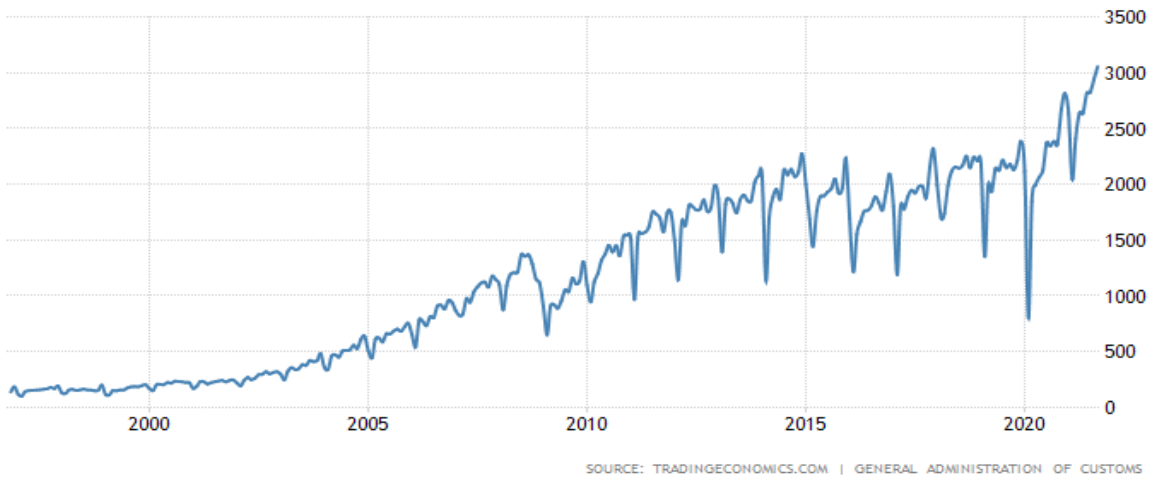


## PROFITABILITY IN CHINA AND JAPAN.

*The National Bureau of Statistics of China has recently published its September profit data for industry enabling profitability for the first three quarters of 2021 to be estimated. For Japan the data is more dated, but the key is its availability up to 2019, the year before the pandemic hit.*

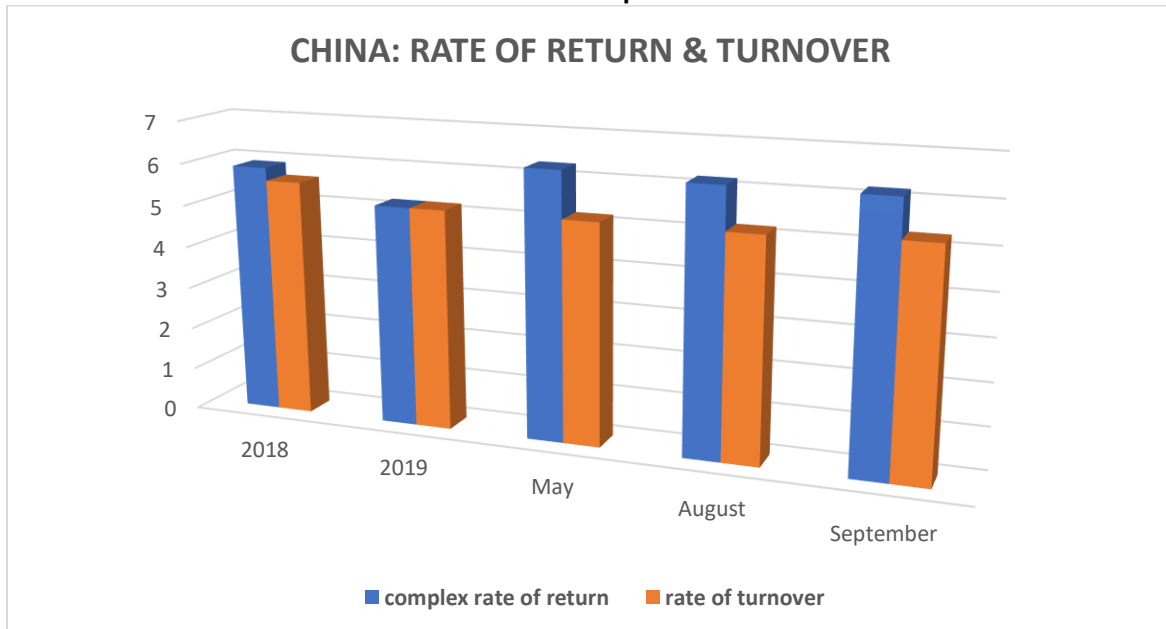
China is key to the world economy. Though US consumers support the Chinese economy as evidenced by the jump in Chinese exports during the pandemic, it is developments in China which will determine the course of the world economy. Later, we will have cause to examine the linkage between Japan and China when we examine Japan and note its dependency on the rhythm of the Chinese economy.

