

RIETI BBL Seminar Handout

April 16, 2015

Speaker: Dr. Randall S. JONES
Head of Japan/Korea Desk Economics
Department, OECD

<http://www.rieti.go.jp/jp/index.html>



2015 OECD ECONOMIC SURVEY OF JAPAN

Revitalising Japan

Research Institute of Economy Trade and Industry
Tokyo, 16 April 2015

www.oecd.org/eco/surveys/economic-survey-japan.htm

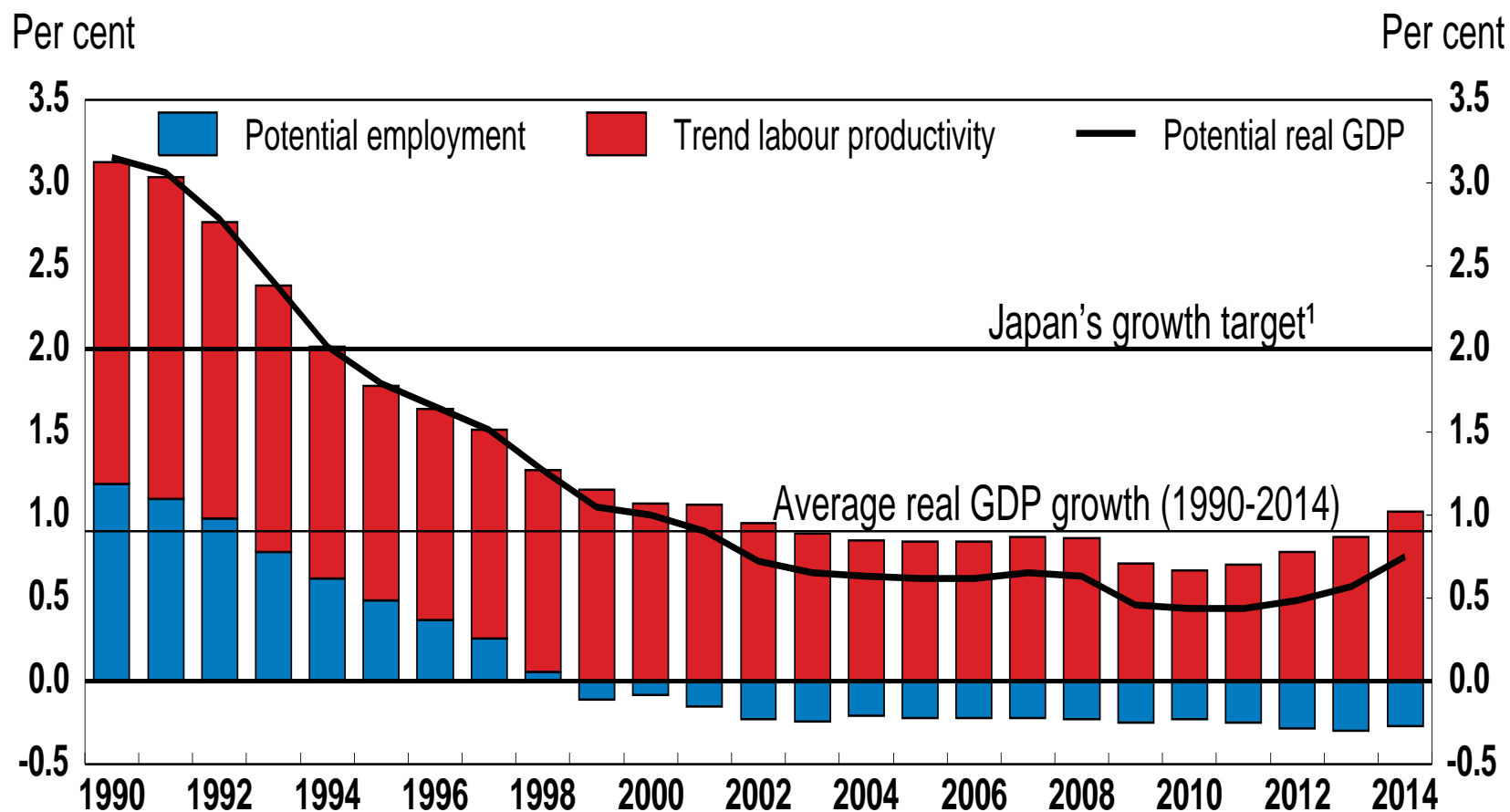


[OECD Economics](#)
[OECD](#)





Japan's growth potential has fallen well below the government's 2% real growth target



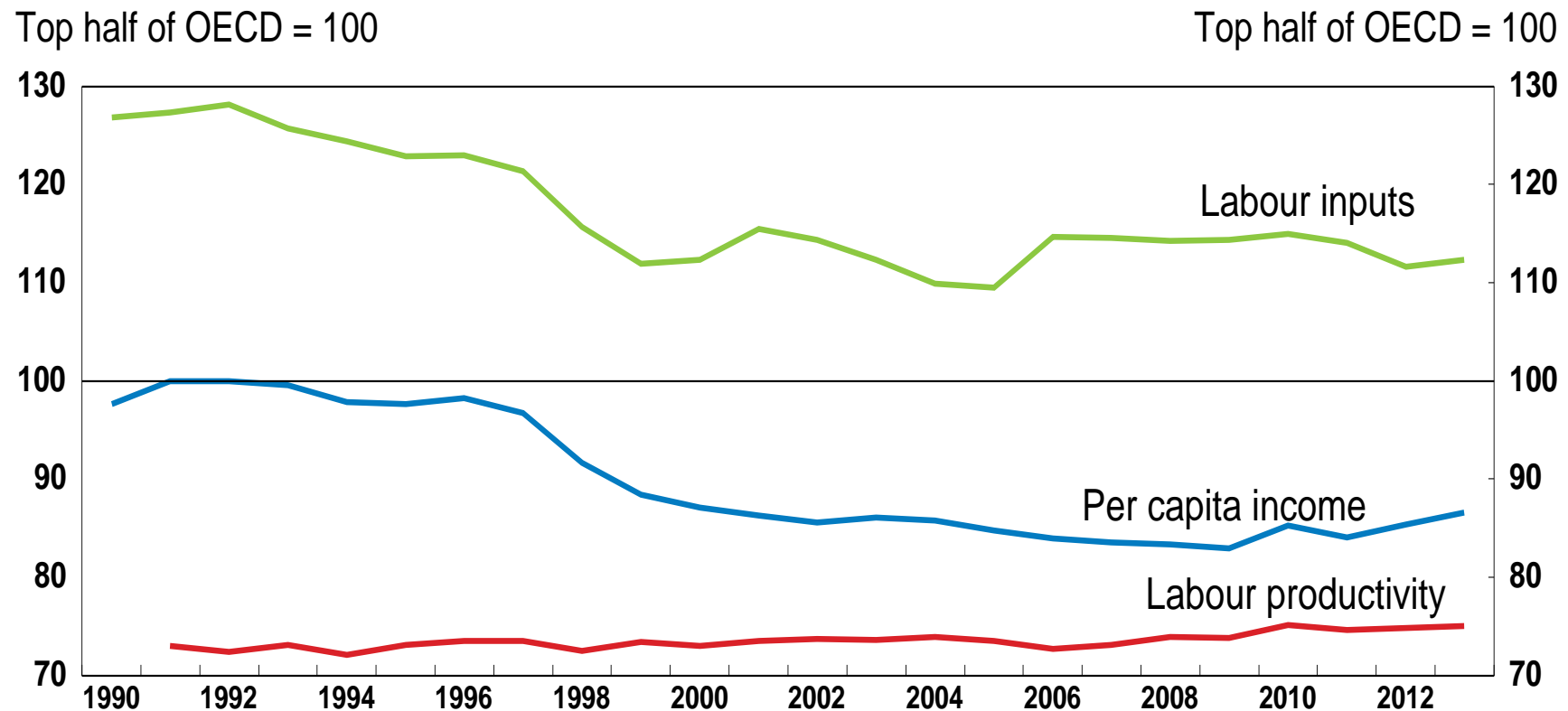
1. The 2% target was set in 2009 and maintained by subsequent governments.

Source: OECD Economic Outlook Database.



The standard of living and productivity in Japan are well below leading OECD countries

Japan relative to the top half of OECD countries¹

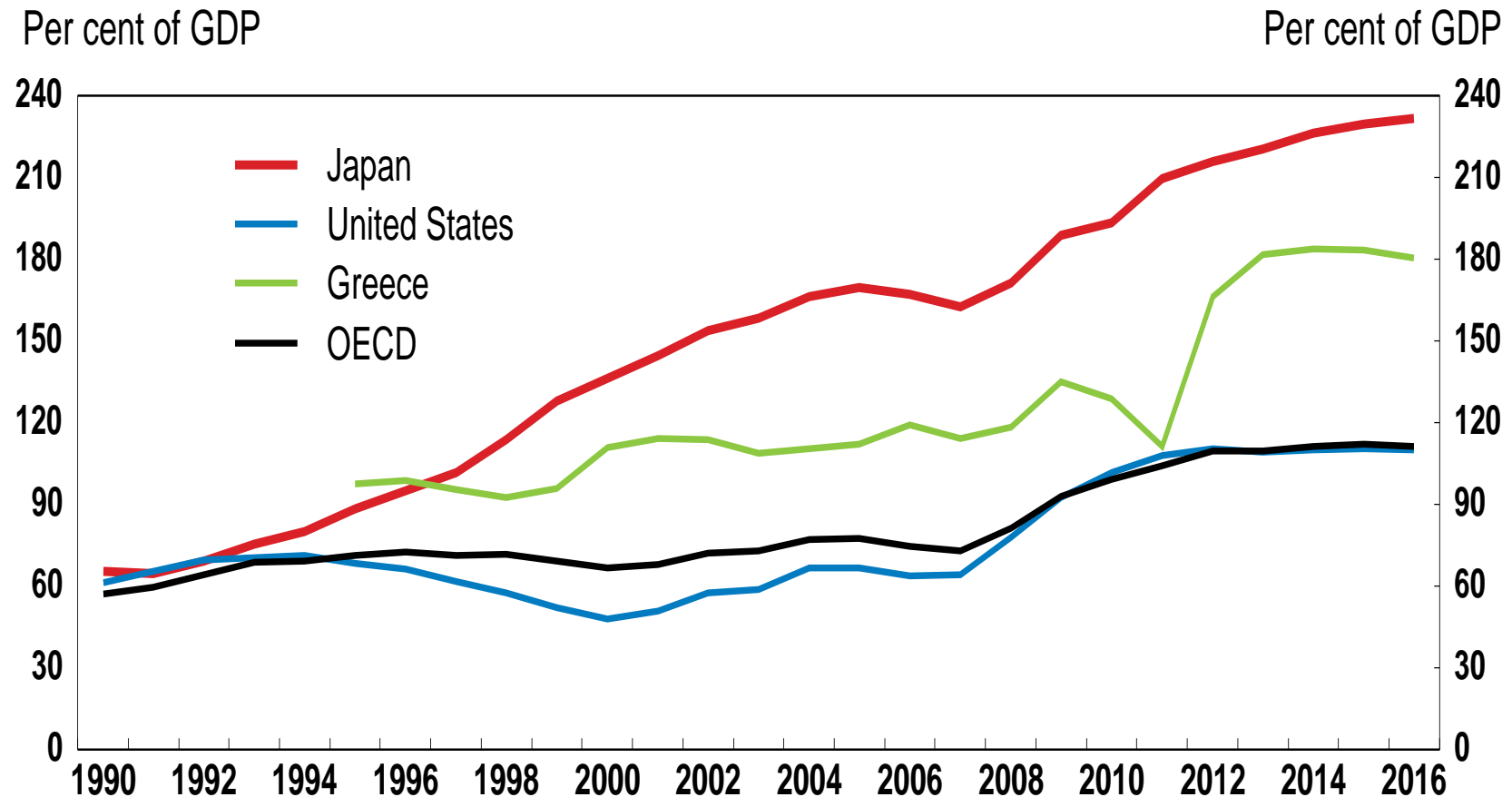


1. Per capita GDP is calculated using 2005 prices and PPP exchange rates. Labour productivity equals GDP per hour of labour input. Labour inputs equal total number of hours worked per capita.

Source: OECD Going for Growth Database.



Government debt is the highest ever recorded in the OECD area¹

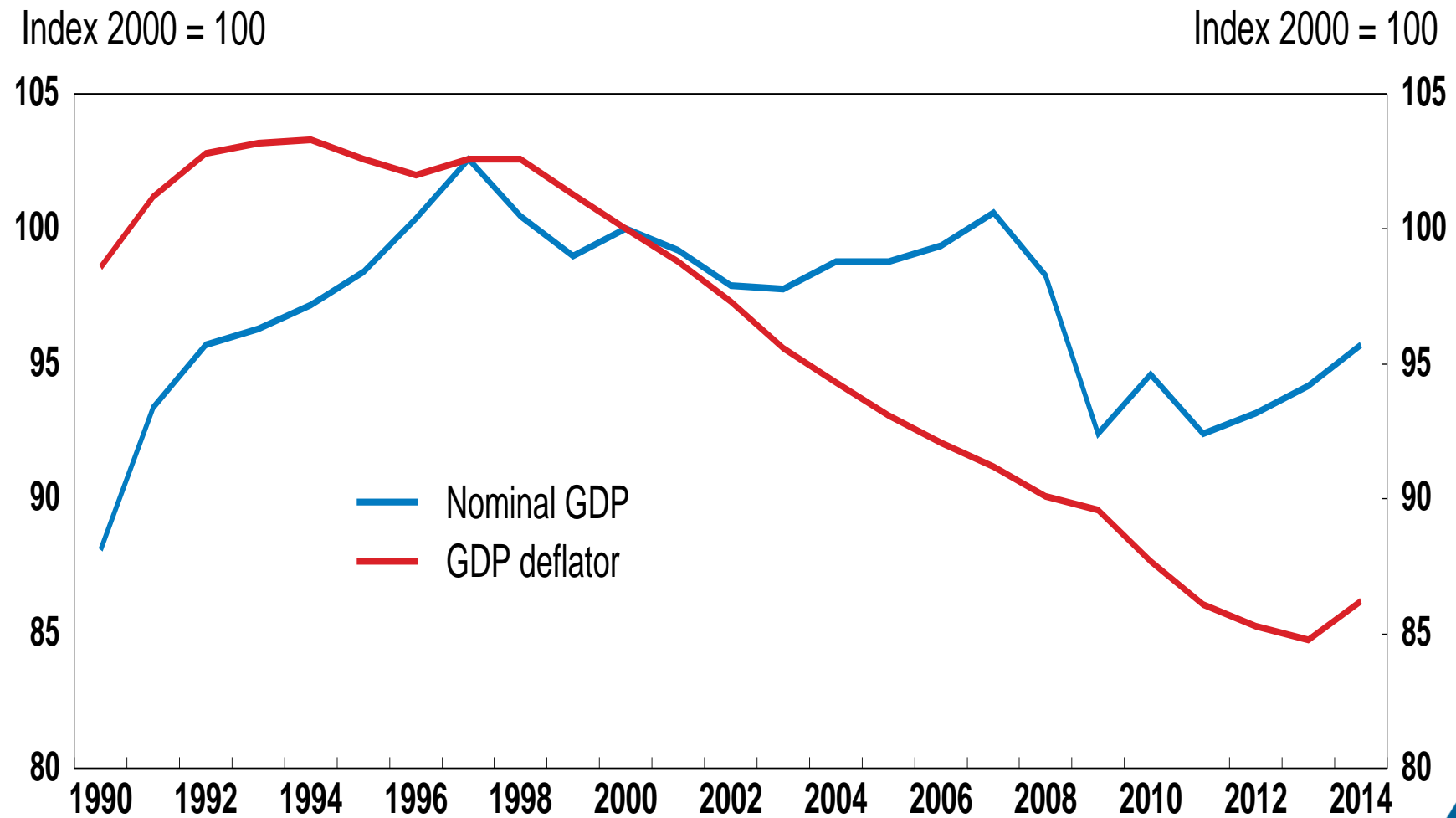


1. OECD estimates for 2014 and projections for 2015-16.

Source: OECD Economic Outlook Database.



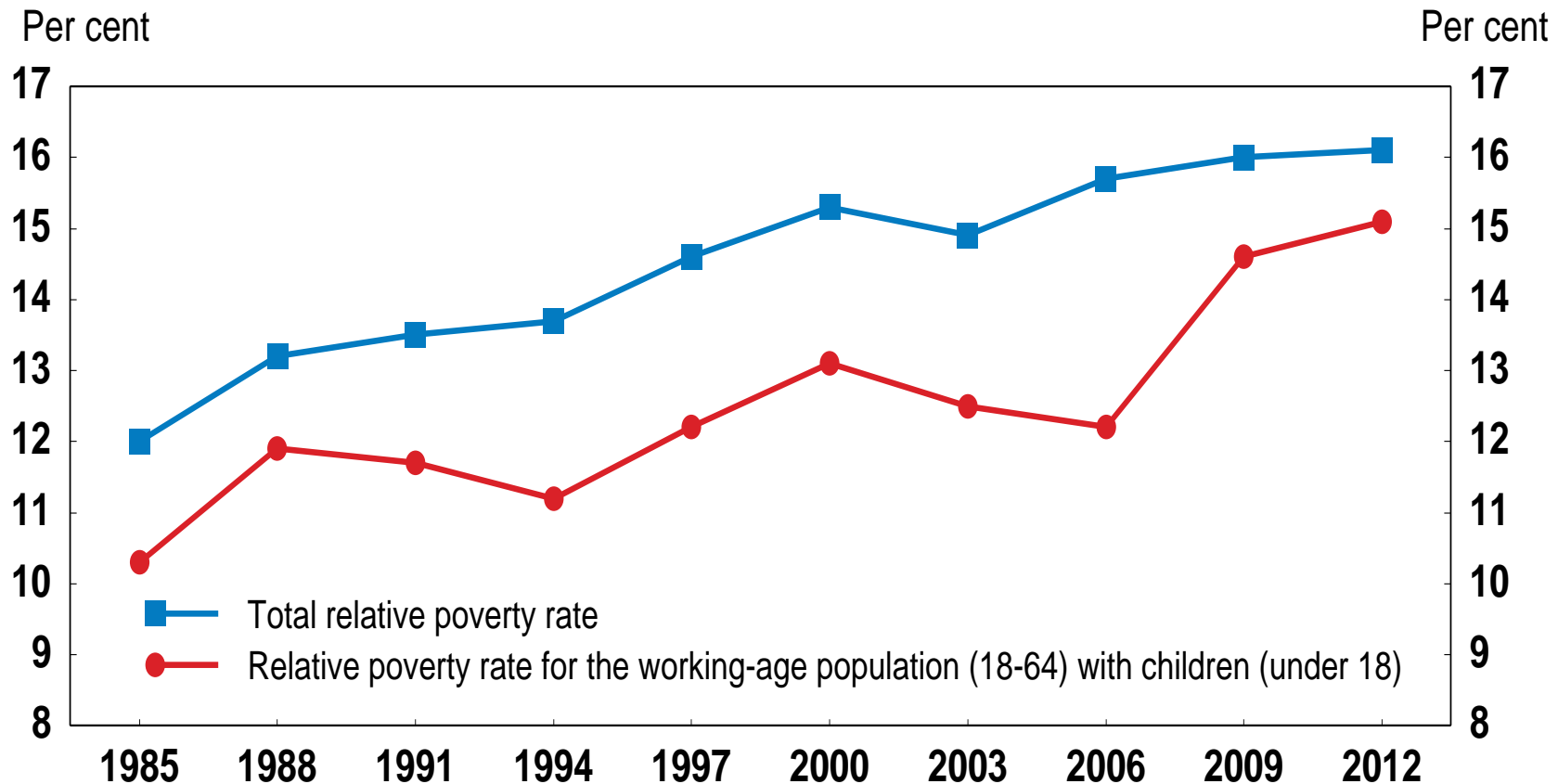
Nominal GDP has fallen in a context of deflation



Source: OECD Economic Outlook Database.



The poverty rate has been trending up



The share of the population with an income after taxes and transfers below half the median equivalent disposable income. Data are based on the Comprehensive Survey of Living Conditions, which is submitted to the OECD by Japan. Another survey, the National Survey of Family Income and Expenditure, shows a much lower relative poverty rate of 10.1% in 2012.

Source: OECD Income Distribution and Poverty Database; Ministry of Health, Labour and Welfare, *Comprehensive Survey of Living Conditions*.



Main findings

1. Sluggish economic growth during the past two decades has left Japan's living standards below the top half of OECD countries.
 - Japan's growth potential has fallen sharply due to a shrinking population and weak productivity gains, reflecting many structural weaknesses.
2. Government gross debt has risen to uncharted territory at 226% of GDP and the gap between government expenditure and revenue remains huge.
3. Persistent deflation has also pushed up the government debt ratio, while acting as a headwind to growth.
4. Income inequality and relative poverty threaten social cohesion.



