

RECENT TRENDS IN CONSUMPTION AND SAVING IN JAPAN

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OUTLINE OF PRESENTATION

- (1) The impact of trends over time in private consumption on trends over time in GDP**
- (2) The determinants of trends over time in household consumption**
- (3) The determinants of trend over time in household saving**
- (4) Future prospects**
- (5) Policy implications & recommendations**

I. THE IMPACT OF TRENDS OVER TIME IN PRIVATE CONSUMPTION ON TRENDS OVER TIME IN GDP

POSTWAR TRENDS IN GDP

- (1) 1955-73: High growth period (double digit rates of economic growth)**
- (2) 1973-85: Stable growth period (structural change due to two oil crises and shift in emphasis from economic growth to social welfare programs, social infrastructure, environmental protection, quality of life, etc.)**
- (3) 1986-91: Asset price bubble caused by the 1985 Plaza Accord and overly expansionary monetary policy designed to offset the impact of yen appreciation**
- (4) 1991-present: “Lost decade (and a half)”**

Sources of Growth of GDP, 1980-2009

Calendar	Private	Government	Private	Private Plant	Government Fixed	Exports	Imports	GDP
			Housing	and Equipment				
Year	Consumption	Consumption	Investment	Investment	Investment			
1980-1985	3.00	3.59	-1.68	5.11	-1.99	6.62	2.04	3.10
1985-1990	4.34	3.41	8.46	10.49	3.29	2.73	11.50	4.79
1990-1995	2.07	3.83	-1.87	-4.66	5.68	1.99	4.87	0.98
1995-2000	0.63	2.75	-3.17	0.82	-2.51	5.21	3.04	0.78
2000-2007	1.58	1.97	-2.65	3.57	-6.95	7.09	4.39	1.84
2007-2008	0.60	0.80	-7.60	-3.90	-6.90	1.80	0.90	-0.70
2008Q4./09Q1	-1.20	0.10	-5.70	-8.50	2.50	-22.50	-14.90	-3.30
2009Q1/09Q2	0.70	-0.30	-9.50	-4.80	7.50	6.40	-5.10	0.60

SOURCES OF GDP GROWTH (1)

- **The growth rate of GDP was relatively high during the bubble period and relatively low during the post-bubble period.**
- **Private consumption has been relatively stable and its growth rate has generally been close to (but lower than) that of GDP, suggesting that it has served as a slight drag on economic growth.**

SOURCES OF GDP GROWTH (2)

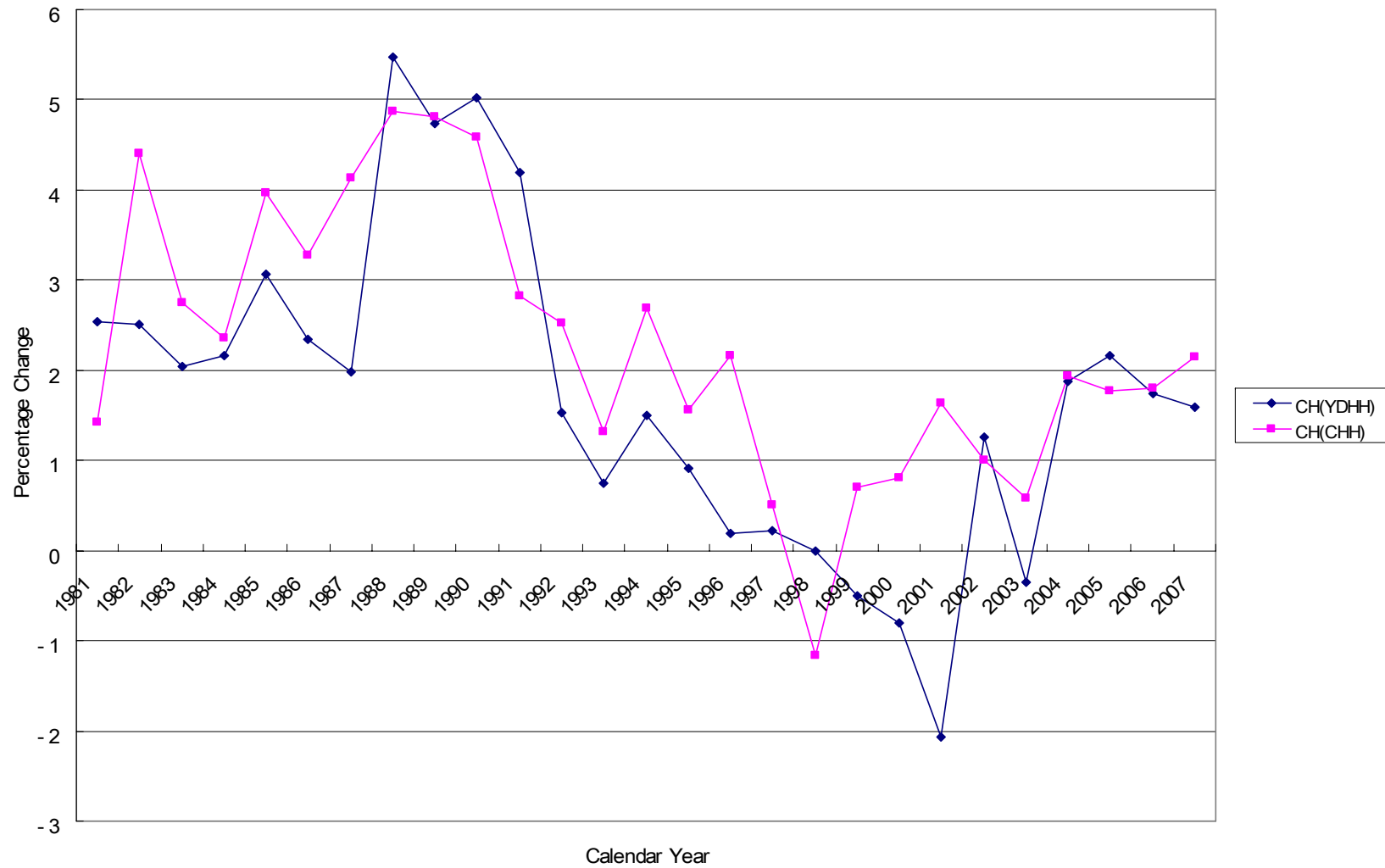
- **Moreover, the growth rate of private consumption exceeded that of GDP growth during the 1990-95 period and in 2008-09.**
- **Thus, private consumption has *not* been the main cause of the stagnation in GDP.**
- **The main causes of the stagnation in GDP have been private and government investment and imports/exports.**
- **Nonetheless, private consumption has not exactly been an engine of growth, and I would next like to consider why.**

