

THE CAUSES OF THE JAPANESE LOST DECADE

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Abstract: As it's stated in the title, this article's aim is to present the causes that have led Japan to a decade with an economic stagnation, called in the literature „The Japanese lost decade”. I will present manufacturing output growth outside of Japan as well as the impact it has had on the Japanese small and medium enterprises, on the Japan's jobless rate, on the trade balance and on the domestic production. I will analyze also the impact of banks on the economic growth, which have infested the real economy after the '89 crisis. Ultimately for a better highlight of the causes of Japanese lost decade, I will present the evolution of gross investments during the reporting period, as well as the decline in weekly hours worked in Japan.

Keywords: Japanes lost decade, lost decade, economic stagnation, Japanese economy

After a period in which the Japanese economy recorded an impressive advance, with the crisis started in the late 80s, Japan had to enter into a period of economic stagnation. Among the causes that led to this stagnation we remember: the outsourcing phenomenon, banking crisis, declining investments, reducing the number of weekly working hours etc.

Outsourcing

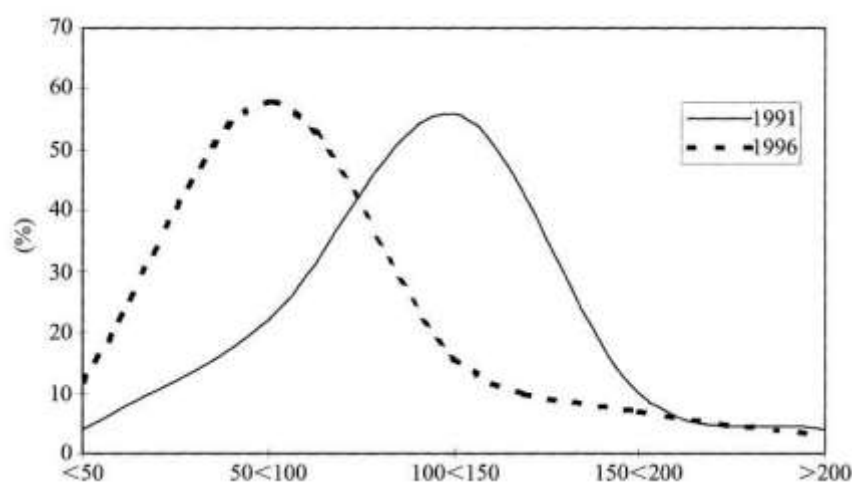
One of the factors that led to a change in the fundamentals of the Japanese was the outsourcing, due to the explosion of FDI after 1985.

Even if the major Japanese companies that operated on foreign markets owned a significant market share¹, in Japan, due to the fact that they have left the boundaries to produce in other countries, many subcontractors found themselves in the situation to have their contracts significantly diminished; moreover, their bargaining power was decimated as transnationals could supply from other markets too.

Having this possibility, many big companies were taking advantage of it, and in addition, both the United States and European Union have imposed strict rules in terms of the provenance of the product, "local content" to be sold on their territories without additional charge. These factors have led to a decrease² in the average number of orders, as can be seen in Figure 1.

¹ According to UNCTAD (UNCTAD. World Investment Report: Foreign Direct Investment and the Challenge of Development New York. New York: United Nations Conference on Trade and Development, 1999, p 43), in 1997, they amounted to own 12% of the corporate, being exceeded only by U.S. multinationals.

² If in 1986 the Japanese transnationals procure 55% of Japanese intermediate percentage decreases significantly because 10 years later to be only 37% (Cowling, Keith and Philip R. Tomlinson. The Japanese Crisis - A Case of Strategic Failure? The Economic Journal, Vol 110, No. 464, 2000: pp. F358-F381, F375 page).

Figure 1. Average number of orders for SMEs 1991 Vs 1996

Source: http://www.chusho.meti.go.jp/sme_english/whitepaper/1996/1996, last accessed 04/05/2014.

Thus, the early '90s brought an impressive number of bankruptcies among small and medium enterprises (accounting for over 98% of all companies). SMEs that have not gone bankrupt saw, thereby, their profit margins greatly diminished, as shown in Table 1.