Structural reforms are badly needed

Abenomics was launched in 2013 to revitalise Japan

1. Bold monetary policy to exit deflation
2. Flexible fiscal policy
3. A growth strategy to boost real output growth to 2% over the next decade



Challenge 1

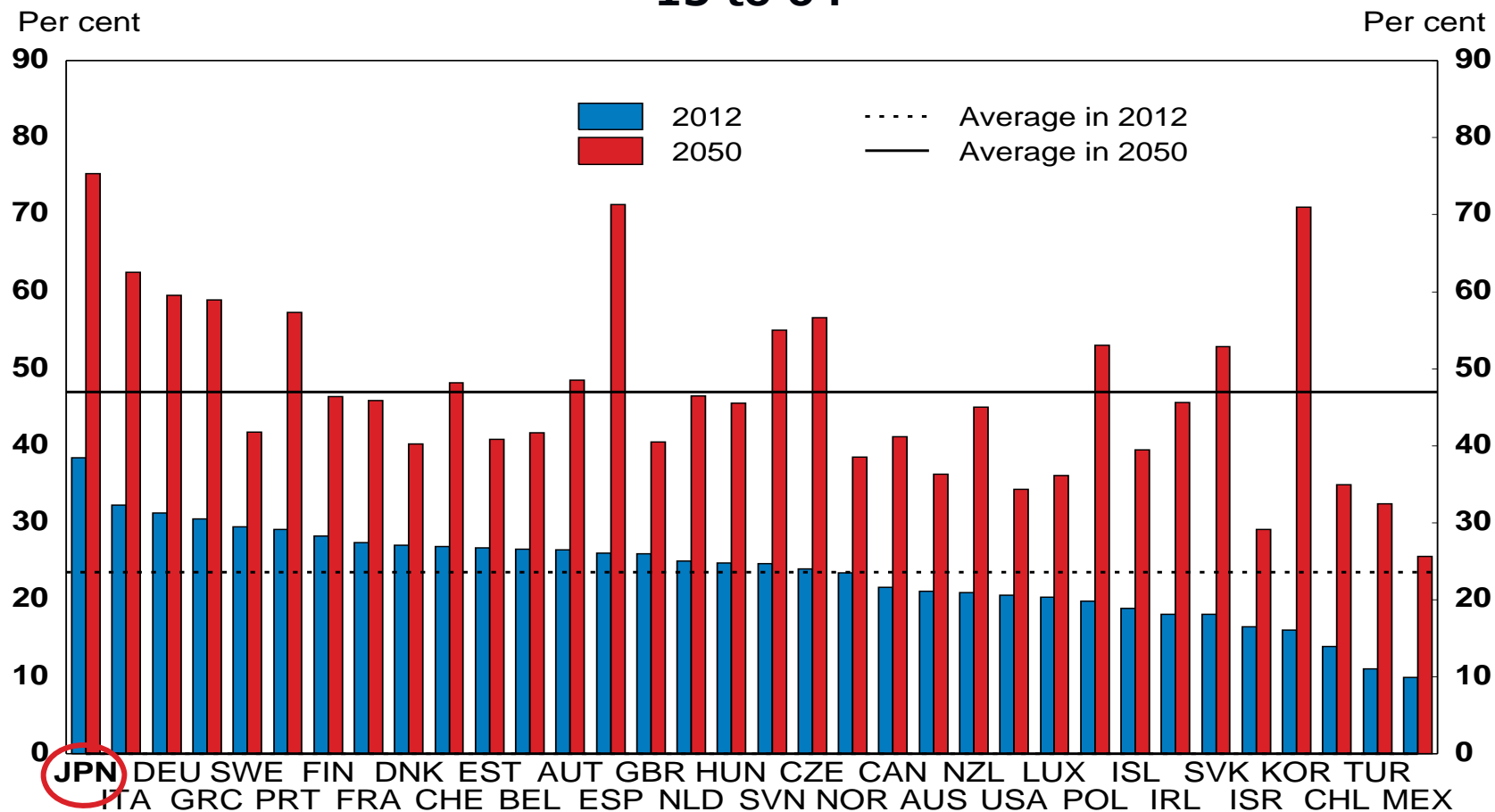
Raising Japan's output growth in the face of:

- **Rapid population ageing**
- **Weakness in the corporate sector**
- **A lack of economic dynamism**
- **Weak integration in the world economy**



Japan will remain the oldest population through 2050

Population aged 65 and over as a share of the population aged 15 to 64

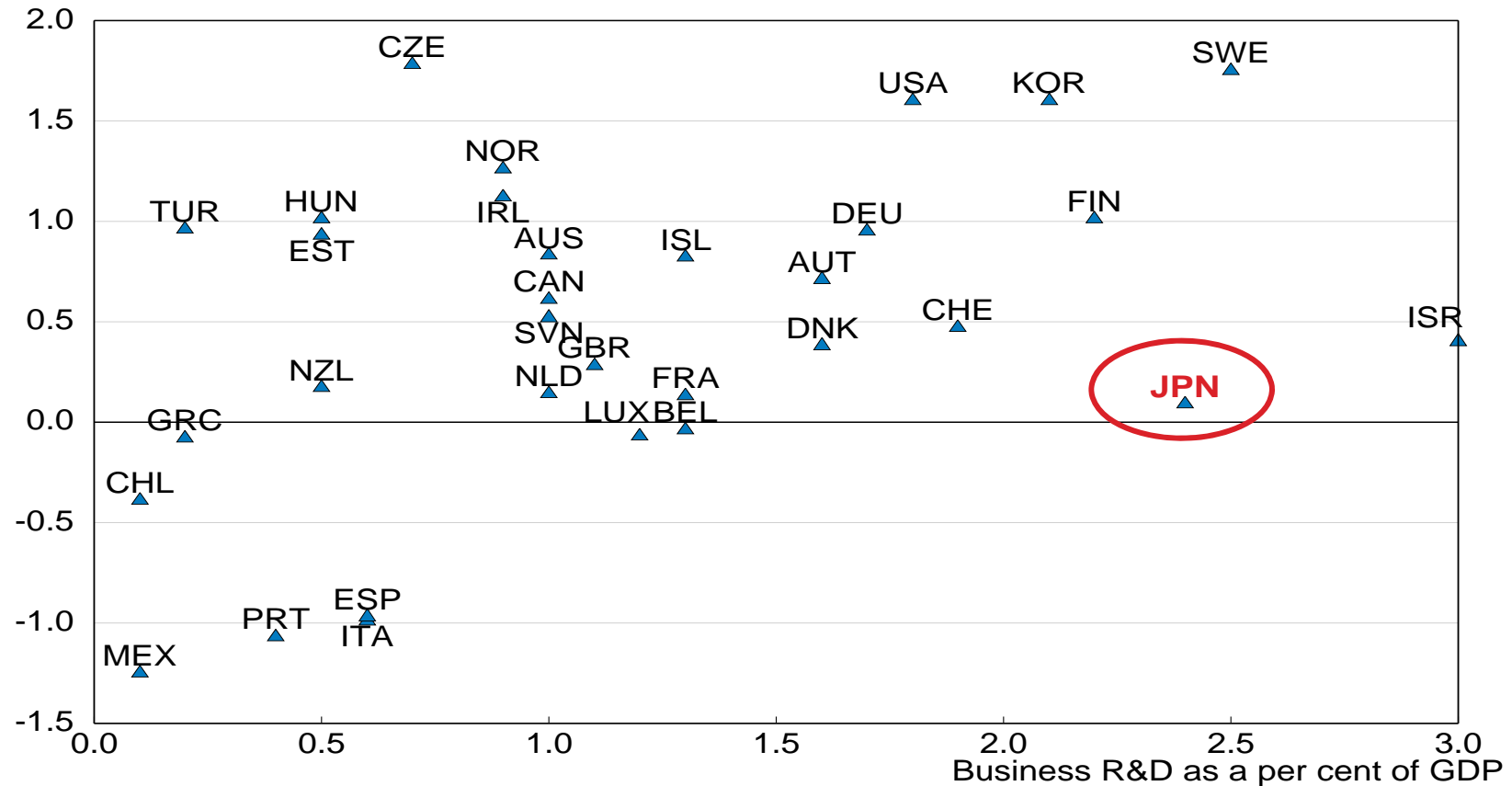


Source: OECD Demography and Population Database.



Total factor productivity growth is slow in Japan despite high business R&D

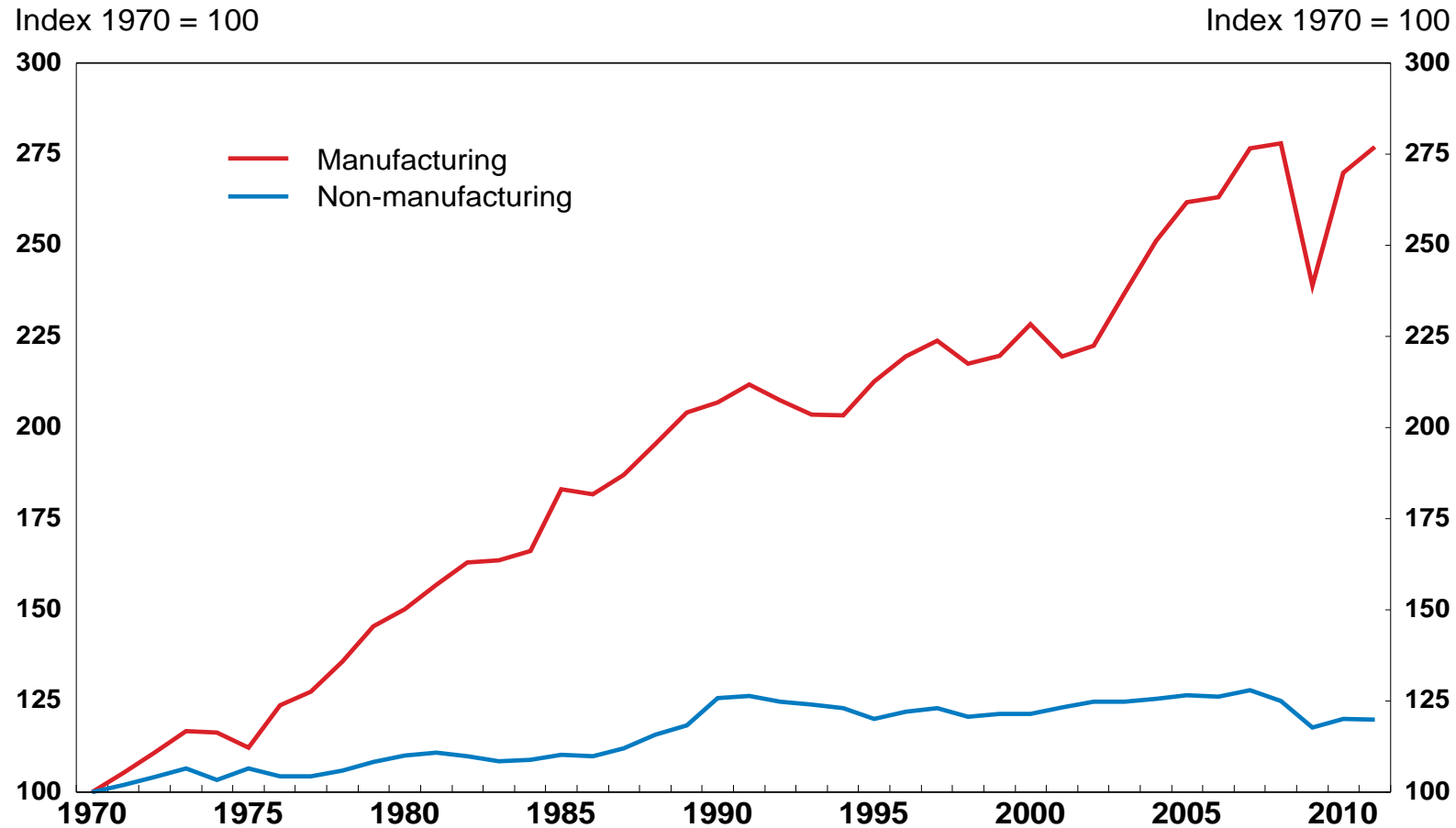
Annual TFP growth in per cent



Source: OECD Economic Outlook No. 96; Long-term Scenario Database; OECD Main Science and Technology Indicators.



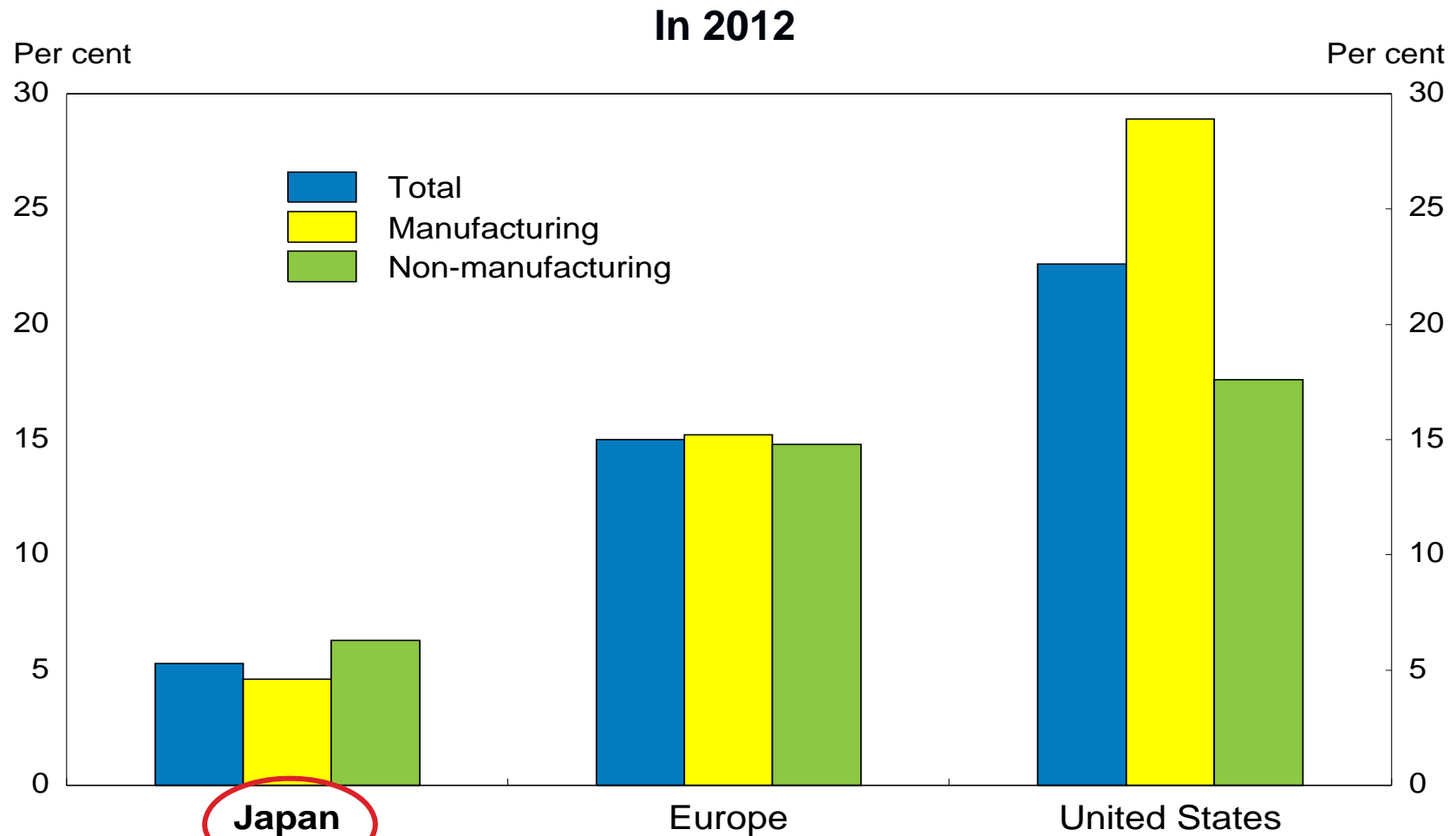
The productivity gap between manufacturing and services has widened sharply



Source: Japan Industrial Productivity Database 2014.



The return on equity in Japanese firms is low

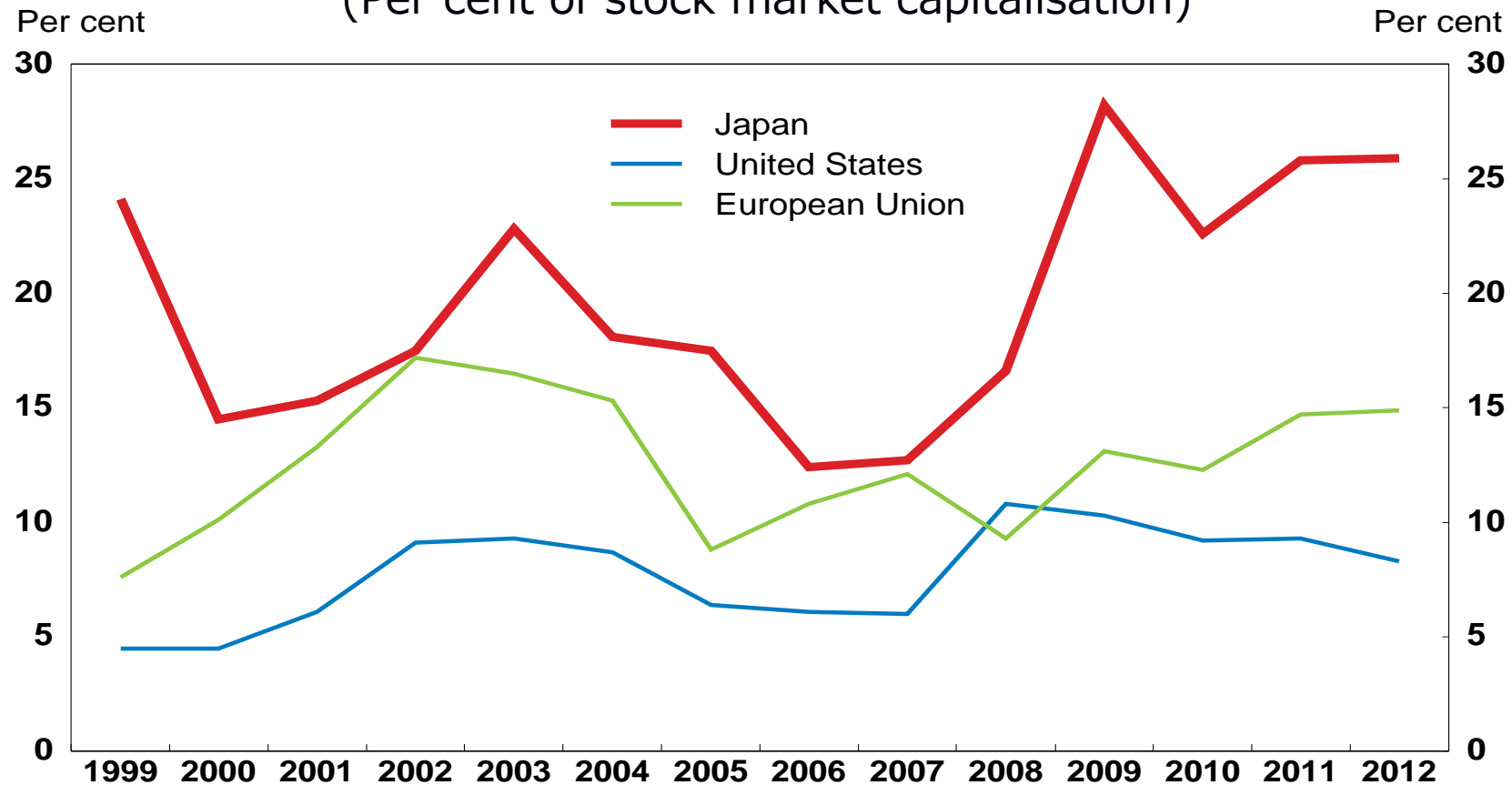


Source: Ministry of Economy, Trade and Industry (2014).



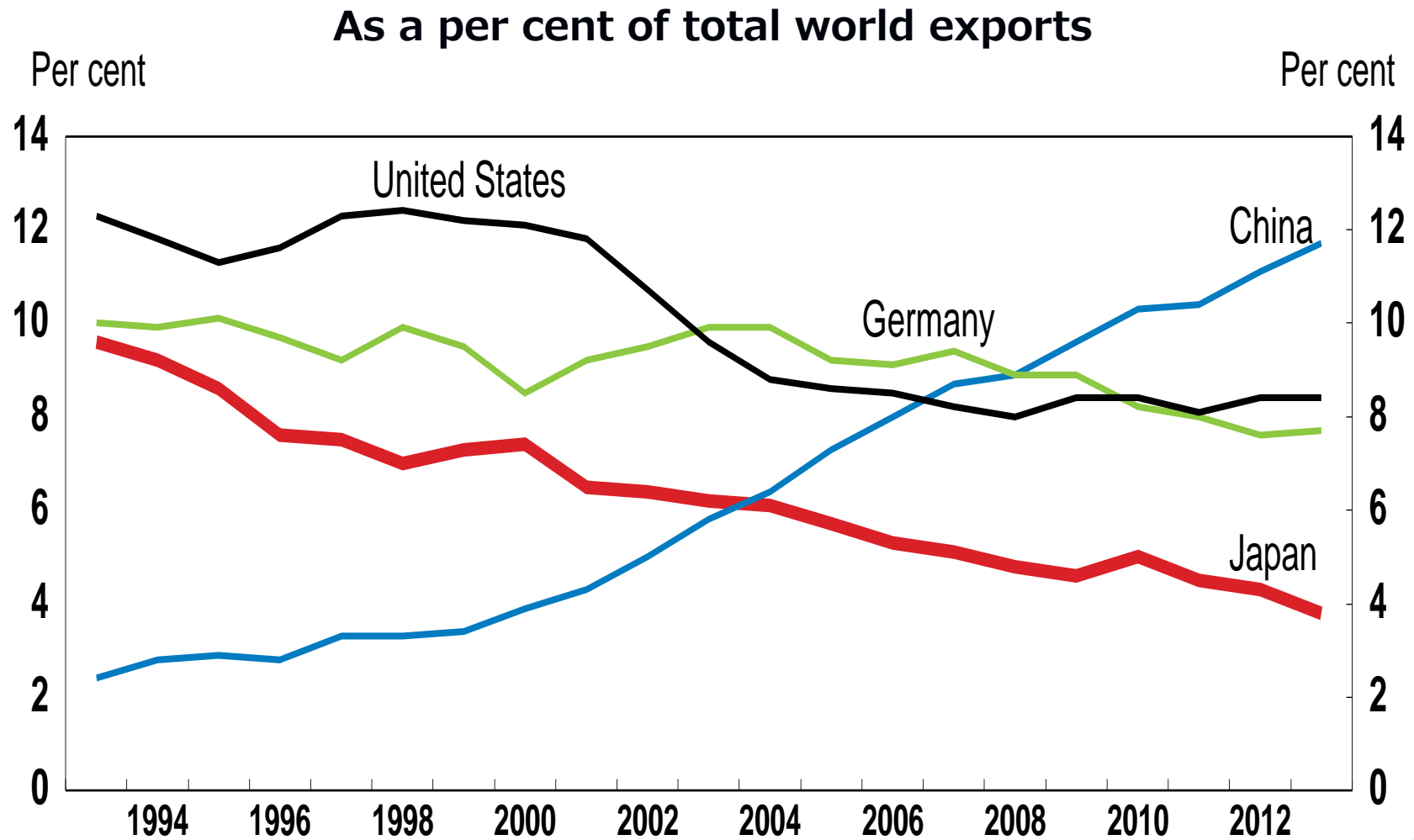
Japanese firms have large cash hoards that could be productively utilised

Cash and marketable securities of listed companies (Per cent of stock market capitalisation)



Source: Bloomberg; OECD calculations.

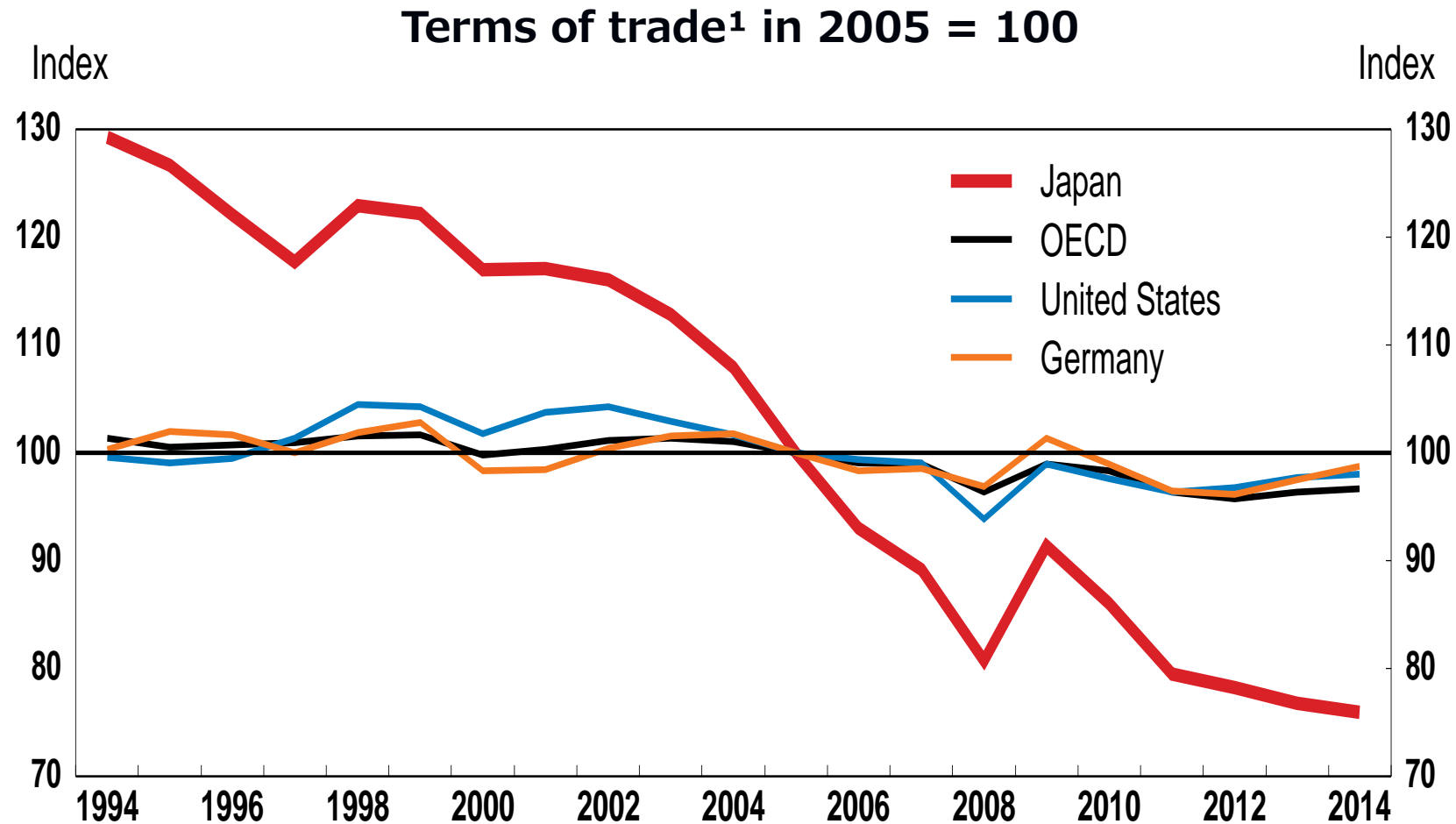
Japan's share of world exports has been falling during the past 20 years



Source: WTO Database.