II. THE DETERMINANTS OF TRENDS OVER TIME IN HOUSEHOLD CONSUMPTION

- (1) Household disposable income**
- (2) Household wealth**
- (3) Uncertainty about the future**

(i) THE IMPACT OF HOUSEHOLD DISPOSABLE INCOME

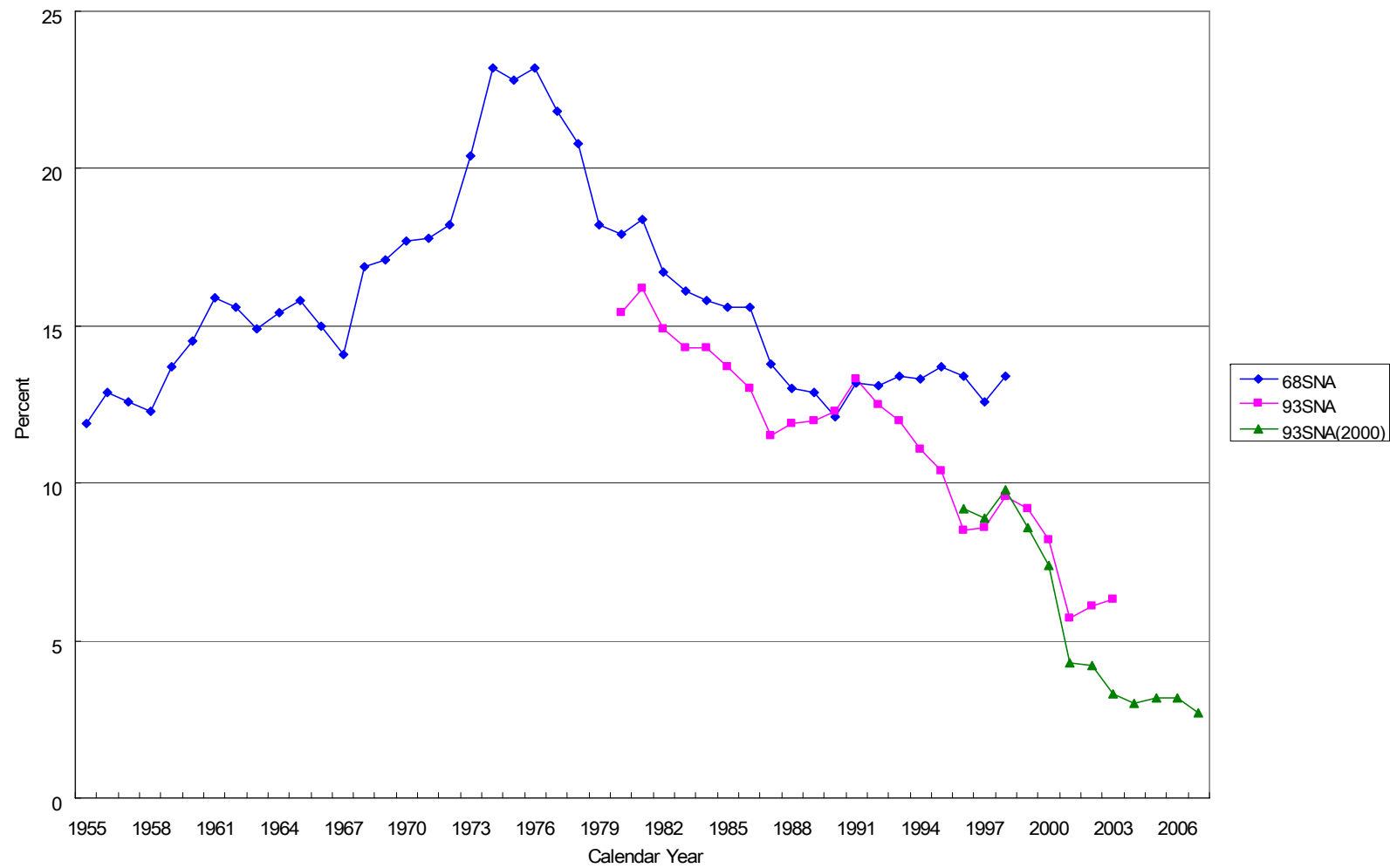
Trends over Time in Household Consumption and Household Disposable Income