**Graph 1. Chinese exports.**



In September the Complex Rate of Return remained at its elevated level unchanged from August.

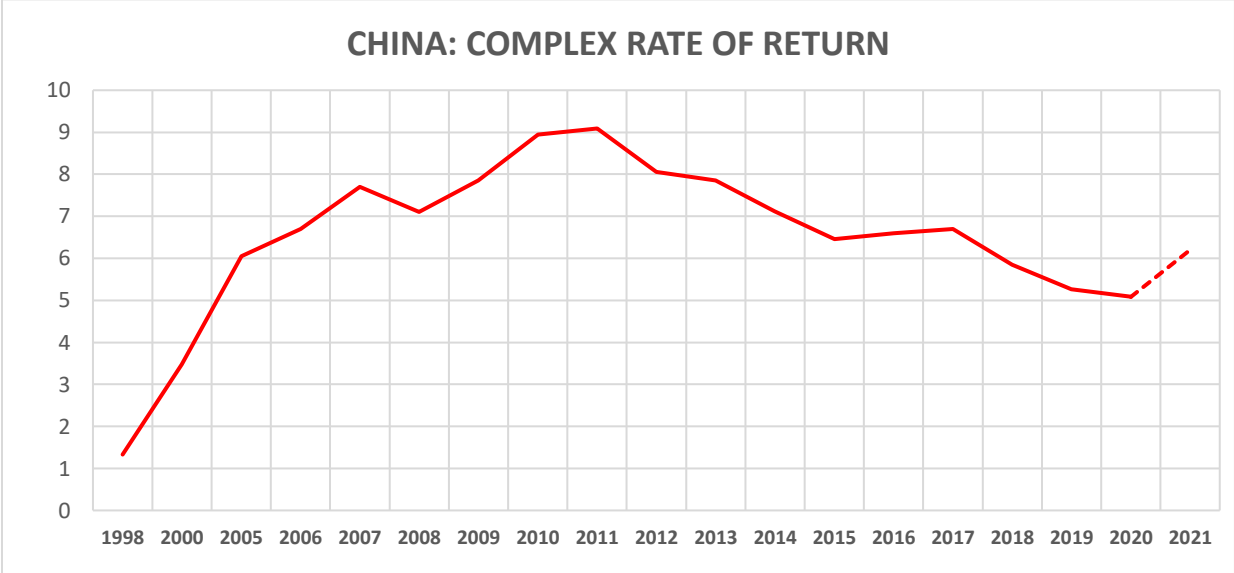
**Graph 2.**



[http://www.stats.gov.cn/enGLISH/PressRelease/202110/t20211028\\_1823886.html](http://www.stats.gov.cn/enGLISH/PressRelease/202110/t20211028_1823886.html)

The primary reason for the improvement in profitability was an Operating Margin of 6.96% in September compared to 5.86% for 2019. The Complex Rate of Return is not commensurate with the Rate of Return in the West as it includes financial assets, which also disadvantages the profitability of State Organised Enterprises (SOEs) compared to Private Enterprises because SOEs have large cross holdings. Graph 3 plots the longer-term annualised rate of return for China. The data for 2021 covers the first 3 Quarters of 2021.

