

A Lost Decade for the Global Economy?

- Lessons from the Japanese Experience -

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Where we stand

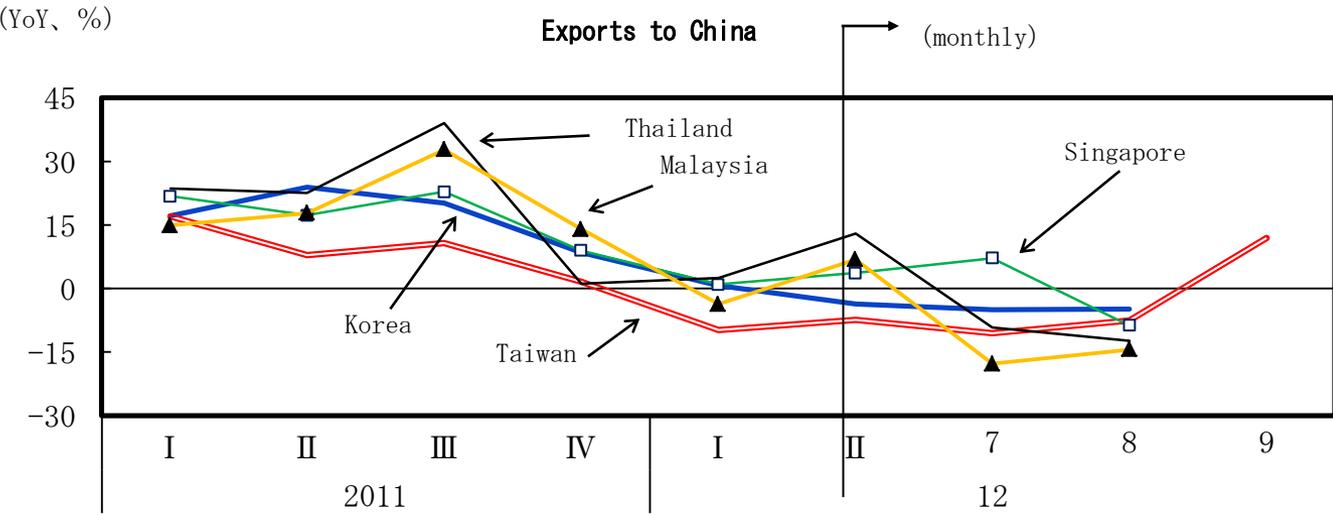
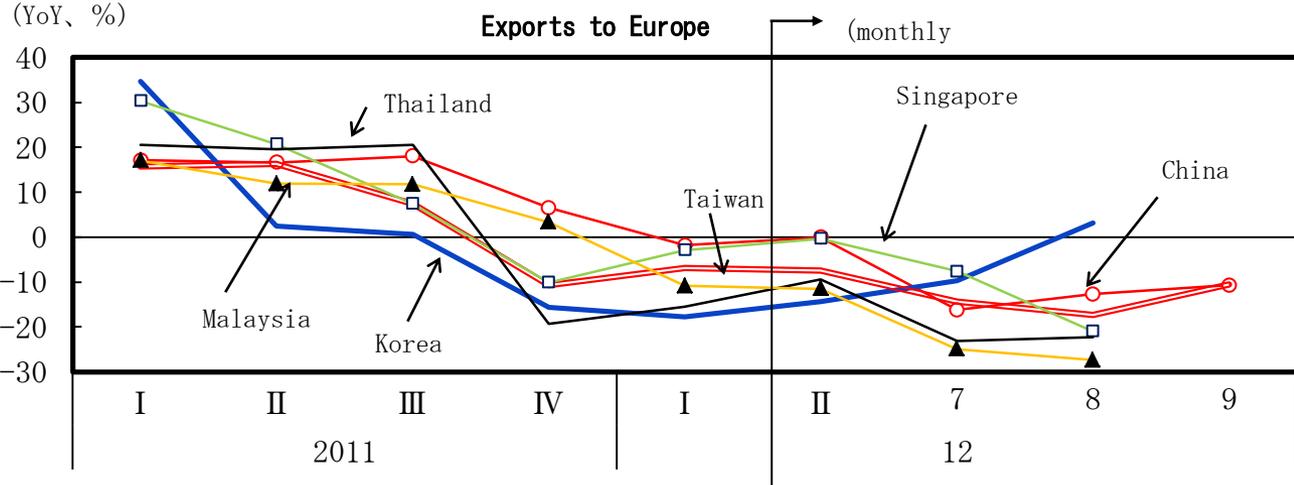
A lost decade for the global economy?

