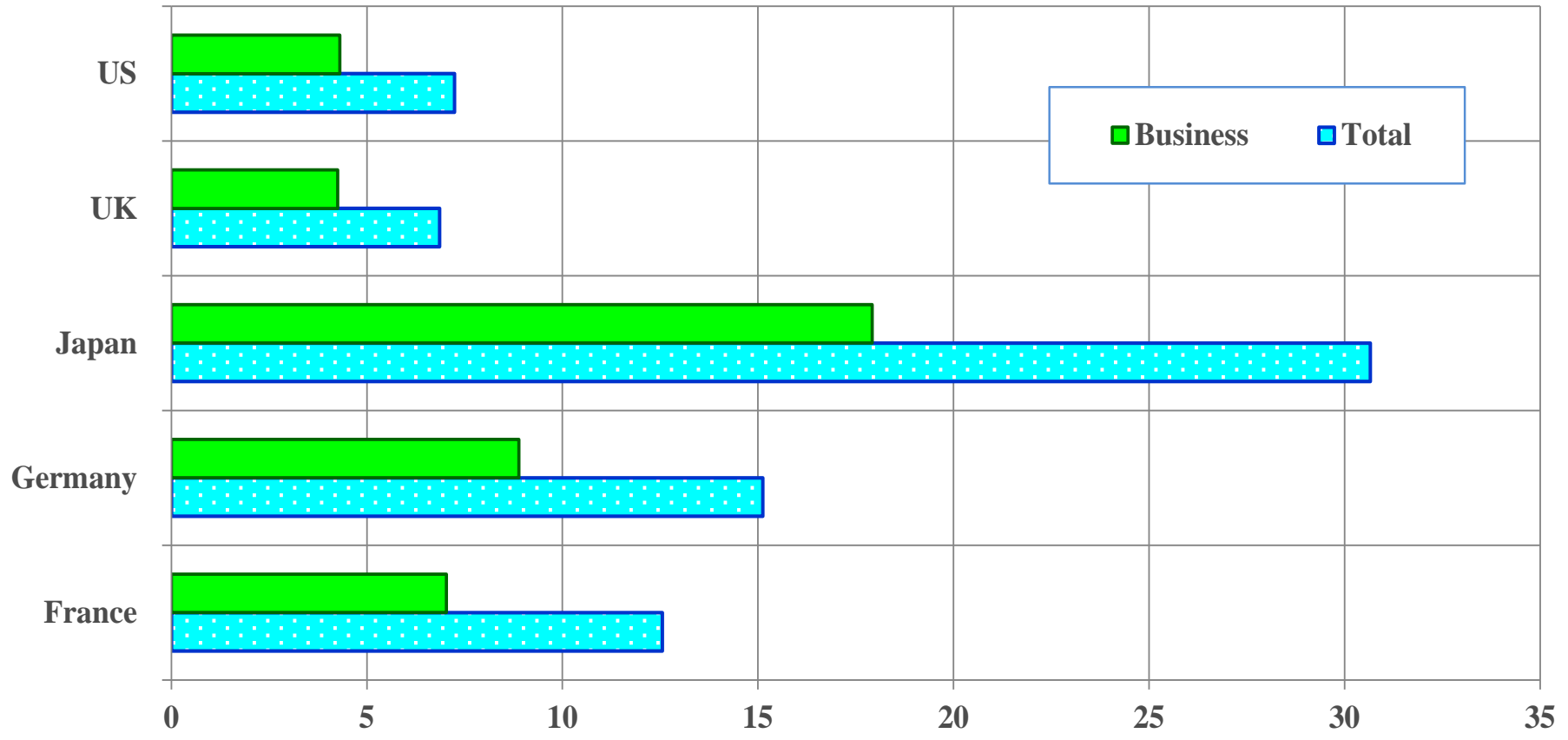
# Slide 11. G5: Growth Rates 1992 - 2012.

Data Sources: National Accounts via Ecwin.



# Slide 12. G5: ICORs (Incremental Capital/Output Ratios).

Data Sources: National Accounts via Ecwin.



Investment as defined as % of GDP divided by % p.a. change in GDP over period.

