

# 'Catch-up' in Economic Stagnation? – A Preliminary Comparison between Japan and Korea

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SHIN Jang-Sup  
National University of Singapore

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## Recent economic performance of Japan and Korea

- Japan's "lost decades"?
  - stagnation... but really lost decades?
- Korea's "successful restructuring"?
  - a rapid growth slowdown in recent years
  - the spectre of stagnation?
- Causes and remedies
  - a consistent explanation through the angle of the three views on Japan's stagnation

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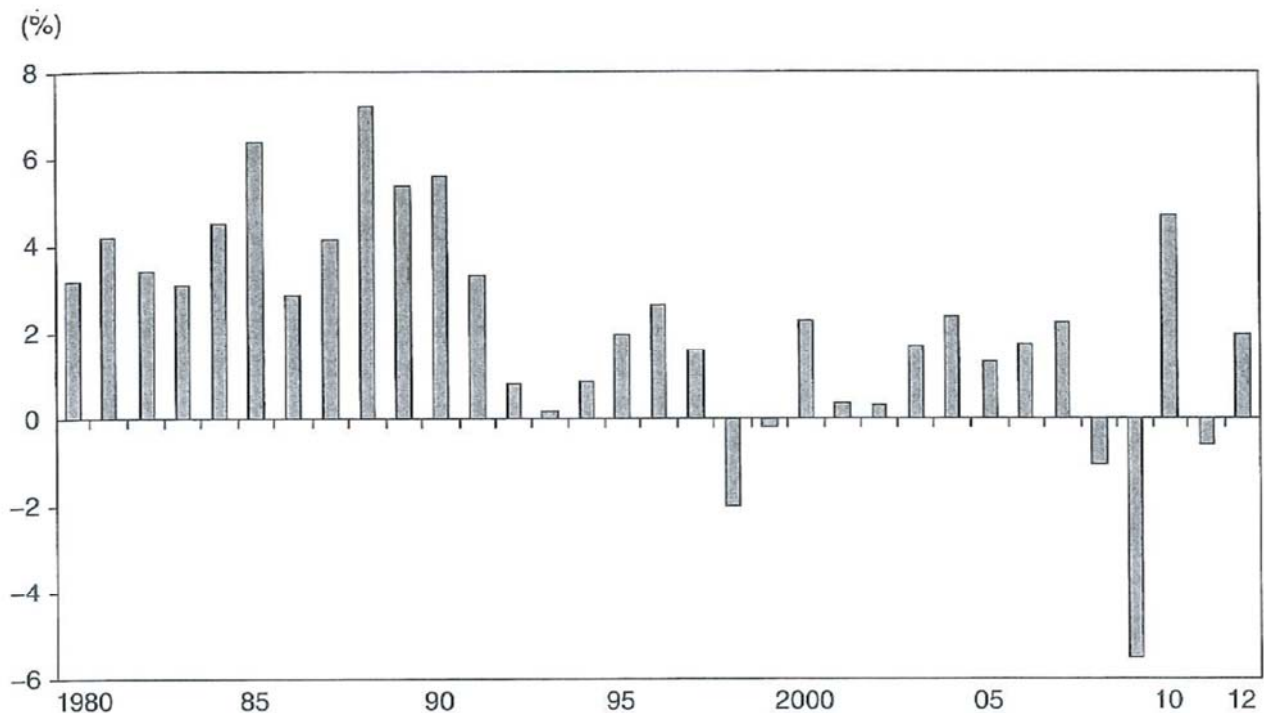
# Japan's performance: Overview

- Stagnation in economic growth
- Stagnation in credit expansion
- Deflation
- Stagnation in labour force growth + rapid ageing

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**Figure 1-1 Economic Ups and Downs**

**(b) Economic Growth**

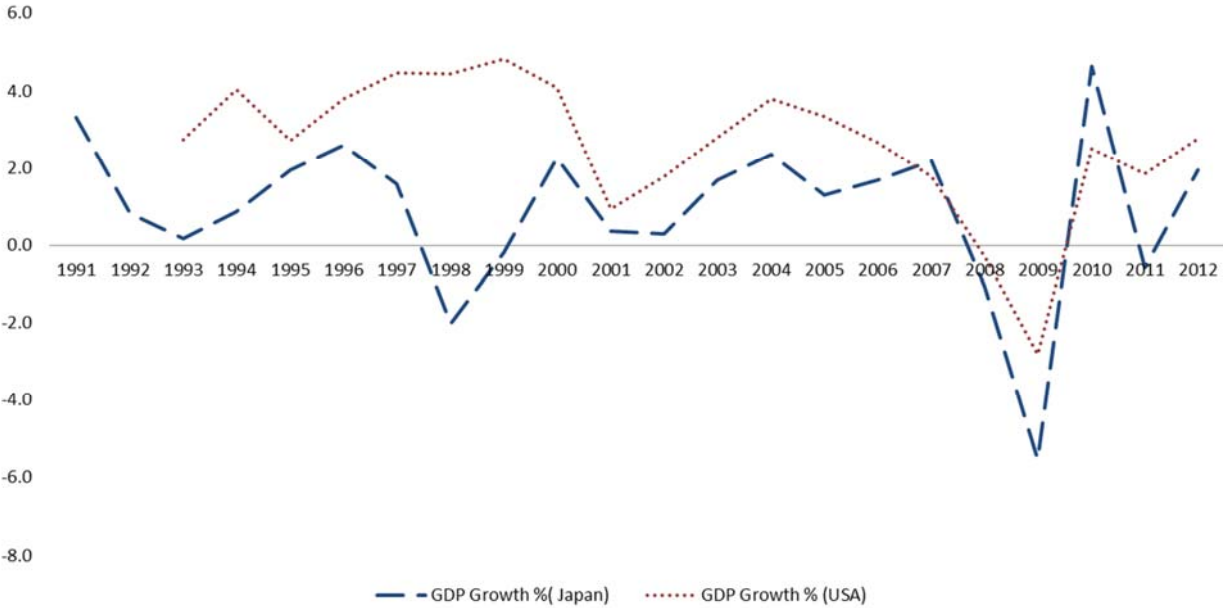


Source: IMF, World Economic Outlook Database (October 2013).

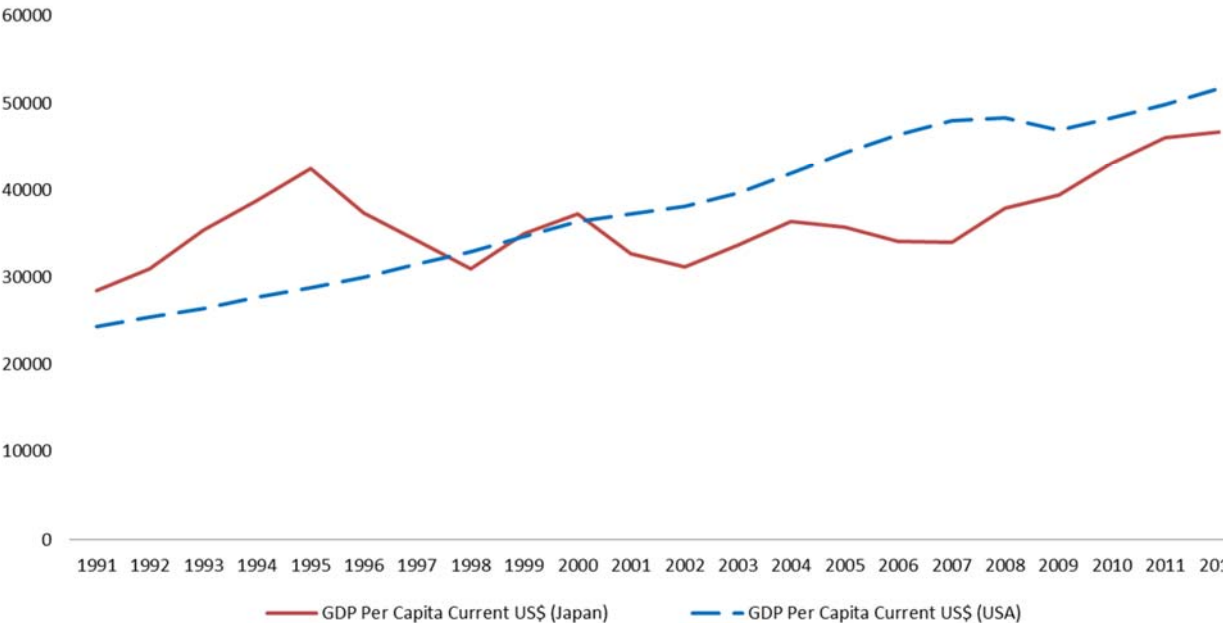
Note: Real GDP growth rate.