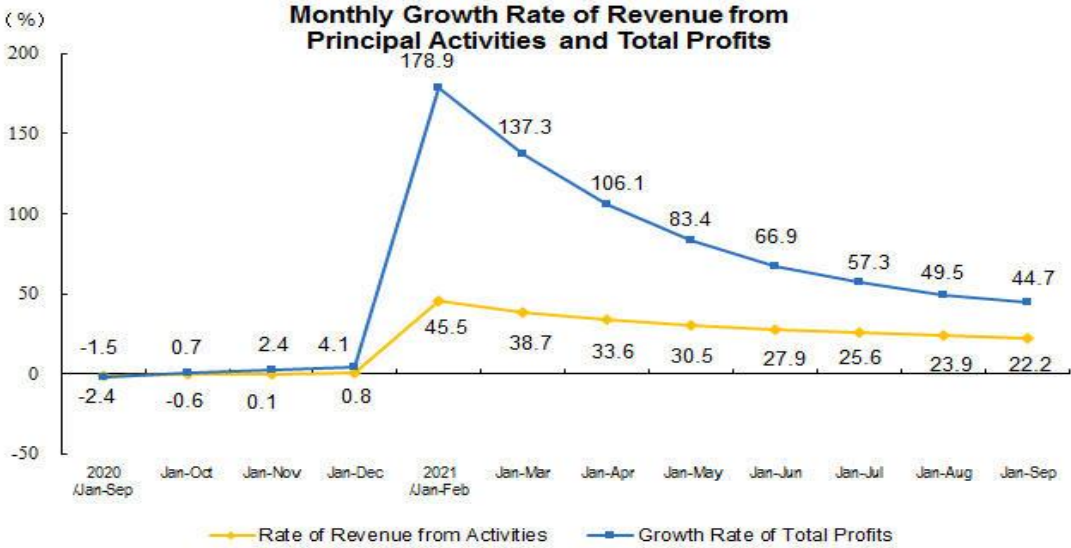
**Graph 3.**



(2021 average for first 9 months)

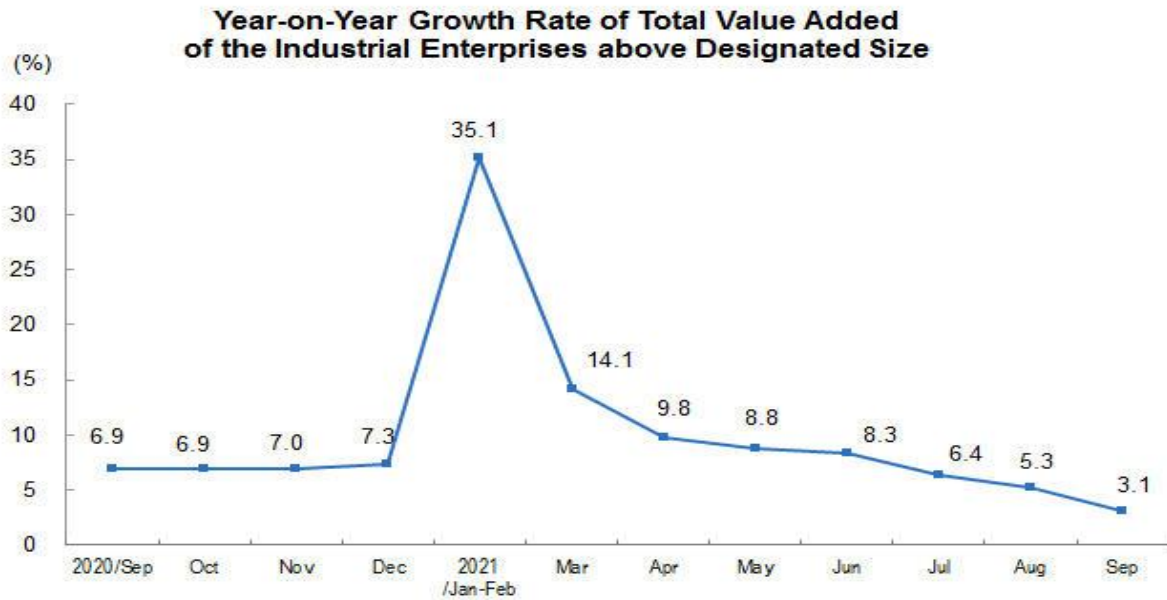
This is the first significant uptick in profitability since the 2011 peak taking the rate back to 2015 levels. This represents a 32% fall from 2011 which is an improvement on the 42% fall registered in 2019. However, it is likely that the Complex Rate of Return for the whole year will be lower than 6.2%