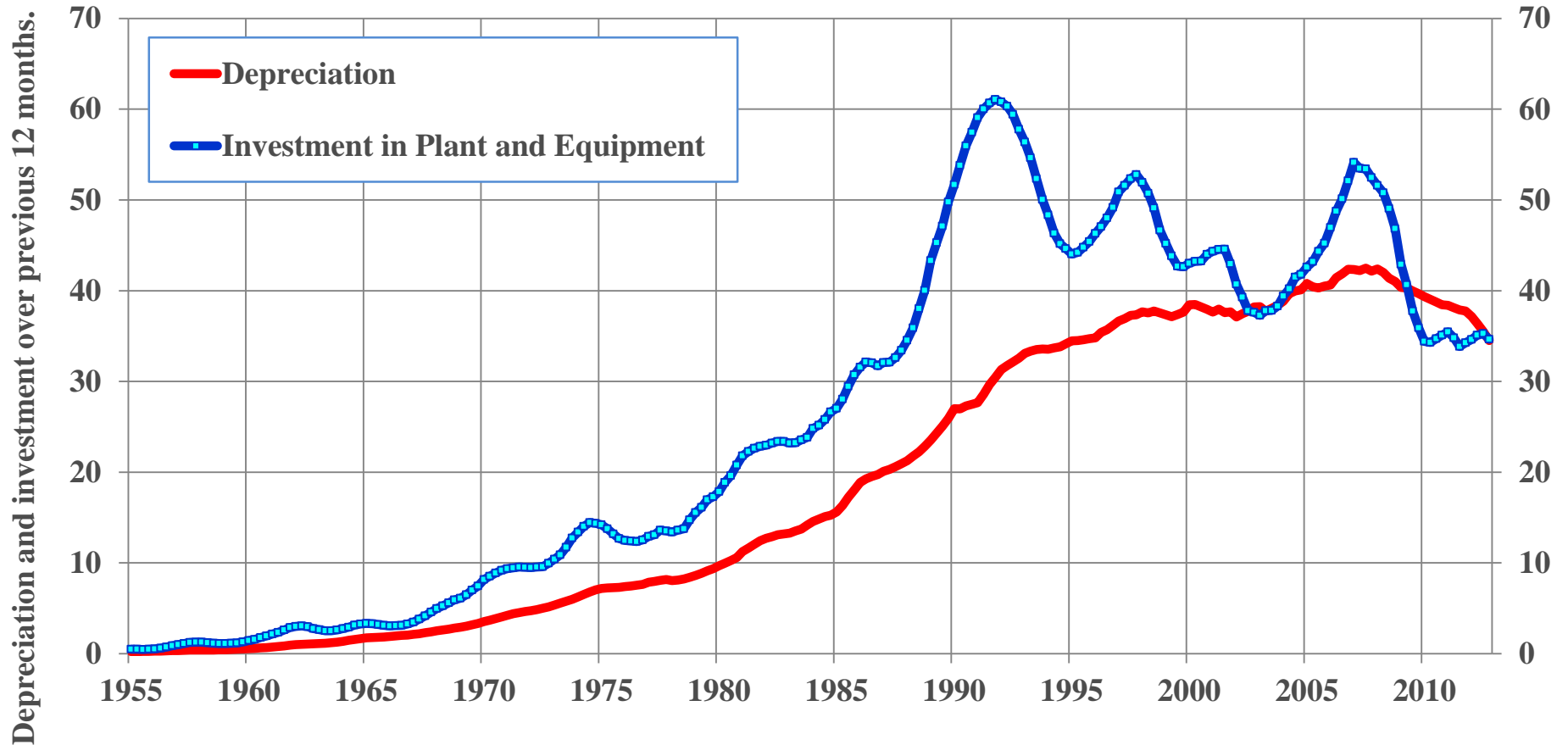
## **Slide 13. The Case for Inflation.**

- **Deflation keeps real interest rates positive.**
- **This depresses investment.**

## **Slide 14. The Case Against Inflation.**

- **It might boost investment, which is too high.**
- **High past investment increases depreciation (Slide 15).**
- **This causes the structural savings' surplus.**

# Slide 15. Japan: Non-financial Companies' Investment in Equipment.



Data Source: MoF Quarterly Survey of Incorporated Enterprises.

