

# New Opportunities for Polish-Japanese Cooperation: Diagnosis and Prospects

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# The Japanese economy and the global financial crisis

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## 1. Introduction

The purpose of this paper is to provide an overview of the Japanese economy and its problems after the global financial crisis, and to discuss the prescription which the government is carrying out. The discussion in this paper shows the importance of new opportunities for the Japanese economy, such as those for V-4 and Japan cooperation, which is the main topic of this conference.

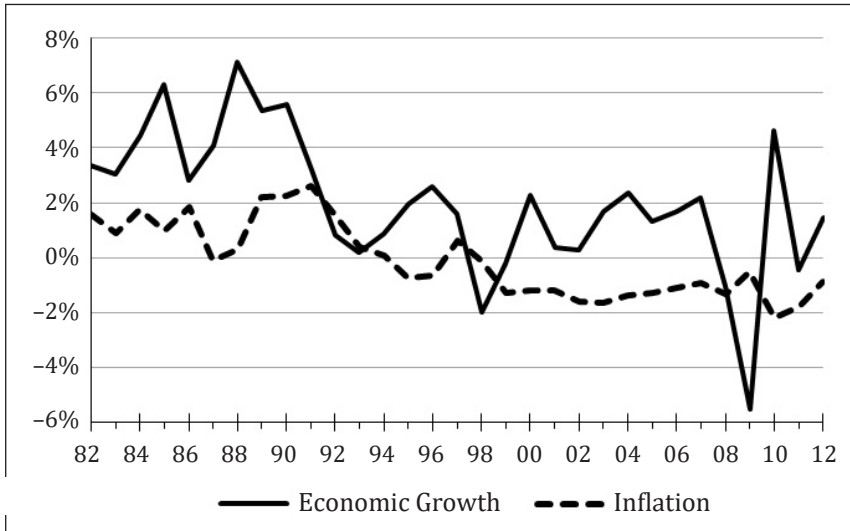
When the global financial crisis hit the world economy, Japan had not fully recovered from the sustained stagnation after the burst of the Japanese bubble in the early 1990s. This made it more difficult for Japan to cope with its economic difficulties. The global financial crisis, together with the earthquake disaster in 2011, kept the economy slow, and the government announced a package of economic policies called “Abenomics” in early 2013 to revitalize the economy.

Section 2 provides an overview of the situation of the Japanese economy in order to discuss its current problems. Then Section 3 examines how effective the “Abenomics” has been to solve the problems. Since it consists of three major policies, the effect of each of them is discussed. The discussion here shows that the Japan needs new economic opportunities for revitalization.

## 2. The “Lost Two Decades” and the global financial crisis

The Japanese economy was in a sustained stagnation called the “lost two decades” when the global financial crisis hit the world. Hence this section provides an overview of the economic situation during these decades and discusses the problems that should be solved in order to recover from the damage caused by the global financial crisis.

The Japanese economy enjoyed the prosperity brought about by the bubble in the late 1980s, but the bubble burst in early 1990s, which started Japan’s sustained stagnation. Figure 1 below shows this economic situation. Economic growth slowed down sharply in early 1990s, and the inflation rate is negative in most of the periods after 1994.



**Fig. 1.** Japanese economy in the lost two decades

**Note:** Real GDP growth rate and the rate of change in GDP deflator

**Source:** Cabinet Office, Japan

It is widely admitted that the stagnation was caused by the structural problems of the economy.<sup>1</sup> During the prosperity of the bubble, inefficient firms – which should have been expelled from the market – sur-

1 For example, see Miyao (2006), chap. 8.

vived, and they were reluctant to make efforts to become efficient. Such firms are now called “zombie” firms,<sup>2</sup> and they kept surviving even after the burst of bubble. They exhibited low productivity, so they stagnated the economy. They also had troubles in paying back their bank borrowings, which led to an accumulation of nonperforming loans which amounted to 40 trillion yen in 2002. This damaged the banking sector and caused a credit crunch, which deteriorated the situation of the Japanese economy.

