

# A Lost Decade for the Global Economy?

## - Lessons from the Japanese Experience -

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G20 Countries

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Where we stand

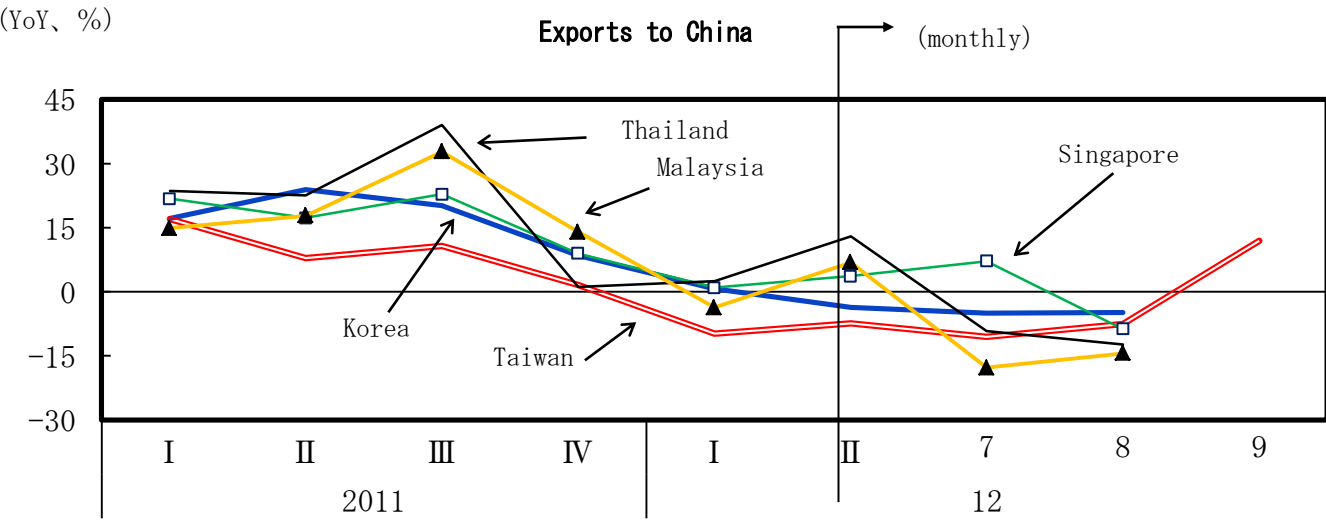
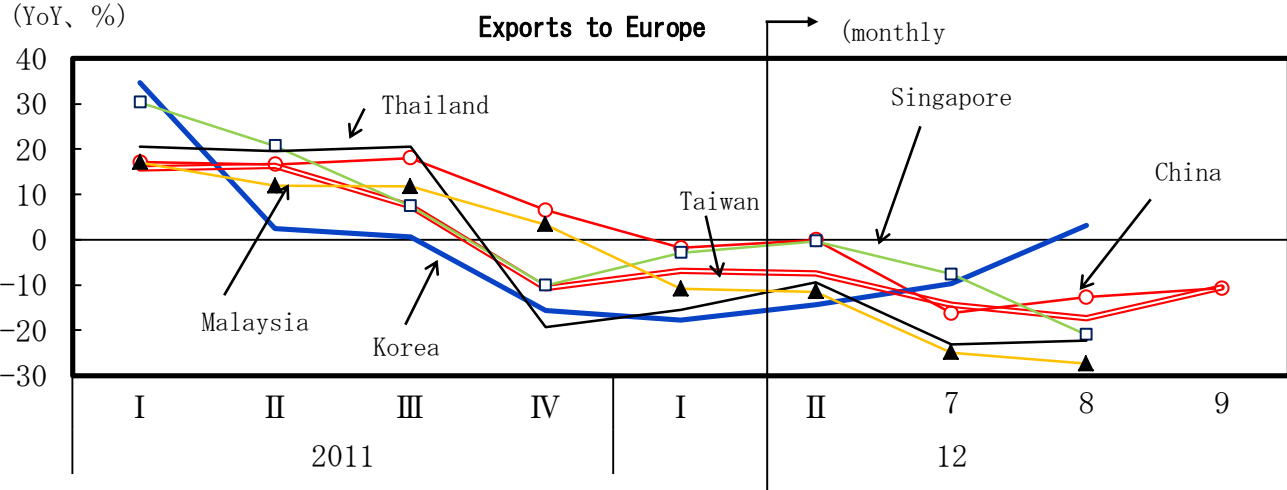
# A lost decade for the global economy?

- 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!

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