Growth Rates of GDP, Household Disposable Income, and Household Consumption, 1980-2007

Time period	Growth rate of GDP	Growth rate of household disposable income	Growth rate of household consumption
1980-1985	3.10	2.47	2.98
1985-1990	4.79	3.91	4.33
1990-1995	0.98	1.77	2.01
1995-2000	0.78	-0.27	0.60
2000-2007	1.84	0.88	1.55

Trends in Japan's Household Saving Rate, 1955- 2007



(i) THE IMPACT OF HOUSEHOLD DISPOSABLE INCOME (cont'd)

- The growth rate of household disposable income was high during the bubble period of the late 1980s and low and sometimes negative during the post-bubble period of the 1990s and early 2000s.**
- The growth rate of household consumption has moved in tandem with the growth rate of household disposable income, suggesting that trends over time in household disposable income is an important determinant of trends over time in household consumption.**

(i) THE IMPACT OF HOUSEHOLD DISPOSABLE INCOME (cont'd)

- Note, moreover, that the growth rate of household consumption has generally exceeded the growth rate of household disposable income, suggesting that households have had to reduce saving in order to maintain consumption levels.**
- The rapid decline in the household saving rate corroborates this story (more on this later).**

(i) THE IMPACT OF HOUSEHOLD DISPOSABLE INCOME (cont'd)