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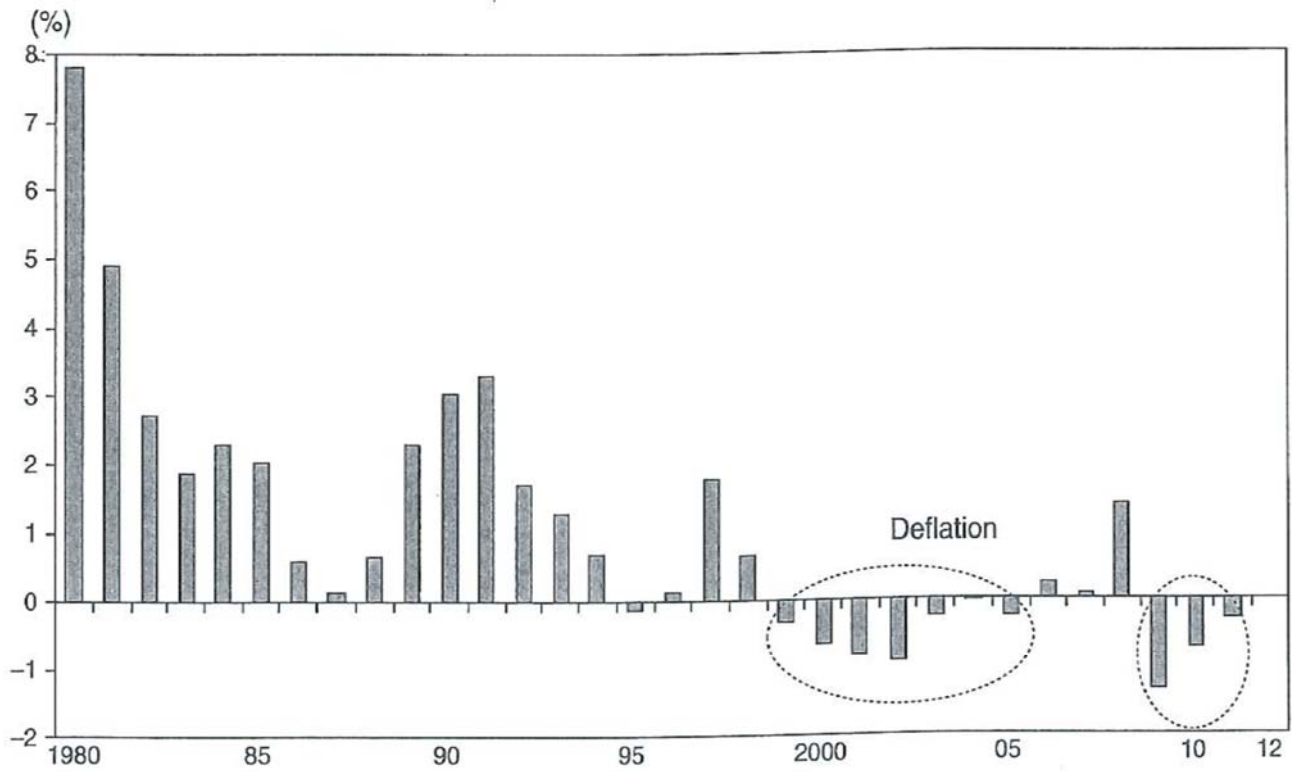
### GDP Growth: Japan & USA



### GDP Per Capita Current US\$: Japan & USA



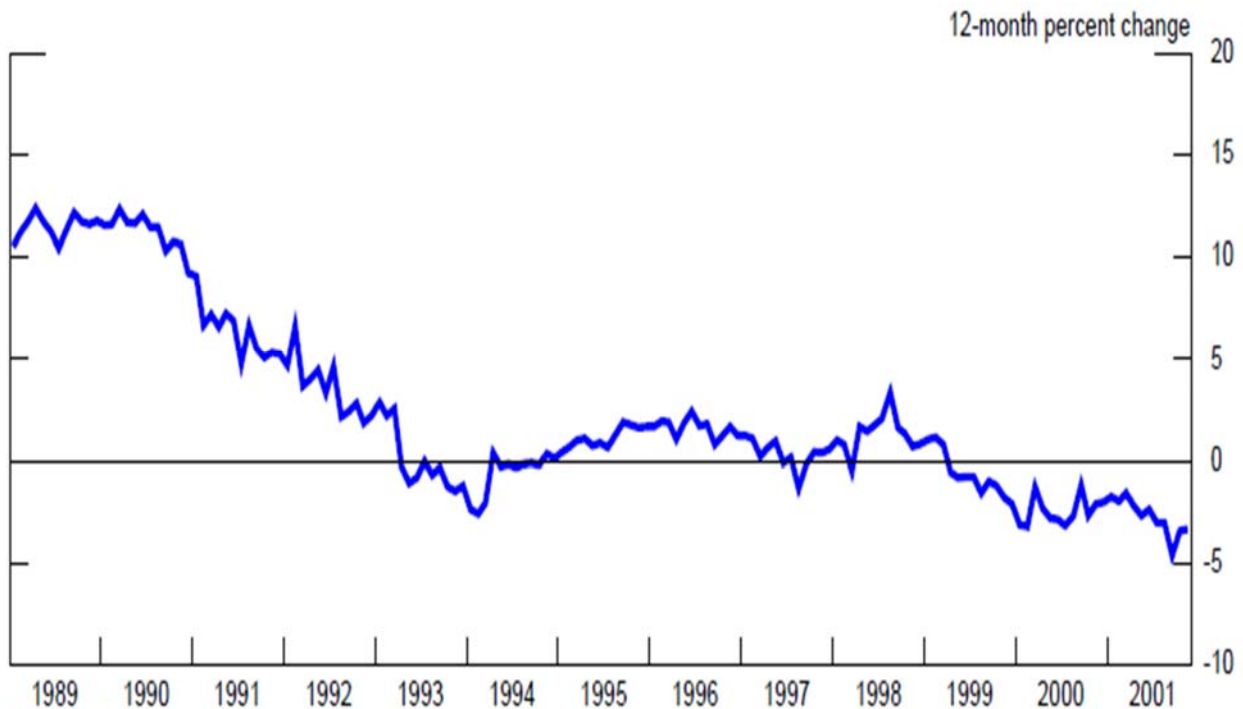
**Figure 1-4 Inflation and Deflation**



Source: IMF, World Economic Outlook Database (October 2013).

Notes: (i) The rate of change in the CPI. (ii) The inflation rate in 2012 was 0.0%.

**Japanese Bank Credit**



Source: BOJ.

# Three views on Japan's stagnation

- The structuralist view
  - the Japanese '*dirigism*', 'deep-seated' problems ...
- A balance sheet recession
  - an inevitable consequence after the burst of a great bubble
- A population problem
  - Stagnation in labour force growth

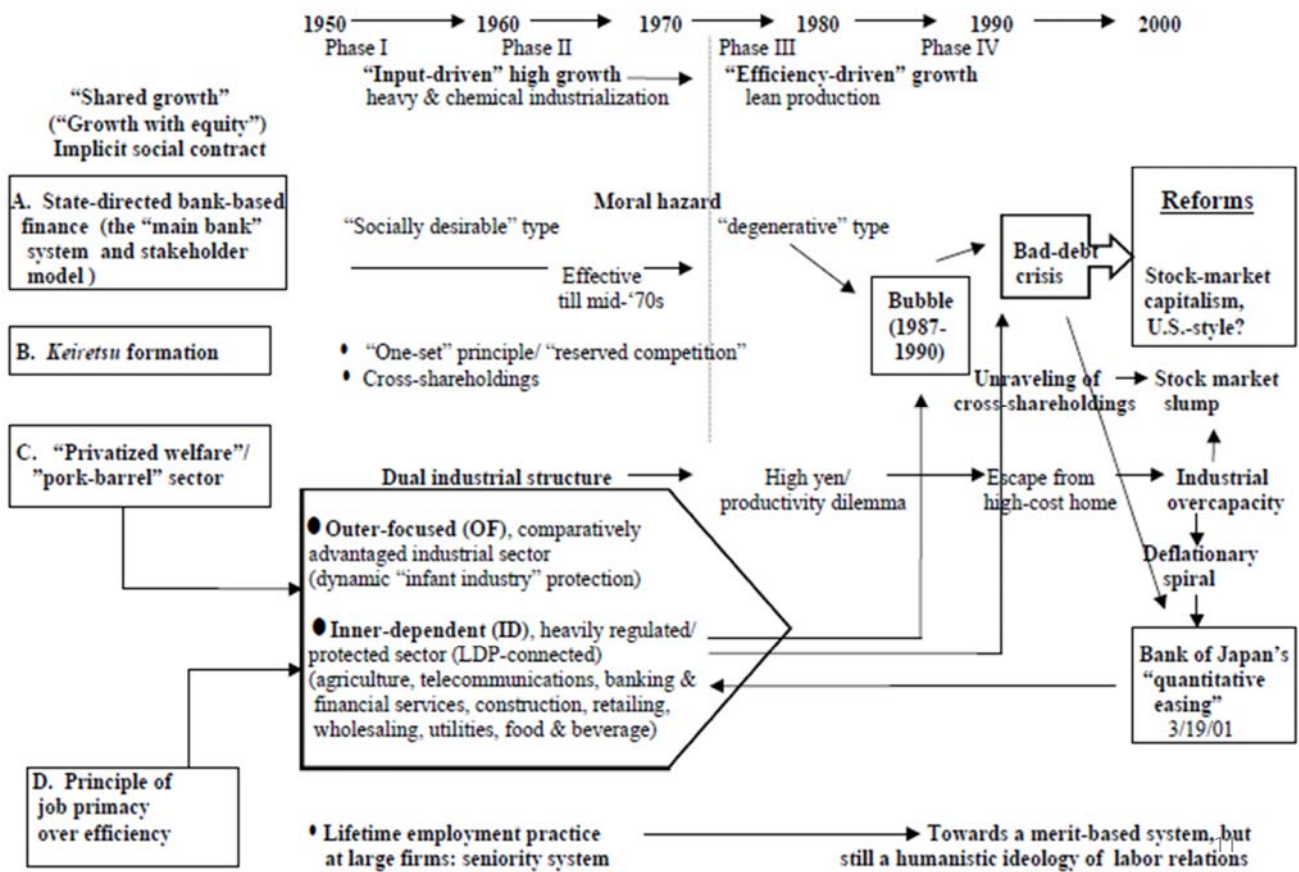
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## 1. The structuralist view – the Japanese '*dirigism*'?