In order to revitalize the firms, and thus the economy, the zombie firms needed to become efficient, or they needed to be expelled from the market to shift their capital and labor to other efficient firms. To promote such structural changes, the government needed to offer a more competitive free market environment for firms and their production activities, instead of protecting them.

The government prompted the banks to deal with the nonperforming loans, aimed both at promoting the structural changes and easing the credit crunch. The nonperforming loans began to decrease after 2002, and the Japanese economy was beginning to pick up slowly. By 2006, the economy seemed to have attained steady growth, though the structural problems were not completely removed.

It was then that the global financial crisis hit the world. The crisis had a huge negative impact on many developed countries, and Japan was no exception, as shown in Figure 1. However, as the financial markets returned to normal, the affected countries quickly started recovering. For example, the U.S., the U.K. and the Eurozone underwent deflation, but their CPI inflation rates reverted to positive by the end of 2009, while that of Japan stayed negative.<sup>3</sup> The crisis had a more severe and longer impact on the Japanese economy, mainly because Japan had not fully solved the structural problems that had arisen from the bubble and its burst.

Thus, Japan needed to solve its structural problems in order to recover its economic growth after the global financial crisis. Unfortunately, after the crisis, Japan suffered from the Earthquake in East Japan in 2011. These shocks kept depressing the economy and made the sustained stagnation even longer. To deal with the stagnation, the Abe administration introduced the package of economic policies called “Abenomics” in early 2013. These are discussed in the next section.

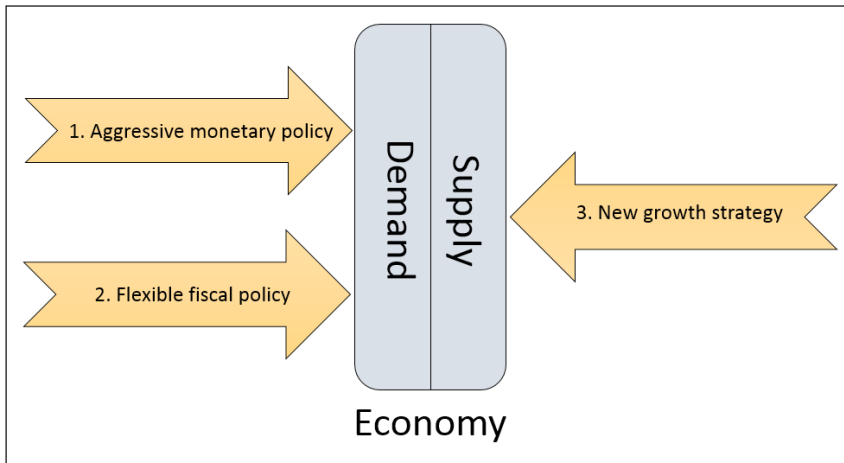
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2 The definition and details of zombie firms are given by Hoshi (2006).

3 For these data, refer to the International Financial Statistics at the IMF website.

### 3. The three arrows of Abenomics

The package of economic policies known as “Abenomics” consists of three “arrows,” which are named after the old Japanese tale from the 16th century. The three arrows are shown in Figure 2.<sup>4</sup> The first and second arrows are the policies to affect demand-side of the economy, and the third arrow is the one aimed at affecting the supply-side, a distinction which is important to the later discussion in this paper.