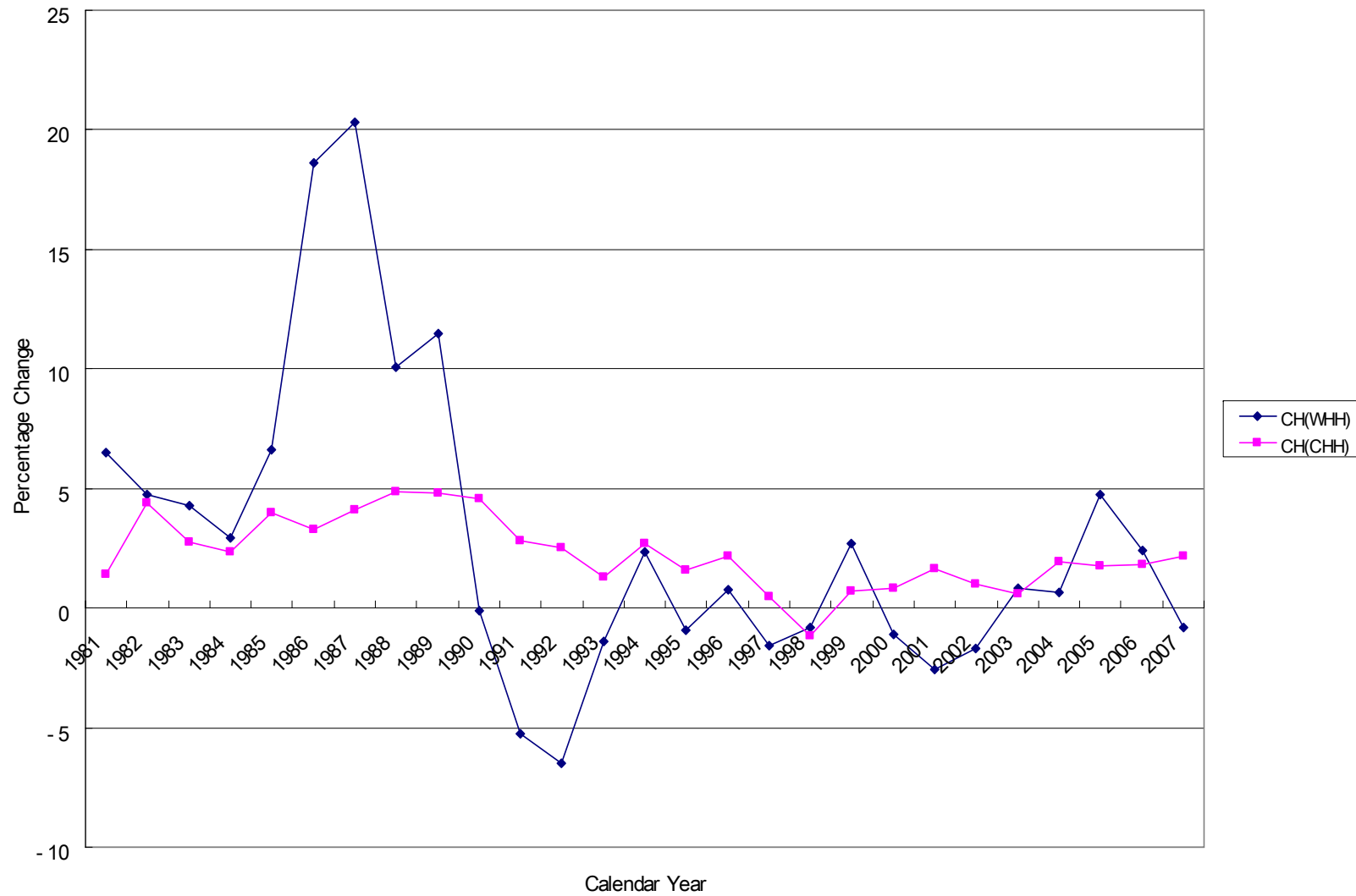
- **The growth rate of household disposable income has been stagnant partly because the growth rate of GDP has been stagnant and partly because the growth rate of household disposable income has generally fallen short of the growth rate of GDP (except during the 1990-95 period), which in turn is because the labor share of income has fallen.**

(i) THE IMPACT OF HOUSEHOLD DISPOSABLE INCOME (cont'd)

- **To summarize, household consumption has been stagnant because household disposable income has been stagnant, and household disposable income has been stagnant partly because GDP has been stagnant and partly because the labor share of income has fallen.**

(ii) THE IMPACT OF HOUSEHOLD WEALTH

Trends over Time in Household Consumption and Household Wealth



Growth Rates of Household Wealth and Household Consumption, 1980-2007

Time period	Growth rate of household wealth	Growth rate of household consumption
1980-1985	5.02	2.98
1985-1990	11.84	4.33
1990-1995	-2.40	2.01
1995-2000	-0.13	0.60
2000-2007	0.49	1.55

(ii) THE IMPACT OF HOUSEHOLD WEALTH (cont'd)

- **Household wealth (especially the value of land and equities) increased rapidly during the bubble period of the late 1980s) and declined rapidly during the post-bubble period of the 1990s.**

(ii) THE IMPACT OF HOUSEHOLD WEALTH (cont'd)

- **Trends over time in household wealth and trends over time in household consumption are not necessarily correlated on a year-to-year basis but seem to be correlated in the longer run, suggesting that trends in household wealth are an important determinant of trends over time in household consumption.**