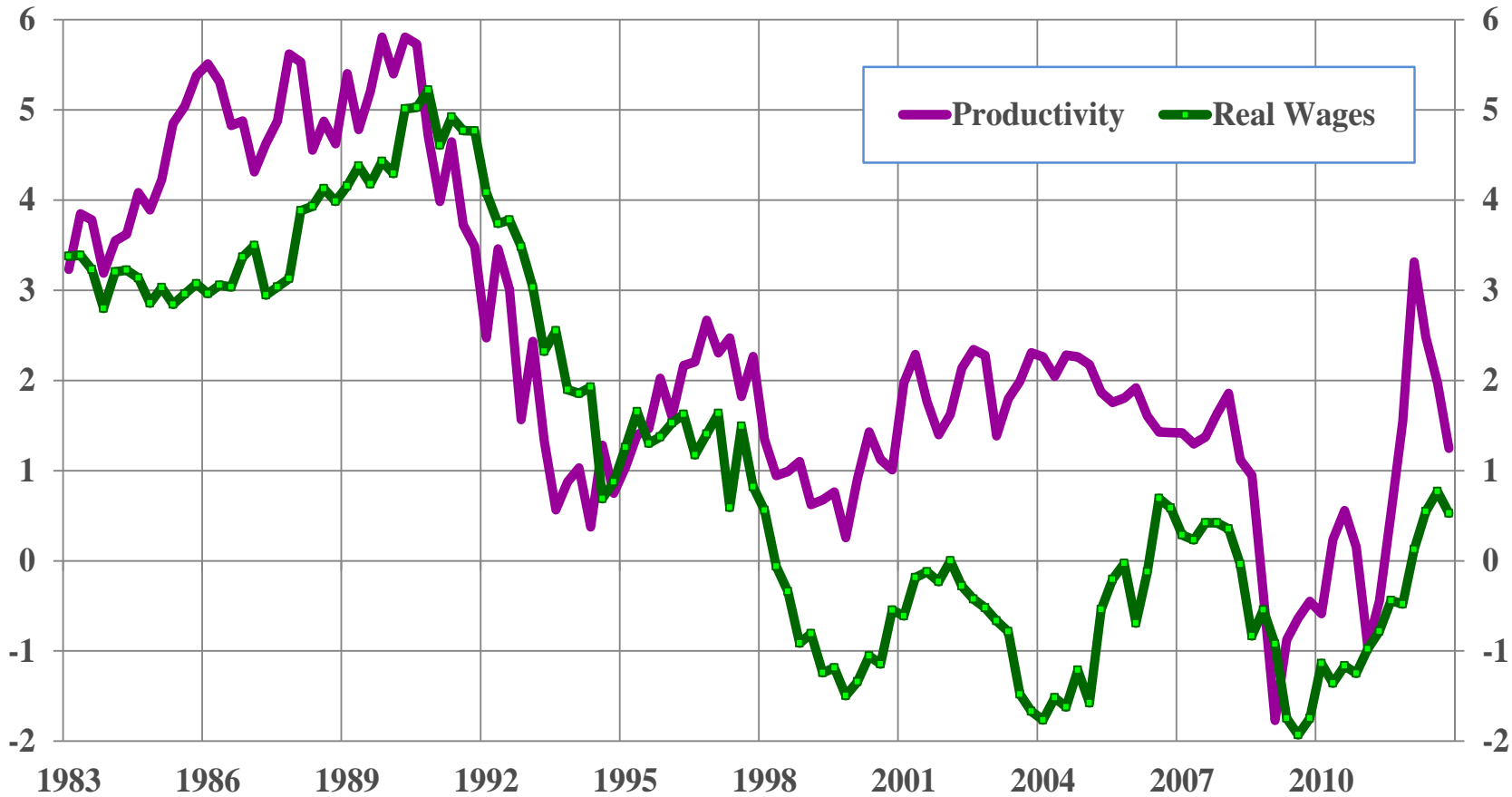


## **Slide 16. Why Corporate Cash Flow is Too High.**

- **Depreciation allowances are too high.**
- **Depreciation is a function of growth or real wages and this has fallen from 4% p.a. in the 1980s to c. 1% today (Slide 17).**
- **Companies don't distribute, as dividends, more than 100% of their profits.**

# Slide 17. Japan: % p.a. Change over 3 Years in Productivity and Real Wages.

% p.a. change over previous 3 years in GDP at constant prices per person employed and employee compensation adjusted for change in CPI.