**Fig. 2.** Three arrows of Abenomics

**Source:** Author

#### 3.1. Aggressive monetary policy

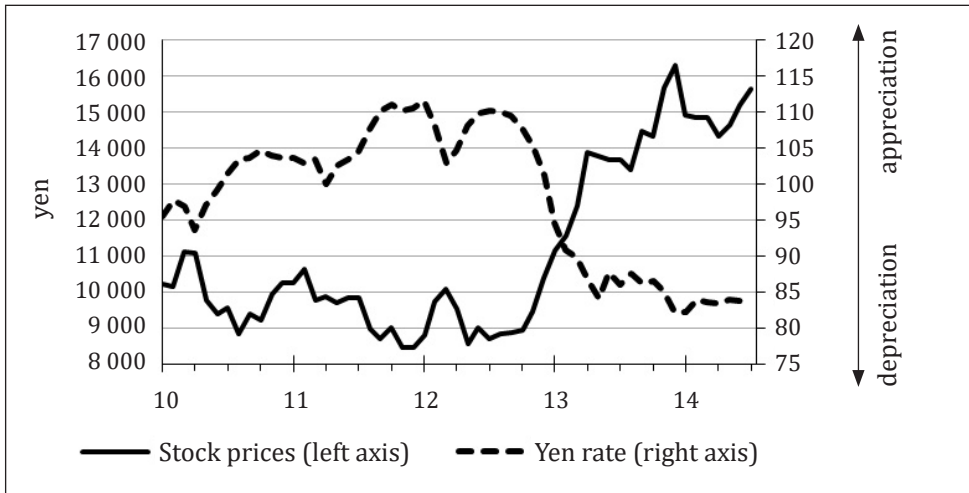
The first arrow is the quantitative easing, while the policy’s interest rate is kept as low as zero. In April 2013, the Bank of Japan (BOJ) announced that it would double the monetary base in two years to achieve 2% inflation. To increase the monetary base by more than 130 trillion yen, the BOJ planned to purchase the Japanese Government Bonds (JGBs).<sup>5</sup>

<sup>4</sup> The details of Abenomics are explained by the Cabinet’s document, “Basic Policies for Economic and Fiscal Management and Reform: Ending Deflation and Revitalizing the Economy,” in June 2013. The Cabinet provides its provisional English translation on its homepage.

<sup>5</sup> See the statement on monetary policy by the BOJ on April 4, 2013.

This aggressive policy of monetary easing had an immediate effect on the financial markets. Figure 3 shows the sharp increase in stock prices and drastic depreciation of the yen.

However, its effect on economic growth and inflation remains controversial. This is because the standard theories of monetary policy argue that an interest rate change plays a key role in order for the policy's effect to be transmitted to economic activity. In Japan, with the interest rates near zero, there is no room for them to fall any further. Those who support the effectiveness of quantitative easing believe that inflationary expectation plays a key role, but this again is open to argument.<sup>6</sup>



**Fig. 3.** Stock prices and Foreign Exchange Rate

**Note:** Nikkei 225 index and nominal effective exchange rate of the Yen (2010 = 100)

**Source:** Yahoo! Japan and the Bank of Japan

### 3.2. Flexible fiscal policy

The second arrow is the fiscal expansion policy. Since the government expands its demand for goods and services, firms sell more to the government, which pulls the economy.

The policy has an immediate effect on economic activity, but it is effective only so long as the government keeps spending. Any spending in excess of the tax revenue must of course be financed by borrowing. With the fiscal expansion policy, the government has accumulated a large national

<sup>6</sup> See Tanaka (2013) for detail.

debt, which is expected to reach nearly 230% of GDP at the end of 2014.<sup>7</sup> This ratio is much worse than in Greece, and such an expansionary policy cannot be sustained forever.

Moreover, there is a concern that the combination of the first and second arrows may hurt fiscal discipline. With the huge outstanding JGBs, their interest rates are less than 1% because the BOJ is keeping them low by purchasing the JGBs. The government plans to issue 84.2 trillion yen of JGBs in total in the fiscal years of 2013 and 2014.<sup>8</sup> The BOJ plans to purchase 7 trillion yen of JGBs per month from the market during these two years and to increase its JGB holdings by 50 trillion yen per year.<sup>9</sup> The BOJ's holding reached 215 trillion yen, which is 21% of the entire outstanding JGB, in June 2014.<sup>10</sup> Even though direct underwriting by the BOJ is prohibited, the central bank is virtually supporting the fiscal deficit through the market.