- Ozawa (2001) "Japan's *dirigiste* institutional setup and a deepening financial morass"
  - "these arrangements [of Japan's economic miracle] quickly became not only obsolete but more importantly obstructive to further growth."

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Figure 2 The *dirigiste* catch-up regime (“institutional matrix”) of Japan’s FG development



## The Japanese 'dirigism'?

- The state-augmented bank-based finance - "the moral hazard effect was thus of the *degenerative* type (in contrast to the earlier *socially justifiable* one). (Ozawa 2001:14)

## The Japanese '*dirigism*'?

- The main bank and *Keiretsu* system
  - overcapacity, overdiversification, excessive number of banks
  - 'It was the Japanese version of "crony capitalism." The macro-financial "insider control" scheme thus has turned out to be a breeding ground for corruption—and the subsequent disastrous banking mess that had to be cleaned up with the use of hundreds of billions of dollars of tax-payers' money.' (Ozawa 2001: 16)

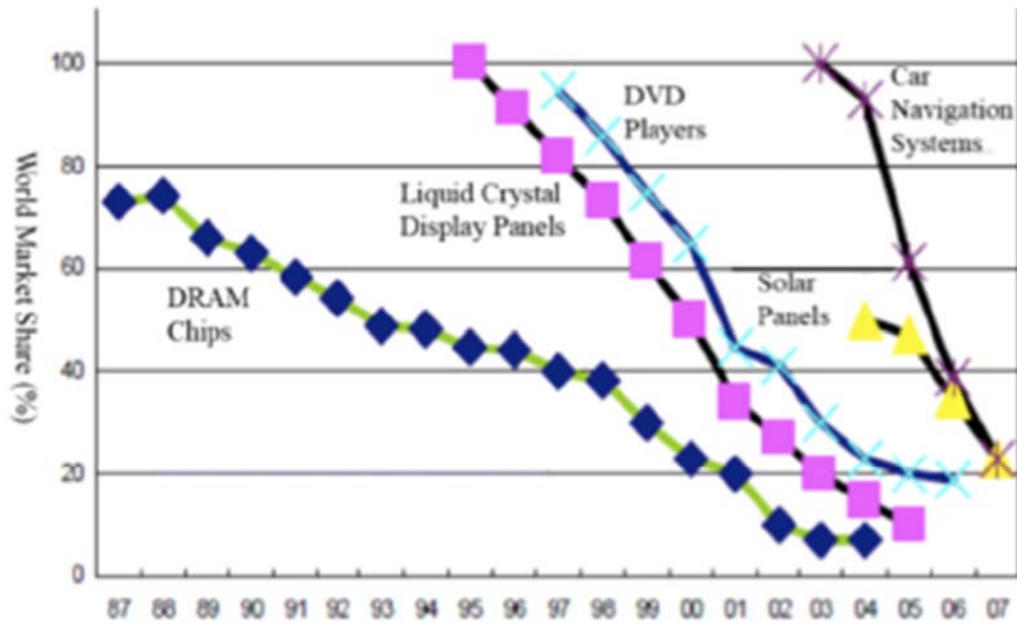
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## The Japanese '*dirigism*'?

- The main bank and *Keiretsu* system
  - "liability" in the Internet age?  
"In the Internet age, however, this integration became a liability as Japanese electronics firms were slow to capture either the cost benefits of modular production or the innovative potential of independent software and components firms. ... [They have done some of these efforts], but they have done so more as means of cutting costs than as a strategic reorganization of the production process." (Steven Vogel 2013: 2),

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FIGURE 1. World Market Share, 1987 - 2007



Source: Ogawa, Kouichi. 2008. "From Product Innovation to Business Model Innovation." *IAM Discussion Paper Series #001*. Tokyo.

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TABLE 1

Share of OECD ICT Goods Exports (percentage)				
	1999	2003	2007	2011
Japan	16.8	15.6	13.3	10.4
United States	23.2	19.6	19.3	19.3
Germany	7.2	9.4	11.1	9.4
Korea	7.8	11.1	13.4	13.7

Source: Adapted from *OECD Factbook 2013*.

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## The Japanese '*dirigism*'?

- The 'pork-barrel' sector

- OF(outer-focused) sector vs. ID (inner dependent) sector

- “instead of having competitive forces rationalize the ID sector, the government used to hold on to—and even reinforced through administrative guidance—its regulatory involvement to further shelter the ID sector. The reason was that the ID sector as a whole ... was the key political power base (that is, financial source) of the Liberal Democratic Party ...”

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## The Japanese '*dirigism*'?

- The 'job primacy over efficiency'

- “The Japanese simply cannot put the livelihood interest of workers behind the pecuniary interest of financiers or rentiers. And this “belief system “ needs to be taken fully into account when one wonders why corporate Japan is so indecisive and slow in carrying out institutional reforms (or becoming more like the U.S.)”

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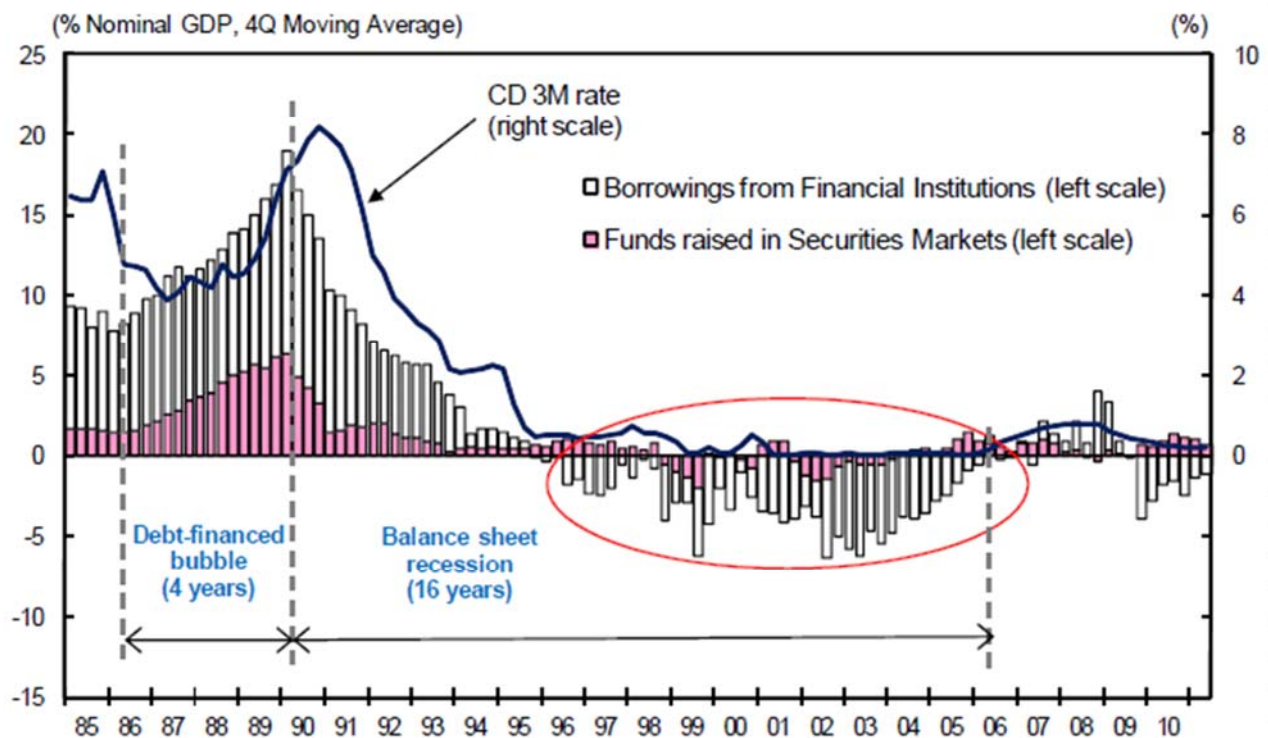
## 2. The balance sheet recession view

- An inevitable consequence after the burst of such a big bubble
  - The private sector deleveraging leading to prolonged slump (Richard Koo 2011).