- Without policy actions, there will be;
 - A lost decade for the advanced economies
 - Agreement with Jörg
 - A lost decade for the emerging and developing economies as well
 - Disagreement with Jörg
- The necessary policy actions are structural policies
 - Structural policies to transform the economic system
 - Difference in emphasis with Jörg

A lost decade for the emerging and developing economies

- Decoupling of economic performance in AE and EDE is difficult in a globalized economy.
 - The hypothesis has been tested for a number of times in the past and has been denied.
 - They will be affected by decline in exports to Europe. → Next figure
 - It has to be the case even more so because EDE's growth is not that strong. → (Jörg's slide 11)

Exports from Asian economies



The root of the problem: Economic systems in transition

- Financial system
 - Basel regulation
 - US system
 - EU system
- Public finance and social security system
 - Reducing deficits and public debt
 - Reform social security system to be sustainable
- Energy supply system
 - Reducing dependence on nuclear power generation
 - Encouraging generation by renewable resources

Difficulties of the transition

- Overall reform becomes necessary. Partial reform is often not possible.
 - Economic systems are complementary to each other (Comparative Institutional Analysis).
- Transforming economic systems is going to be a long and a difficult task.

Transition's negative short-term impact

- Transition of systems requires adjustments.
- They exert downward pressure on economy.
 - Deleveraging
 - Where is it taking place? → (slides 9,19, and 20)
 - Spending cuts and raising taxes
 - Lower benefits and higher contribution
 - Energy conservation and higher electricity rates

What “lost decade” means

- “Lost decade” is about transforming economic systems, not only about a macroeconomic stagnation.
- Japanese experience offers some lessons.

“Lost decade” in Japan

- “Lost decade” (1991-2001) was a result of the burst of the *Bubble Economy* (1986-1990).
- It was not a cyclical phenomenon.
- It was a result of the fact that the Japanese economic system, which supported the *Rapid Growth Period* (1955-1970), has become outdated.
 - Demographic change (i.e. aging and decline of population)
 - Globalization (e.g. competition from emerging economies)
 - Technological change (e.g. IT revolution)

“Lost decade” in Japan (contd.)

- Japan still hasn't completed the transition.
 - What is to come after the *lifetime employment system*?
 - What is to come after the *main bank system*?
 - What is to come after the *keiretsu system*?
- Recovery in the 2000s has been helped by external demand, while domestic demand remains to be weak.
- Suggestions that Japan is facing “lost two decades” !

Future of the global economy

- It depends on whether economic systems will be overhauled at this occasion
- The *new* economic system needs to be;
 - Growth friendly
 - Distortion free
 - Sustainable
 - Incentive compatible
 - Globally consistent
- Global rebalancing will not settle without sustainable domestic balances, which would only be made possible by the new economic system.

What G20 can do

Creating the basis for structural policy coordination

- Transforming economic systems require international coordination
 - There are externalities.
 - There are constraint in available instruments offsetting negative influences.

Three possible scenarios

- *Scenario A*
 - Successful transition to new economic systems
 - “Lost decade” avoided. “Prosperous decade” in sight
- *Scenario B*
 - Muddling through with the problem
 - “Lost decade”, with a possibility of an extension

Three possible scenarios

- *Scenario C*
 - Trying to grow out of the problem by short term stimulus
 - Short breathing time, but “lost decade” coming later
- Macroeconomic policies without economic reforms is dangerous.
 - It provides excuses for postponing economic reform.
 - It accompanies risks.

Risks of macroeconomic policies without economic reforms

- Risk in an active monetary policy without economic reform
 - Because real activities are structurally constrained, it may create bubbles in asset markets.
- Risk in an active fiscal policy without economic reform
 - Because multiplier effects will be limited, it may end up piling-up public debt which will leave less room for dealing with aging of population.

Suggestions for the G20

- G20 should have in sight *economic system reforms* as well as *macroeconomic policies*.
- G20 could be a forum for creating the basis for *international coordination of economic system reforms*.

Suggestions for the G20 (Contd.)

- Coordination of economic system reforms
 - It is not only about financial sector reforms.
 - Japan made lengthy efforts to dispose non-performing loans, and to restructure the financial sector. But it is still suffering from “the lost two decades”.
 - It is not only about fiscal consolidation.
 - Raising taxes changes incentives.
 - Cutting expenditures involves changes in pensions, health care, etc.
 - It is about reforming the whole economic system!

Thank you for listening!

Jun Saito