(iii) THE IMPACT OF UNCERTAINTY

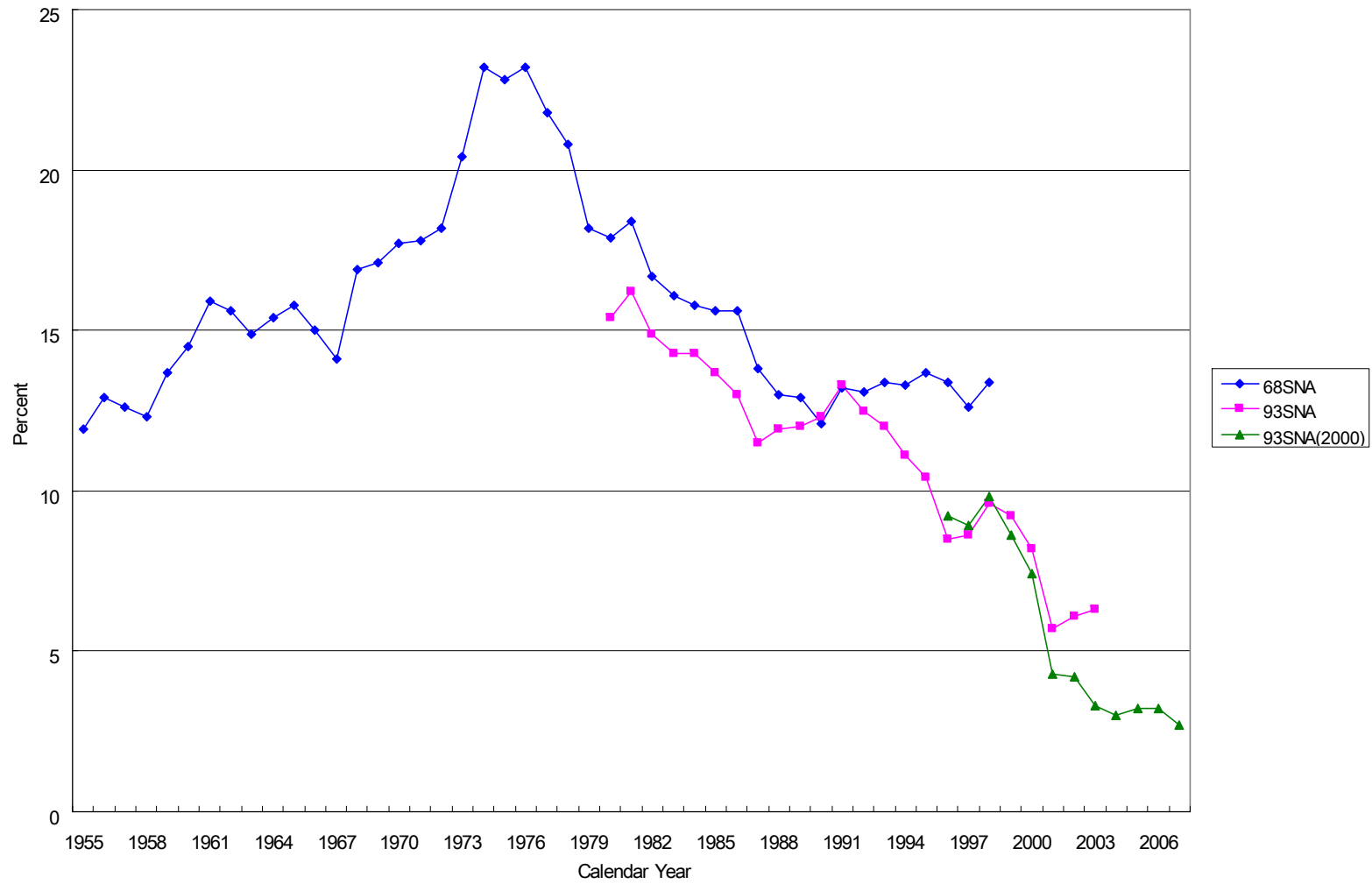
- **Studies have shown (1) that people have become more worried about future economic conditions, future employment prospects, future earnings, future public pensions, future medical insurance provisions, future long-term care insurance provisions, etc., and (2) that increased uncertainty about the future has increased precautionary saving and put a damper on household consumption.**

(iii) THE IMPACT OF UNCERTAINTY (cont'd)

- **Note, however, that the sharp decline in the household saving rate suggests that the increased desire for precautionary saving was more than offset by the need to cut saving to maintain consumption levels (more on this later).**

