Japan’s financial system and economy and the need for a new role in Asia

Jenny Corbett
Australia-Japan Research Centre, Crawford School, ANU
Question

- What problems does Japan’s financial system possess in its relationship with the global economy/Asian economy and post-earthquake reconstruction?
Productivity and Performance in Services and Financial Sector

• Japan is predominantly a service economy so productivity in service sectors matters (charts 1 and 2).
• Though productivity growth in service sectors is lower than manufacturing (chart 3) services productivity growth has contributed a lot for Japan (chart 2)
• Japanese and European services’ productivity levels and growth rates are low relative to US (charts 3 and 4)
• Japan’s finance sector productivity is about average in OECD in level and growth rates (chart 5, 6).
Chart 1  Sectoral Contribution and Productivity in Japanese Economy

Service and Manufacturing Sector for Year 1973-2006

Note: Service sector includes industry 66-107 in the JIP code; manufacturing sector consists of industry 8-59 without 30 and 31; average TFP growth is computed with Domar weight.

Source: Japan Industrial Productivity Database 2009
Chart 2

Contribution to aggregate labour productivity growth, 1990-2002

Annual average contribution to GDP per person employed (percentage points)

- Market services
- Other services
- Manufacturing and other industries

Aggregate labour productivity growth

Percentage points

1.0 1.2 1.3 1.4 1.5 1.6 1.9 2.1 2.2 2.3 2.4 2.4 2.9 4.0 4.3

Notes:

The sum of the contributions per industry may be slightly different from the aggregate values.

Chart 3

Labor Productivity: Japan-US Comparison


Chart 4  TFP growth in the market sector: by sector and by country

Source: EU KLEMS Database, March 2008.

Source: K Fukao, 2007, Service Sector Productivity in Japan: the key to future growth, RIETI, WP 10-P-007,
Labour productivity growth in services

Anita Wölfl, Enhancing the Performance of the Services Sector, Chapter 2 in OECD, 2006, The Service Economy in OECD Countries, p 39
Chart 7  **Growth accounting with intangible capital by sector**

**Growth accounting with intangibles (Manufacturing sector)**

- Contribution of TFP growth
- Contribution of intangible capital
- Contribution of tangible capital
- Growth rate of labor productivity

**Growth accounting with intangibles (Service sector)**

- Contribution of TFP growth
- Contribution of intangible capital
- Contribution of tangible capital
- Growth rate of labor productivity

Enhancing Services Productivity

- Benefits can come from “catching up” to best practice in low productivity areas, but technological improvement needed in sectors close to frontier (includes finance: charts 3, 4, 5)
- Ineffective use of ICT and low “intangible capital” have been identified as causes (Fukao, Jorgenson)
- Improving services sector productivity has value on its own but may also be linked to productivity in other sectors (mixed evidence).
Financial Services are central

- What is the relationship between financial sector function and overall productivity? Complex.
- Did banks’ misallocating capital by “evergreening” loans to “zombie firms” during Lost Decade contribute to the decline in general TFP growth? (Hoshi-Kashyap)
- Could this again be a risk in government programs to support banks that are intended to reduce distress?
- When to move on? How to choose between supporting old activities and making way for new?
- This will be a key factor in success of post earthquake success.
OECD Concerns on Finance

• Japan’s financial markets and institutions still provide too little support for innovation, entrepreneurship and new business.

Box 3.3. Summary of recommendations for Japan’s New Growth Strategy (cont.)

Reform in the financial sector

• Promote the supply of risk money, such as venture capital, for R&D and innovative business start-ups through policy measures to stimulate this market, which is relatively inactive in Japan.

• Scale back the size of public financial institutions, thereby reducing the flow of savings to the public sector and enhancing the availability of funds for venture business and new start-ups.

• Follow through on the privatisation of Japan Post.

• Reduce credit guarantees and relax the government’s policy of encouraging financial institutions to increase lending to SMEs, with the economic recovery.
Opening and Integrating can help

- Financial services sector still has barriers to entry (chart 8).
- Economic effects of barriers are cost increasing and resource wasting.
- Opening to trade in financial services – by all modes, including commercial presence – can increase bank efficiency and stability of credit supply.
Restructiveness Indexes for ASEAN + 6 Countries
Average 1997 - 2005

Source: Corbett et al, 2007, Barriers to Services Trade in ASEAN, ERIA joint study for Deepening Economic Integration Study.
How much scope in the region?

• Japan is not closely “integrated” into regional financial markets.
  – Measured both by indexes of integration or by patterns of financial investment (excluding FDI)
• ASEAN countries are more integrated with each other than are CJK with each other or individually with ASEANs.
• So considerable scope for closer financial integration as well as more trade in financial services.
Chart 9

Overall Integration - Principal Components
Chart 10
Also potential welfare gains

• Research shows Japan could benefit from closer integration with China and with a regional group including Philippines, Australia and Singapore as a result of welfare gains from risk-sharing by integrating with countries that have different business cycle patterns.
Trade Policy Implications

• TPP could be a useful vehicle to get services sector productivity improvements through market opening.

• Services elements in TPP are strong and set high barrier. Can Japan meet them?

• They will be more valuable than agriculture.
Macro effects of services productivity

Chart 11: Elasticities of Japan’s Real GDP to Productivity Shocks

Here a once and for all one per cent rise in the level of sectoral total factor productivity is imposed in 2011. The graph shows the subsequent path of real GDP in cumulative per cent deviations from a baseline simulation. These deviations are then elasticities of response.

Source: Simulations of the model described in the text.

Post-tsunami strategies

• Move as quickly as possible towards facilitating finance for new activities, not locking in the old.
• Focus on improving productivity in services by encouraging investment in ICT and “intangibles” such as human capital
• Use trade policy and behind-the-border reforms to foster open markets in services
• Focus regional financial integration strategies on countries that have different business cycle.