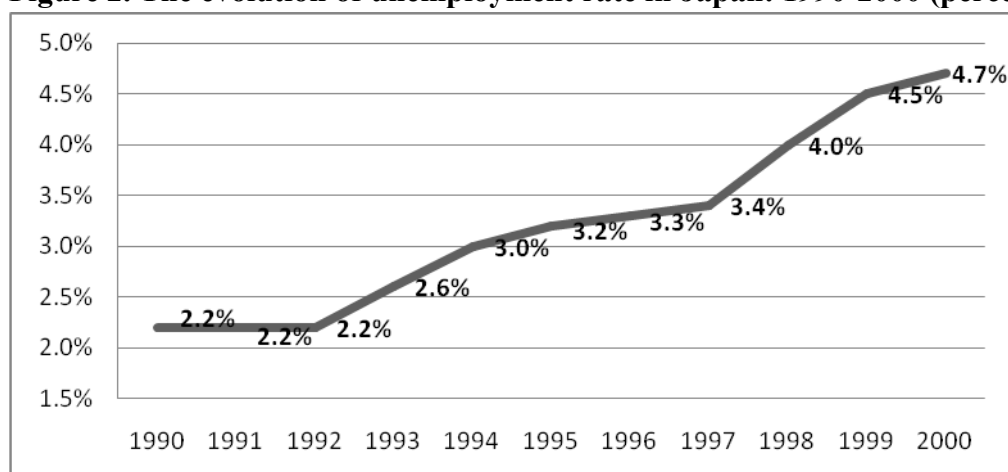
Table 1. The evolution of gross margin profit of Small Firms between 1986-1991 and 1992-1997

| Gross margin profit | | | | |
|---------------------|-------------------|----------------------|----------------------|---------------------|
| Period | All manufacturing | Industrial machinery | Electrical equipment | Transport equipment |
| 1986-1991 | 3.5 | 4.2 | 3.7 | 3.3 |
| 1992-1997 | 1.6 | 0.9 | 1.4 | 1.5 |

Gross margin profit= ratio of gross profit/gross sales

Source: (Cowling și Tomlinson 2000, 19)

As a result of both the fact that the big companies were producing abroad and SMEs were in a delicate period, the unemployment rate increased in this decade nearly 2.5 times (as can be seen in Figure 2). If traditionally, Japan was close to full employment through the lifelong employment system, since 1992 the unemployment rate practically exploded, reaching almost 5% level across the U.S.

Figure 2. The evolution of unemployment rate in Japan: 1990-2000 (percent)

Source: <http://www.stat.go.jp/english/data/chouki/19.htm>, last accessed 04/05/2014

In a comparative analysis of production across borders, concerning the manufacturing sector we can see that Japan recorded the highest growth, with more than 330% between 1985 and 1997, while the United States had an extra 67% and Germany 44%.

Table 2. Comparative Growth of Japanese Manufacturing Production Overseas Percentage of Domestic Production

| | 1985 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 |
|--|------|-------|-------|-------|-------|-------|-------|
| Industry 1985=100 | | | | | | | |
| All Manufacturing (Index 1985=100, all countries) | | | | | | | |
| Japan | 100 | 206.7 | 246.7 | 286.7 | 300 | 386.7 | 433.3 |
| USA | 100 | 156.6 | 150.6 | 156.6 | 172.9 | 165 | 167 |
| Germany | 100 | 109.6 | 128.3 | 138.5 | 141.6 | 143.5 | 144 |
| Proportion of output produced overseas (%) | | | | | | | |
| Japan's industrial sectors: | | | | | | | |
| Chemicals | | 4.8 | 7 | 8.1 | 8.3 | 10 | 11 |
| Electrical machinery | | 10.8 | 12.6 | 15 | 16.8 | 19.7 | 20.3 |
| Industrial machinery | | 4.1 | 5.8 | 8.1 | 8.1 | 11.7 | 13.4 |
| Precision tools | | 3.6 | 5.6 | 6 | 6.6 | 8.6 | 9.7 |
| Steel and iron | | 5.0 | 6.3 | 5.4 | 9.2 | 12.1 | 13.7 |
| Textiles | | 2.3 | 3.2 | 4 | 3.5 | 7.6 | 8,5 |
| Transport equipment | | 17.5 | 17.3 | 20.3 | 20.6 | 24.9 | 27.4 |
| All industries | 3.0 | 6.2 | 7.4 | 8.6 | 9.1 | 11.6 | 13 |
| Japanese TNC's | 8.7 | 17.3 | 18.3 | 22 | 25.1 | 27.5 | 29.2 |