Japan's terms-of-trade have been declining

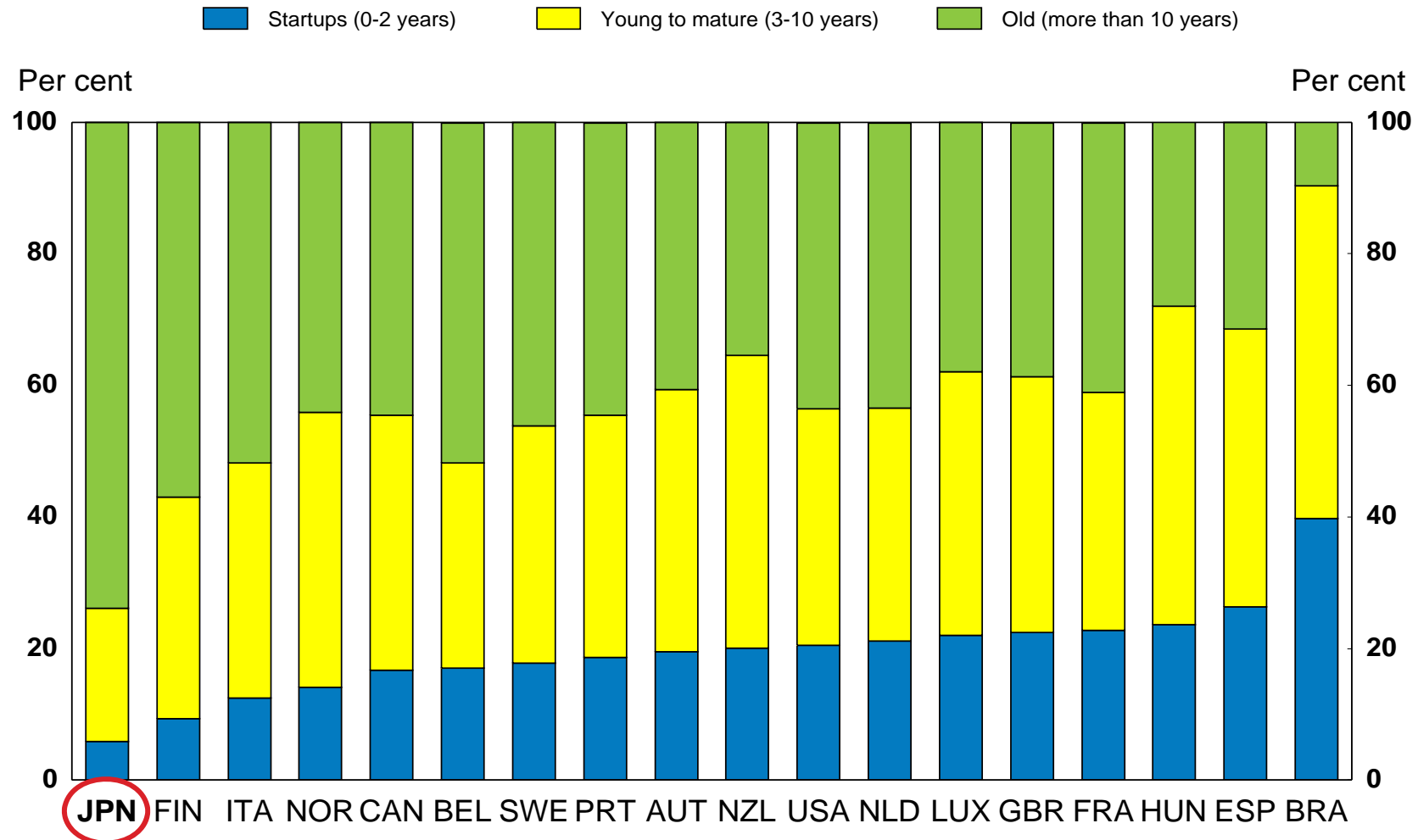


1. Ratio of export prices to import prices, with 2005 set as the base year.

Source: OECD Economic Outlook Database.



Small firms in Japan are old, suggesting a lack of economic dynamism

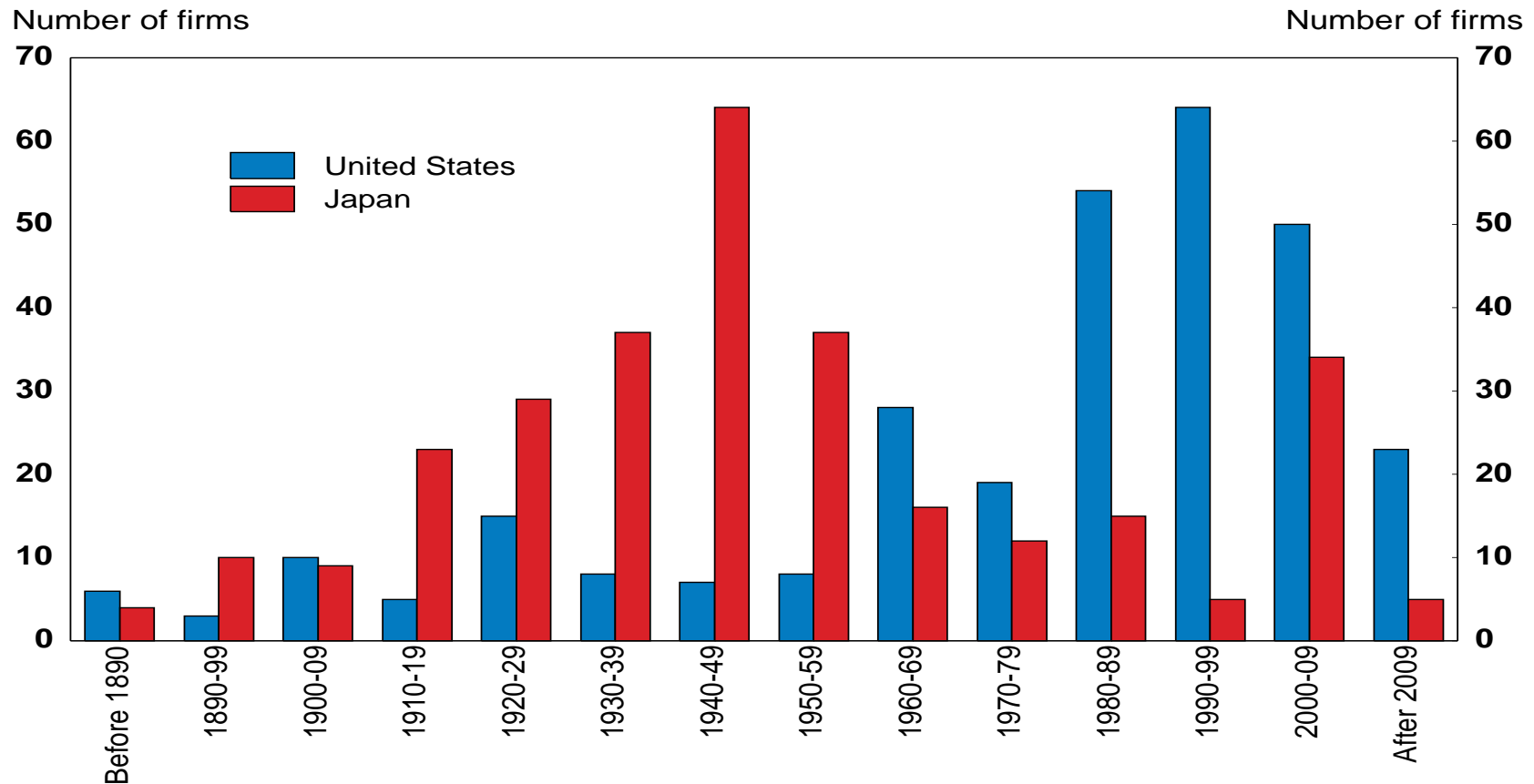


Source: Criscuolo et al. (2014).



Large firms in Japan are also relatively old

Year of establishment of the 300 largest firms by market capitalisation¹

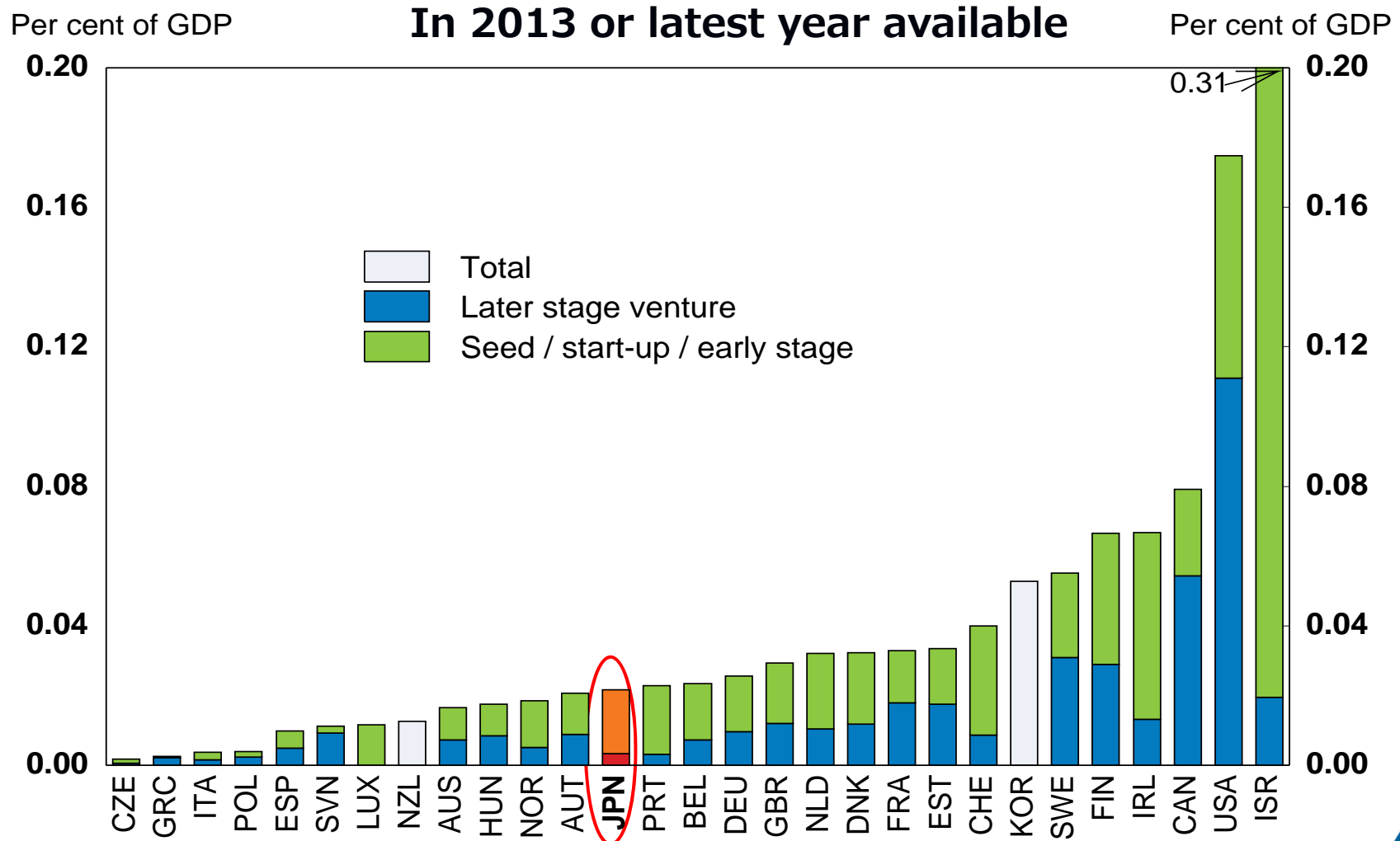


1. As of March 2015. The increase in the number of Japanese firms established between 2000 and 2009 reflects the creation of a large number of holding companies during that decade.

Source: Thompson Reuters; OECD calculations.



The role of venture capital in Japan is small



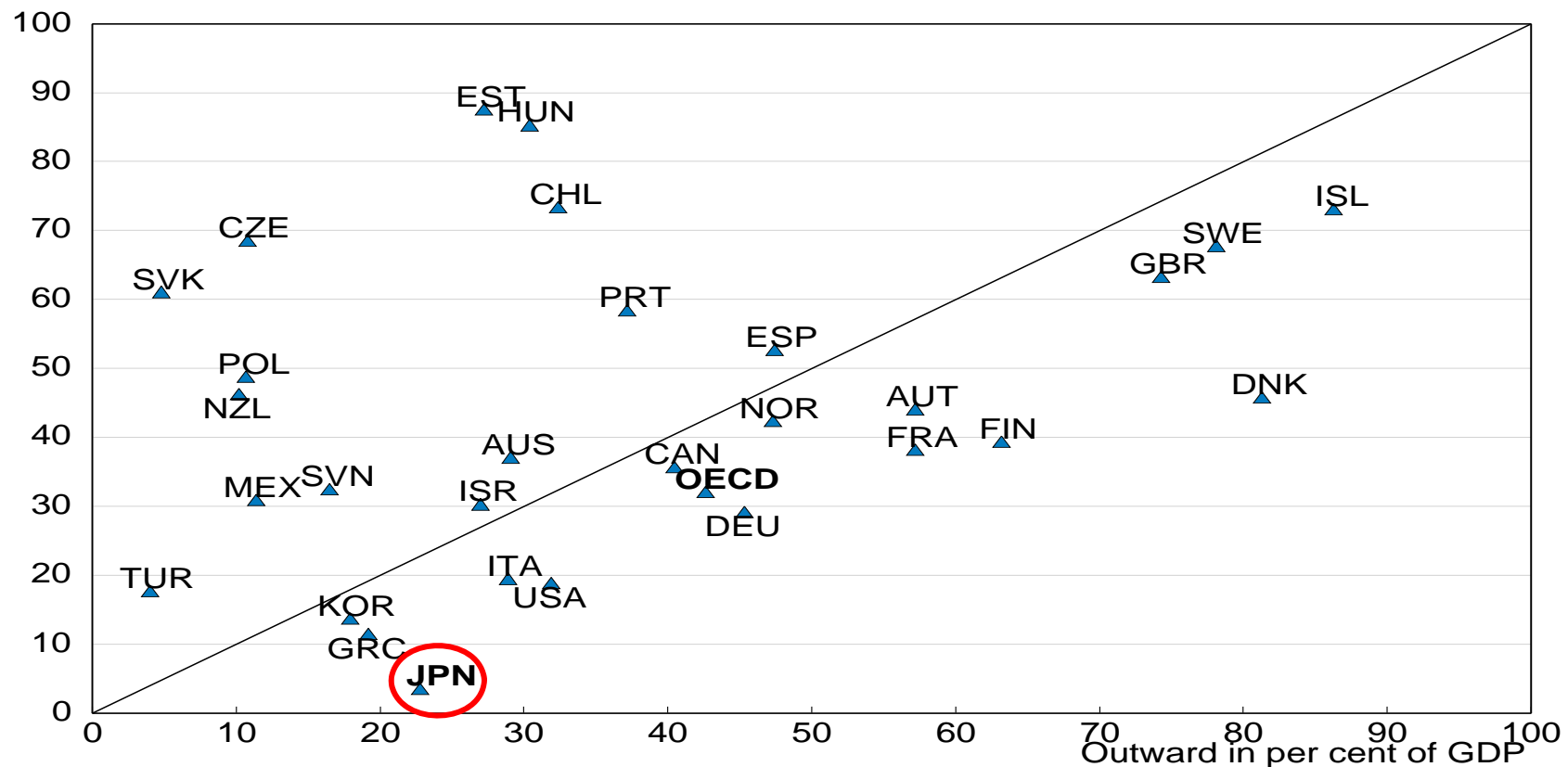
Source: OECD (2014f), *Entrepreneurship at a Glance 2014*, OECD Publishing, Paris.



The stock of inward FDI in Japan is the smallest in the OECD

Inward and outward stocks of direct investment as a per cent of GDP in :

Inward in per cent of GDP

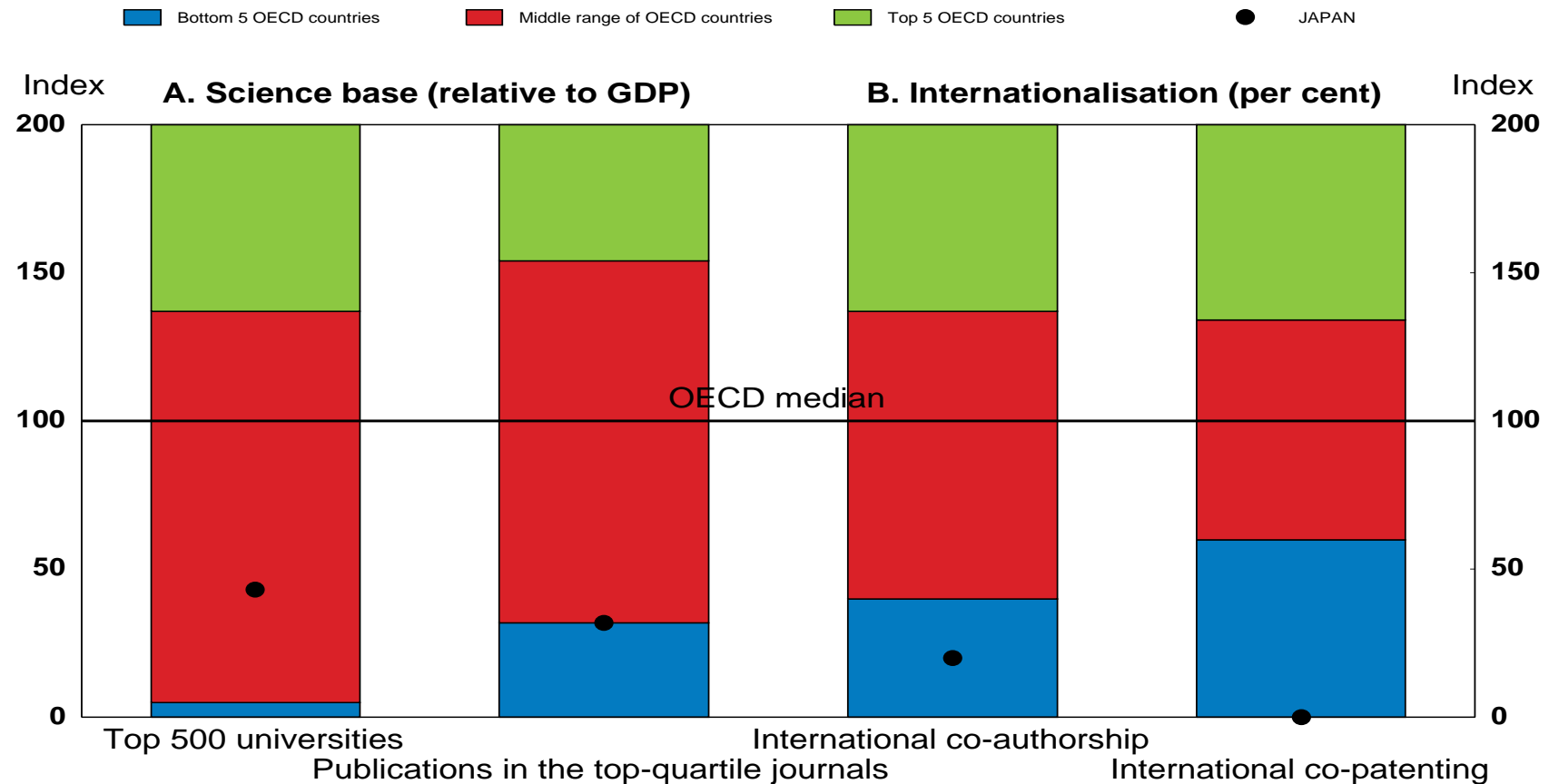


1. Belgium (189,200), Ireland (231,173), Luxembourg (301,234), The Netherlands (134,83.7) and Switzerland (194,115).

Source: OECD (2014), *Economic Globalisation Indicators 2014*, OECD, Paris.



Japan's innovation system is weakened by problems in universities and a lack of participation in international R&D¹

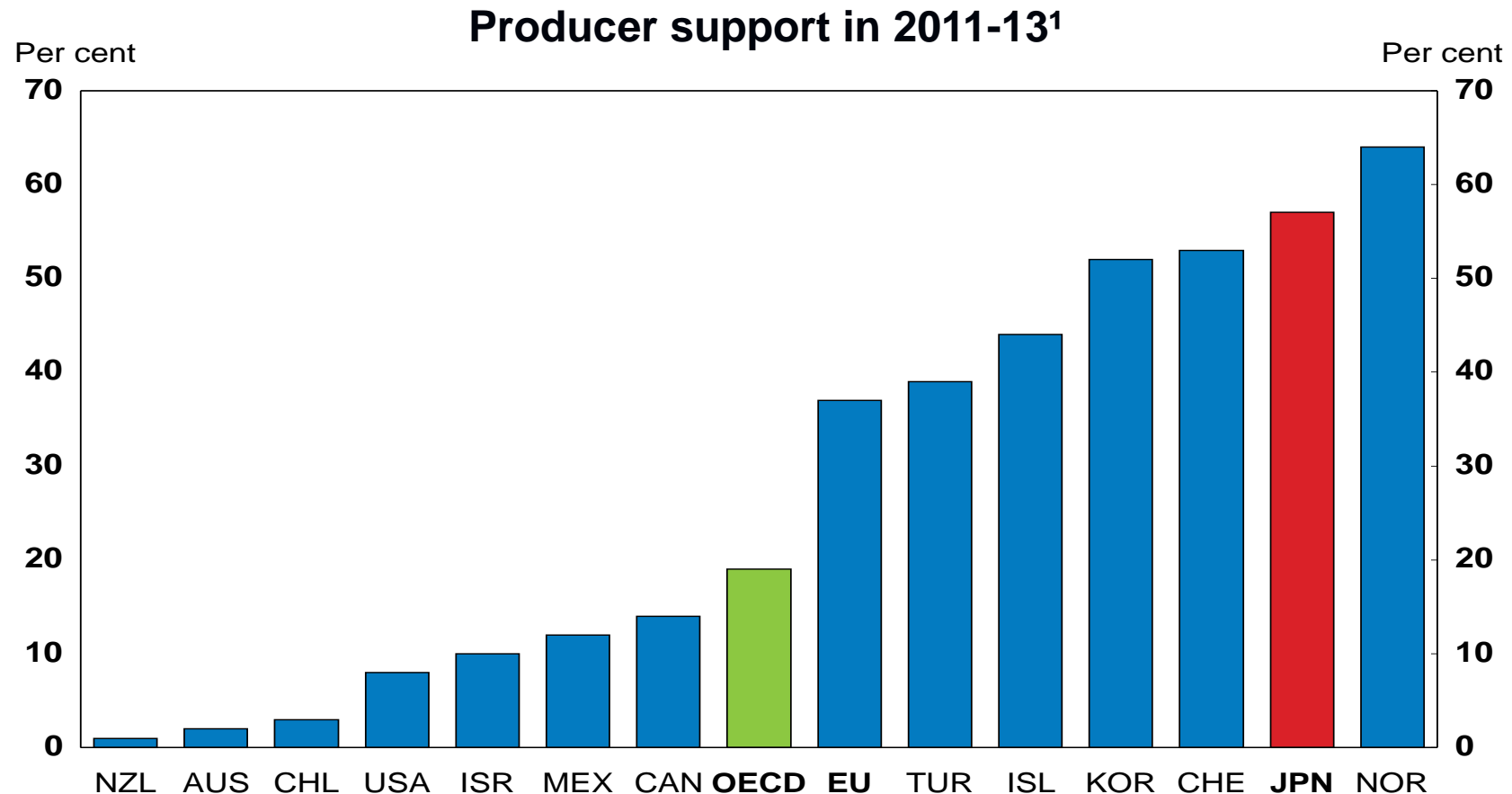


1. Normalised index of performance relative to the median values in the OECD, which are set at 100. The top performer is set at 200 and the lowest at zero. The fifth-highest performer in the case of the "Top 500 universities" had a score of 137 relative to the OECD median, while the fifth lowest had a score of 5. Japan, with a score of 43, was in the middle range.