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Exhibit 5. Japan's Deleveraging under Zero Interest Rates Lasted for 10 Years

### Funds Raised by Non-Financial Corporate Sector



Sources: Bank of Japan, Cabinet Office, Japan

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# A balance sheet recession

- Deleveraging

- The private sector completing its balance sheet repair only in 2005
- The massive increase in government debt was a necessary action to compensate for the shrinking of the private sector demand

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# A balance sheet recession

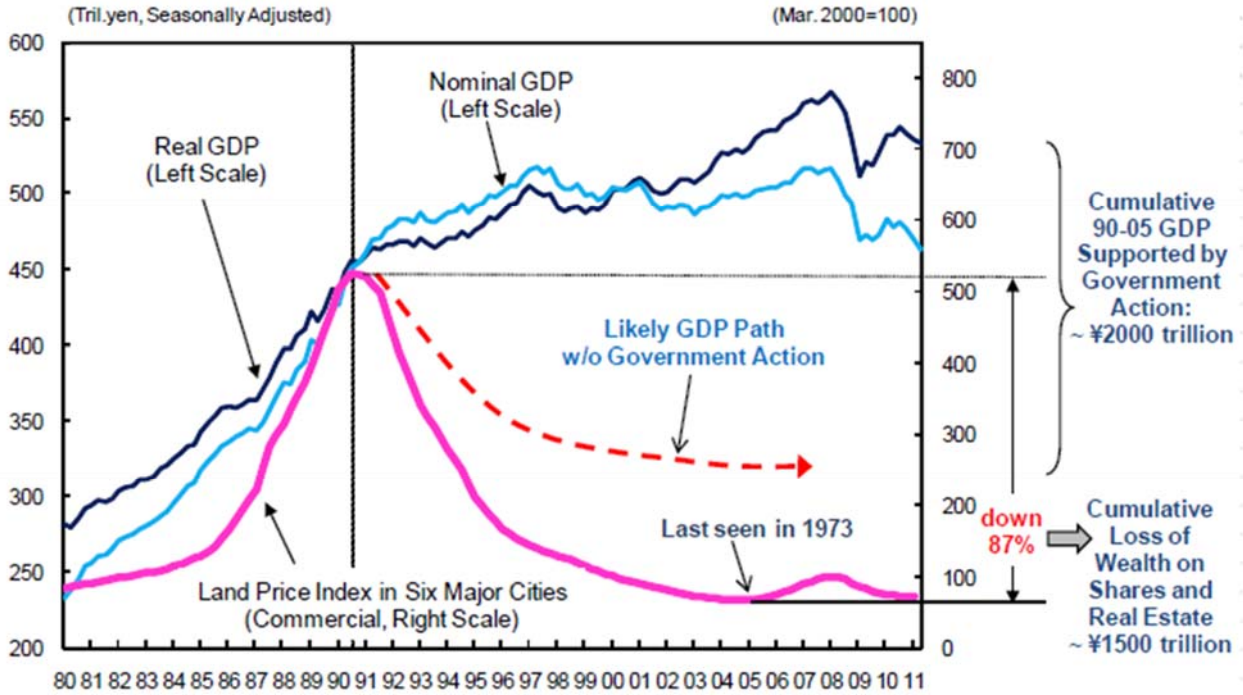
- Deleveraging

- The same situation happened in the US during the Great Depression

“This is exactly what happened during the Great Depression, when everyone was paying down debt and no one was borrowing and spending. From 1929 to 1933, the U.S. lost 46 percent of its GDP mostly because of this debt-repayment-induced deflationary spiral. It was also largely for this reason that the U.S. money supply shrank by nearly 30 percent during the four-year period.” (p.22)

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**Exhibit 6. Japan's GDP Grew despite Massive Loss of Wealth and Private Sector Deleveraging**

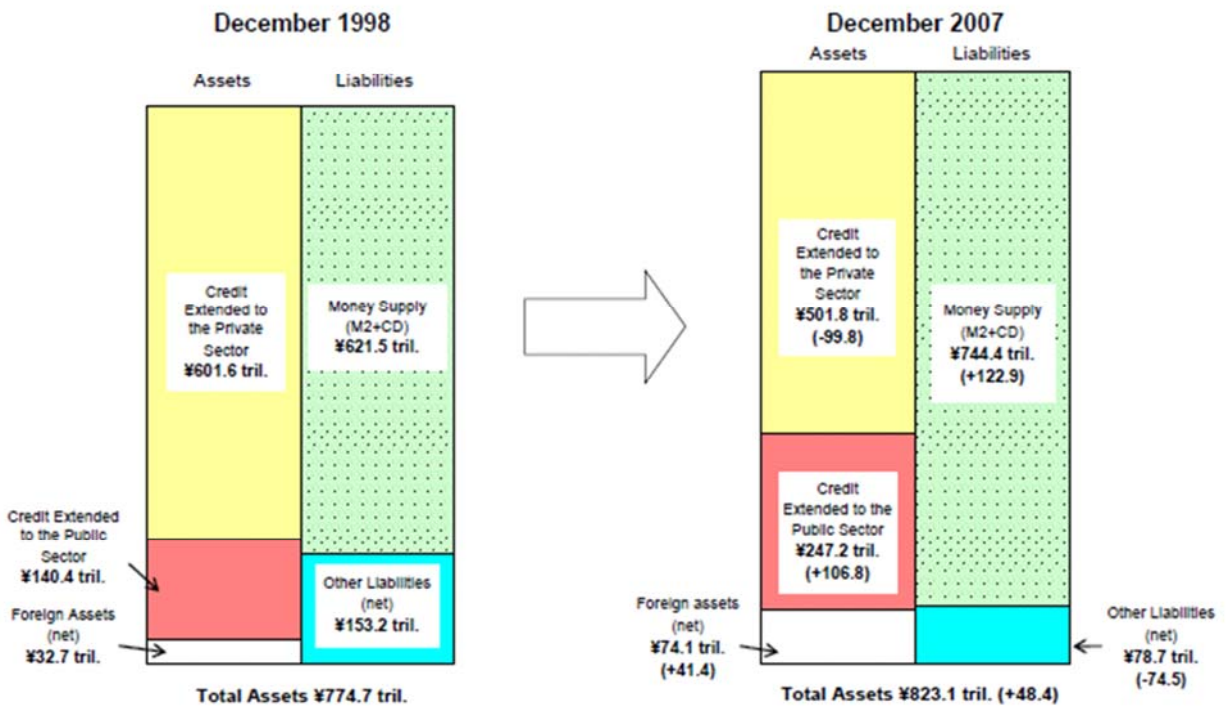


Sources: Cabinet Office, Japan Real Estate Institute

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**Exhibit 7. Japan's Money Supply Has Been Sustained by Government Borrowings**

Balance Sheets of Banks in Japan



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# A balance sheet recession

- Policy mistakes?

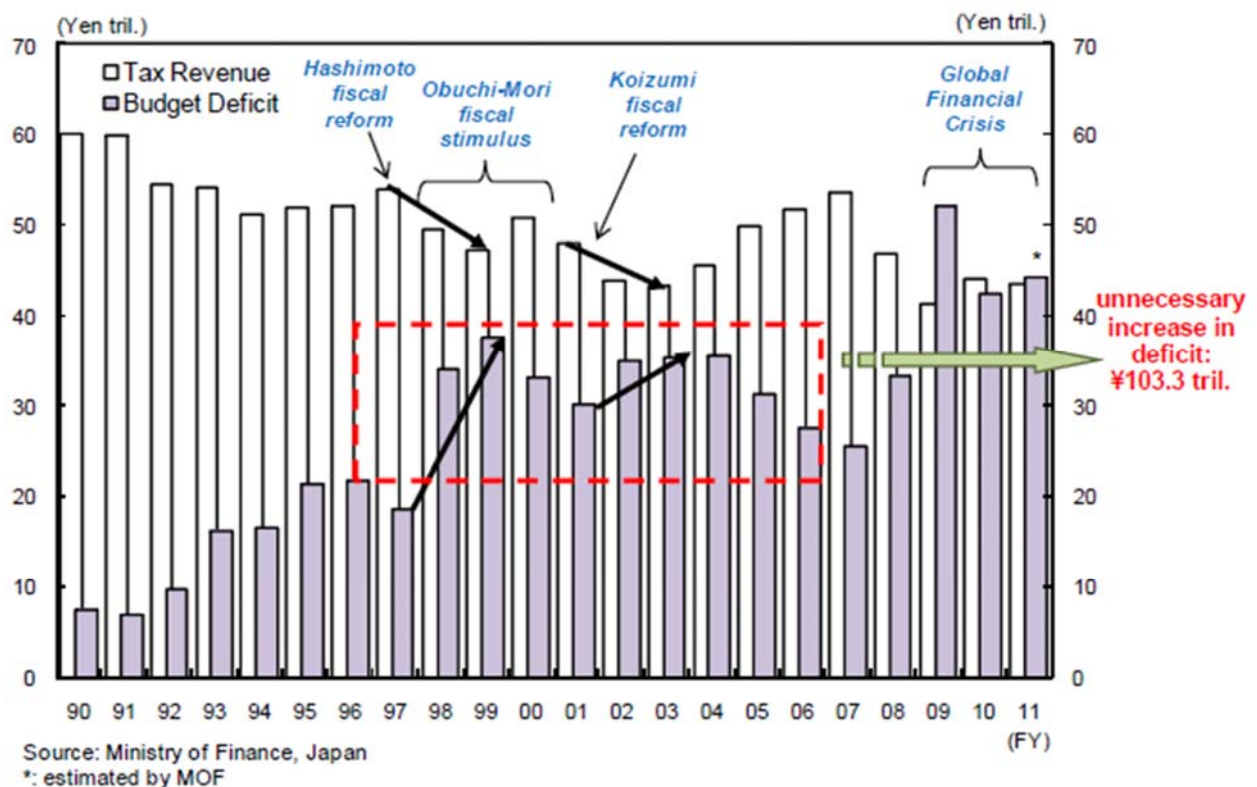
- Should have taken more aggressive and prolonged fiscal expansion

- “the policy zigzag”

“premature fiscal consolidation in 1997 and 2001”

“... prolonged the recession by at least five years if not longer and added at least \$1 trillion to the public debt unnecessarily”

**Exhibit 11. Premature Fiscal Reforms in 1997 and 2001 Weakened Economy, Reduced Tax Revenue and Increased Deficit**



# A balance sheet recession

- Policy mistakes – why?