**Graph 4.**

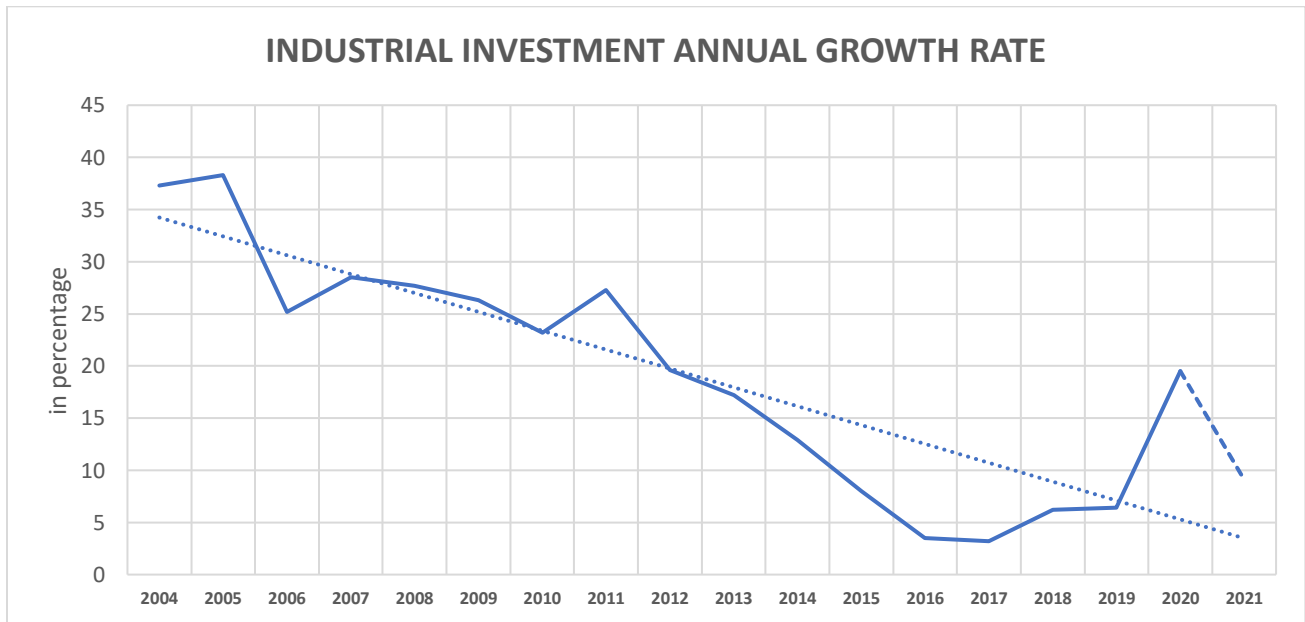


The reason for this is found in Graph 4 above where there has been a deceleration in the growth rate of profits and revenue as the year has progressed. Further, given the growing divergence between producer price indexes and consumer price indexes, a margin squeeze is in progress. The latest leading soft data - survey data - confirms that industrial production is decelerating. Thus the outlook for profits, production and investment in China is deteriorating as Graphs 5 and 6 below point out. (2021 = 9 months)  
[http://www.stats.gov.cn/enGLISH/PressRelease/202111/t20211101\\_1824026.html](http://www.stats.gov.cn/enGLISH/PressRelease/202111/t20211101_1824026.html)

**Graph 5.**



**Graph 6.**



Investment which increased in 2020 because of the influx of orders due to the pandemic and a switch in consumption worldwide to industrial goods, heralded an annual rise in investment of nearly 20%. That rise has been reversed in the first nine months this year and is expected to fall further. Its fall is likely to deepen given the crisis in the property market and the sharp slowdown in construction there. All in all, over the next 6 months, unless there is something unexpected, and despite re-armament, the annual growth in investment will be below 5% once more at best, or what is the same thing, back on trend.