Source: OECD (2014), *OECD Science, Technology and Industry Outlook 2014*, OECD Publishing, Paris.



Japan's inefficient agricultural sector depends on a high level of government support



1. Producer support is the annual monetary value of gross transfers from consumers and taxpayers arising from policies that support agriculture, regardless of their nature, as a per cent of the value of gross farm receipts.

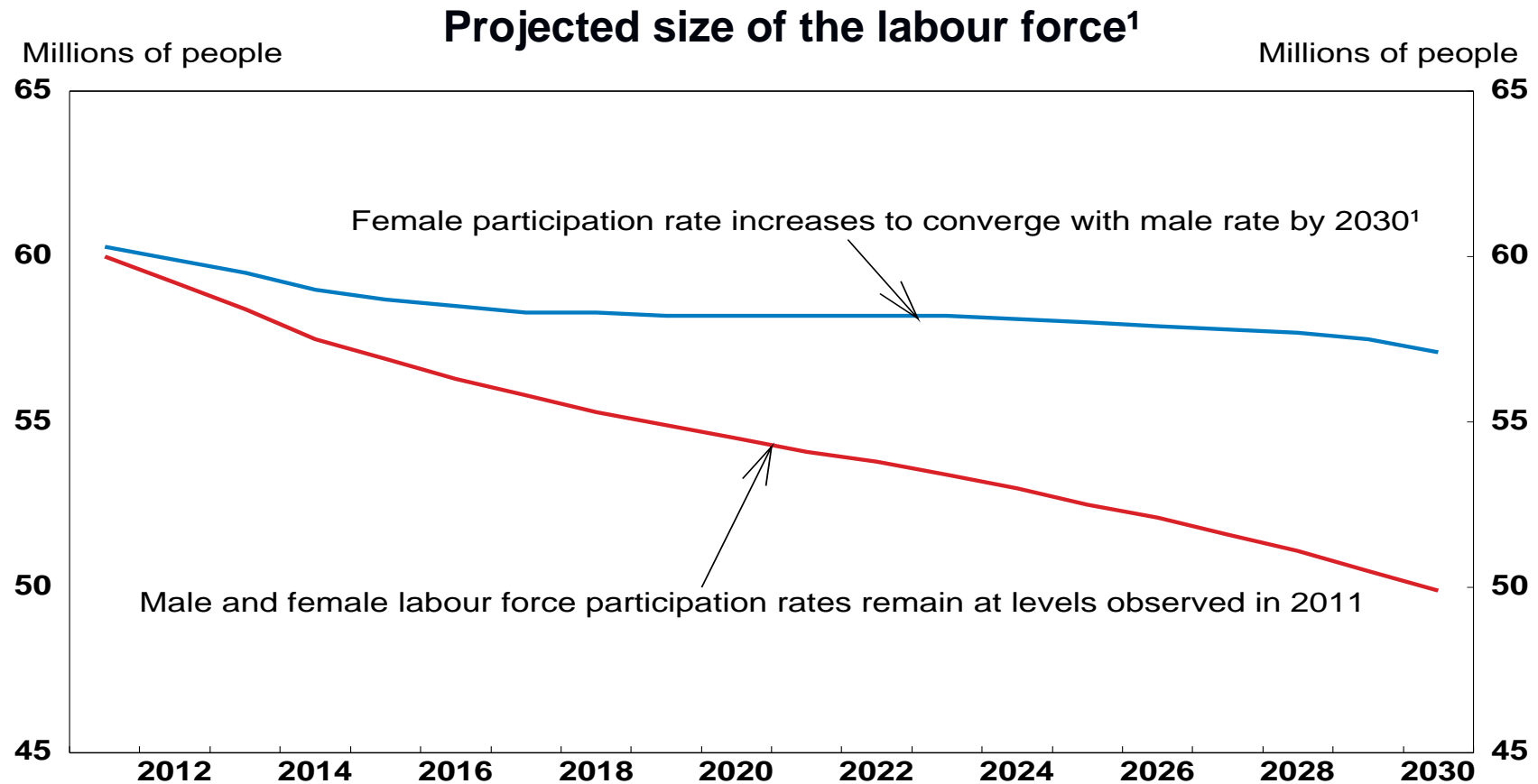
Source: OECD PSE/CSE Database 2014.



Recommendations to boost economic growth



Increase the employment of women

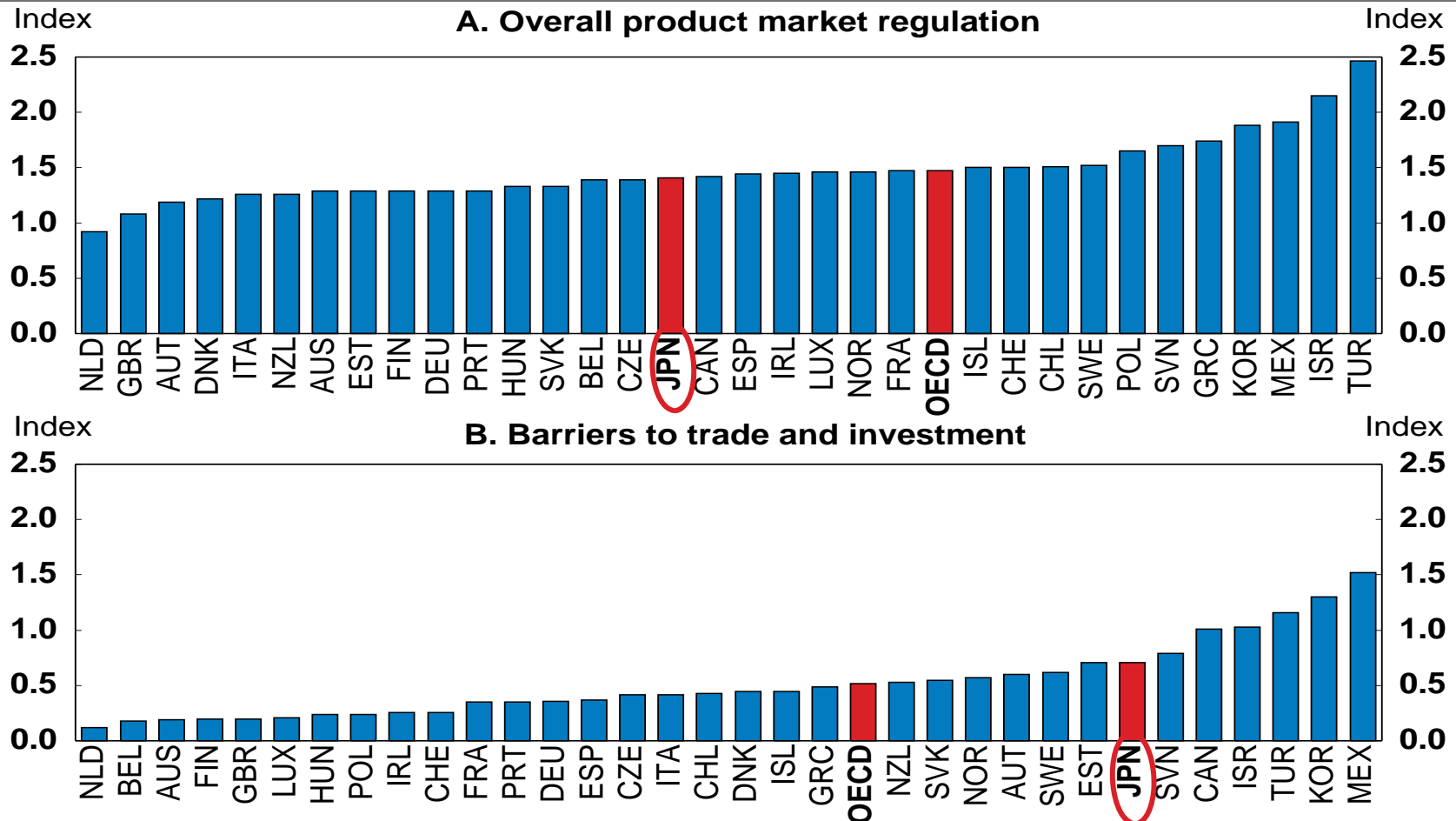


1. For the working-age population (15-64), assuming that the labour force participation rate for men remains constant from 2011 to 2030.

Source: OECD (2014).



Reduce product market regulation and barriers to trade and investment¹



1. Indicators for 2013. The OECD Indicators of Product Market Regulation are a comprehensive and internationally-comparable set of indicators that measure the degree to which policies promote or inhibit competition. Research shows that the indicators have a robust link to performance. The indicator, based on more than 700 questions, ranges from zero (most relaxed) to six (most stringent).

Source: OECD Product Market Regulation Database; Koske et al. (2015).



Increase R&D links between firms, academia and foreign sources

R&D funding in 2013

Source of funding	Share of total R&D spending	Allocation of R&D spending by sector performing it			
		Government	Universities	Business enterprises	Total
Government ¹	18.1	54.4	40.2	5.4	100.0
Universities	5.9	0.6	99.3	0.1	100.0
Business enterprises	75.5	0.6	0.5	98.9	100.0
Foreign sources	0.5	9.6	1.6	88.8	100.0

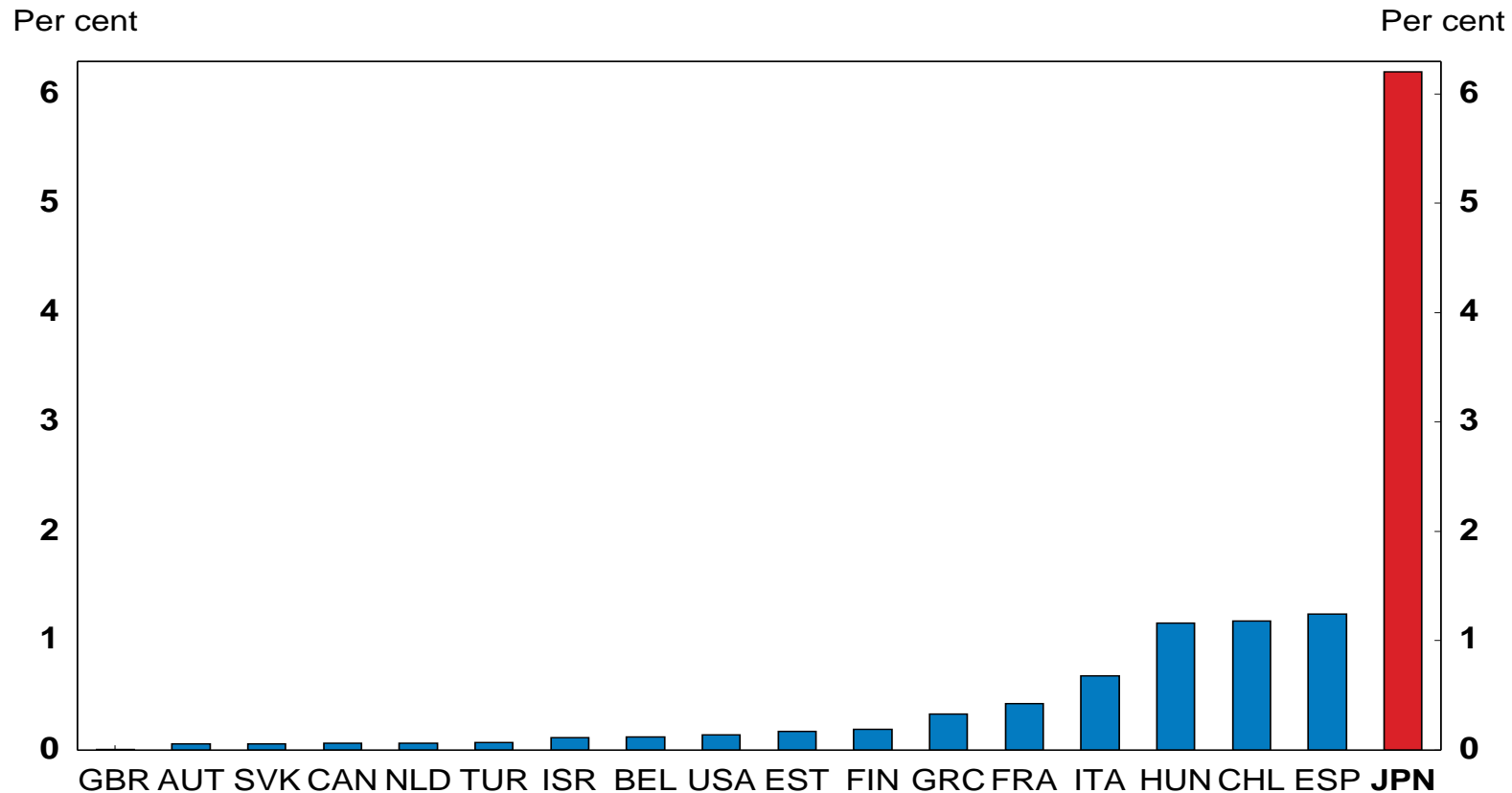
1. Includes private non-profit institutes.

Source: OECD R&D Statistics Database.



Shift SME policies from support to fostering restructuring

The stock of guarantees as a share of GDP in 2013

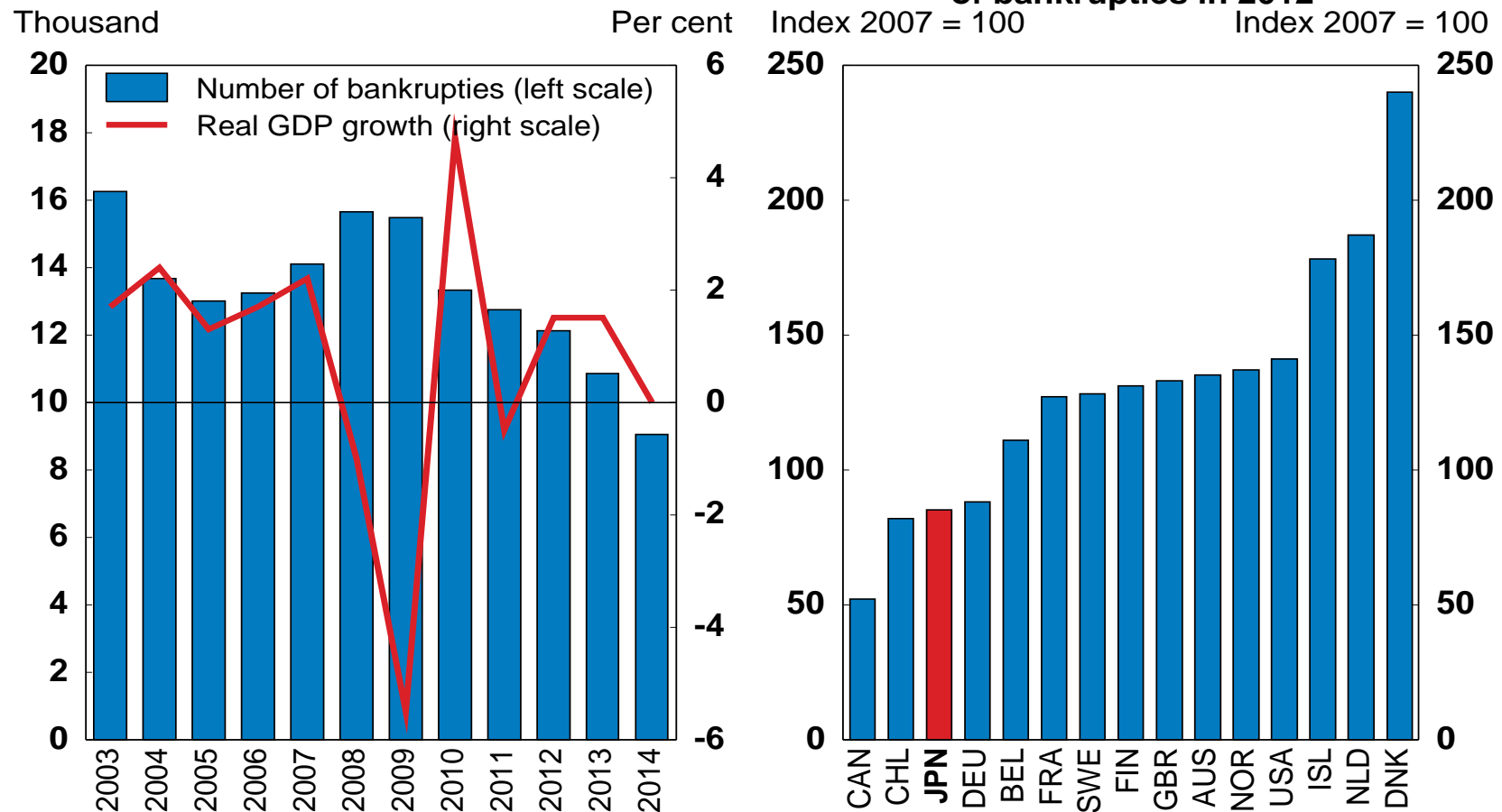


Source: OECD (2015), *Financing SMEs and Entrepreneurs 2015: An OECD Scoreboard*, OECD Publishing, Paris, forthcoming.



Ensure the exit of non-viable firms

A. The number of bankruptcies is falling in Japan **B. International comparison of number of bankruptcies in 2012**

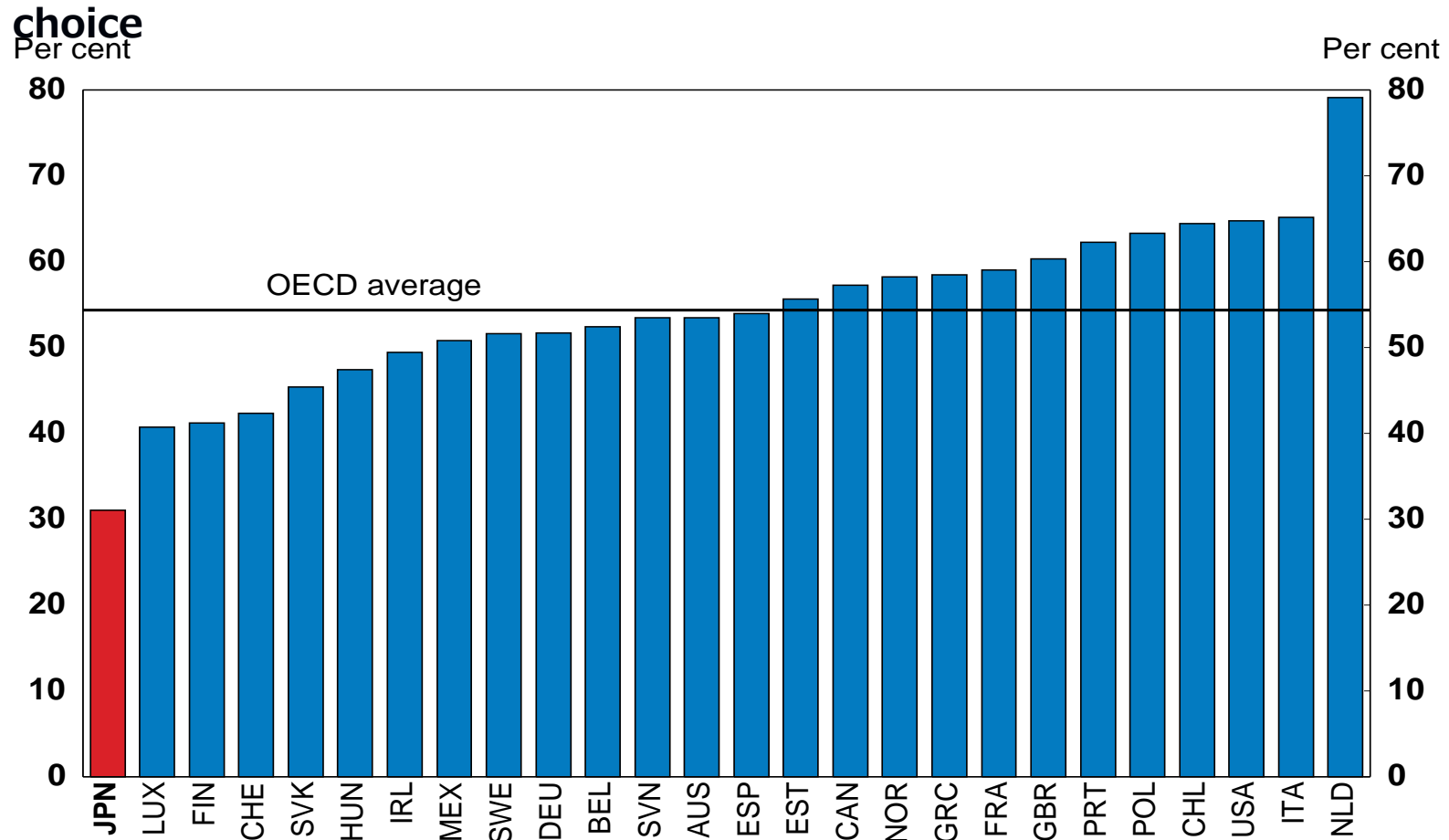


Source: OECD (2014f, *Entrepreneurship at a Glance 2014*, OECD Publishing, Paris; OECD Economic Outlook Database.



Improve the perception of entrepreneurship

Share of the population that views entrepreneurship as a good career choice

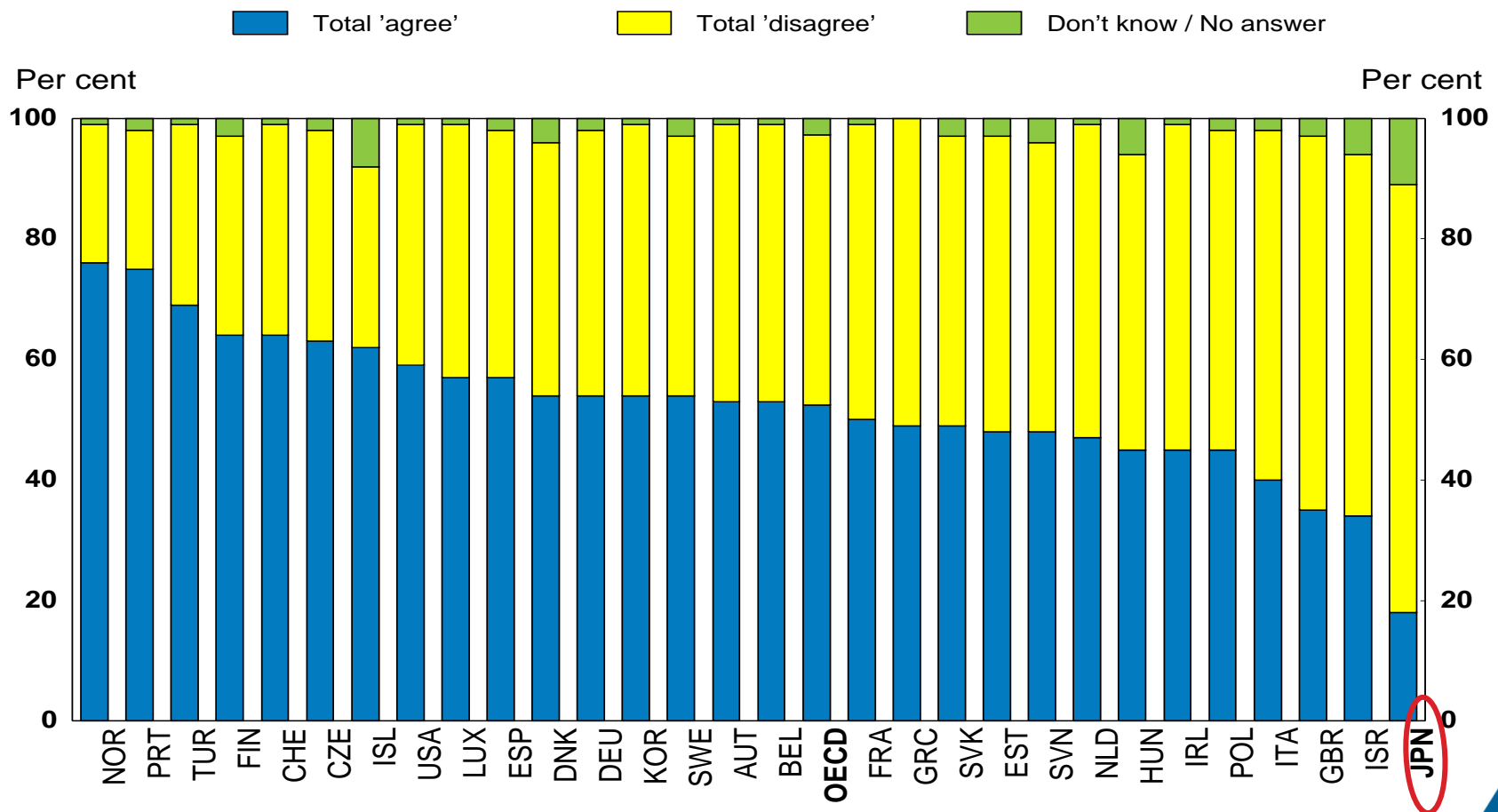


Source: Global Entrepreneurship Monitor (2015).