IV. TRENDS OVER TIME IN THE HOUSEHOLD SAVING RATE

Trends in Japan's Household Saving Rate, 1955- 2007



(i) Trends over Time

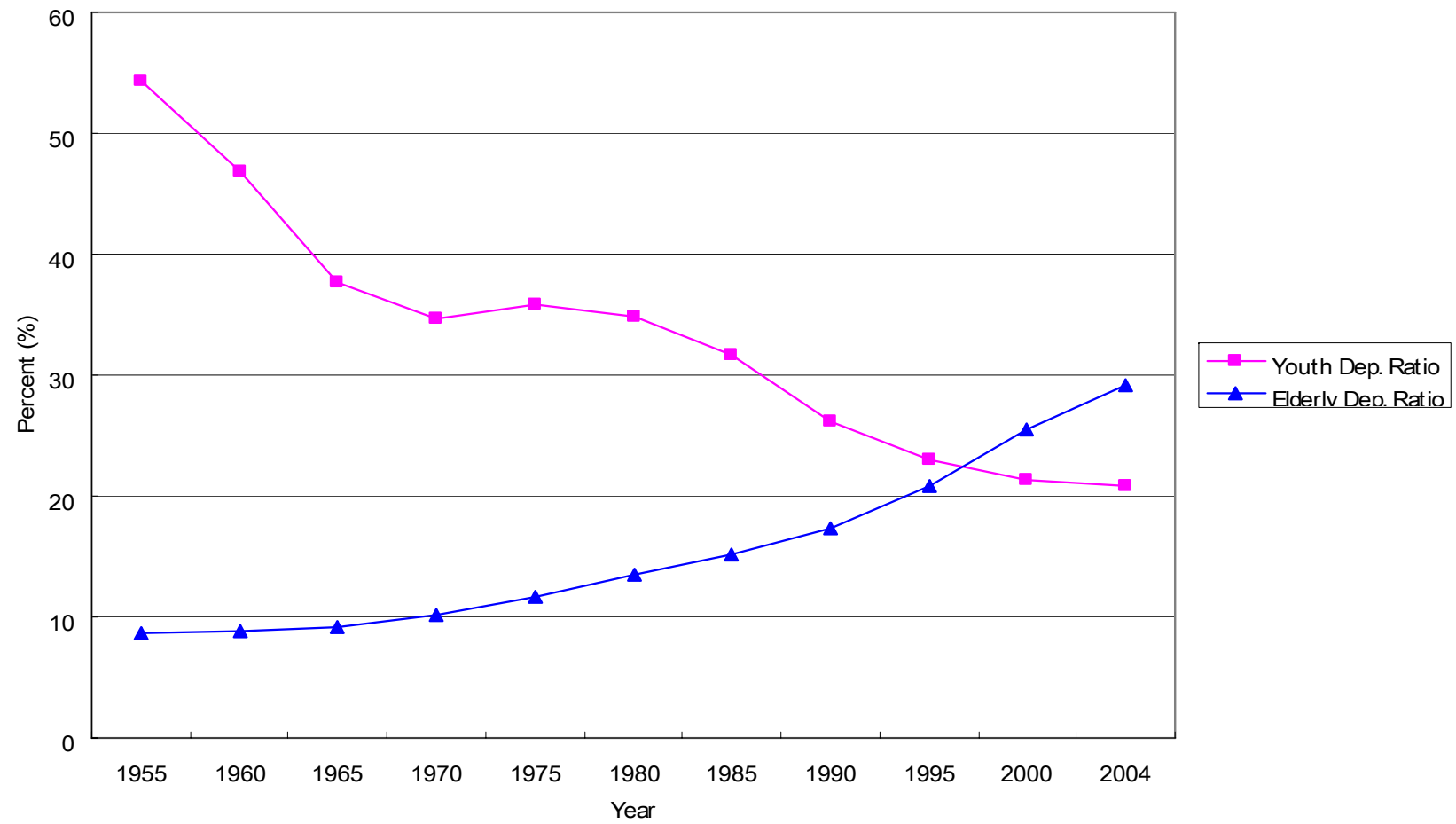
- **Upward trend until the mid-1970s, peaking at 23 percent**
- **Downward trend since the mid-1970s, falling to about 3 percent at present**
- **Japan's household saving rate is no longer high in either absolute or relative terms**

(ii) Determinants of Trends over Time (1)

(a) The age structure of the population

- Rapid declines in the youth dependency ratio caused the household saving rate to increase until the mid-1970s.**
- Rapid increases in the elderly dependency ratio caused the household saving rate to decline after the mid-1970s and can be expected to cause it to continue declining as population ages progresses even further.**

The Age Structure of Japan's Population, 1955- 2004



(ii) Determinants of Trends over Time (2)

(b) Stagnation of household disposable income

- As noted earlier, the growth of household disposable income has been stagnant since the 1990s, and this has made it necessary for households to reduce their saving rates in order to maintain consumption levels.**

(ii) Determinants of Trends over Time (3)

(c) Factors that should have caused the household saving rate to increase:

- Increased uncertainty about the future**
- It appears that factors causing downward pressure on the household saving rate (such as the aging of the population and the stagnation of household disposable income) more than offset factors causing upward pressure thereon.**

(iii) Future Trends in Japan's Household Saving Rate

Japan's household saving rate can be expected to decline even further, perhaps even becoming zero or negative, even if the economy recovers, because the aging of the population is continuing and even accelerating.

V. POLICY IMPLICATIONS (1)

- **My findings imply that the most effective way of stimulating private consumption is to increase household disposable income, for example by:**
 - **(1) Reducing unemployment**
 - **(2) Expanding worker training programs**
 - **(3) Improving the social safety net**
 - **(4) Tax cuts and/or tax breaks**

V. POLICY IMPLICATIONS (2)

- **How does Prime Minister Hatoyama's policy proposals stack up?**
- **He advocates placing top priority on economic recovery so he has his priorities right.**
- **However, I am opposed to some of his specific proposals for stimulating the economy.**

V. POLICY IMPLICATIONS (3)

- For example, his proposal to raise the **minimum wage** will increase unemployment and will therefore not necessarily increase household incomes.
- His proposal to prohibit **contractual workers** in the manufacturing sector will increase unemployment and reduce household incomes.