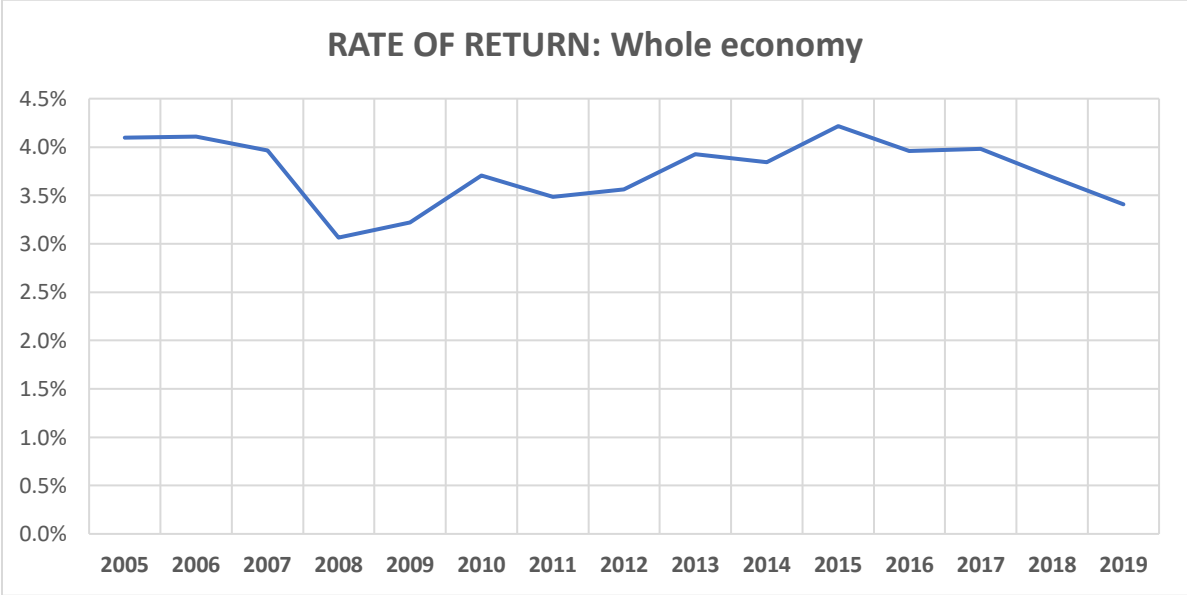
I do not intend to look at Chinese GDP trends as these are the most unreliable. However, even GDP data is now beginning to decelerate sharply in line with the USA. Some commentators have said tongue in cheek, that the country which benefited the most from the Covid Relief funds in the USA and Europe, was China. Those days are behind China and whatever deal Biden manages to cobble together, it is unlikely to feed goods production as before, something which China excels at producing.

It is clear that we are in the post Covid Relief Age when most of the funds have been spent and where savings rates have normalised. This reduction in demand will in turn reveal the real damage the pandemic has done to the economy in the form of unemployment, inflation, bad debts and now the compression of profit margins. Thus in common with the world economy, and adding to it, the outlook for the Chinese economy is deteriorating.

**Japan.**

Unlike the high frequency data produced by the Chinese Bureau of Statistics, Japanese data is more dated. Most of its data only goes up to 2019 as found in the 2021 Yearbook. This however is adequate because 2019 is the last full year prior to the pandemic, thus the last year in which to examine the underlying health of an economy yet to be buffeted by the effects of the pandemic. Graph 7's Rate of Return covers the whole economy as key data for industry is missing. (For data see the attached spreadsheet.)