Provide skills need for entrepreneurship in schools

Per cent that agree that school education provided enabling skills and know-how to run a business (2012)

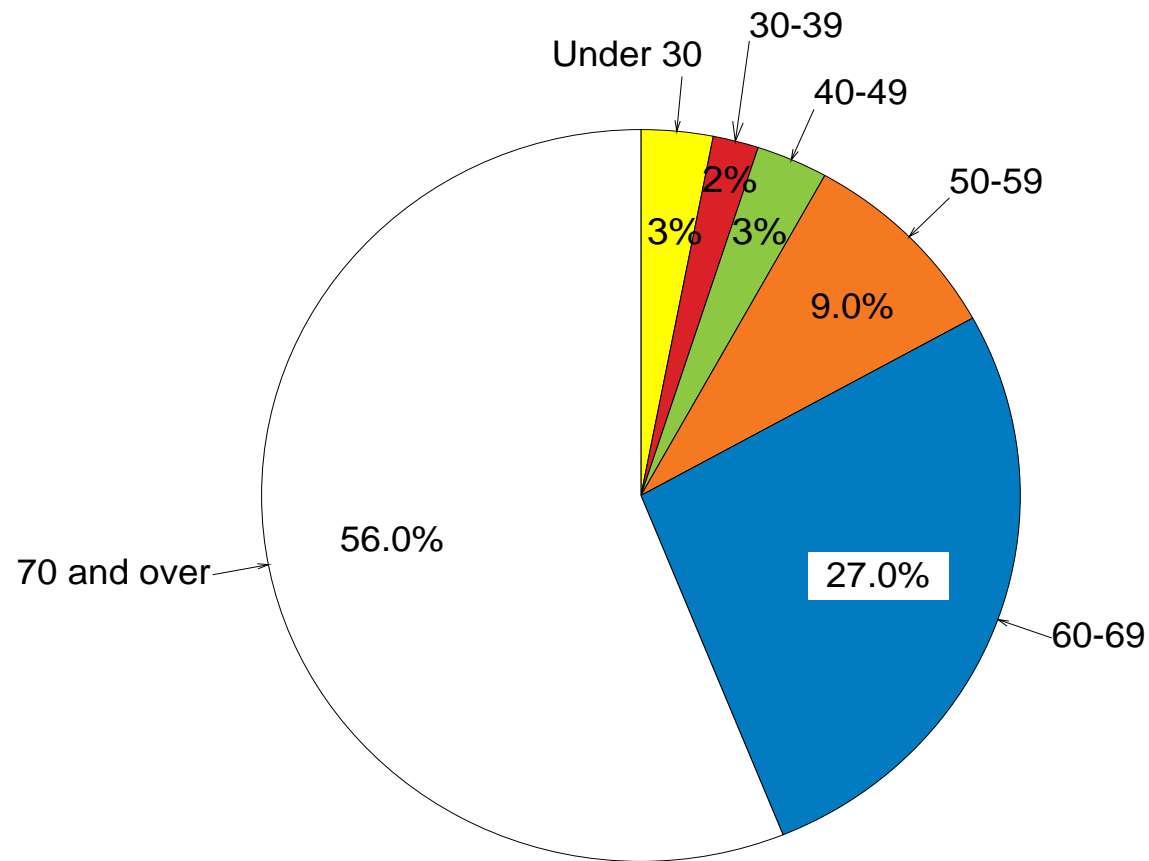


Source: OECD (2013), *Entrepreneurship at a Glance*, OECD Publishing, Paris.



Japan's elderly farm workforce creates an opportunity for fundamental reform

83% of farmers were over 60 years old in 2010



Source: Ministry of Agriculture, Forestry and Fisheries, 2010 Census of Agriculture and Forestry.



Summary of recommendations to boost economic growth

1. Mitigate the decline in the labour force by boosting the participation rate, particularly for women, and expanding the use of foreign workers.
2. Strengthen competition and corporate performance by reducing product market regulation and improving the corporate governance framework.
3. Enhance Japan's integration in the world economy by participating in high-level trade agreements, notably the TPP.
4. Move to a more market-based agricultural system.
5. Improve the R&D framework to increase the return on investment in innovation.
6. Revitalise venture capital investment to promote firm creation and innovation.
7. Improve the entrepreneurial climate and developing entrepreneurial education.
8. Reduce government support for SMEs to promote the restructuring of viable firms and the exit of non-viable ones.



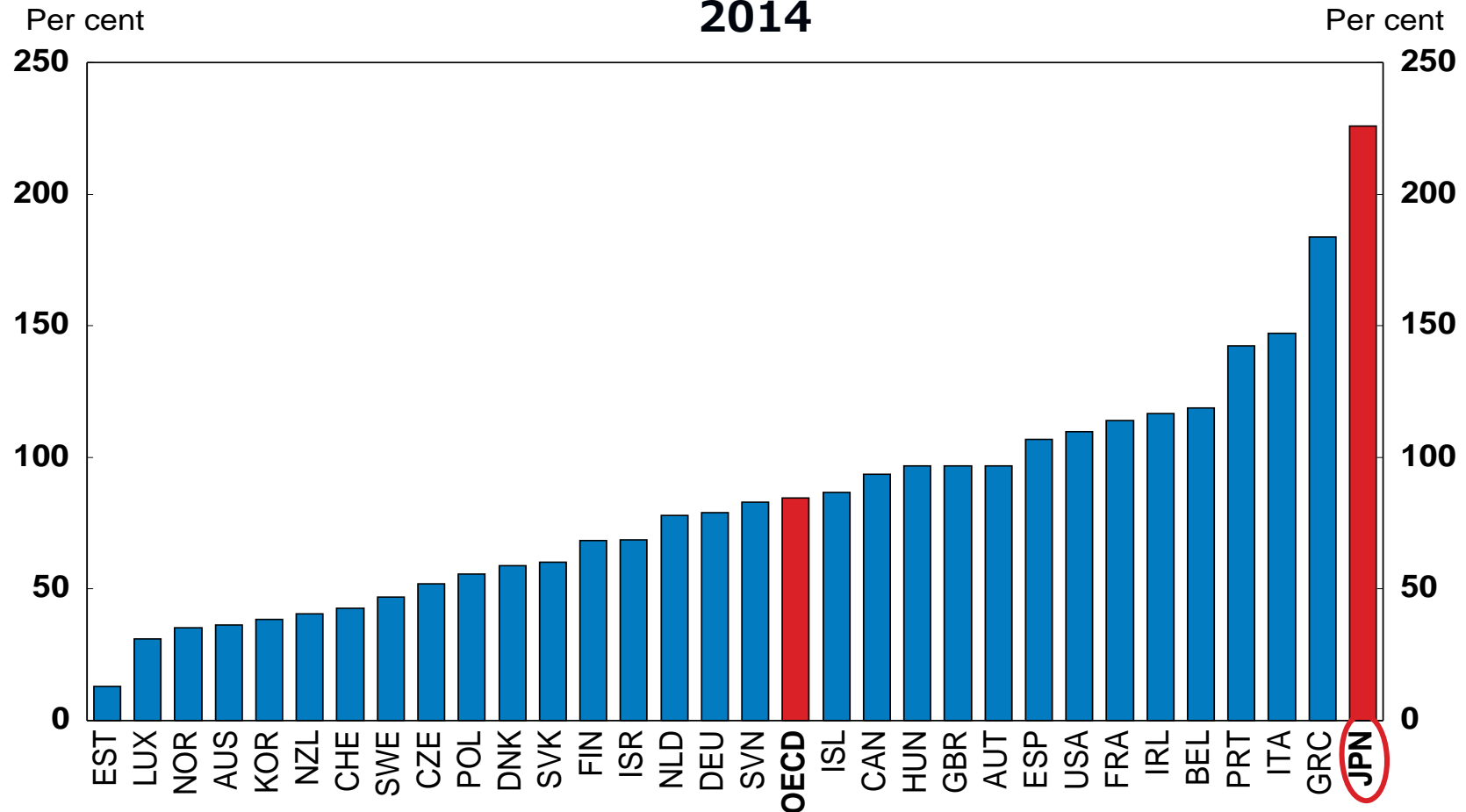
Challenge 2:

Reducing government debt



Japan's gross debt ratio is the highest in the OECD

General government basis in per cent of GDP in 2014

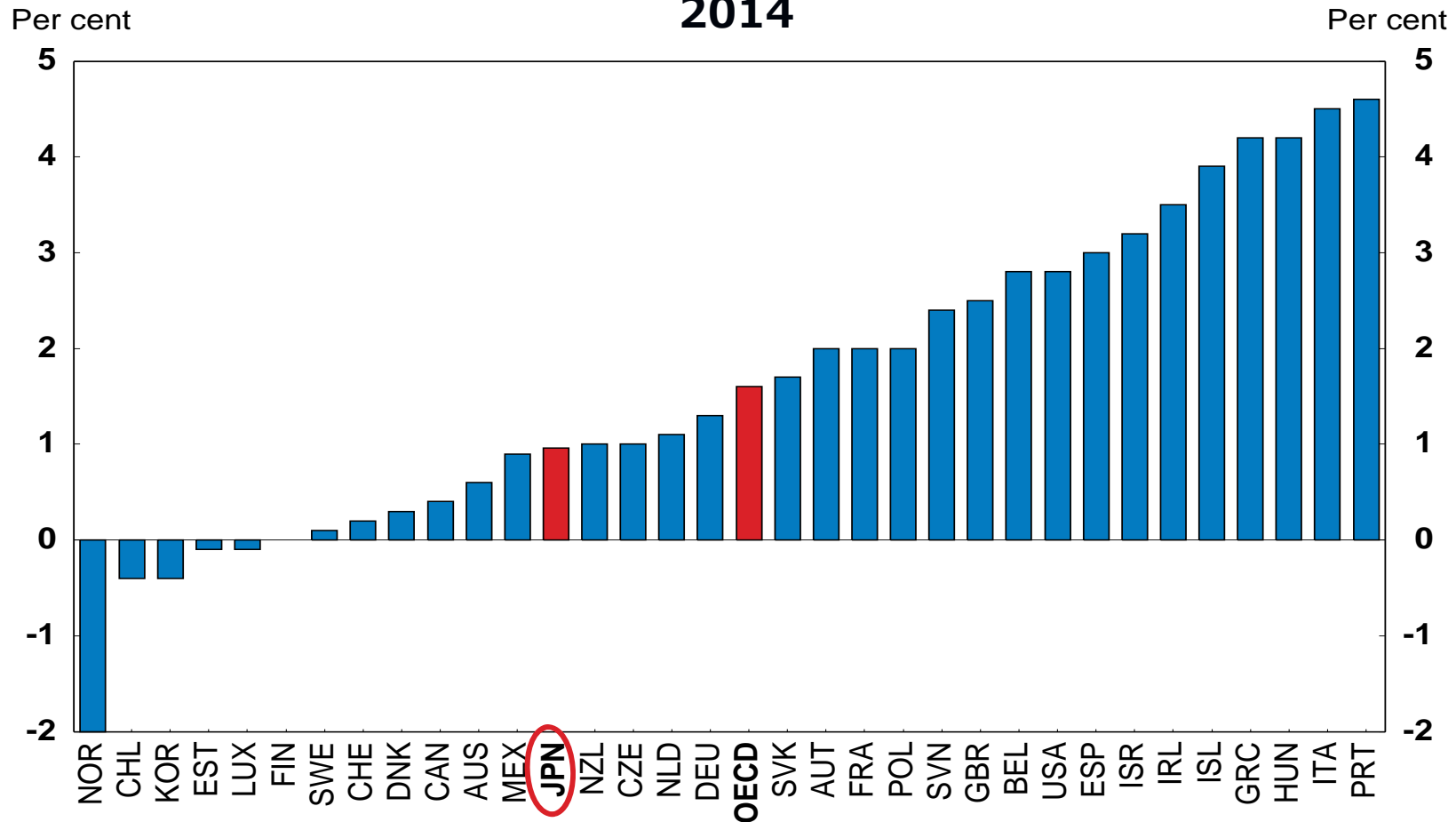


Source: OECD Economic Outlook Database.



The impact of the high debt is mitigated by low interest rates in Japan

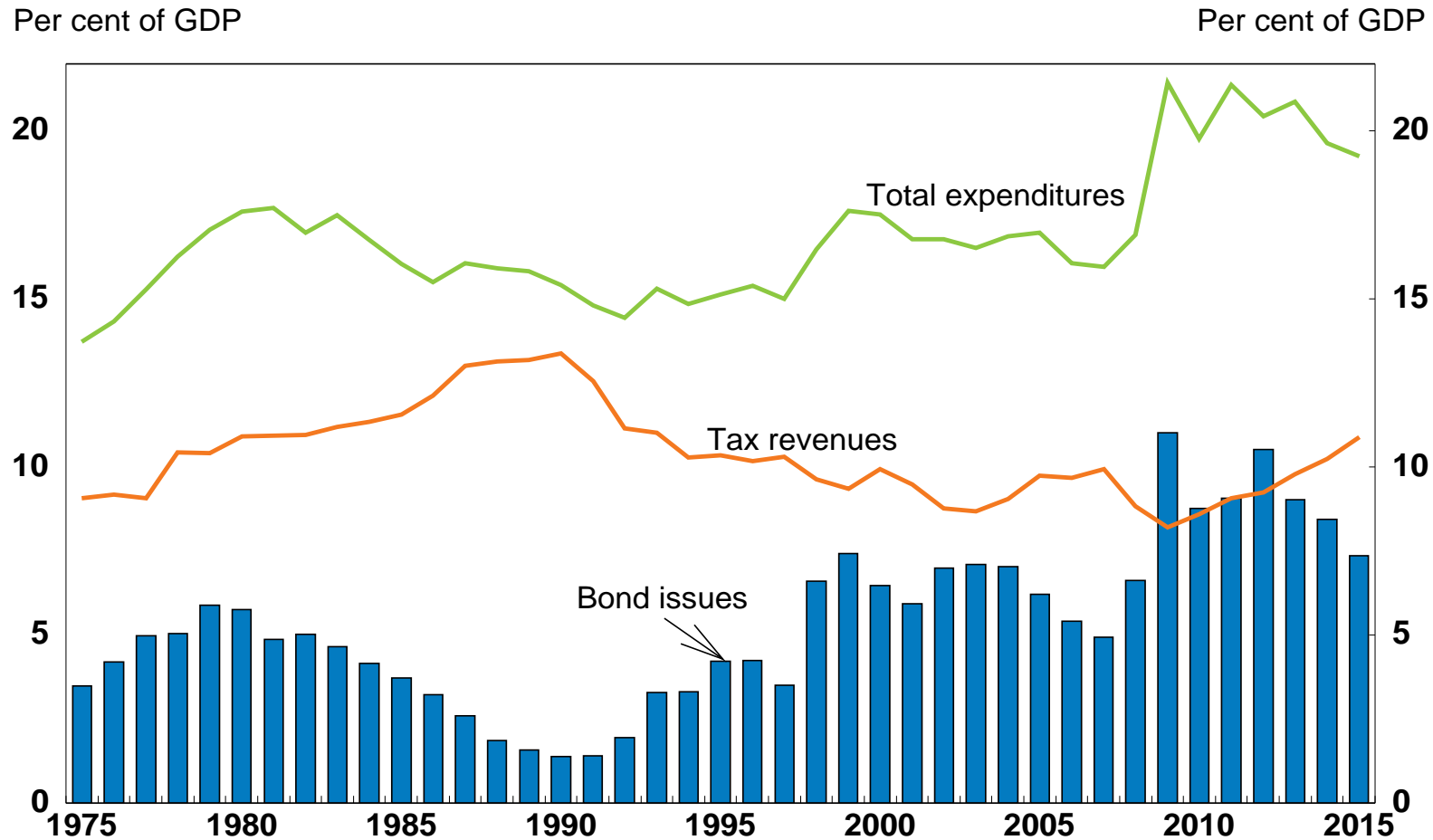
General government basis in per cent of GDP in 2014



Source: OECD Economic Outlook Database.



The gap between government expenditure and revenue is large

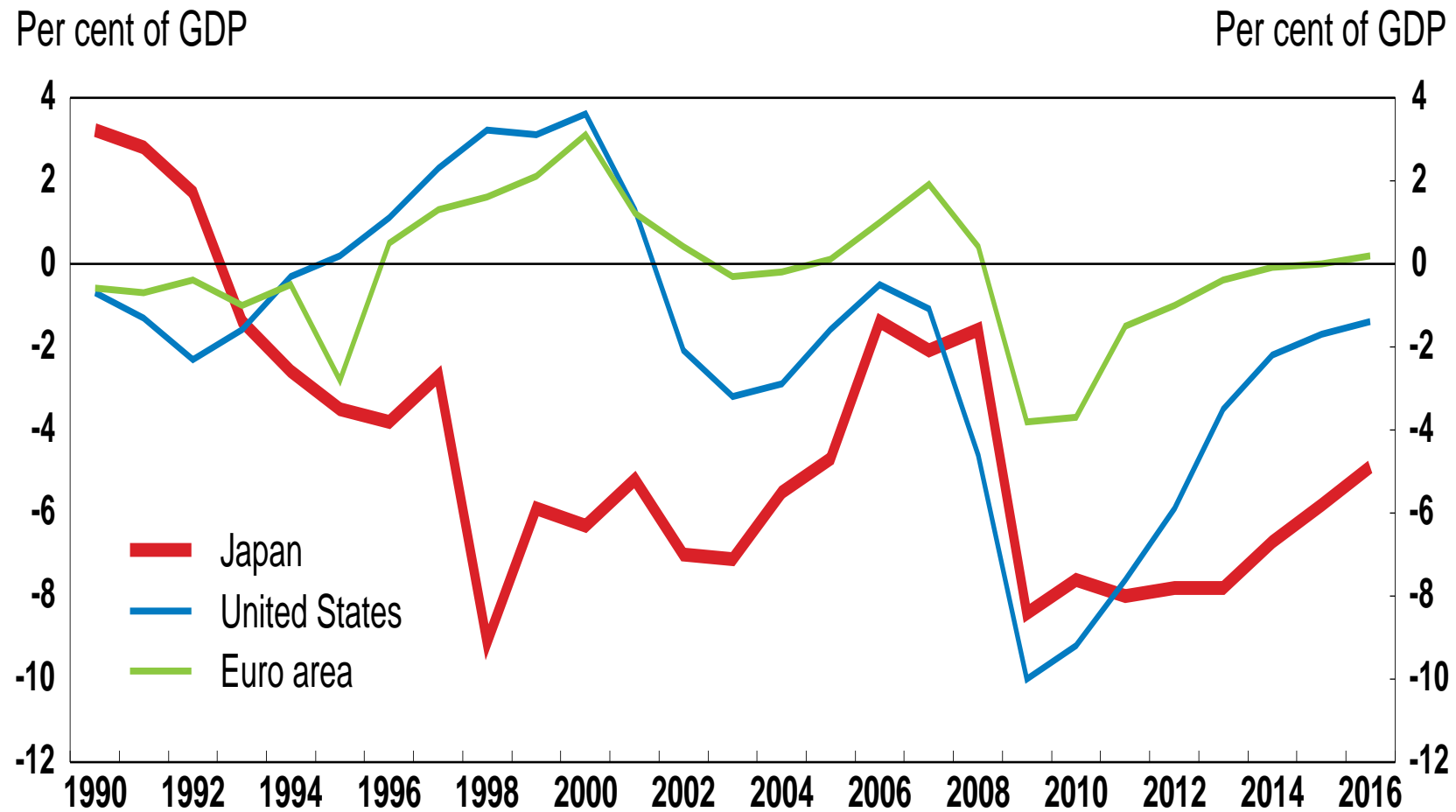


Note: Central government general account as per cent of GDP.

Source: Ministry of Finance; OECD calculations.



Japan's primary deficit remains large

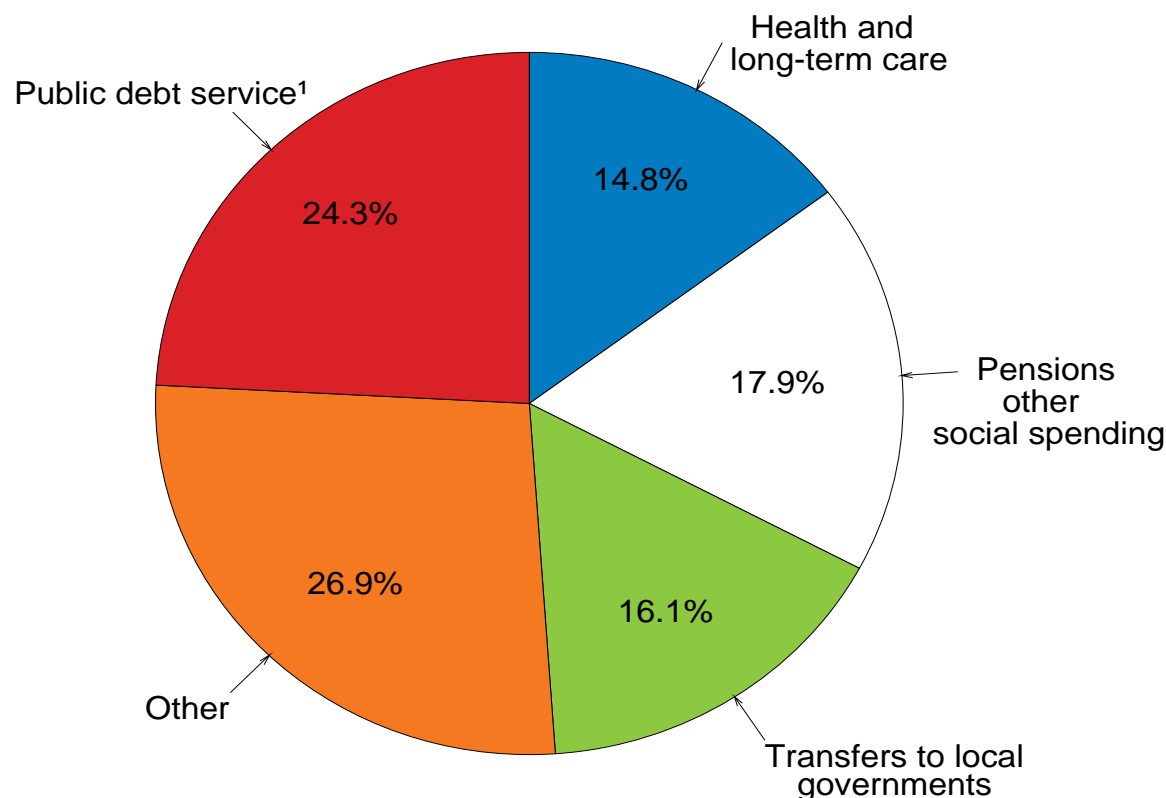


Source: OECD Economic Outlook Database.