- Political difficulties in sustaining fiscal expansion for a prolonged period while public debts are mounting rapidly

- “Even those who manage to prevent an economic meltdown by implementing necessary fiscal stimulus before the crisis are likely to be bashed instead of praised by the public. This is because the general public typically cannot envision what might have happened in the absence of fiscal stimulus.

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# A balance sheet recession

- Policy mistakes – why?

- ...Seeing only a large deficit and no crisis, they assume the money must have been wasted on useless projects. That is exactly what happened to Liberal Democratic politicians in Japan ... Although their actions saved their economies from devastating deflationary spirals, they were bashed because the public is unable to contemplate the counterfactual scenario. The man or woman who prevents a crisis never becomes a hero. For a hero to emerge we must first have a crisis, as Hollywood movies will attest.” (p.33)

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### 3. The stagnant workforce view

- GDP growth rate (1991-2012)
  - USA 2.61%
  - Germany 1.67%
  - Japan 1.04%
- GDP growth per labour force (1991-2012)
  - USA 1.66%
  - Germany 0.87%
  - Japan 0.91% (equal to that in USA in the 2000s)

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**Real GDP per Labor Force: Germany, Japan, and United States**



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# The stagnant workforce

- The real reason? – the labor force growth
  - USA 23.0%,
  - Germany 14.1%
  - Japan 0.6%
- Japan's failure? (Cline 2013)
  - aging population
  - limited immigration

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# The myth of the 'lost decades'?

- Even doing better than the USA?
  - Life expectancy
  - Infrastructure
  - Unemployment rate
  - Current account surplus + creditor nation

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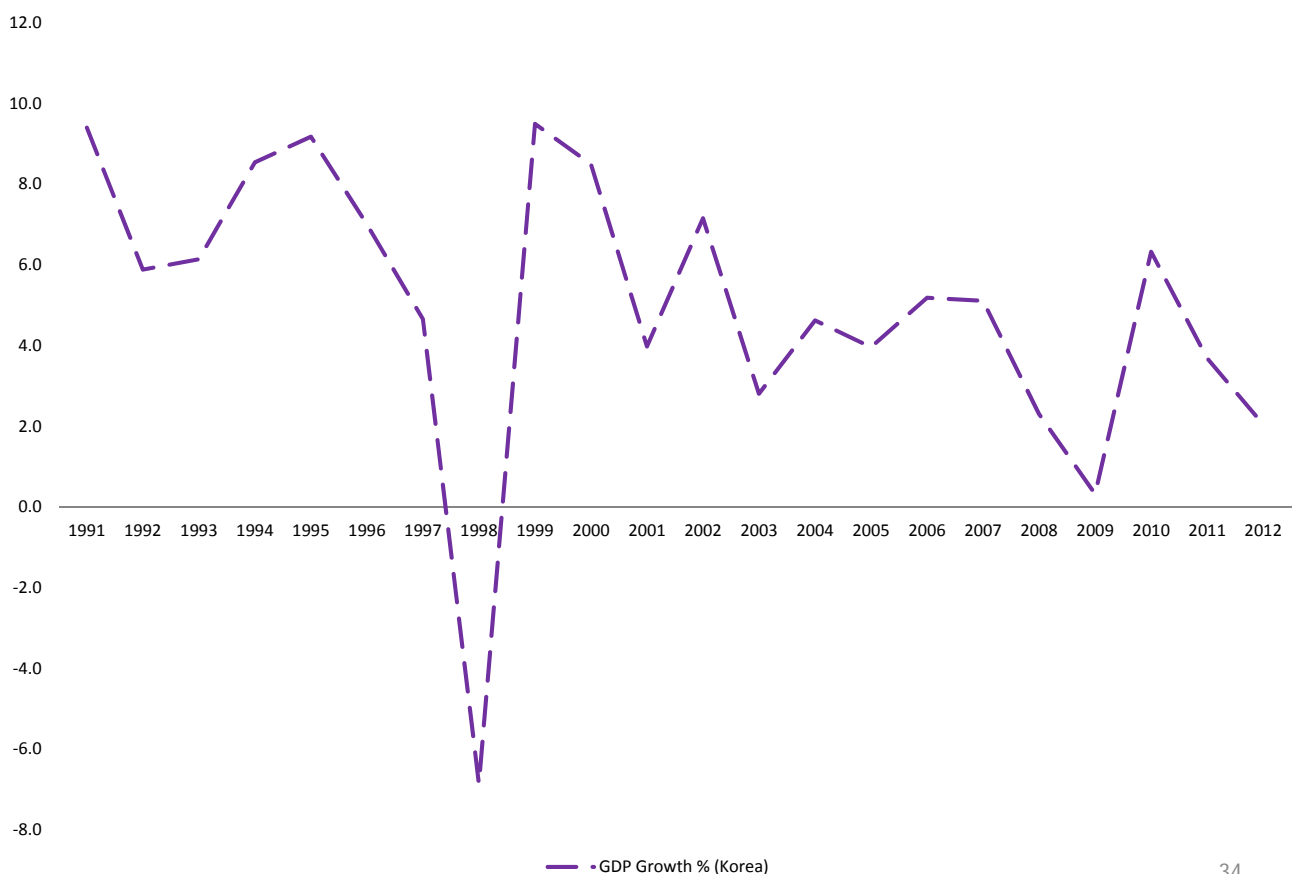


# Korea's economic performance

- Average GDP growth rate
  - 1990-1997: 7.5%
  - 2000-2008: 4.9%
  - 2010-2013: 2.8%
- Inevitable slowdown due to maturity?
  - still a middle-income country
  - per capita income passed US\$20,000 only in 2007

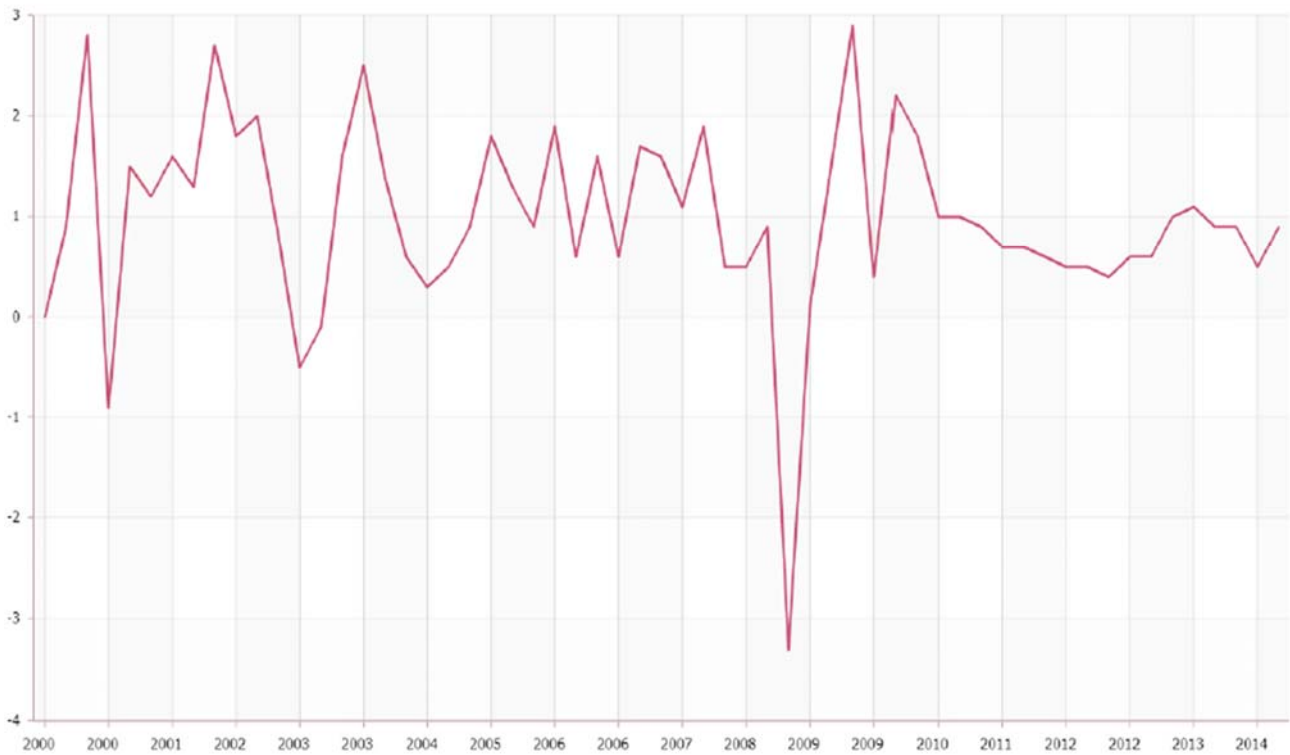
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GDP Growth: Korea