| Japanese overseas manufacturing employment | | | | | | | |
|--|--|-----|------|-----|------|------|--|
| Absolute number (millioans) | | 1.1 | 1.5 | 1.8 | 1.8 | 2.2 | |
| % of domestic employment | | 7.2 | 10.8 | 12 | 12.8 | 17.2 | |

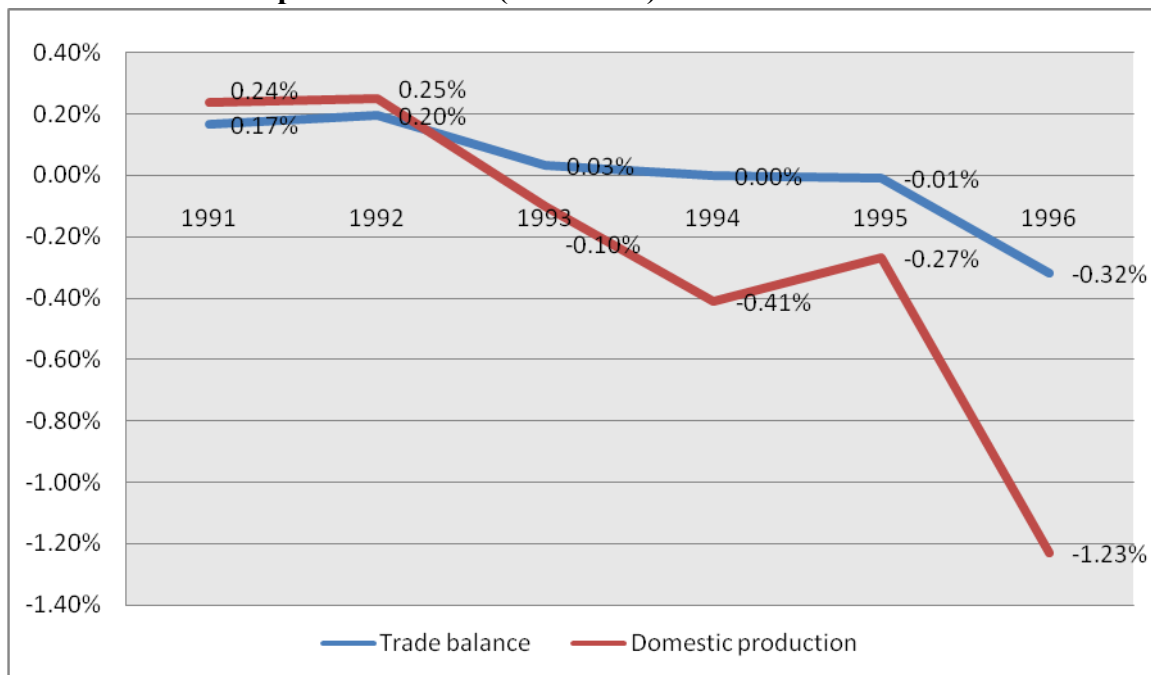
Japanese TNC: Sony, Panasonic, LG, Toyota, Nissan, Honda

Source: (Cowling și Tomlinson 2000, 16)

The number of employees in Japanese manufacturing system fell by over 1 million, ie 10% between 1992-1996, while abroad doubled from 1.1 to 2.22 million, representing 17.2% of the working population in Japan in this field (according to data in Table 2).

