Bruegel-Graduate School of Economics, Kobe University Conference

Secular Stagnation in Europe and Japan

Monday, 5 October 2015
Bruegel, Rue de la Charité 33, 1210 Brussels

Event Notes

Session 1: The new secular stagnation- review from Japan and Europe

Chair: **Guntram Wolff**, Director, Bruegel

- **Yoichi Matsubayashi**, Professor, Graduate school of Economics- Kobe University
- **Coen Teulings**, Montague Burton Chair of Labour Economics and Industrial Relations, University of Cambridge
- **Natacha Valla**, Deputy Director, CEPII

Secular Stagnation is the theory that the equilibrium real interest rates which are associated with full employment have been steadily declining due to a number of factors. This has led to a situation in which satisfactory economic growth has often been accompanied by financial instability.

The reasons for low equilibrium interest rates are an increase in the supply of loanable funds (due to demographic forces, and the global savings glut), coupled with a decrease in the demand for these (due to the increase in importance of the IT sector, which is much less capital-intensive, and a decrease in the relative cost of capital): reduced investment demand and increased propensity to save both exert a downwards pressure on the equilibrium real interest rate.

Solutions to the problem of excess savings could be raising the retirement age or introducing pay-as-you-go pension plans. Another solution would be to provide more stores of value by increasing “risk-free” sovereign debt, or even by creating bubbles.

The fiscal framework of the European Union is not helpful in this sense, as it limits the amount of debt countries can run, and therefore possible stores of value for the excess savings. An answer could therefore be to introduce debt at the federal level.

Advanced countries have a number of lessons to learn from the Japanese experience: a bold and prompt disposal of bad loans is required after a crisis, companies can undertake myopic strategies following a recession, which can lead to deflation or disinflation, and innovation should be supported.

Event notes by Álvaro Leandro Fernández-Gil, Research Intern

Session 2: Inequalities, ageing societies and secular stagnation

Chair: **Masahiko Yoshii**, Professor of Graduate school of Economics, Kobe University
Discussant: **Rainer Münz**, Fellow at Large, Bruegel

- **Paul Swaim**, Principal Economist, Directorate for Employment, Labour and Social Affairs, OECD
- **Atsuko Ueda**, Professor, Waseda University

Panellists discussed the possibility that inequality, an ageing society, and secular stagnation are mutually reinforcing: lower population growth leads to less investment, and inequality drives down consumption as people with lower marginal propensities to consume hold a greater share of the wealth. Suggested policy solutions to this mutual reinforcement problem included policy tools that address each challenge individually (e.g. fiscal redistribution, aggregate demand stimulus), or exploration of policy tools that address multiple issues at once.

Turning to more demographic issues, panel members showed correlations between higher inequality and lower mobility across generations, higher returns to schooling and lower intergenerational earning mobility, and low education expenditure and low mobility. One strong parallel between Japan and Europe is that the EU28 working population is peaking now while Japan's working population peaked in the 1990s. Low fertility, growing life expectancy, and baby boomers' retirement will create a gap of approx. 53mn in the labour market by 2060. Raising the retirement age by 10 years would only cut this gap by 50%, and immigration alone is insufficient to fill the gap because it would require more immigrants than are politically feasible (about 3x the gap). Female participation in the labour market is another option to help close the gap, although this alone would also not be enough. The labour gap needs to be filled because infrastructure maintenance and debt repayment become more costly as the labour gap grows.

Concluding, the panellists suggested that current economic problems are not solely an aftershock of the 2008-2009 recession but rather a result of demographics. Speakers also cautioned that today's problems in Japan might not be Europe's problems of tomorrow - and that China might not be the US of tomorrow, but the Japan.

Event notesby Hallie Saunders, Research Intern

13.15- 14.30 Macroeconomic policy, growth strategy and redistribution

Chair: **Grégory Claeys**, Research Fellow, Bruegel
Discussant: **Masahiko Yoshii**, Professor, Graduate school of Economics, Kobe University

- **Juan F. Jimeno**, Head of the Research Division, Banco de España
- **Naoyuki Yoshino**, Dean, ADBI

Juan Jimeno starts his presentation by sketching out the macroeconomic environment in Europe since the financial crisis: high levels of public debt and adverse structural trends in productivity and demography. Interactions between them led to an equilibrium with a permanent shortfall of demand and a negative natural real rate of interest.
In terms of measures that should address expectations about the future, Juan argues that monetary policy is unable (or unwilling) to accommodate such change. Fiscal policy can only be effective if it implements intergenerational transfers. There are two options for this necessary redistribution from old to young: either through pension reforms, which is politically infeasible, and a restructuring of debt. Then there is also the channel of structural reforms where he emphasises focusing on productivity.