**Graph 7.**

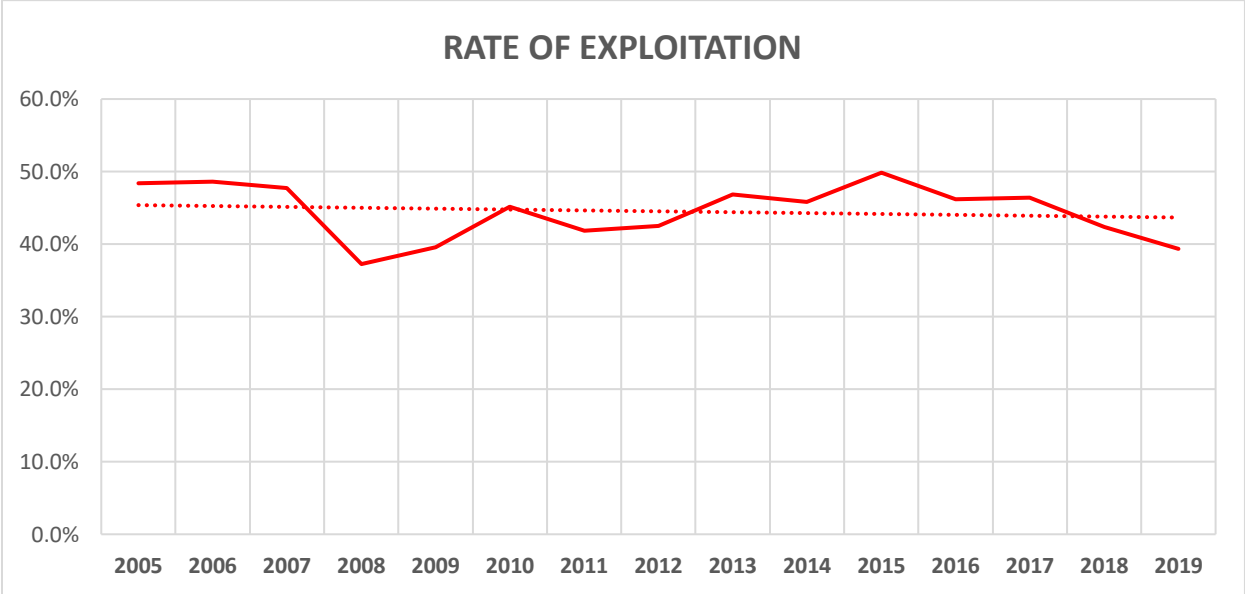


The equation used to calculate the above graph is: National Income less Worker Compensation divided by Fixed Assets and Inventories, or the entirety of constant capital.