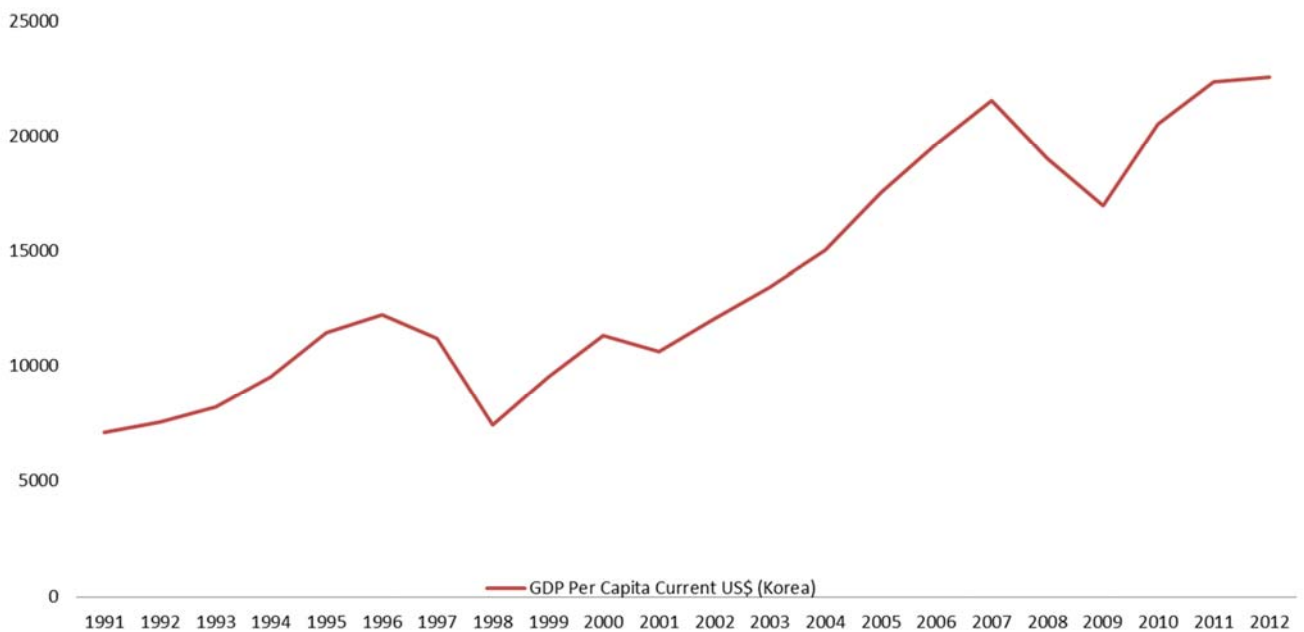
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## Quarterly Growth Rates (2000-2014)



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## GDP Per Capita Current US\$: Korea



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# Interpreting Korea's performance

## 1. The structuralist view

- "the most successful restructuring in the history the IMF programme" ...
- What more?

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# Interpreting Korea's performance

## 2. A balance sheet recession

- A forced & rapid balance sheet recession in the corporate sector through regulations by the financial authority?
- An ongoing balance sheet recession from household debts overhang?

## 3. A population problem

- More serious than Japan?

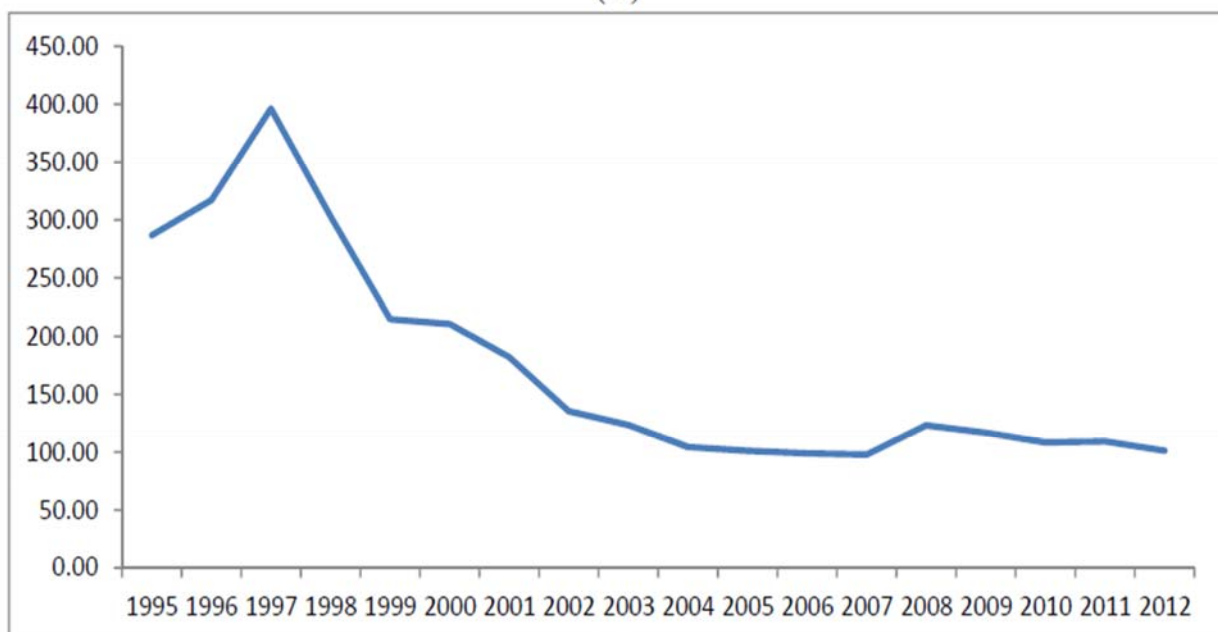
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# 1. Successful restructuring?

- Reduction in corporate debt-equity ratio
  - preventing 'over-investment'?
  - more reliance on the stock market?
    - preventing necessary corporate investment?
- What else?
  - financial stability?

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Figure. Trend of the Corporate Debt-Equity Ratio (Manufacturing)  
(%)

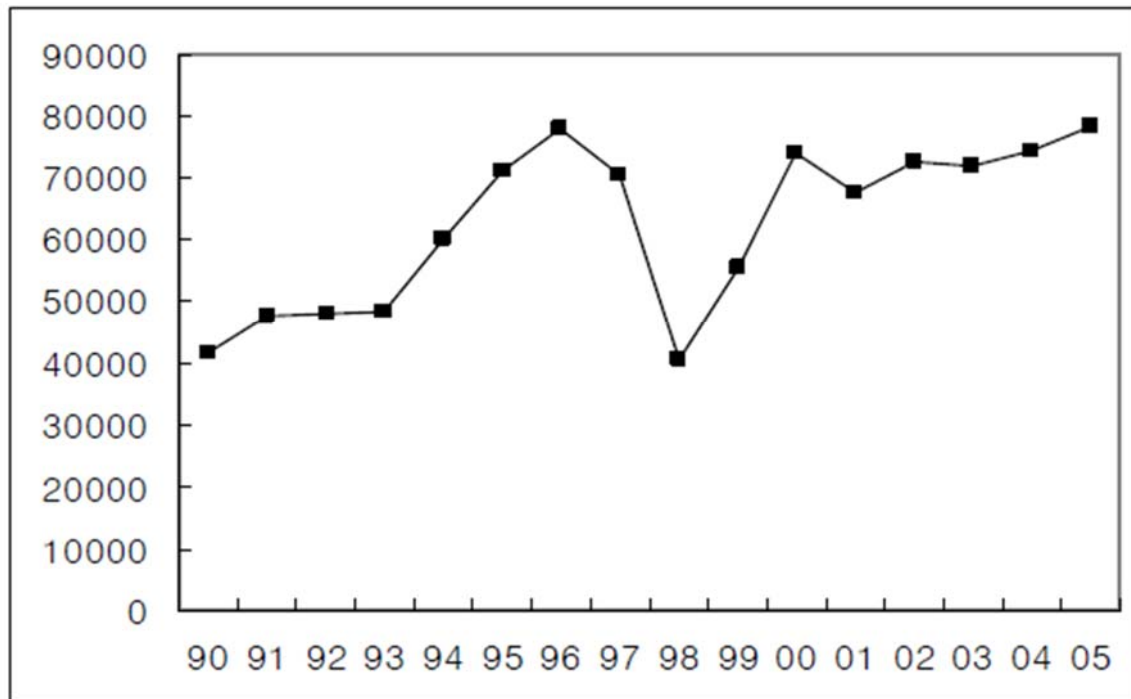


Source: Korea Statistics Office

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**Figure. Trend of Equipment Investment in Korea**