According to some empirical studies of MITI, it has resulted that the stagnation of the Japanese economy was in close correlation with the transnational activity. After analyzing unemployment, Keith Cowling and Philip R. Tomlinson went on and did their own analysis, which revealed:

Figure 3. Net Impact of Japanese Outsourcing on Trade Balance and Domestic Production as a Proportion of GDP (1991-1996)



Source: (Cowling și Tomlinson 2000, 21)

Thus, in Figure 3 can be seen that the outsourcing had a marked effect on both the trade balance and domestic production.

Regarding the trade balance, Japan, besides the fact that it exported less, began to encounter problems to opposing imports too, which reached 11.2% of total imports in 1996 (80% were from Asia), reducing the commercial surplus from the nominal point of view and the real one. Secondly, the decrease in domestic production became even more serious, for example, in

1995 the external production of 3 major auto giants Toyota, Honda and Nissan exceeded the internal one. If in 1985 less than a third of Japanese TV sets were produced outside of Japan, in 1988 the percentage would equilibrate to 50-50%, so that in 1996 to produce externally 40.5 million colour TVs, that is six times more than internally³.

In addition to this phenomenon of outsourcing, to the financial crisis that confronted Japan was added an economic one too, the disastrous situation of banks infesting also the real economy. Several authors⁴ showed that this occurred primarily because of the importance of the credit channel of monetary policy transmission, weakening the financial institutions by drastically reducing their effectiveness.

The banking crisis

The banking crisis has affected macroeconomic fundamentals, generating instability, due to the decision of banks to increase loans, even when the odds that these would be paid were extremely low. This explains why bank profits were significantly reduced and also the very difficult growth of the Japanese economy, many companies "crawling" only because of refunds, subsidies, etc.

This type of companies, called "zombie" not only suffered losses, but through the advantages they enjoyed, they prevented other companies in those sectors to establish. A study conducted by Caballero, Hoshi and Kashyap⁵ shows that while the jobs created in the construction industry fell sharply, waiving the employees became extremely difficult, which shows a lack of restructuring of the system. The same authors brought empirical evidence according to which sectors that encompass several companies of "zombie" have performed worse than those who had fewer such companies.

Healthy banks no longer gave loans considering that businesses will be very hard to fight those "zombie" supported by "bad banks" and subsidies. In addition, there is a lack of confidence at the level of financial institutions refusing to lend each other because they did not know which ones have underperforming credit and in what percentage.

Therefore, troubled banks infested both the financial system and the real economy (through lending companies that could not repay loans), the chosen solution being the injection of liquidity into profitable activities.

We disagree with the extreme explanation made by Fumio and Prescott⁶, according to which the Japanese financial sector development is not relevant, and that is because Japanese companies would have been able to find funding elsewhere. In our opinion, only a part of the Japanese companies had access to leverage loans from international markets, but as I pointed

³ Cowling, Keith și Philip R. Tomlinson. *The Japanese Crisis - A Case of Strategic Failure?* The Economic Journal, Vol. 110, No. 464, , 2000: pp. F358-F381, pag 17, 21.

⁴ As Woo David (Woo, David. *In Search of Credit Crunch: Supply factors behind the slowdown in Japan*. IMF Working paper, 1999: 1-37), Morsink James și Bayoumi Tamin (Morsink, James, și Tamin Bayoumi. *The monetary transmission mechanism in Japan*. Japan: Selected issues IMF, 1999: 1-30), Sekine Toshitaka (Toshitaka, Sekine. *Firm investment and balance-sheet problems in Japan*. IMF working paper, 1999: 1-31), Kwon Eunkyung (Kwon, Eunkyung. *Monetary Policy, Land Prices, and Collateral Effects on Economic Fluctuations: Evidence from Japan*. Journal of Japanese and International, 1998: 45-63).

⁵ Caballero, Ricardo J., Takeo Hoshi și Anil K. Kashyap. *Zombie Lending and Depressed Restructuring in Japan*. American Economic Review, 2008: 1943-1977.

⁶ Fumio, Hayashi și Edward C. Prescott. *The 1990s in Japan: A Lost Decade*. Review of Economic Dynamics, 2002: 206-235.

