

Basic Strategy for Post-Crisis Growth

More Stress on Domestic Demand Needed

By Naoyuki HARAOKA

Japan's yen-denominated exports declined 35% in value in December 2008 from a year earlier for the third straight year-on-year decline, according to trade statistics released by the Finance Ministry. Japan's trade surplus in that month also shrank by about \$300 million for the 10th consecutive year-on-year decline. According to the 2004 interindustry relations table for Japan, the export-induced production coefficient was about 2.14. This means that a decline in the value of exports per unit would induce a 2.14-fold decrease in the value of production. Meanwhile, the consumer spending-induced production coefficient was relatively small at 1.49. So, a decline in external demand would exert larger deflationary effects on the Japanese economy than a decrease in consumer spending. These data clearly show how risky it is to maintain external demand-led economic growth amid a global deflationary spiral, such as the one that is currently gripping the world.

In addition, this theory is supported by the so-called diffusion index (DI) of confidence in economic activity. (The index represents a differential in the percentage of firms expecting an improvement in business conditions and that of those anticipating deterioration.) According to a quarterly survey of overseas subsidiaries released in December 2008 by the Ministry of Economy, Trade and Industry, the sales DI, which indicates corporate sales projections, sharply worsened to minus 14 percentage points in the July-September quarter of 2008 from the same period a year earlier. This survey has been conducted since 1997 on a quarterly basis to acquire data, in a timely manner, on overseas economic trends and on the so-called hollowing-out of Japanese industry by looking into business conditions and future prospects of Japanese

subsidiaries overseas. The survey was launched in response to Japanese firms' globalization efforts that resulted in an increase in their overseas subsidiaries. The latest figure of minus 14 in the sales DI was the worst since the launch of the quarterly survey. The index hit an all-time low in all regions, standing at minus 22 for North America, minus 19.4 for Europe, and minus 11.7 for Asia. It is particularly notable that the index for Asia fell into negative territory for the first time ever.

As stated earlier, it is extremely dangerous to pursue external demand-led economic growth both now and in the future amid the financial and economic crisis. Moreover, after the crisis has run its course, Asian countries, spearheaded by Japan, would find it difficult to maintain export-led economic growth, as they have done so far, by continuing to finance the United States' huge current-account deficits, even though it depends on Washington's future economic policies. The so-called Maekawa Report, compiled by a panel led by former Bank of Japan Gov. Haruo Maekawa and released in April 1986, proposed that Japan shift its economic policy focus from heavy dependence on external demand to more vigorous growth led by domestic demand to strengthen Japan's international cooperation and eventually make the country an internationally oriented state. Did Japan pursue the path of economic growth proposed by the Maekawa Report?

Table 1 indicates economic growth figures in the past 20 years for the Group of Seven (G-7) countries – Japan, the United States, Canada, Britain, France, Germany and Italy. Japan saw its surplus in the external balance of goods and services grow faster than its gross domestic product (GDP) from 1989 to 1994. The total of final con-

TABLE 1
Economic growth figures for G-7 countries

National currency, current prices (millions)