Public debt service is now the biggest item in the budget

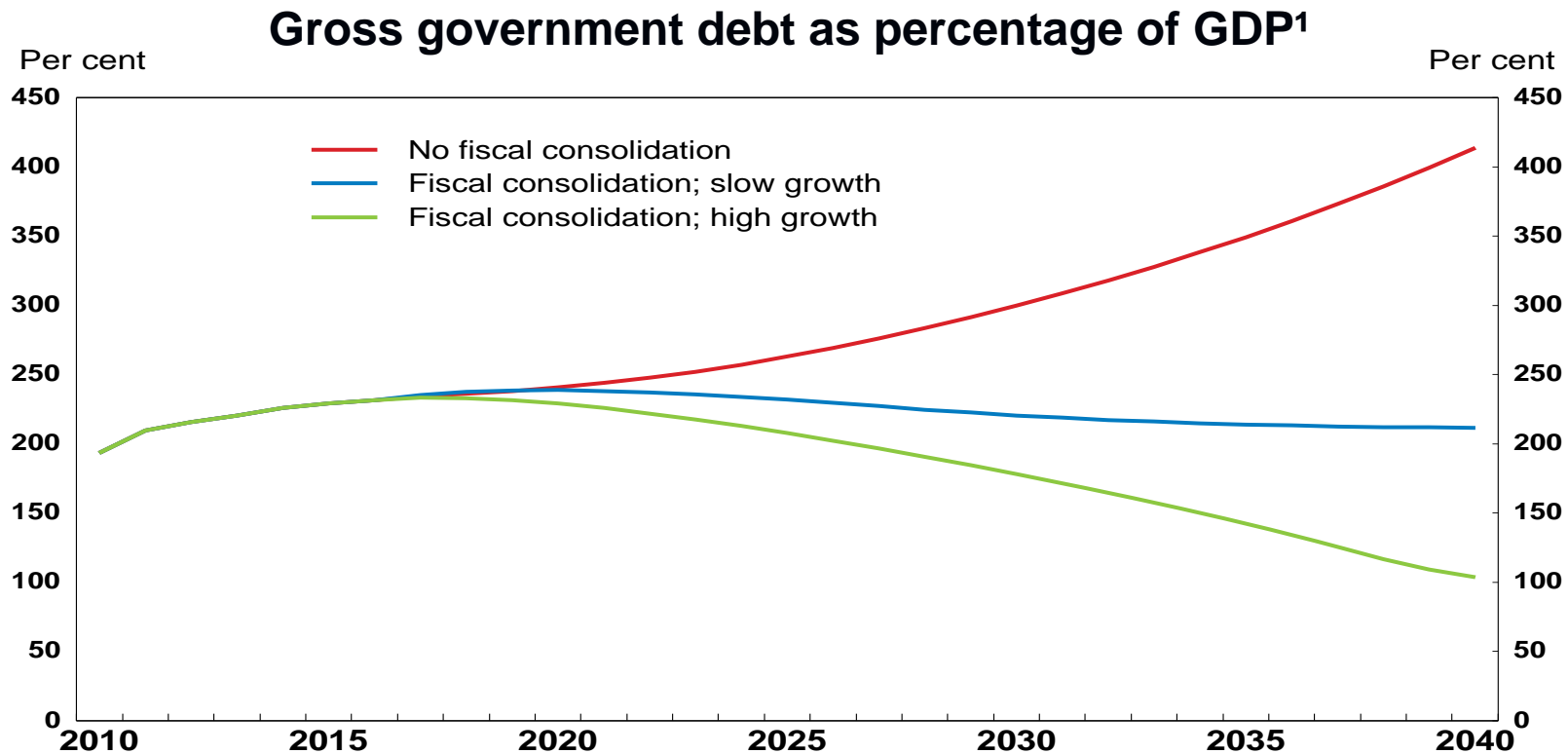
FY 2015 central government budget



1. National debt service includes 13.3 trillion yen of debt redemption, which is not included in general government spending, and 10.1 trillion yen of interest payments.
Source: Ministry of Finance.



Reducing government debt requires fiscal consolidation while boosting real growth and inflation



1. In the no fiscal consolidation scenario, nominal growth is around $2\frac{3}{4}$ per cent (1% real growth, $1\frac{3}{4}$ per cent inflation).

Fiscal consolidation of 7% of GDP over the decade 2017-26 is assumed in the other two scenarios. Output growth rates over 2015-40, resulting in varying levels of interest rates:

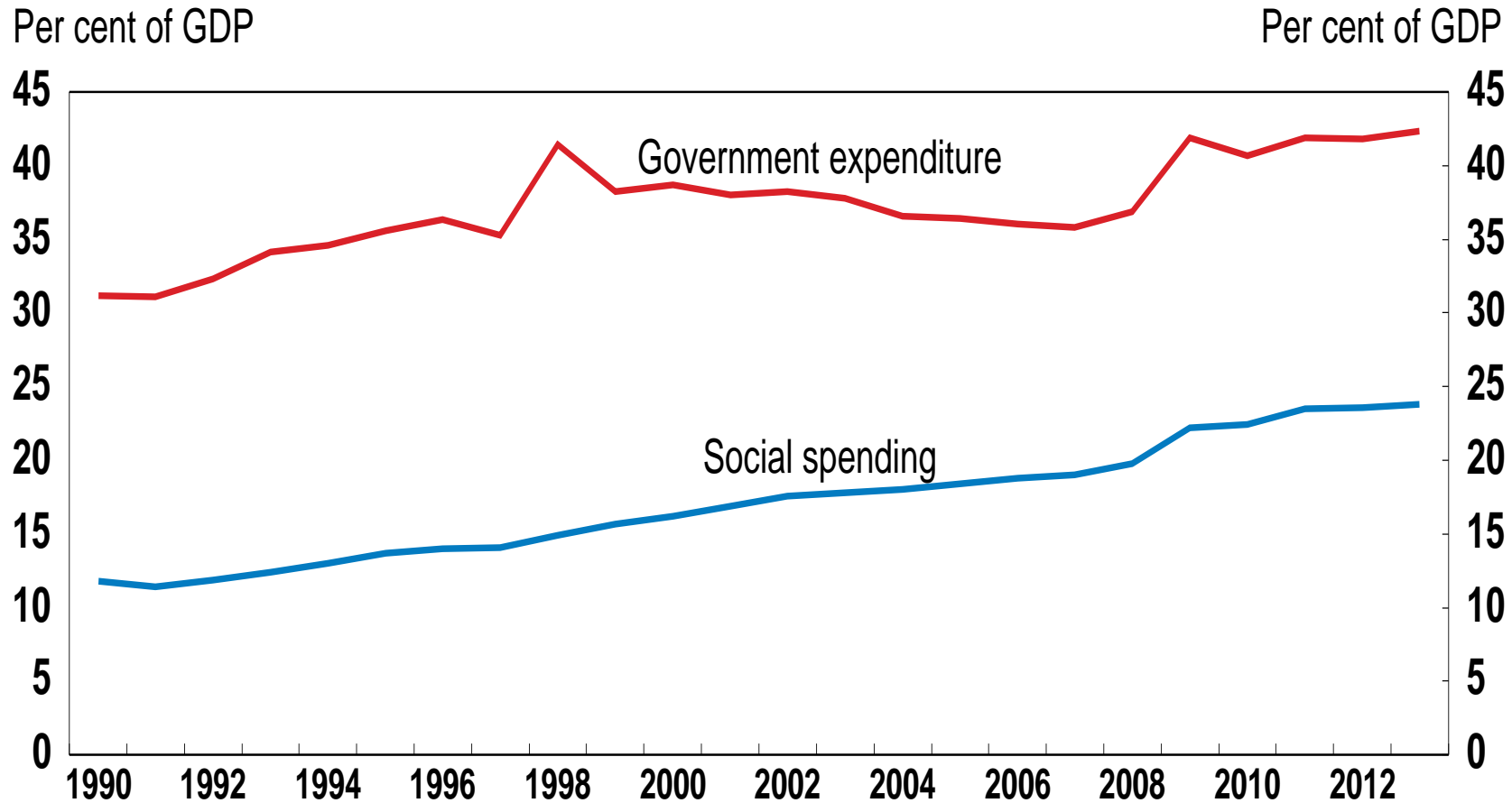
Low growth: nominal growth of $1\frac{1}{2}$ per cent (1% real growth, $\frac{1}{2}$ per cent inflation).

High growth: is nominal growth of 4% (2% real growth and 2% inflation).

Source: OECD Economic Outlook Database; OECD calculations.



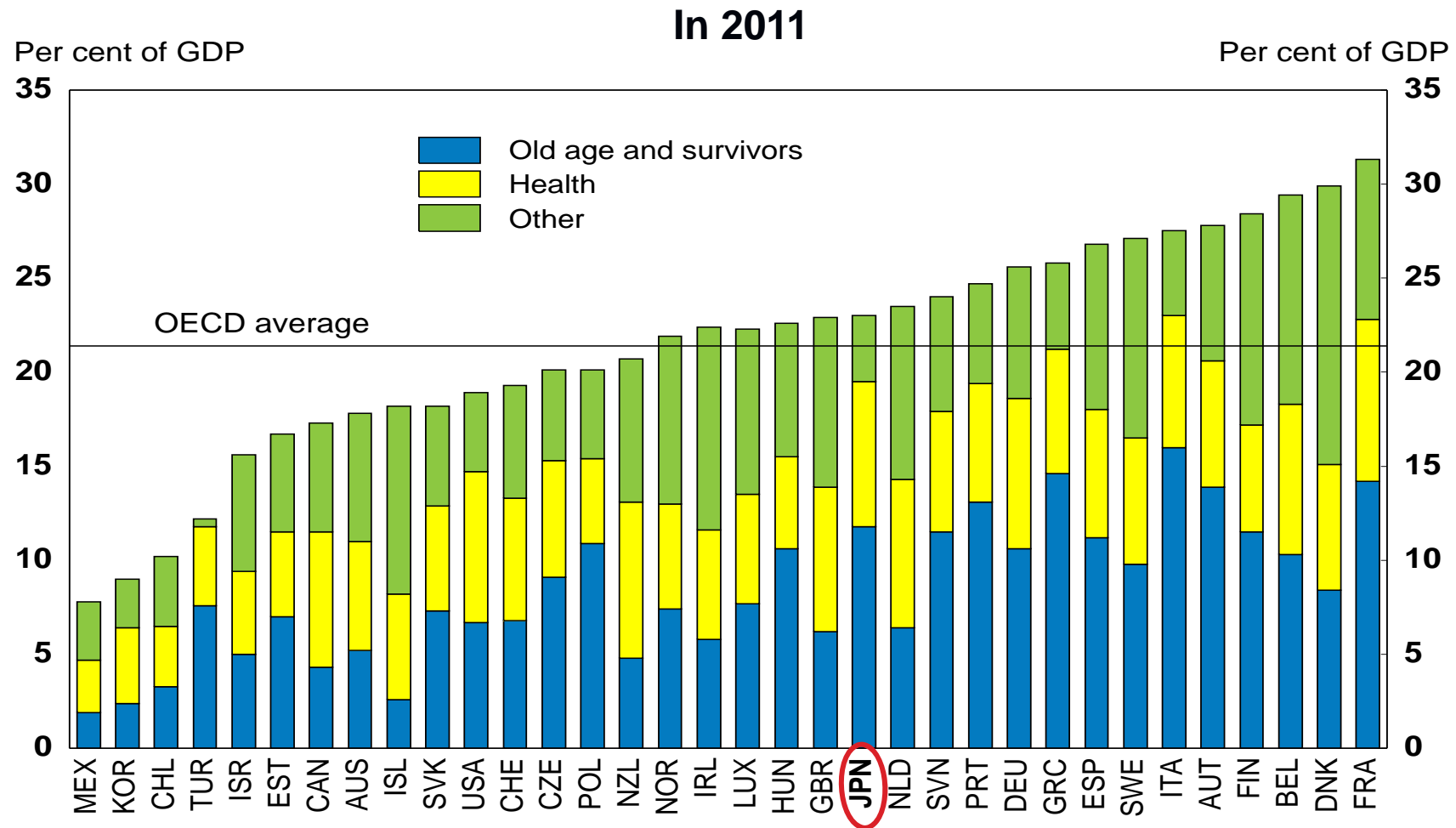
Government social spending has doubled as a share of GDP



Source: OECD Economic Outlook Database.



Public social spending in Japan is concentrated in health and elderly-related outlays



Source: OECD Social Expenditure Database.



Cut healthcare costs by reducing hospital stays and doctor visits

In 2012 or latest year available

	Average total hospital stay ¹	Average hospital stay for curative care ¹	Total number of hospital beds ²	Number of acute-care beds ^{2,3,4}	Number of long-term care beds ^{2,3,4}	Number of beds in long-term care facilities ^{2,4}	Number of doctor consultations per capita per year
Japan	31.2	17.5	13.4	7.9	2.7 (11.1)	6.0 (25.0)	13.0
OECD average	8.4	7.4	4.8	3.3	0.6 (3.8)	7.7 (48.5)	6.7
Highest country	31.2	17.5	13.4	7.9	3.2 (27.4)	13.5 (72.2)	14.3
Lowest country	3.9	3.9	1.6	1.5	0.0 (0.0)	2.4 (17.7)	2.7

1. In days.

2. Per 1 000 population.

3. In hospitals.

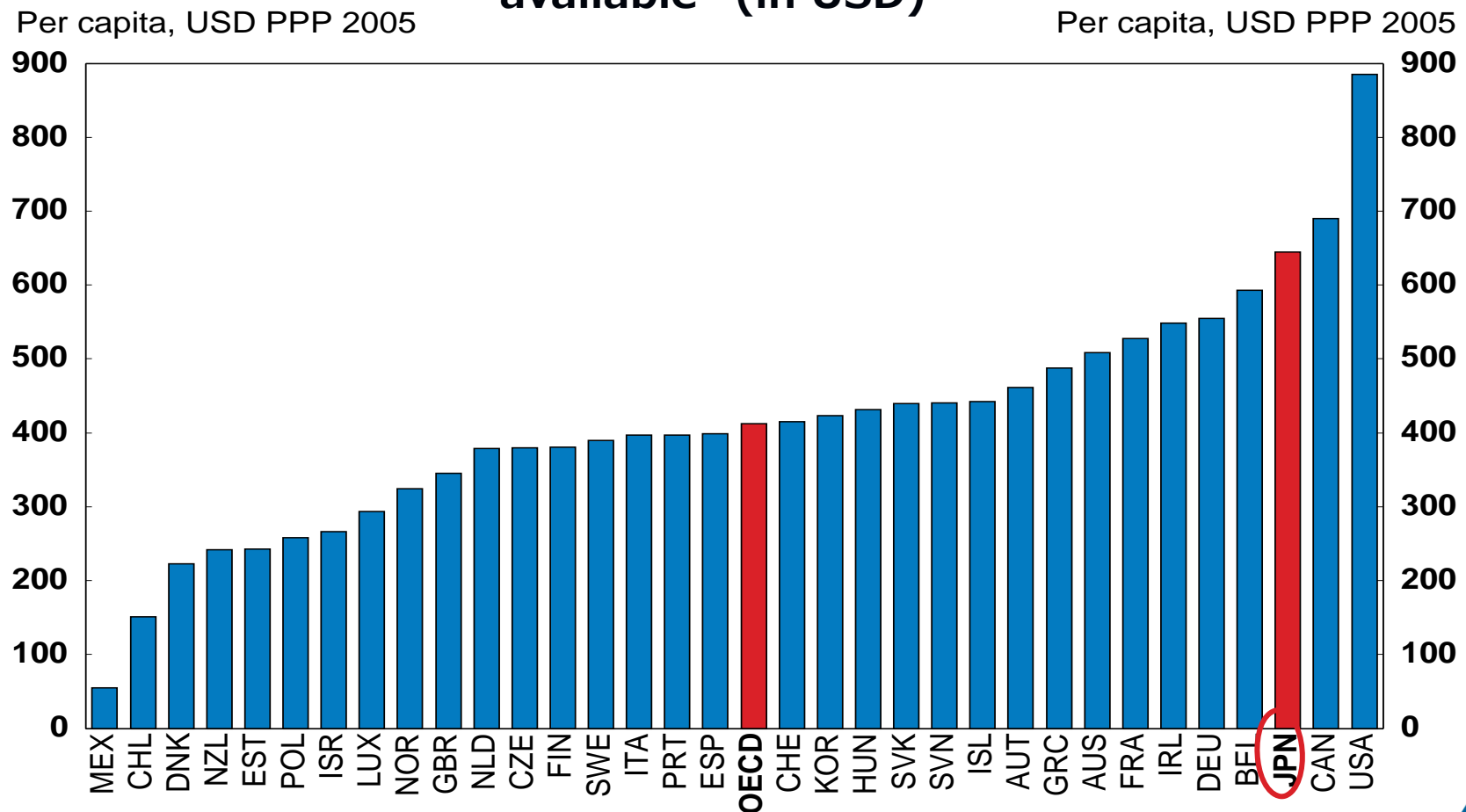
4. The numbers in parentheses show the number of beds per 1 000 population aged 65 and over.

Source: OECD Health Database.



Pharmaceutical consumption per capita is high in Japan

Per capita expenditure on pharmaceuticals in 2012 or latest year available¹ (in USD)

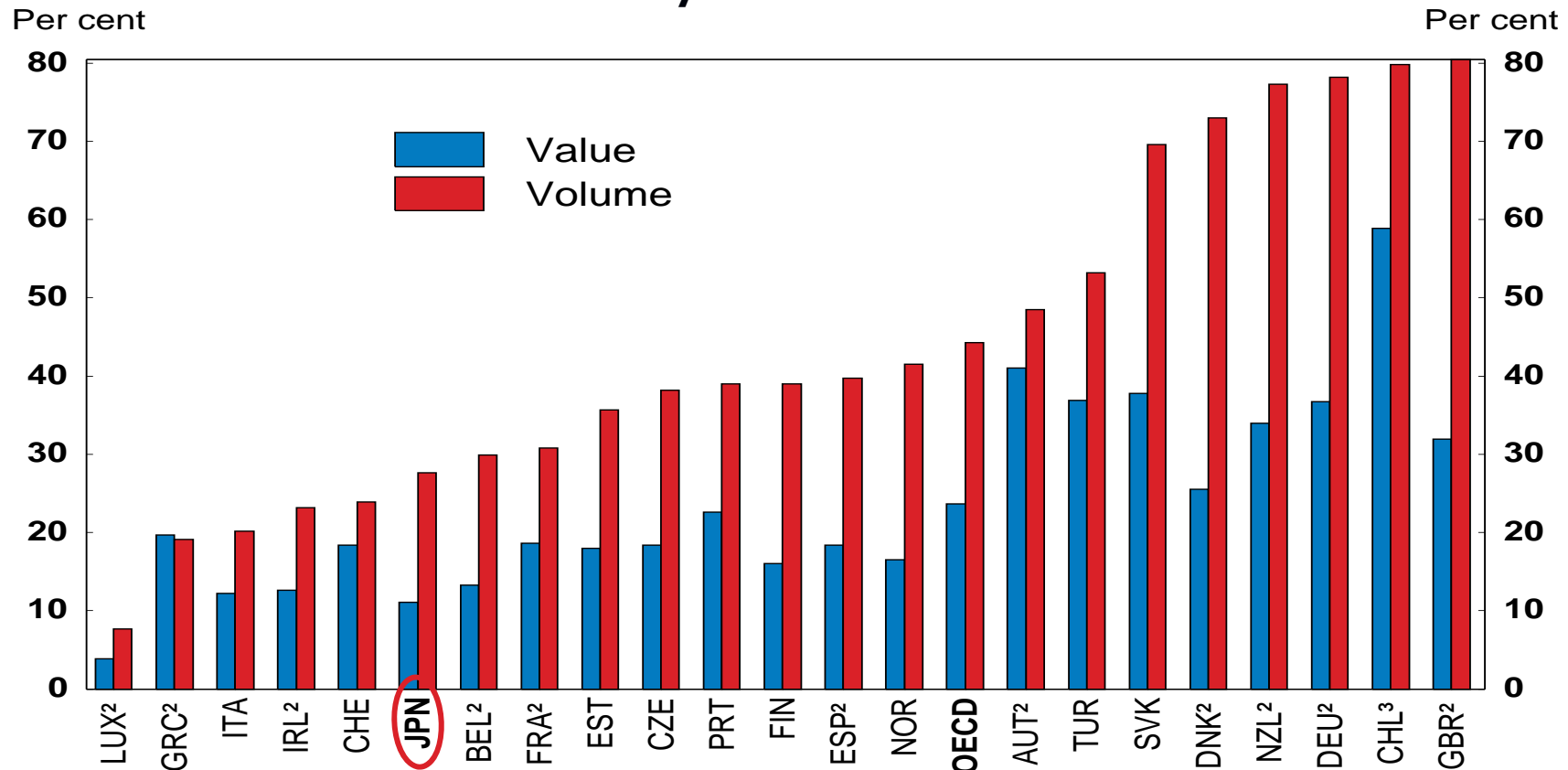


1. Includes medical non-durables.
Source: OECD Health Database.



The high level of spending reflects less use of generic drugs in Japan

Share of generics in the total pharmaceutical market in 2013 or latest year available¹



1. Includes medical non-durables.
 2. Reimbursed pharmaceutical market.
 3. Community pharmacy market.
- Source: OECD Health Database.

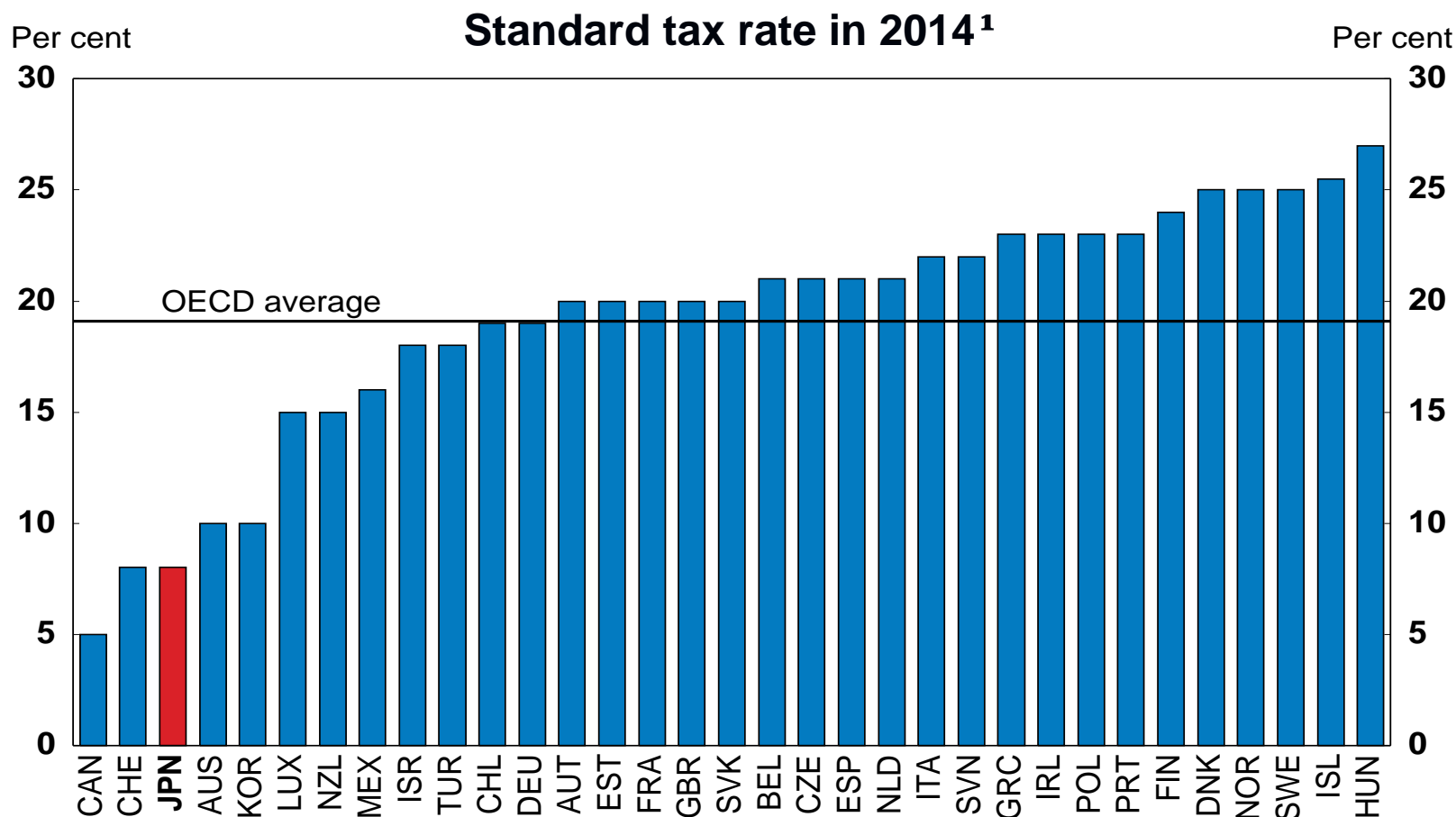


Reduce the growth of social spending

- Reduce the length of hospital stays by shifting long-term care away from hospitals to home-based care or specialised institutions.
- Shift away from a fee-for-service system to reduce the number of doctor visits and shorten hospital stays for curative care.
- Increase efficiency and raise co-payments for health and long-term care, while taking account of equity implications.
- Reduce spending on pharmaceuticals by boosting the use of generics from their relatively low level at present.
- Increase the pension eligibility age to limit the increase in spending on pensions, while raising the labour participation of older workers and reducing intergenerational transfers.