V. POLICY IMPLICATIONS (4)

- His proposal to make **highway tolls** free will benefit consumers, but it will exacerbate traffic jams, is not eco-friendly, and moreover, it helps the rich more than the poor because the rich are more likely to own their own cars.

V. POLICY IMPLICATIONS (5)

- His proposal to introduce a system of **child allowances** with no income restriction is not fair because it will raise the incomes of those who are already rich, and it will also not be very effective because the rich have lower marginal propensities to consume. Moreover, there is no guarantee that the money will really be spent on children or that it will be spent on things that benefit children such as education. It would be far more effective to give parents tuition vouchers rather than cash to ensure that the money is spent on children's education.

V. POLICY IMPLICATIONS (6)

- His proposal to make **high school tuition** free makes more sense than his proposed system of child allowances, but again it is not fair because it benefits the rich as well as the poor. It would be better to impose income restrictions on tuition exemptions or to charge tuition but to give scholarships to children from low-income households.

V. POLICY IMPLICATIONS (7)

- However, I agree with some of Prime Minister Hatoyama's policies.
- For example, I am intrigued by his **pension reform** proposal to raise the minimum pension and to fundamentally reform the financing of the system, with the subsidy from general tax revenue being higher for the low-income than for the high-income.

V. POLICY IMPLICATIONS (8)

- Moreover, I like Prime Minister Hatoyama's stance of not intervening in **foreign exchange markets** to weaken the yen except in exceptional circumstances is admirable because it will avoid trade and economic frictions with other countries, and at the same time, benefit Japanese consumers by making imported goods cheaper.

V. POLICY IMPLICATIONS (9)

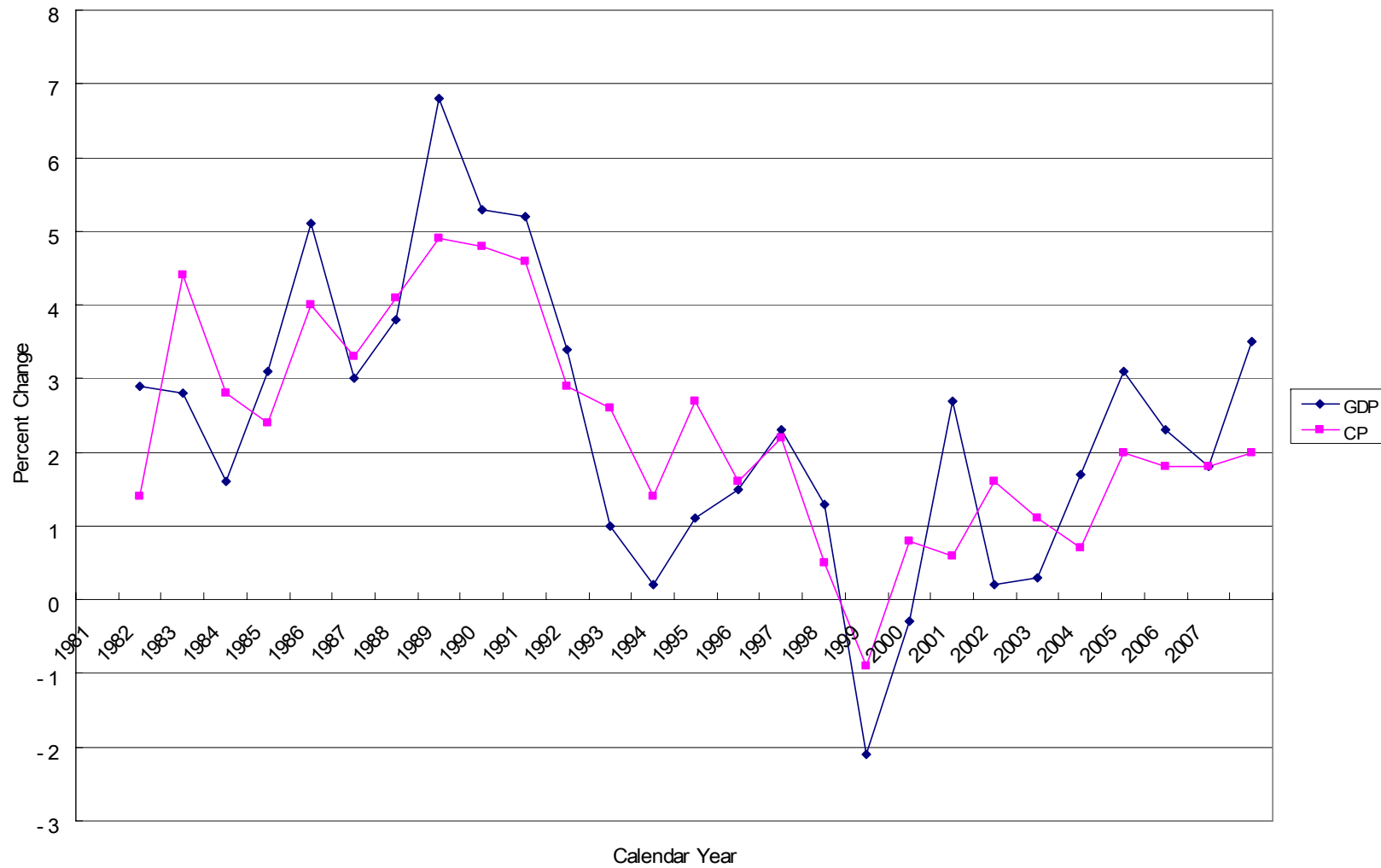
- I hope that Prime Minister Hatoyama will give top priority to economic recovery, as he has promised, and that he will fine-tune his specific proposals so that they benefit lower income households more and so that they are more cost-effective in raising household incomes and stimulating private consumption. (Since 2001, corporate saving has risen and this has offset the decline in household saving but this is a temporary phenomenon and cannot be counted on to keep the national saving rate high.)**