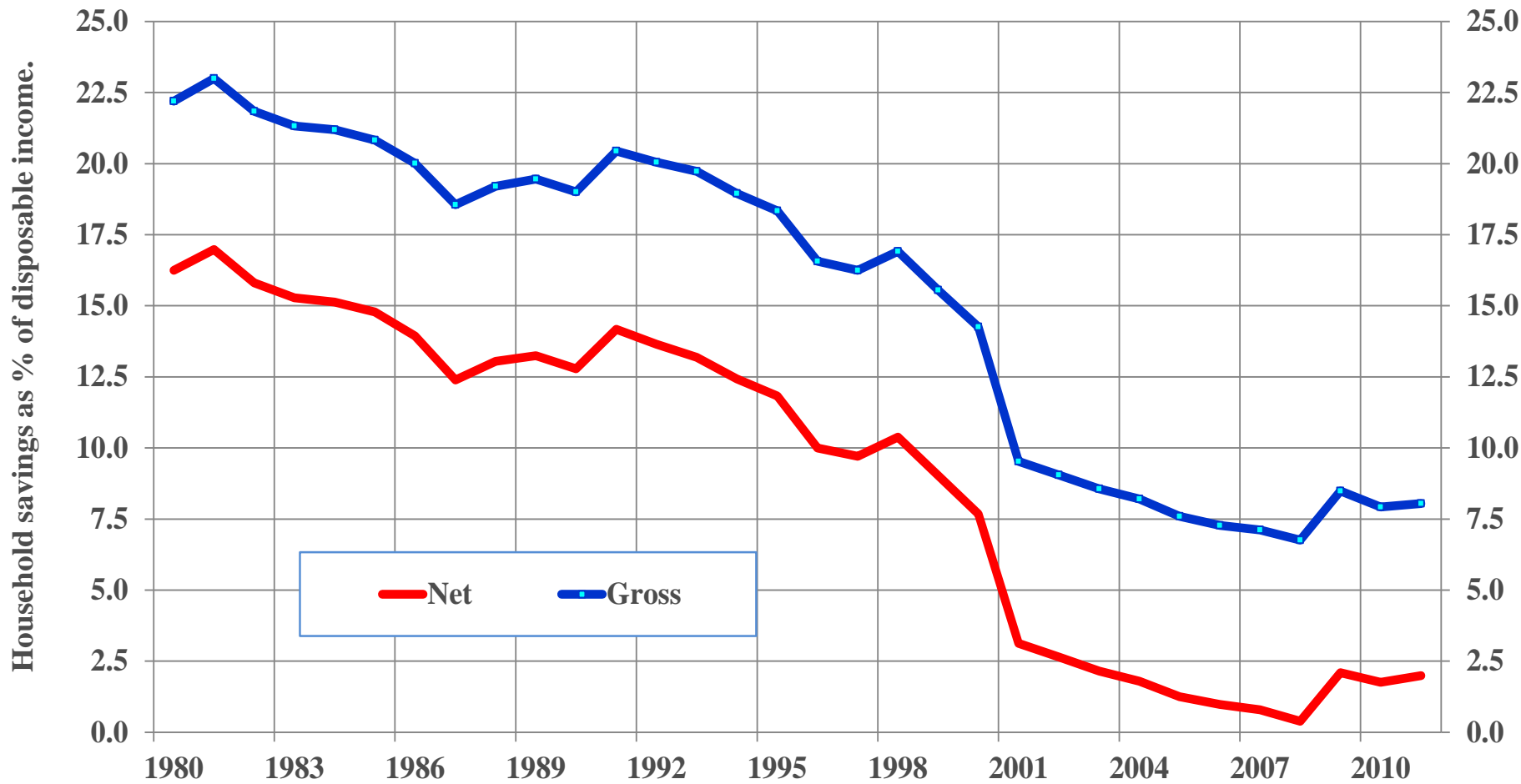


Data Sources: MIC and Cabinet Office.

## **Slide 18. Other Changes Needed.**

- **Companies cannot take full burden.**
- **Current account surplus must also rise.**
- **The fall in the yen is essential and must be maintained.**
- **Household savings are already low (Slide 19).**

# Slide 19. Japan: Household Savings.



Data Sources: Cabinet Office National Accounts 2011 and 2009.

## **Slide 20. Lost Decades Conclusion.**

- **Largely a myth.**
- **Deflation has been more help than hindrance.**
- **Weak Yen essential – must be kept down.**
- **Corporation tax reform essential.**