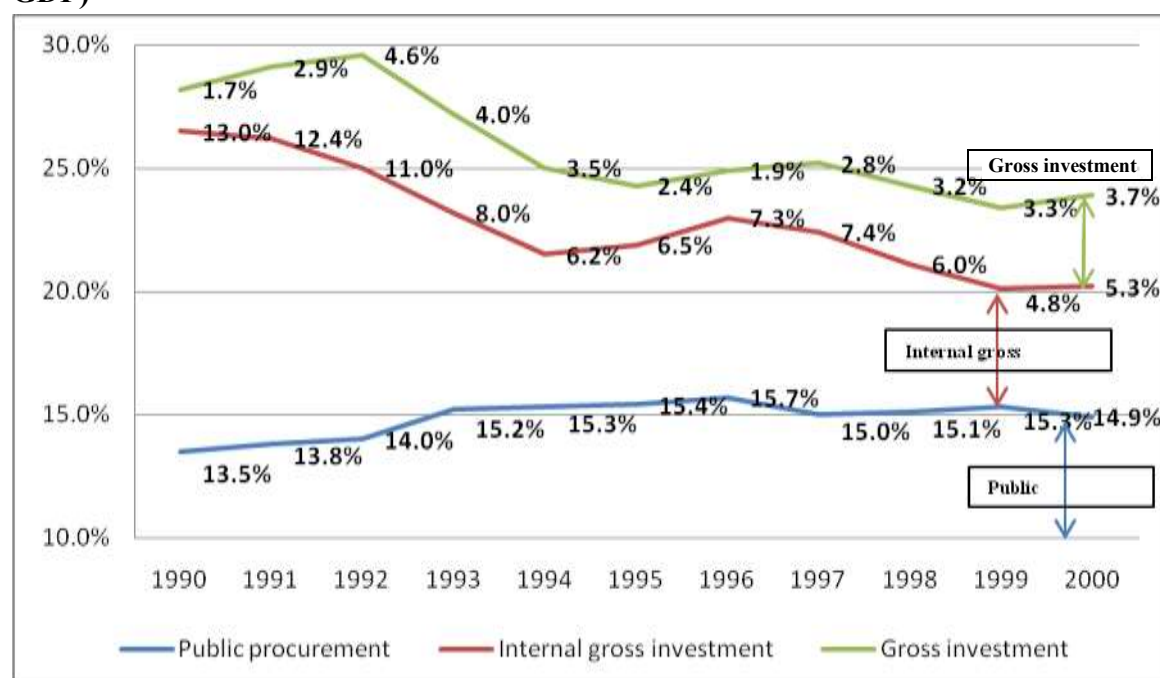
out, as a result of this, they were becoming less dependent on the state and less responsive to its wishes. In addition, small and medium enterprises accounted for over 98% of all companies.

The decrease of investments

Another reason that led to the Japanese economic stagnation during this period was related to declining investments. After a survey of large companies, Kazuo Ogawa and Suzuki Kazuyuki⁷ brought important evidence, according to which the price of land as collateral significantly affected their investments.

Changing the paradigm of economic growth from the "steady-state growth path" to the "steady-state capital-output" led to a significant decrease in the Japanese productivity investments following a downward trend, as can be seen from Figure 4.

Figure 4. Evolution of public procurement and gross investment: 1990-2000 (Percent of GDP)



Source: (Fumio și Prescott 2002, 9)

Diminishing the number of hours worked per week

Another important factor of this stagnation we consider to be the decrease in hours worked per week, due to the revision of the Labour Standards Law (consequence of the report Maekawa). In order to provide more leisure time to employees (to boost domestic demand) it was decided to triple the number of national holidays.