Thus, Japan is facing the choice between economic growth and fiscal discipline. The government raised the rate of consumption tax (VAT) in April 2014, and it aroused concern over its negative effect on economic growth. The government is working on some other tax reforms to achieve a well-balanced combination of growth and discipline.

### 3.3. New growth strategy

The third arrow is industrial policy. It is a policy to offer a competitive free market environment for firms and their production activities by deregulation, tax reduction, subsidization, building infrastructure, and so on. While the first and second arrows affect the demand-side of economy, the third arrow affects its supply-side.

The demand-side policies may be able to stimulate the economy by expanding demand, but they do not solve the structural problems that inefficient firms face in their production activities as suppliers. It is industrial policy that helps these firms to become efficient and productive, i.e. to solve their structural problems.

As discussed in Section 2, Japan has been suffering from its structural problems for more than two decades. Therefore, the third arrow is the policy aimed at eliminating the real causes underlying the sustained stagnation.

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7 Estimated by the OECD in June 2014.

8 The JGB issuance plans for 2013 and 2014 by the Ministry of Finance.

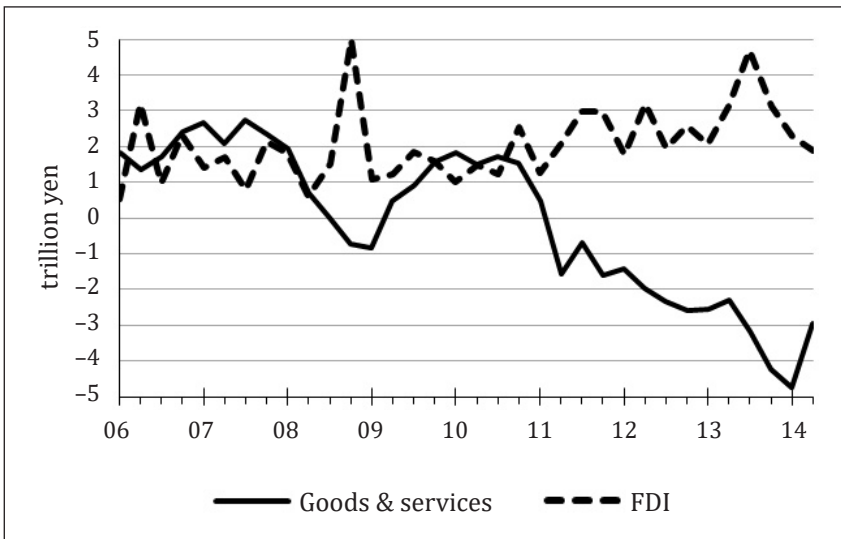
9 See the statement on monetary policy by the BOJ on April 4, 2013.

10 The BOJ's Flow of Funds data.

Industrial policy is important but often difficult to carry out. This is because it often generates conflicts of interest among industries or any other economic groups. For example, lowering trade barriers benefits competitive manufacturers, but is often disadvantageous to the domestic agricultural industry. Thus, the Abe administration needs to coordinate the various interests in order to carry out industrial policy.

One of the important measures for industrial policy is to develop new business opportunities, both domestic and international, for firms. So, the main topic of this conference, “New Opportunities for Japan and V-4 Cooperation,” is very important for Japan in this context, and this importance is reflected by the statement issued at the meeting of the V-4 and Japanese Prime Ministers in June 2013.

Japanese firms have been seeking for new opportunities in foreign countries and have been making a large amount of foreign direct investment (FDI). However, although the yen is depreciating (as shown in Fig. 3), Japan is also experiencing a trade deficit (as shown in Fig. 4). The trade deficit puts downward pressure on FDI, and so the government needs to deal with the situation before FDI begins to have difficulties in sustaining its present level.