V. POLICY IMPLICATIONS (10)

- **Moreover, I hope that Prime Minister Hatoyama will turn his attention to fiscal reconstruction once the economy recovers fully because the government debt to GDP ratio in Japan is the highest in the developed world and approaching unsustainable levels and because the continuing decline in Japan's household saving rate will lower the national saving rate if government saving is not increased to partially offset this decline.**

**Thank you very much for your
attention!**

Trends over Time in Private Consumption and GDP



(iv) THE IMPACT OF FISCAL POLICIES

- **Fiscal policies relating to consumption have generally been a failure, with some government policies having the (unintended?) effect of dampening consumption and some government policies intended to increase consumption not having much of an effect.**

(a) The Case of 1997

- **Temporary income tax cuts were suspended, the consumption tax was increased from 3 percent to 5 percent, and copayments for medical insurance were increased in the same year (1997), putting a damper on household consumption and propelling the economy back into recession.**

(b) Tax Cuts and Handouts

- Tax cuts have taken the form of temporary tax cuts, and the shopping coupons of 1999 (20,000 yen per child or elderly) and the cash benefits of 2009 (12,000 to 20,0000 yen per person) were also temporary handouts, and as theory suggests, these one-time tax cuts and cash handouts have not had much of an impact on consumption. (Similar to Bush Junior's tax cuts.)**

(c) Eco Point System

- **Passed as part of the 2009 supplementary government budget, this program encourages the purchase of fuel-saving cars and electrical appliances by awarding eco-points that can be applied toward future purchases. (Similar to Obama's stimulus package.)**

(d) Employment Training Programs

- The government beefed up employment training programs in response to the sharp increase in youth unemployment, and this will stimulate consumption by reducing unemployment, but it was too little, too late.**

(e) Tax Cuts on Housing Purchase

- Tax cuts on housing purchase took the form of cuts in the gift tax on financial assistance from parents to children for housing purchase, and this is believed to be one of the few government policies that had a non-negligible impact on household spending. Resurrected as part of the 2009 government supplementary budget.**

Summary re Fiscal Policies

- **Thus, fiscal policies relating to household spending have worked in the wrong direction, took the wrong form, and/or were too little, too late, in large part because the government's deficits were already too big to begin with.**
- **Expanded worker training programs and fundamental reform of the public pension, medical insurance, and long-term care insurance systems would have been far more effective in stimulating household spending than the policies that were actually tried.**

(v) THE IMPACT OF MONETARY POLICY

- **Monetary policy was overly contractionary during the early 1990s, and this was a major cause of the contraction of the economy.**
- **Monetary policy was finally relaxed in the late 1990s, but was prematurely tightened in August 2000, aborting the incipient economic recovery.**

Summary re the Impact of Government Policies

- **Thus, there were mistakes in both fiscal and monetary policies, and thus government policies often exacerbated the recession rather than making it better.**

V. LESSONS FOR THE U.S.

- **The most important lesson for the United States is that the most effective way of stimulating household consumption is to increase consumer confidence by improving employment prospects and fundamentally reforming the social security and medical insurance systems rather than relying on temporary tax cuts and tax rebates.**

Example: Public Pension Reform

- **Public pension reform in the form of increases in contribution rates, decreases in benefits, increases in the pensionable age, and government mismanagement of pension records have reduced household wealth and increased uncertainty about old age security, leading to more saving for retirement.**