(billion won, constant prices in 2000)



Source: Korea Statistics Office

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**Table . External Financing of the Corporate Sector (Non-Financial)**

(Trillion won)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012 <sup>f</sup>
Total	118.7	118.0	27.6	51.7	66.5	51.9	86.8	89.1	67.7	109.0	189.9	184.3	230.4	152.3	117.1	151.3	136.3
Indirect	33.2	43.3	-15.8	2.1	11.3	1.1	51.6	34.3	2.9	23.7	68.0	98.6	115.0	19.4	23.4	48.1	19.0
Banks	16.6	15.1	0.2	15.5	23.3	3.3	41.6	41.1	14.9	20.3	60.4						
NBFIs	16.5	28.1	-16.5	-13.2	-11.9	-2.3	9.6	-6.7	-11.8	3.4	7.4						
Direct	56.0	44.0	49.4	24.7	18.9	36.8	23.0	28.8	29.2	52.9	79.9	54.1	66.9	95.4	61.5	63.8	70.2
CPs	20.7	4.4	-11.6	-16.1	-1.1	4.2	-0.3	-2.5	-1.8	4.1	14.7						
stocks	12.9	8.9	13.5	41.1	20.8	16.5	28.9	27.5	22.2	19.2	28.7	33.6	28.4	33.1	29.6	27.0	18.5
CBs	21.2	27.4	45.9	-2.8	-2.1	11.7	-7.8	-1.0	1.7	12.5	25.4	-4.8	24.6	69.6	28.4	28.4	29.6
Foreign loan	12.3	6.5	-9.8	11.5	15.7	2.2	3.5	4.6	8.6	5.6	5.9	6.4	8.4	6.1	4.3	15.2	14.7
Others	17.0	23.9	3.8	13.2	20.3	11.6	8.5	21.1	26.8	26.6	36.1	25.2	40.0	31.4	27.9	24.2	32.4

Source: Report on Flow of Funds, Bank of Korea

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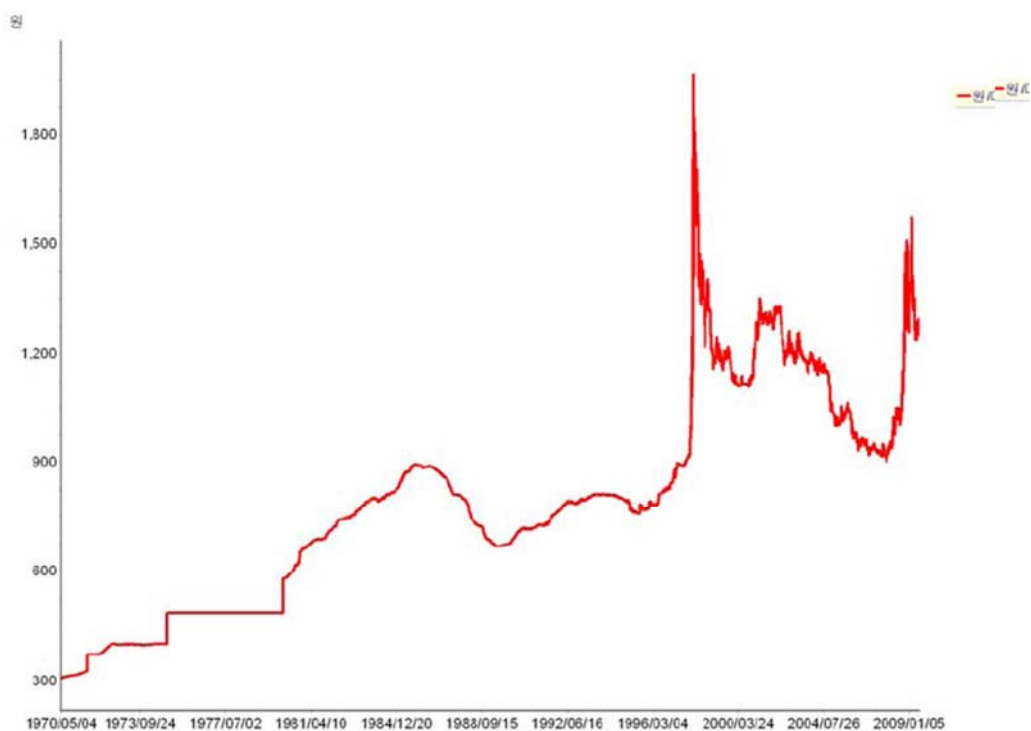
**Table. The Korean Stock Market for Corporate Financing**

(billion won)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total
<b>Inflow</b>	41,123	14,367	12,169	9,250	11,265	8,276	6,758	6,499	17,258	5,080	11,616	2,939	1,359	147,958
<b>Outflow</b>	3,427	9,283	9,823	7,812	15,317	13,498	12,538	14,985	15,191	11,151	22,529	28,254	11,161	174,969
stock purchase	453	5,380	5,975	1,925	8,090	3,319	2,650	5,458	4,620	3,680	13,912	18,731	2,324	76,517
dividends	2,974	3,903	3,848	5,887	7,227	10,179	9,888	9,527	10,571	7,471	8,617	9,523	8,837	98,452
<b>Net inflow</b>	37,696	5,084	2,346	1,438	-4,052	-5,222	-5,780	-8,485	2,066	-6,071	-10,913	-25,315	-9,802	-27,011

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**Long-Term Trend of US\$-KRW Rate**



Source: Bank of Korea  
Source: Bank of Korea

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## Performance of countries during the global financial crisis

Group	Countries	FX Rate		Stock Price Index				GDP Growth	
				Local currency		US\$			
		2008	2009 H1	2008	2009 H1	2008	2009 H1	2008	2009p
G1	Korea	-25.8	-26.5	-39.3	-25.0	-65.2	-51.5	2.2	-1.5
	UK	-26.4	-17.1	-30.9	-33.8	-57.3	-50.9	0.7	-3.5
	Russia	-19.5	-21.2	-72.5	-57.0	-92.0	-78.2	3.5	-9.0
	Brazil	-24.2	-8.2	-40.2	-18.1	-64.4	-26.2	4.3	1.0
G2	USA	0.0	0.0	-39.0	-36.6	-39.0	-36.6	1.1	-2.5
	Euro Zone	-4.2	-3.8	-53.4	-44.7	-57.5	-48.4	0.8	-4.6
	Japan	23.2	15.9	-39.7	-32.2	-16.5	-16.4	-0.7	-3.4
	Singapore	0.6	-0.6	-49.1	-32.6	-48.5	-33.2	-0.8	-4.0
	Malaysia	-4.2	-5.9	-38.9	-25.1	-43.1	-31.0	1.1	-4.0
	Taiwan	-1.0	-1.3	-44.8	-22.7	-45.8	-24.0	-1.2	-4.3
G3	China	6.9	6.8	-65.5	-43.9	-58.6	-37.1	9.3	8.0
	India	-19.1	-17.7	-52.5	-28.6	-71.6	-46.3	7.5	6.5

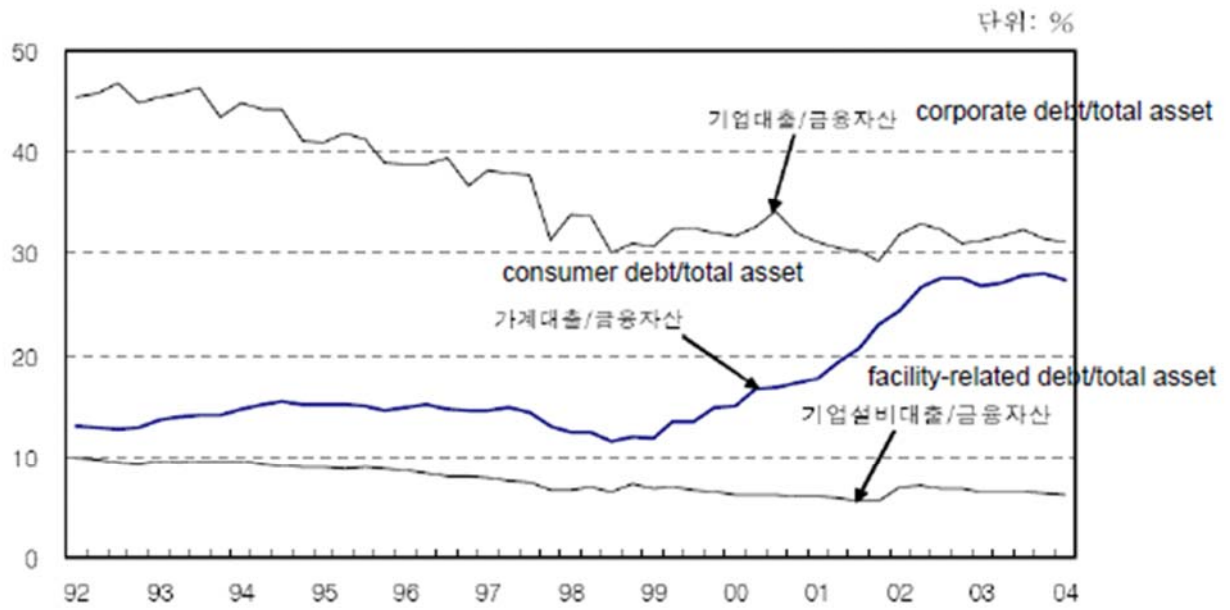
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## 2. A balance sheet recession