Raise the consumption tax further



1. In January 2014, except for Japan, which reflects the consumption tax hike to 8% in April 2014.

Source: OECD, *Consumption Tax Trends 2014*.



Broaden the personal income tax base

Deductions as a percentage of personal income¹

	Basic deduction	Spouse deduction	Child-rearing deduction	Deduction for social insurance premium	Wage income exemption	Others	Total deduction
Japan	7.8	7.8		13.9	31.0		60.5
United States	41.3		16.1				57.4
Germany	36.0			13.8	2.2	0.2	52.2
United Kingdom	26.6						26.6
Netherlands							0.0
Sweden	3.3						3.3

1. Married household with two children with one worker earning the average wage.

Source: OECD (2014b), *Taxing Wages 2014*, OECD Publishing, Paris.

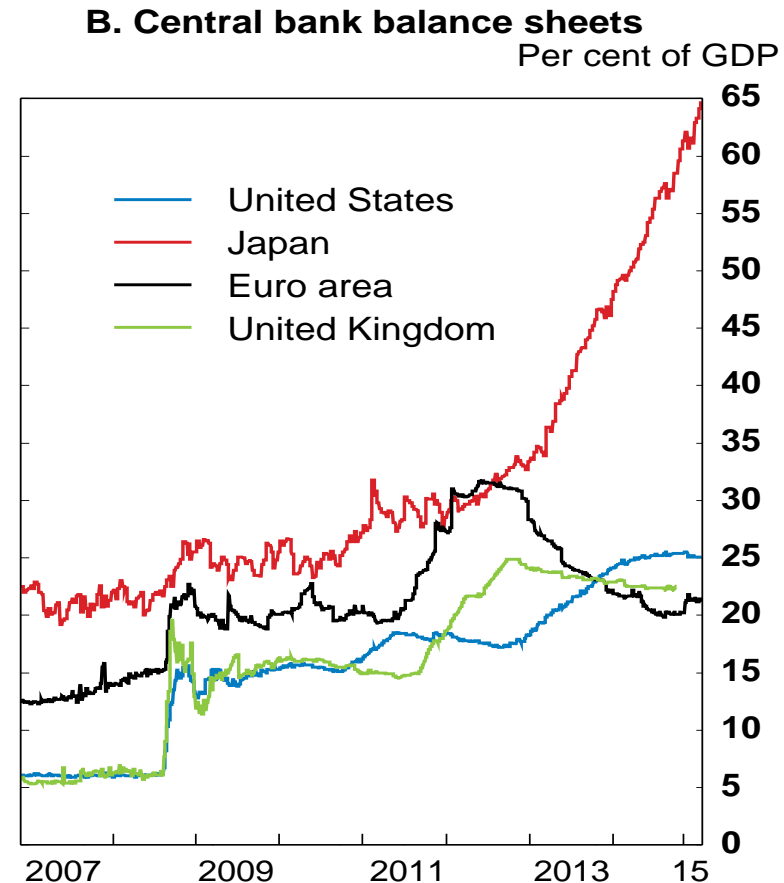
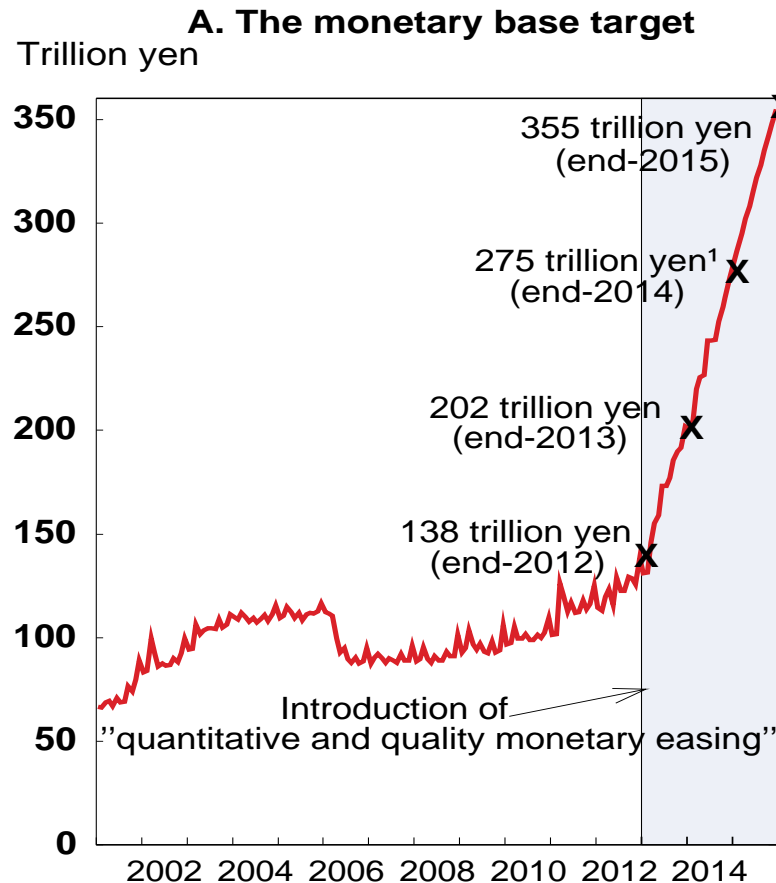


Challenge 3:

**Achieving a definitive exit
from deflation**



Quantitative and qualitative easing is rapidly increasing the monetary base

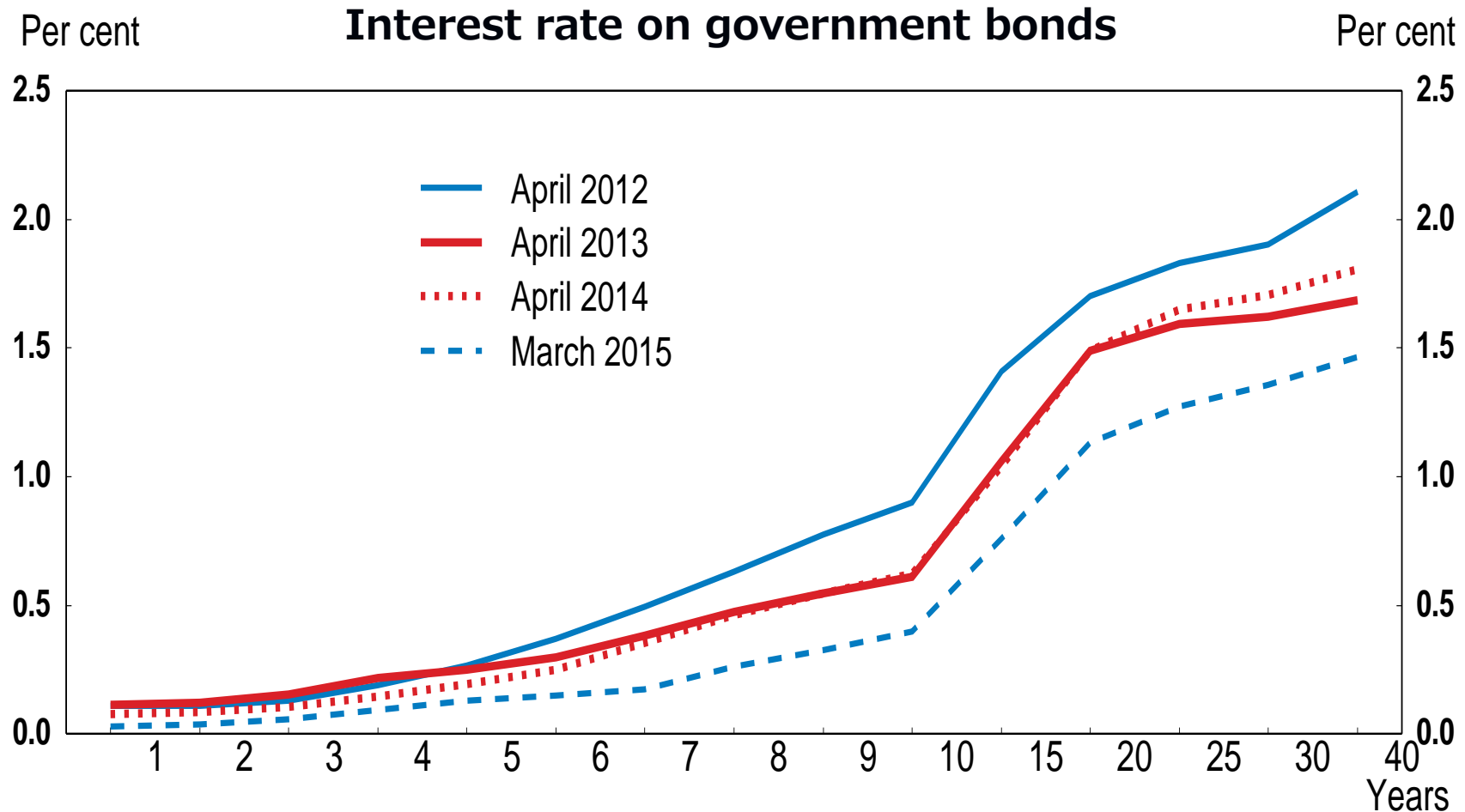


1. The target increased from 270 trillion yen to 275 trillion yen with the increase in QQE in October 2014.

Source: Bank of Japan; Thomson Financial.



Quantitative and qualitative easing has reduced interest rates across the yield curve¹

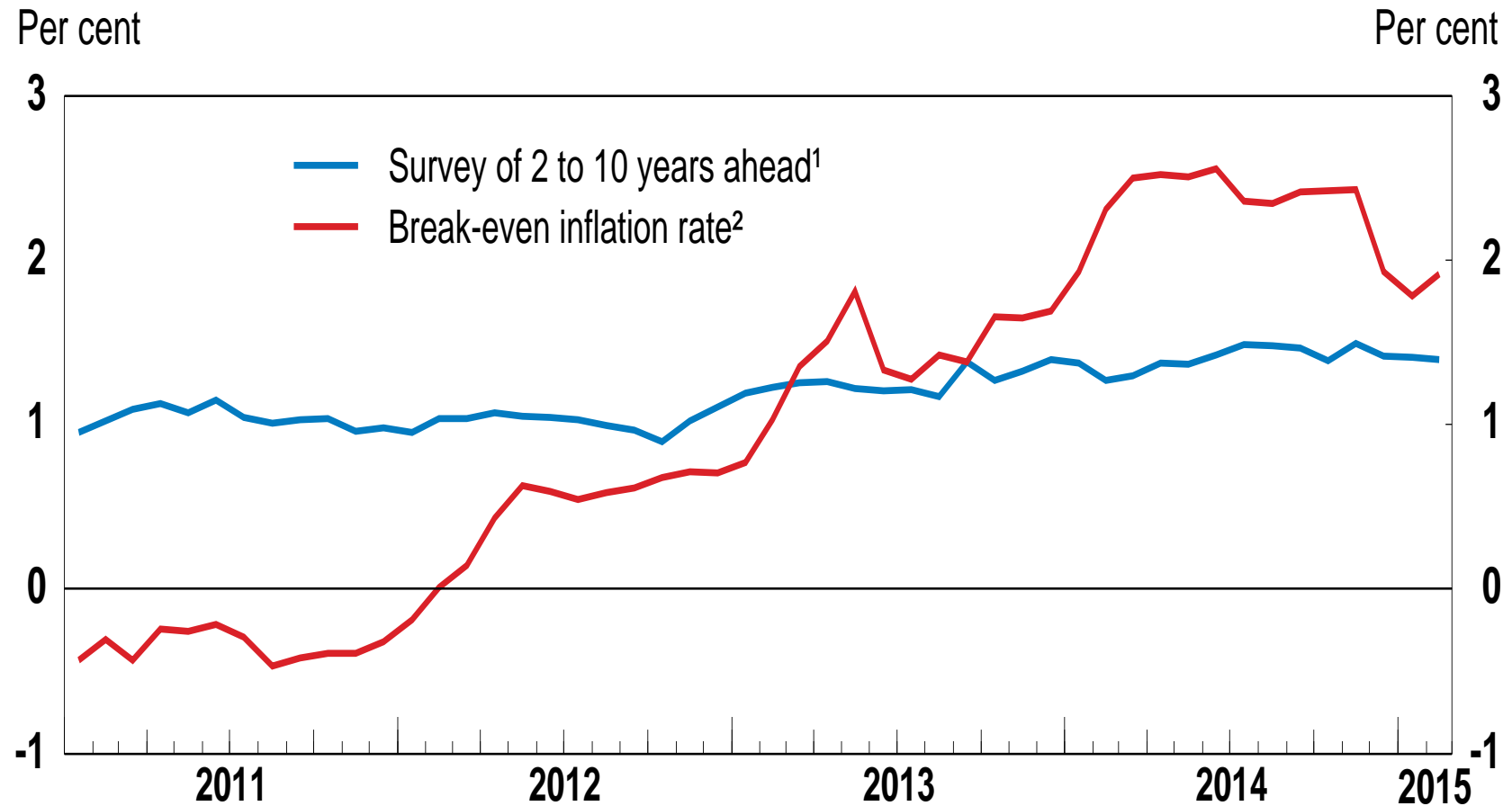


1. Market base rate using compounded growth rate. The data refer to the rate at the end of the month.

Source: Ministry of Finance.



Inflation expectations have increased



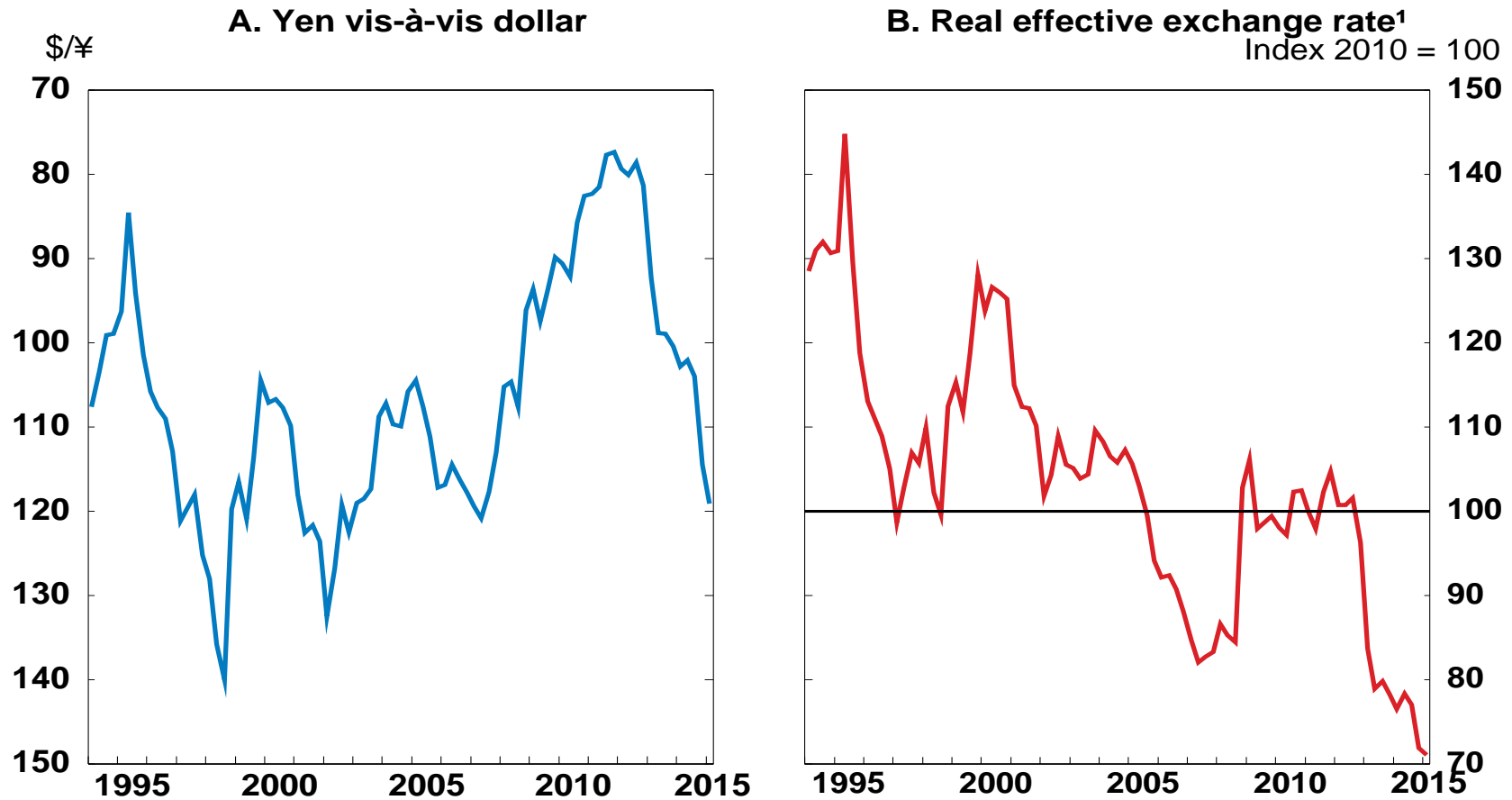
1. The QUICK Monthly Market Survey.

2. Yield spreads between fixed-rate coupon-bearing JGBs and inflation-indexed JGBs.

Source: Bank of Japan; Thomson Financial.



The yen has depreciated sharply since 2012

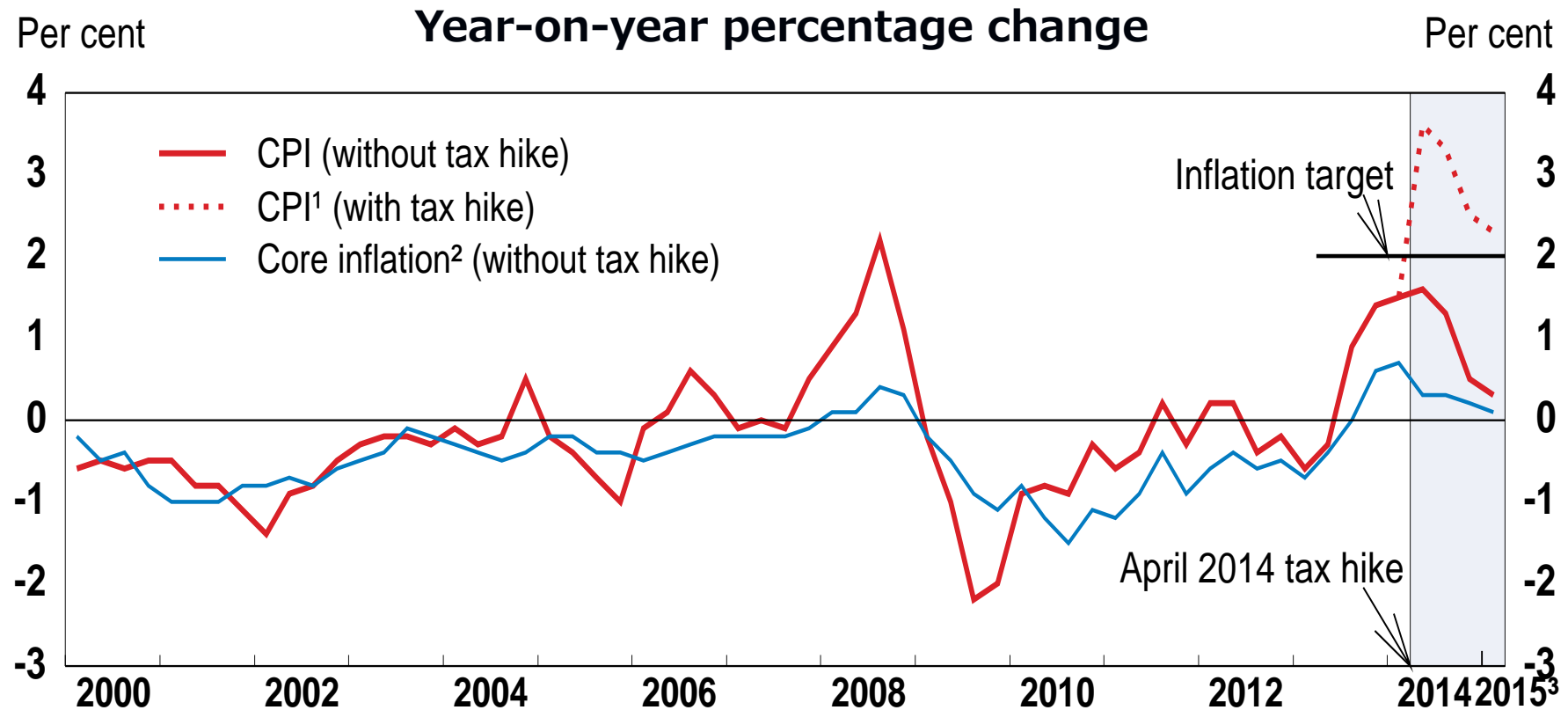


1. Trade-weighted, vis-à-vis 49 trading partners and deflated based on consumer price indices.

Source: OECD Economic Outlook Database; Bank of Japan.



Despite quantitative and qualitative easing, inflation has slowed close to zero



1. In April 2014, the consumption tax was raised from 5% to 8%. The tax hike added 2 percentage points to inflation according to estimates by the Bank of Japan and the Cabinet Office.