Naoyuki Yoshino adds the Japanese perspective on the issue. While Japanese public debt is mostly held domestically and Japan is therefore unlikely to be the next Greece, the flipside of this is that soon all domestic savings might have been absorbed. As he points out in his presentation, in Japan savings do not go into the stock of capital via investments, possibly fostering growth, but rather they go to the elderly via government spending.
He identifies several areas where Japan needs to improve to address the challenges of secular stagnation: as for keeping the elderly in the workforce he advocates a productivity-based wage rate, postponing the retirement age, increasing female labor participation, and a child-care system that makes the latter possible. Apart from measures targeting the labor market, Naoyuki Yoshino also talks about the new lease structure in farming enabling the young to cultivate it productively. Last, he points to the funding problems start-ups and SMEs are facing despite excess capacities and thus potential for growth.

To bring the two perspectives together, a question touched upon in the talks and discussed further with the audience was whether Europe is to expect a “japanisation”, i.e. a Japan-style secular stagnation. There were voices arguing that the phenomenon in Europe is still too young to be called secular. Others made the point that for Europe the problem for monetary policy might in fact be more challenging. There are more international issues compared to the ones Japan was facing in the 1990s and the private sector balance sheet situation in Japan was relatively worse back then. While the ECB’s response was much more swift compared to the BoJ, the Japanese communication strategy in central banking now is much more aggressive than the one by the ECB.

Event notes by Bennet Berger, Research Assistant

14.45-17.00 What policy lessons to draw?

Chair: **Toshiki Jinushi**, Dean, Kobe University
Discussant: **Guntram Wolff**, Director, Bruegel

- **Marcia De Wachter**, Director, National Bank of Belgium
- **Philipp Hartmann**, Deputy Director General Research, ECB
- **Ryuzo Miyao**, Professor, University of Tokyo and Former Member of Policy Board- Bank of Japan
- **Xavier Ragot**, President OFCE, CNRS

The cases of Europe and Japan are very different. Analogies in key factors of secular stagnation in Europe and Japan need to be drawn carefully, and policy recommendations need to be broad.

In Europe the panelists identified key areas that require targeted policy response such as innovation and technology adoption, demographics and ageing, combination of aggregate supply and demand, and fiscal policy and nominal adjustment. In terms of innovation, Europe needs to accelerate ICT adoption in productivity-enhancing sectors, facilitate knowledge-transfer between academic institutions and the private sector, support targeted scientific talent attraction from abroad, and encourage banks to lend to start-ups.

Policy responses to the demographic and ageing problem include increasing the retirement age, influencing fertility, increasing the integration of women into the workforce and providing better childcare. In the meantime, outcomes from immigration are potentially positive, although this will require a political consensus.

Persistent lack of demand and the precautionary saving behaviour of corporations, households and firms represent the biggest obstacles to in promoting consumption and boosting investment. In particular, the corporate sector needs to be incentivised to invest instead of hoarding liquidity and excess savings. Public sector investment could boost private investment and public sector wage increases can potentially raise private sector wages - encouraging spending. Wage adjustments, tax incentives for workers and strengthening the effectiveness of labour market institutions are identified as channels to induce consumption.

The panelists recognised the importance of nominal adjustments and coordinated fiscal policies across the EU. The argument that monetary policy has reached its limit is doubtful, but there is only so much that monetary policy can do to boost investment and bring the necessary level of inflation to accompany the recovery.

In Japan, the mistakes of the policy responses were mainly twofold. Firstly, full resolution of non-performing loans (NPL) was delayed until late 2002-2003. Total factor productivity (TFP) declined greatly during the process of attempting to solve the bad loans problem, as a result zombie firms continued to operate in the economy perpetuating the misallocation of credit. At the same time, public investment declined over time in parallel with significant decline in output. Secondly, the Bank of Japan resorted to unconventional measures but was criticised for not being aggressive enough. The problem in Japan was treated as a financial issue and approached as such, failing to recognise the macroeconomic dimension. Therefore, the main lessons from Japan include 1) recognising the importance of macroeconomic implications of deleveraging and balance-sheet adjustment 2) effective coordination between the different aspects of macroeconomic policy and 3) a sound political system to support policy coordination.

The ensuing discussion revolved around three main common challenges that both Europe and Japan are facing in regard to secular stagnation. These are demographics and ageing, excessive corporate, firm and household saving that blocks investment and productivity, and last but not least, finding the right mix of monetary and fiscal policy instruments to boost spending, cut wage rigidities and encourage demand.

There has been positive developments, however, recorded in both Japan and Europe. Japan, traditionally an export-driven manufacturing economy, recorded a two year pick up in capital expenditure in the non-manufacturing sector, raising hopes for a service-oriented recovery in the future. In Europe, gradual positive outcomes can be observed from the ECB's quantitative easing (QE) since March. At the same time, both European and Japanese corporations are increasingly looking to invest their large savings in global investment opportunities.

Event notes by Uuriintuya Batsaikhan, Research Assistant