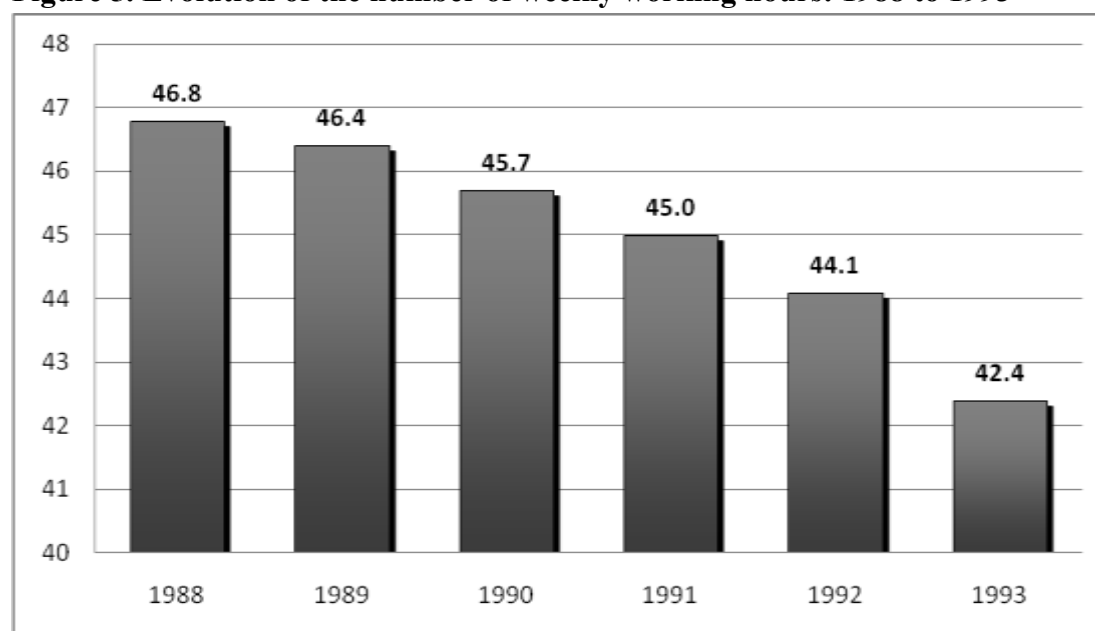
As we can see in Figure 5, the actual number of hours worked per week decreased from 46.8 to 42.4, which means a reduction of almost 10%, while wages have remained the

⁷ Ogawa Kazuo și Kazuyuki Suzuki. *Land Value and Corporate Investment: Evidence from Japanese panel data*. Journal of the Japanese and International Economies, 1998: 232-249.

same. The immediate effect was the increase in labour costs, which subsequently influenced the companies.

As empirically demonstrated Fumio Hayashi and Edward Prescott⁸, these last two factors (low investment and working time) had an increased importance as these were strongly affecting a traditional Japanese element, namely the productivity factor, the strong chapter of Japanese economic growth. Stephen Roach (quoted by Nouriel Roubini⁹), important analyst on Wall Street, said that "the road towards the revival of Japanese competitiveness will be longer and harder than that of U.S. in the early 80".

Figure 5. Evolution of the number of weekly working hours: 1988 to 1993



Source: <http://www.stat.go.jp/english/data/chouki/19.htm>, last accessed: 06.04.2014

Conclusions

The banking crisis has affected macroeconomic fundamentals, generating instability such as lack of funding, lack of trust existing in the market (between firms and banks, and the banks between them), along with the reduction factor productivity made the small and medium enterprises to perform increasingly weaker, and in Japan their share is a significant one.

Once the crisis deepened, and the cutting of investments, in conjunction with reducing the average number of hours worked weekly, these put their mark on the degradation state companies, respectively Japanese companies.

All this, but also the phenomenon of outsourcing have forced the Japanese archipelago to the point where they no longer managed the increase we were accustomed with after the Second World War, even with the recession where they struggled at the end of the 1990 - 2000 registered an average of only 1%. It was a time when Japanese economic growth was in the range (-2, 2%), called in this case, by many authors as the "lost decade".

⁸ Fumio, Hayashi și Edward C. Prescott. *The 1990s in Japan: A Lost Decade*. Review of Economic Dynamics, 2002: 206-235, pag. 212.

⁹ Roubini, Nouriel. *Japan's economic crisis. Business practices and entrepreneurial spirit in Japan and the United States*. Tokyo: Tokyo University Press, 1996. 1-6, pag 4,5.

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