**Fig. 4.** Trade and FDI

**Note:** Net export of goods and services, and net outflow of FDI

**Source:** Ministry of Finance, Japan



## 4. Concluding remarks

This paper has presented an overview of the present condition of the Japanese economy after the global financial crisis and discussed the prescription that the Abe administration is implementing. The discussion here shows the importance of new economic opportunities, including those between V-4 countries and Japan.

When the global financial crisis hit the world, Japan had not fully recovered from the sustained stagnation after the burst of its bubble in the early 1990s, which made the Japanese recovery slower than other developed countries. So, this paper has discussed the real causes underlying the Japanese stagnation and slower recovery, and the discussion made it clear that they were structural problems.

Next the package of economic policies called “Abenomics” was examined. The examination carried out in this paper has shown that, among the three policies (“arrows”) in Abenomics, only industrial policy solves the real causes of Japanese stagnation. One of the means for such industrial policy is to develop new economic opportunities, both domestic and international, and thus seeking out new opportunities among V-4 countries and Japan is important for Japan’s economic revitalization.

## Streszczenie

Celem artykułu jest analiza problemów, przed jakimi stanęła gospodarka japońska po globalnym kryzysie finansowym z 2008 roku, a także przesłedzenie programu, jaki uruchomił rząd Japonii w celu ich rozwiązania, czy chociażby złagodzenia. W momencie gdy światowy kryzys finansowy wybuchł z całą siłą, Japonia jeszcze nie zdążyła „wyjść na prostą” po okresie długotrwałej stagnacji, spowodowanej pęknięciem bańki spekulacyjnego wzrostu z lat 90. XX w. To sprawiło, że jeszcze trudniejsze okazało się zmierzenie z nowymi wyzwaniami. Słaba koniunktura gospodarcza, wywołana skutkami światowego kryzysu finansowego, wraz z tragedią trzęsienia ziemi i tsunami z 11 marca 2011 roku, skłoniła rząd do ogłoszenia pakietu rozwiązań stymulujących wzrost i pobudzających poziom aktywności ekonomicznej. Polityka ta została nazwana „abenomiką” od nazwiska aktualnie urzędującego premiera Japonii, Shinzo Abe.

Autor artykułu dokonuje najpierw charakterystyki japońskiej gospodarki, by na tym tle przyjrzeć się najważniejszym wyzwaniom, przed jaki-

mi stoi dzisiejsza Japonia. W konkluzji autor zastanawia się nad efektywnością tzw. trzech strzał „abenomiki”. Spośród trzech rodzajów polityk: monetarnej, fiskalnej oraz przemysłowej, jedynie ta ostatnia jest, zdaniem A. Tanaki, w stanie dać realną receptę na wyjście z recesji. Poszukiwanie nowych ekonomicznych możliwości, krajowych i zagranicznych, powinno przynieść dobre rezultaty w analizowanym zakresie. Korzystne dla Japonii z punktu widzenia ożywienia gospodarki wybory z pewnością będą dotyczyć także współpracy międzynarodowej Japonii z krajami Grupy Wyszehradzkiej.

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This monograph covers the output of the conference titled “2014 – New Opportunities for Japan and V-4 Cooperation” and contains Japanese and Polish contributions. It offers reflections on the *statu nascendi* of economic and cultural relations between the two nations. Viewpoints and research results mirror the various interests and arguments of the scholars (mainly economists, sociologists, and japanologists), businessmen, and representatives of administrative bodies (central and local governments) who participated in the conference, all of whom are searching for common solutions.

The presented papers are very much diversified with respect to their content and writing styles. The book itself reflects an eclectic approach. The multifaceted approach to the discussed issues facilitates the comparison of expectations against real life activities. The most important goal of the book is to identify the potential for collaboration and crucial fields in which there exist challenges and a need for changes, all in the interest of leading to a new stage of reciprocally profitable relations between Poland and Japan in today’s globalised world.



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