		1989	1994	1994/1989 (magnification)	1999	1999/1994 (magnification)	2007	2007/1999 (magnification)
Japan	GDP	405655394.7	486551700.0	1.20	497628600.0	1.02	515804800.0	1.04
	Final consumption expenditure + Gross capital formation	399560479.3	476668700.0	1.19	489736200.0	1.03	507172500.0	1.04
	External balance of goods and services	6237100.0	9883000.0	1.58	7892400.0	0.80	8632400.0	1.09
United States	GDP	5441700.0	7017500.0	1.29	9216200.0	1.31	13741600.0	1.49
	Final consumption expenditure + Gross capital formation	9476700.0	7047800.0	1.28	9476700.0	1.34	14449400.0	1.52
	External balance of goods and services	-88200.0	-93600.0		-260500.0		-707800.0	
Canada	GDP	657728.0	770873.0	1.17	982441.0	1.27	1535646.0	1.56
	Final consumption expenditure + Gross capital formation	657129.0	762929.0	1.16	946395.0	1.24	1506464.0	1.59
	External balance of goods and services	213.0	9113.0	42.80	35955.0	3.95	29863.0	0.83
Britain	GDP	525274.0	692987.0	1.32	928730.0	1.34	1401042.0	1.51
	Final consumption expenditure + Gross capital formation	544132.0	695952.0	1.28	942219.0	1.35	1447827.0	1.54
	External balance of goods and services	-18858.0	-2965.0		-13489.0		-47480.0	
France	GDP	980533.5	1154733.1	1.18	1367966.0	1.18	1892241.5	1.38
	Final consumption expenditure + Gross capital formation	992153.2	1144734.5	1.15	1339318.0	1.17	1928643.5	1.44
	External balance of goods and services	-11619.7	9998.6		28648.0	2.87	-36402.0	
Germany	GDP	1301407.6	1780780.0	1.37	2012000.0	1.13	2489400.0*	1.24*
	Final consumption expenditure + Gross capital formation	1313087.5	1778190.0	1.35	1994560.0	1.12	2331550.0*	1.17*
	External balance of goods and services	-6844.3	2590.0		17440.0	6.73	157850.0*	9.05*
Italy	GDP	634021.2	877708.1	1.38	1127091.1	1.28	1535540.4	1.36
	Final consumption expenditure + Gross capital formation	634006.7	847910.2	1.34	1106138.6	1.30	1540246.0	1.39
	External balance of goods and services	14.5	29798.4	2055.06	20955.0	0.70	-4705.0	

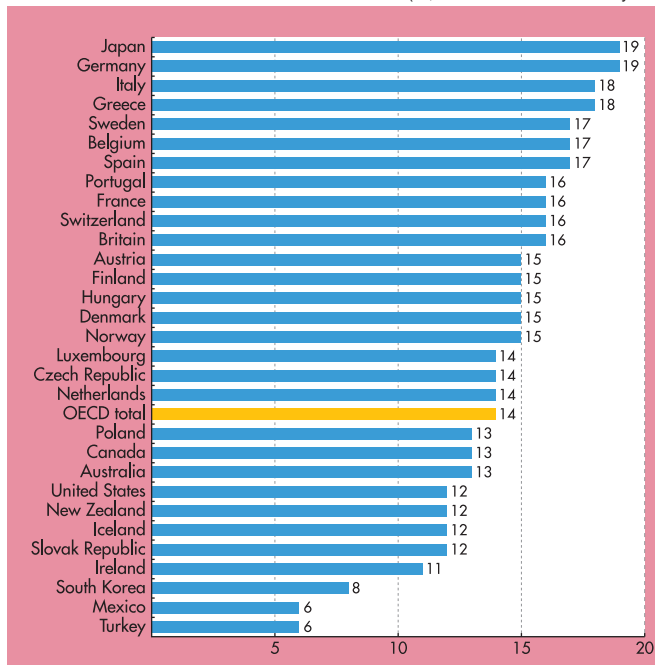
Note: *Figures for Germany in 2008, not 2007

Source: Compiled by Japan SPOTLIGHT based on OECD statistics

CHART 1

Percentage of elderly population by country

(% of 2003 or latest available year)



Source: "OECD Factbook 2007: Economic, Environmental & Social Statistics,"
Organization for Economic Cooperation & Development

sumption expenditure and gross capital formation (in other words, domestic demand) outgrew GDP from 1994 to 1999. However, Japan's goods and services surplus again outgrew GDP from 1999 to 2007. Other G-7 member countries, except Germany, saw growth in domestic demand pulling their economic growth in the 1999-2007 period. In addition, what attracts attention is Japan's slow economic growth. Japan's GDP growth has been the slowest among the G-7 countries since 1999. In other words, Japan could manage to achieve an extremely slow growth only with an increase in its goods and services surplus in recent years. This shows how fragile the Japanese economy is. It is extremely important for Japan to depart from such fragile economic growth and to instead follow the path of domestic demand-led growth to maintain steady growth after the ongoing global financial crisis is over, as mentioned earlier.