2. OECD measure, which excludes food and energy.

3. January and February 2015.

Source: OECD Economic Outlook Database; Bank of Japan (2014); Cabinet Office (2014)

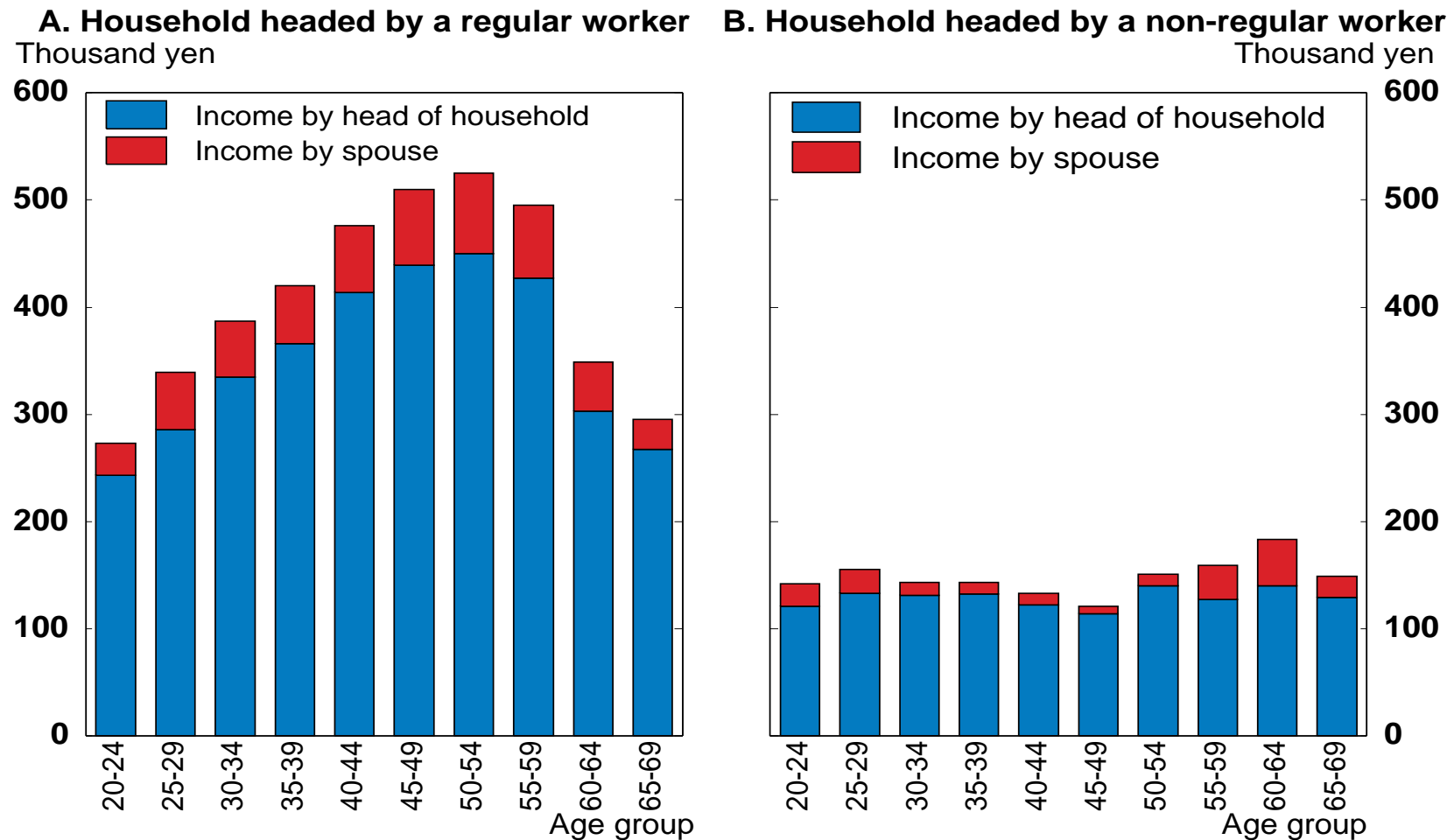


Challenge 4:

Promoting social cohesion



Break down labour market dualism to reduce income inequality and poverty



Source: Ministry of Health, Labour and Welfare (2014).



Non-regular worker households suffer from a high poverty rate

Poverty rate by employment status of spouses¹

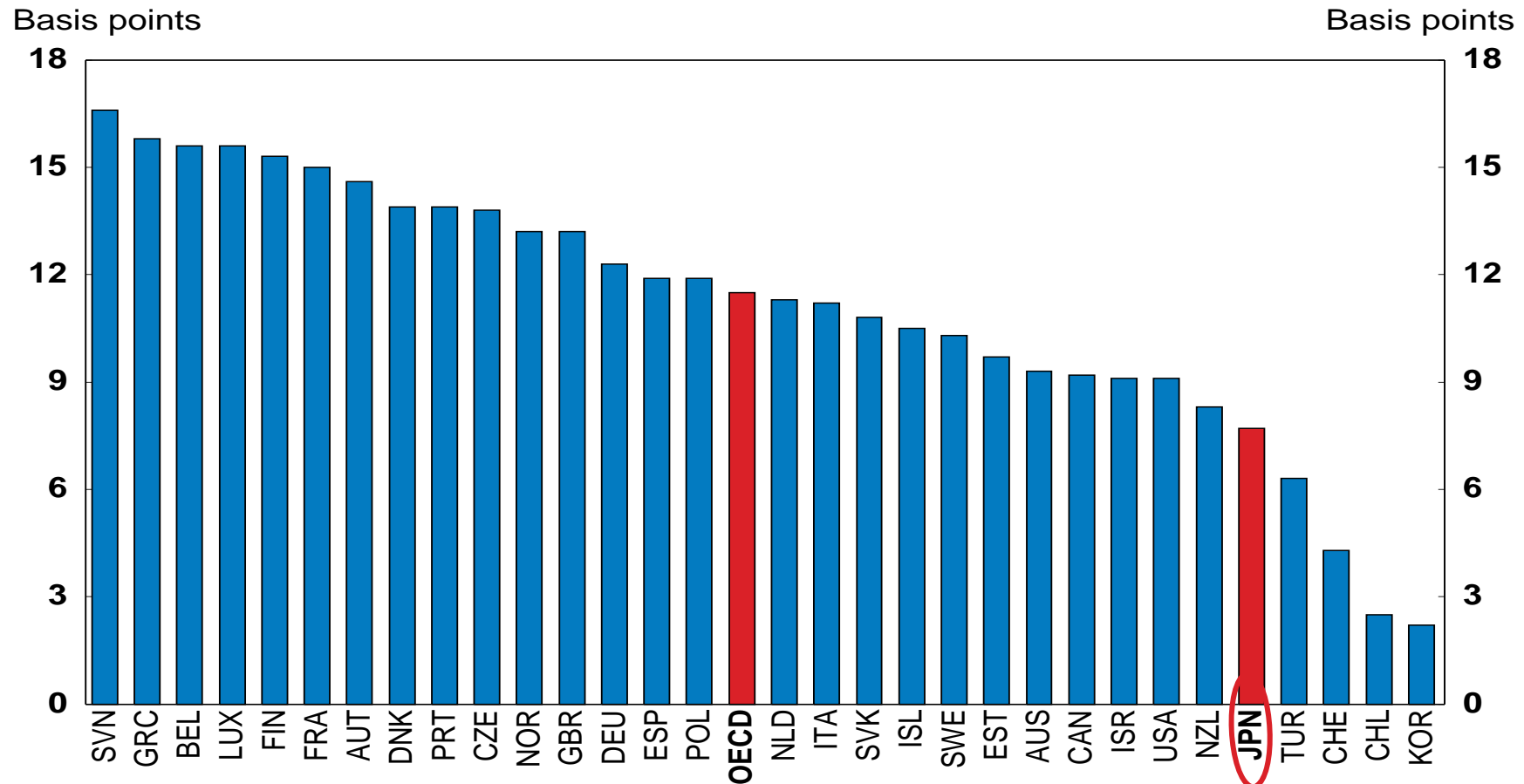
Husband (%)	Wife (%)			
	Regular	Non-regular	Self-employed	Not employed
Regular	1	3	3	5
Non-regular	7	19	16	35
Self-employed	5	16	13	23
Unemployed	8	38	21	47

1. The data are based on a survey of nearly 10 000 people.
Source: Higuchi (2013).



Impact of tax and transfers on income inequality is weak in Japan

Reduction in inequality (Gini coefficient)¹, working-age population in 2012 or latest year available



1. The Gini coefficient is a measure of income inequality that ranges from 0 (where all individuals have the same income, or complete equality) to 1 (where one individual has all the income).

Source: OECD Income Distribution and Poverty Database.

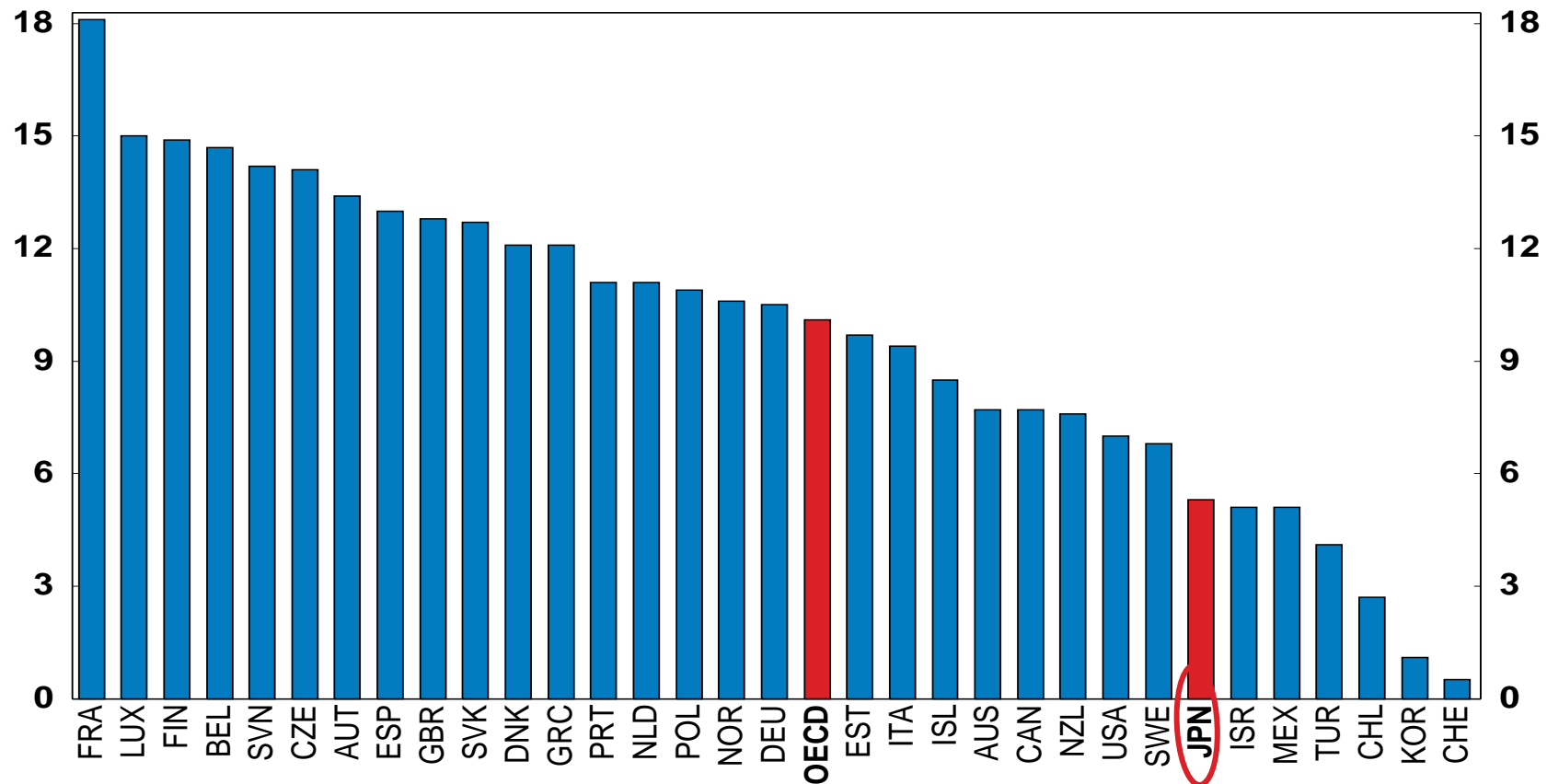


Impact of tax and transfers on poverty is weak in Japan

Reduction in relative poverty rate¹, working-age population in 2012 or latest year available

Percentage points

Percentage points

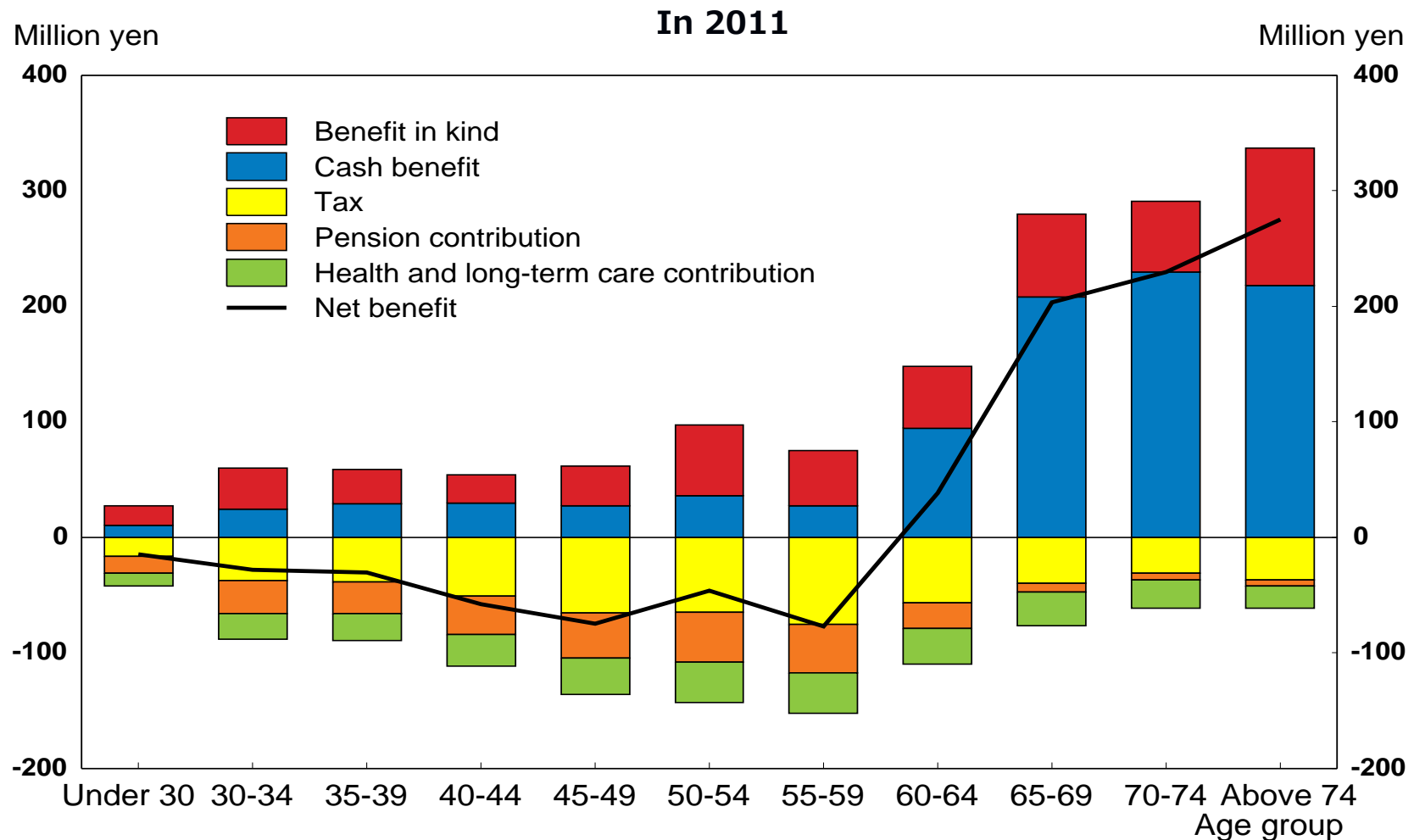


1. The relative poverty rate is the percentage of the population whose income is less than half median income.

Source: OECD Income Distribution and Poverty Database.



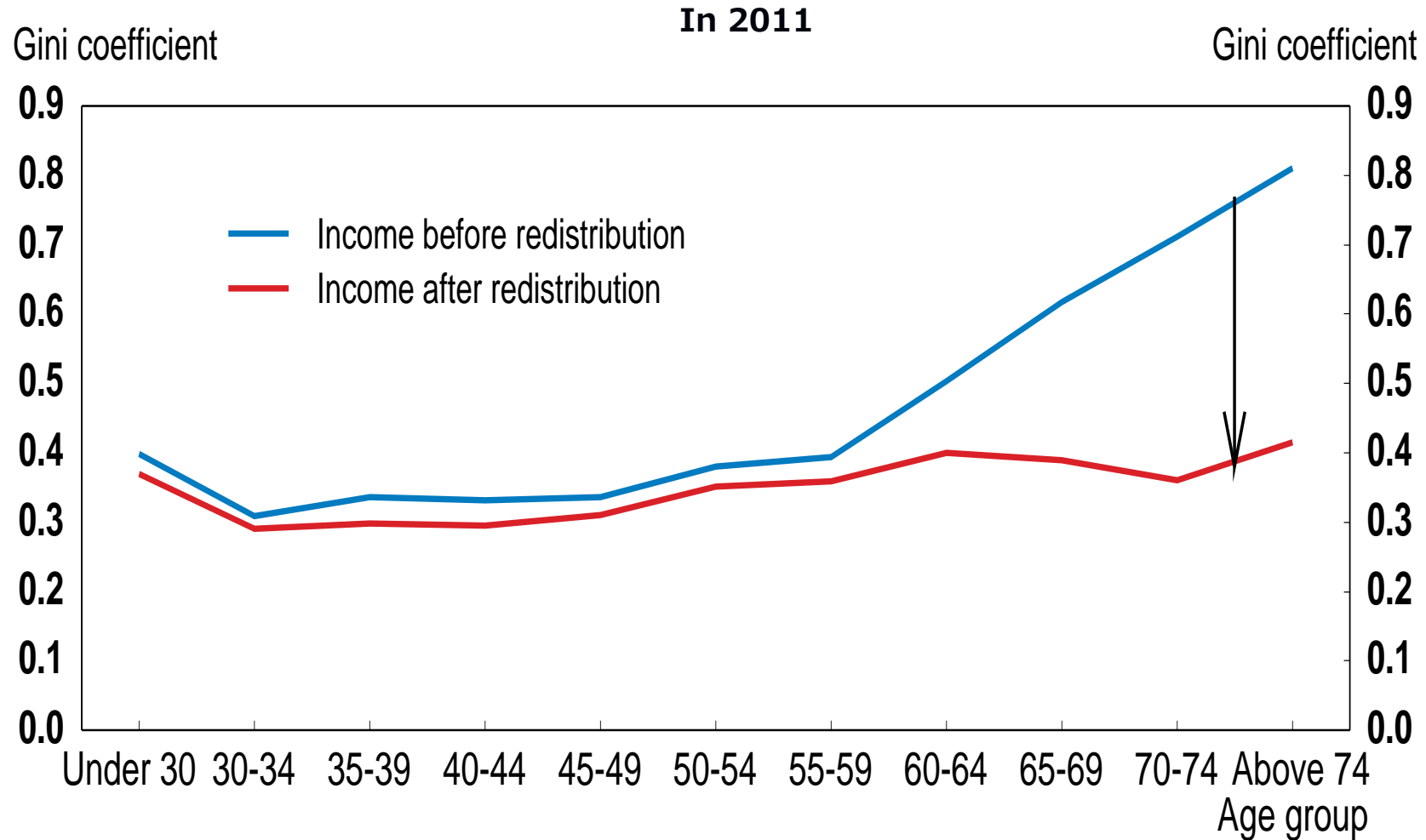
Japan's tax and benefit system transfers income from young to old



Source: Ministry of Health, Labour and Welfare, *Survey on Income Redistribution in 2011*.



Japan's tax and benefit system has little impact on income inequality, except among the elderly



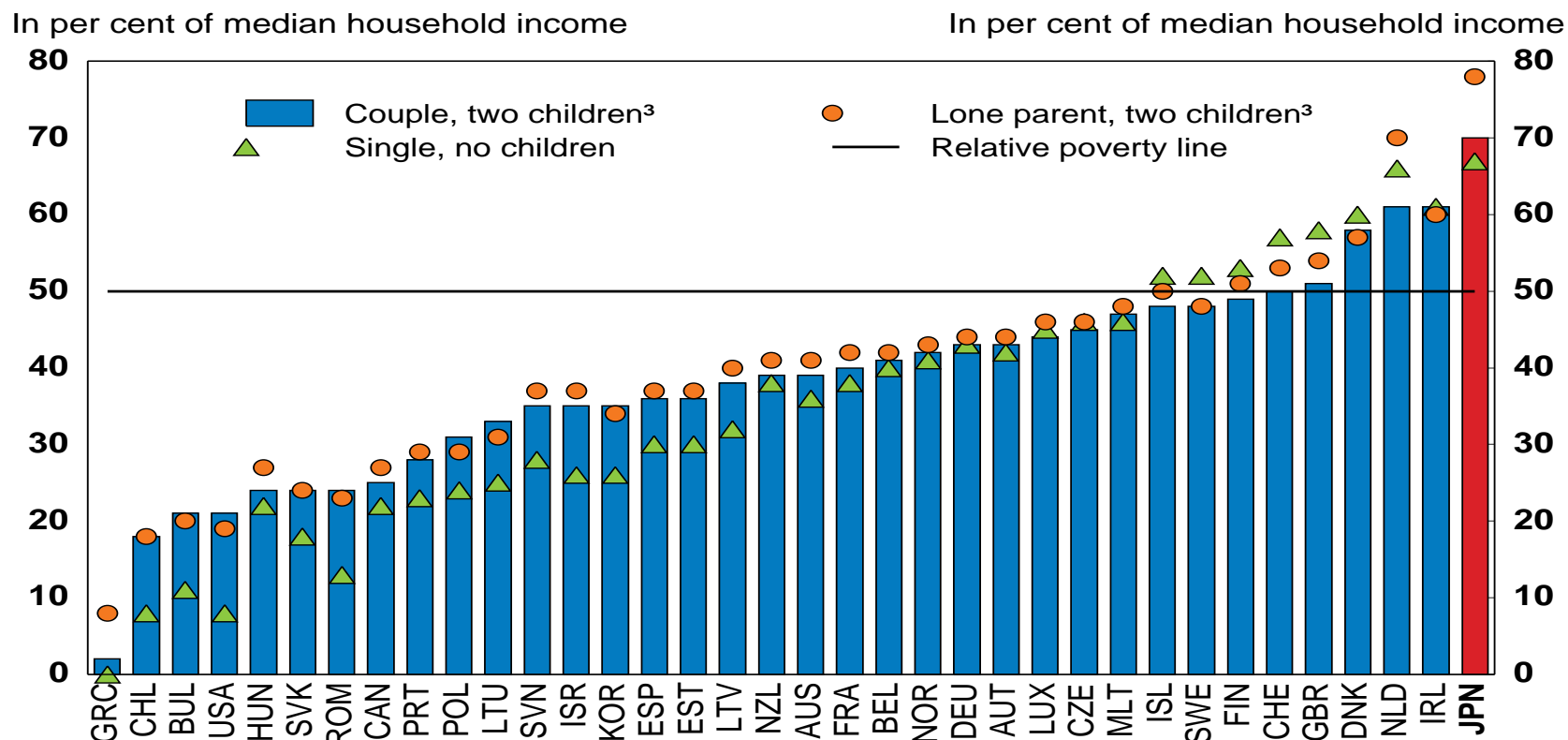
1. The relative poverty rate is the percentage of the population whose income is less than half median income.

Source: Ministry of Health, Labour and Welfare, Survey on Income Redistribution in 2011.



The Basic Livelihood Protection Programme provides generous in-kind and cash benefits¹

Income levels² provided by cash minimum-income benefits in 2012



1. The results from the OECD tax-benefit model are shown on an equivalised basis (square root of household size).

2. Income level includes all relevant cash benefits (such as social assistance) for a family with a working-age head, no other income sources and no entitlements to primary benefits such as unemployment insurance. However, it excludes in-kind benefits such

as free healthcare. Benefits are net of any income taxes and social contributions.

3. Calculations for families with children assume two children aged 4 and 6 and do not include childcare benefits and costs.

Source: OECD, *Tax-Benefit Models*; Ministry of Health, Labour and Welfare.



Key recommendations

- Effectively implement Abenomics' three arrows to revitalise Japan.
- Make reducing debt the top fiscal priority.
- Continue monetary expansion to durably raise inflation to the 2% target.
- Boost economic growth through bold structural reforms.
 - Increase female employment by expanding childcare and breaking down labour market dualism to reduce gender inequality.
 - Participate in high-level trade agreements, notably the Trans-Pacific Partnership and a Japan-EU Economic Partnership Agreement.
- Improve the targeting of public social spending and introduce an earned income tax credit for low income workers.



Reduce income inequality and poverty

- Break down labour market dualism, thereby reducing wage inequality.
- Introduce an earned income tax credit to assist those with low incomes and promote work incentives.
- Improve social assistance by reducing the generosity of the Basic Livelihood Protection Programme and expanding its coverage.



More information...



www.oecd.org/eco/surveys/economic-survey-japan.htm



[OECD Economics](#)

[OECD](#)



Disclaimers:

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.