- Household debts overhang
  - a push for consumption-led growth?
  - a miserable failure
  - eg. credit card crisis,
  - lower consumption growth rate
- Continuing regulations on corporate debt-equity ratio
  - more problematic to SMEs and 2nd-tier *chaebols*

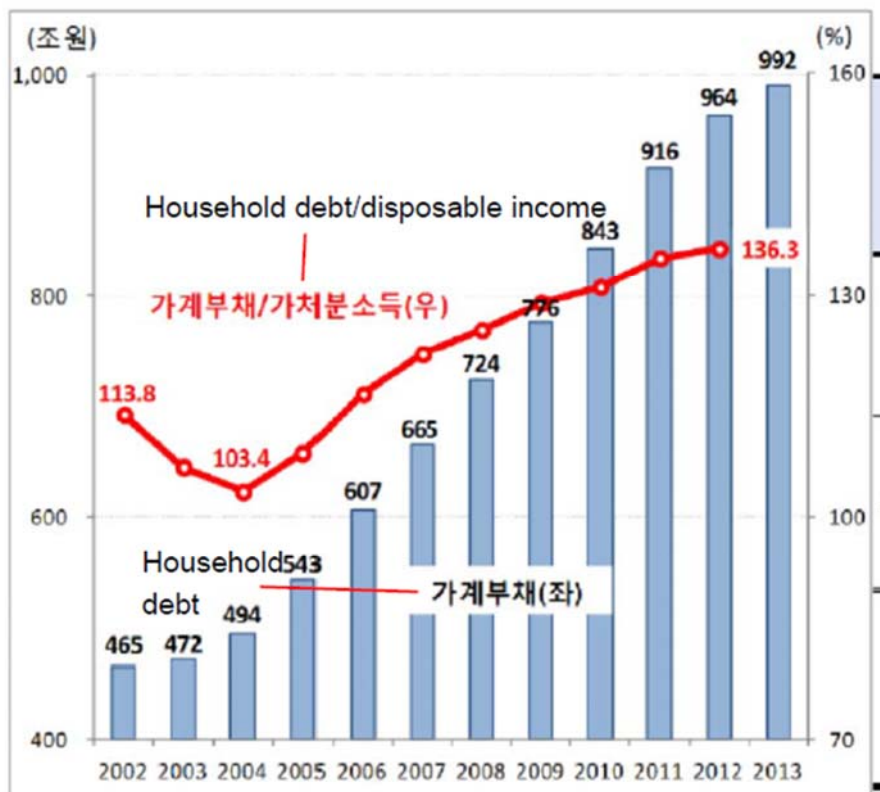
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Figure. Composition of Assets Held by Deposit Banks



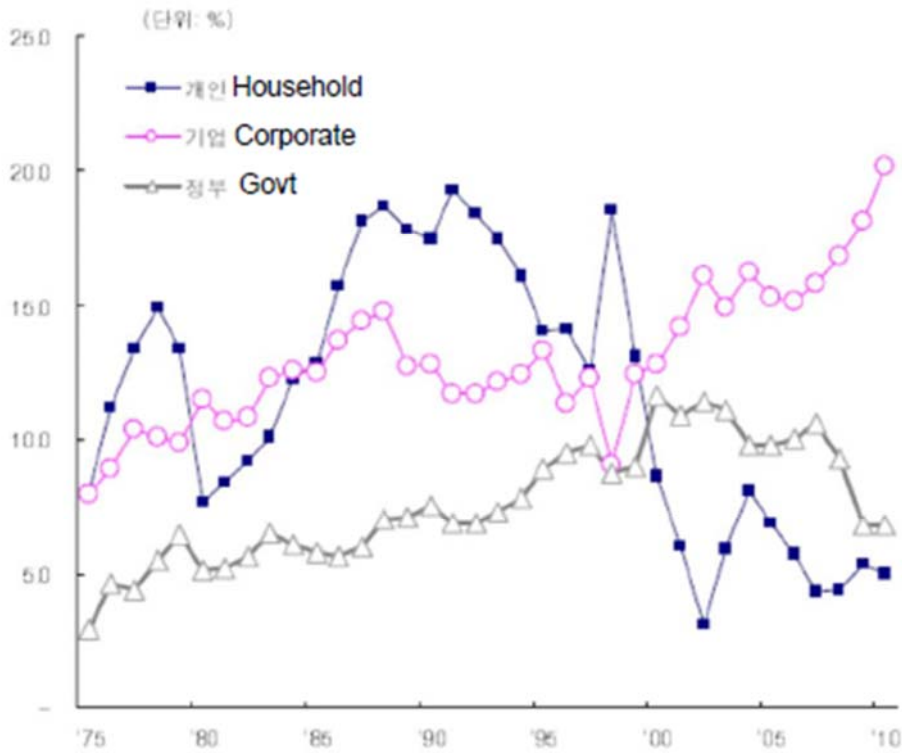
Source: Kang (2005)

### Increase in Household Debts



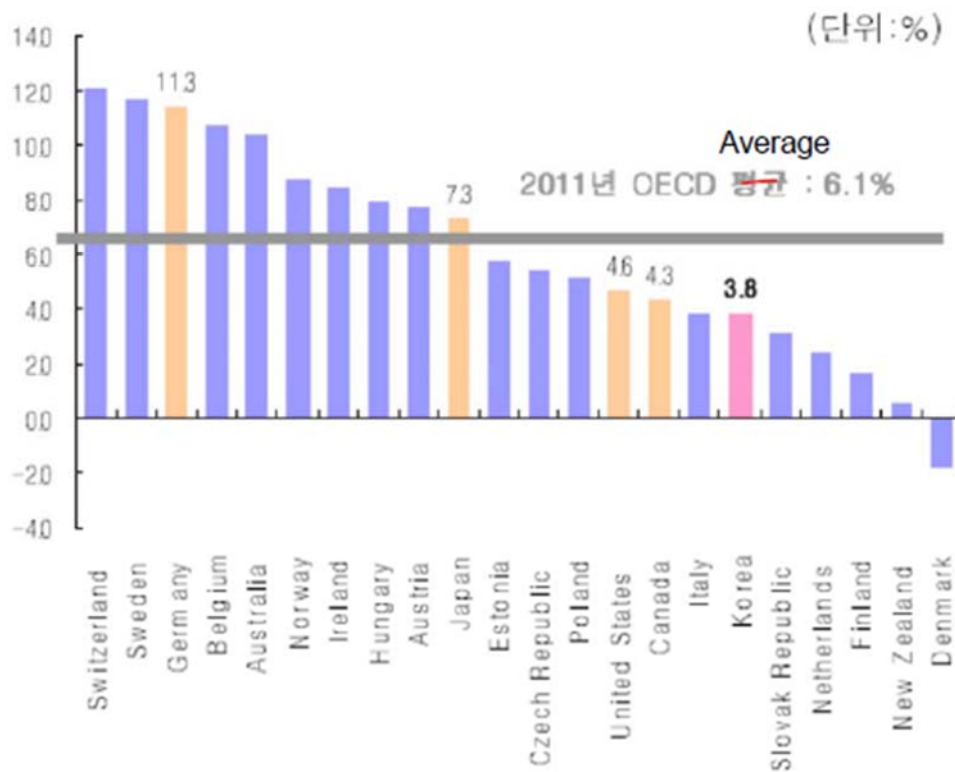


## Trend of Household Net Savings Rate (OECD)



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## Net Savings Rate Across OECD Countries (2011)



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## 3. A population problem

- The spectre of population nightmare?
  - The most rapidly ageing country
    - the end of 'population dividend' in 2012  
cf. Japan's end in 1991
    - the shrinking of 'economically active population' from 2016
  - The lowest fertility rate
  - Possibility of changing immigration policy?

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## A comparison: Japan vs. Korea

1. The structuralist view
  - a very weak argument
2. The balance sheet recession view
  - a bubble bust + policy 'zigzag'
  - policy-driven corporate balance sheet recession and its aftermath + balance sheet recession caused by household debts
3. A population problem
  - common to both countries, but Korea's problem likely to be more serious

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# Abenomics vs. Choi-nomics

- “Three Arrows of Abenomics”
  - (1) monetary easing
  - (2) fiscal stimuli
    - combating the balance sheet recession
    - ‘wage surprise’ happened?
  - (3) structural reforms
    - what for?
- Any solution to the population problem?

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# Abenomics vs. Choi-nomics

- Choi-nomics
  - (1) monetary easing
  - (2) fiscal stimuli
    - resolving debts overhang by increasing more debts? How to increase growth rate?
  - (3) structural reforms – more deregulations
    - what for?
- Any solution to the population problem?

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