Japan has greater potential demand than other countries to achieve the target. According to an international comparison on social overhead capital compiled by the Ministry of Land, Infrastructure, Transport and Tourism, Japan's per-capita urban park space was only 15 in 1994 against the base average figure of 100 for six countries – Japan, Britain, Germany, France, Italy and the United States. Japan's per-car length of expressways was 44 on the same standard in 1992, while the diffusion of public sewage systems was 71 in 1996. It is a good idea to improve Japan's poor social infrastructure, which has long been pointed out. But in present-day Japan there is large potential demand for social capital and services that is quickly emerging afresh due to population aging and other changes in its social environment.

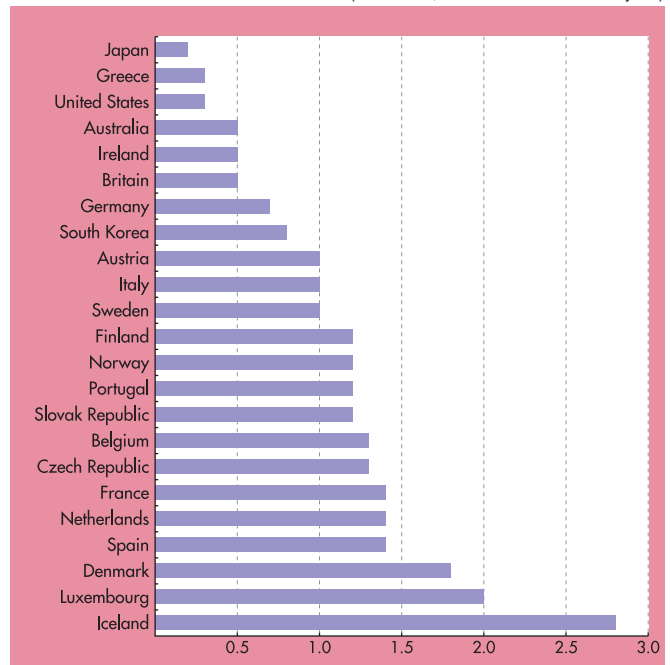
First of all, according to OECD statistics, Japan, together with Germany, ranks top among OECD member countries in the percentage of elderly people in the total population, as shown in *Chart 1*. This suggests the presence of very large potential demand in Japan for nursing-care facilities and services for the elderly and also for medical and health support facilities and services for them.

Secondly, the use of authorized child-care facilities remains low, with only 20% of working Japanese women using them, sharply

CHART 2

Government expenditure on recreation & culture

(% of GDP, 2004 or latest available year)



Source: "OECD Factbook 2007: Economic, Environmental & Social Statistics,"
Organization for Economic Cooperation & Development

lower than 42% in France and 44% in Sweden, although the ratio of women workers in the child-raising female generation reached 60%-70% in 2005 in Japan to approach the levels in Europe and North America. As the rate of labor participation by women is expected to rise in the future, the current level of authorized child-care facilities is insufficient. There is fairly high potential demand for support facilities and services for child-rearing.

Thirdly, as Japanese society matures, an increasing number of people have come to strengthen their desire for self-realization. In response, the need for recreational and cultural activities is growing stronger. However, as shown in *Chart 2*, Japan ranks at the bottom among OECD member countries in government expenditures on recreation and culture. An improvement in infrastructure and services for recreational and cultural affairs is one of major challenges to be faced in Japan.

To satisfy such potential demand, Japan needs to boost public expenditures and step up private-sector efforts for reform of its industrial structure. Although Japan's budget deficit is the largest among OECD member countries, the share in GDP of revenues from indirect taxes such as the consumption tax is the lowest only after the United States. A review of the current tax system would be necessary to achieve the essential target of materializing a domestic demand-led economic structure.

Not only Japan but other Asian countries are also required to build a domestic demand-led economic structure in the years that follow the ongoing global financial crisis. If Japan could be successful in reforming its industrial structure and in performing a role model for other Asian countries in this field, the country would make a great contribution to Asia as a whole. Moreover, an improvement in social infrastructure would lead to a better business environment for foreign firms active in Japan. It would also contribute to materializing a more open society. **JS**

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