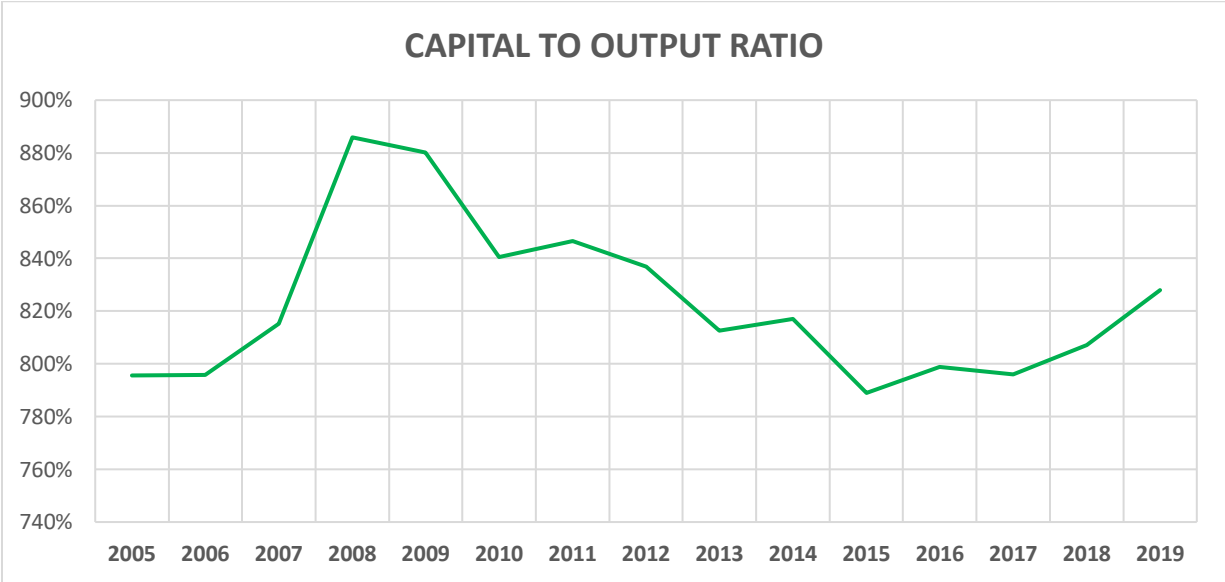
We note that the rate of return peaked in 2015 at 4.2% before falling to 3.4% in 2019. This represented a twenty percent fall in the rate of return and mimicked the fall in all the major economies beginning with China earlier. However, changes to profitability were much more subdued compared to the more dynamic Chinese economy. Profits in China went up 3% between 2005 and 2011 before falling 4% into 2019. In Japan the movement in both directions was around 1%.

The reason for the fall in Japanese profitability is explained by the three graphs below showing the accumulation of constant capital versus the rate of exploitation.

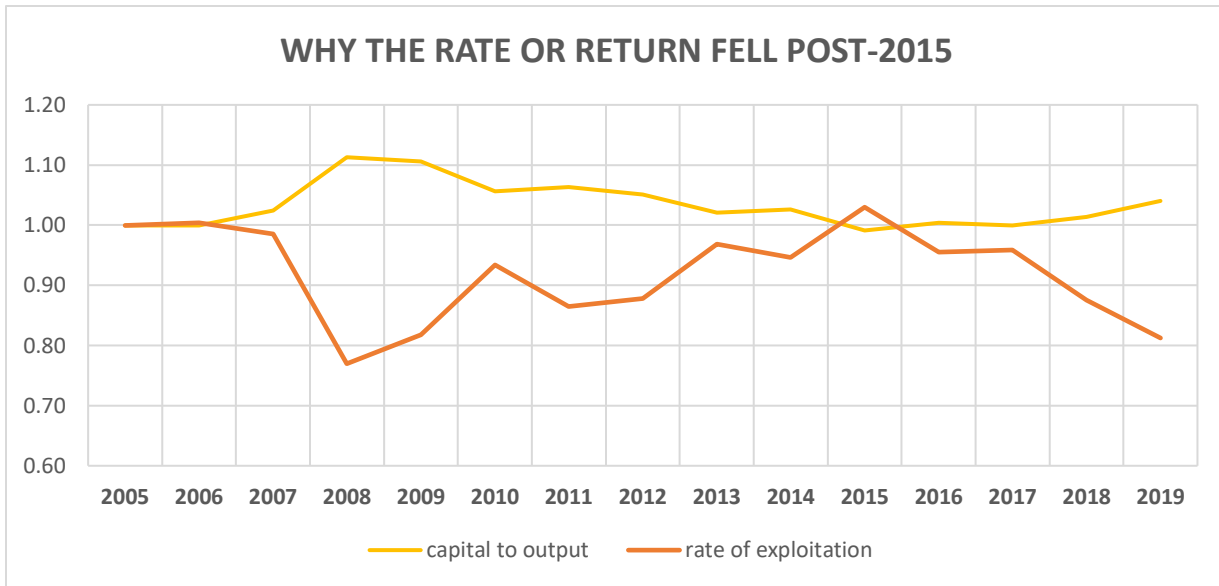
**Graph 8.**



**Graph 9.**

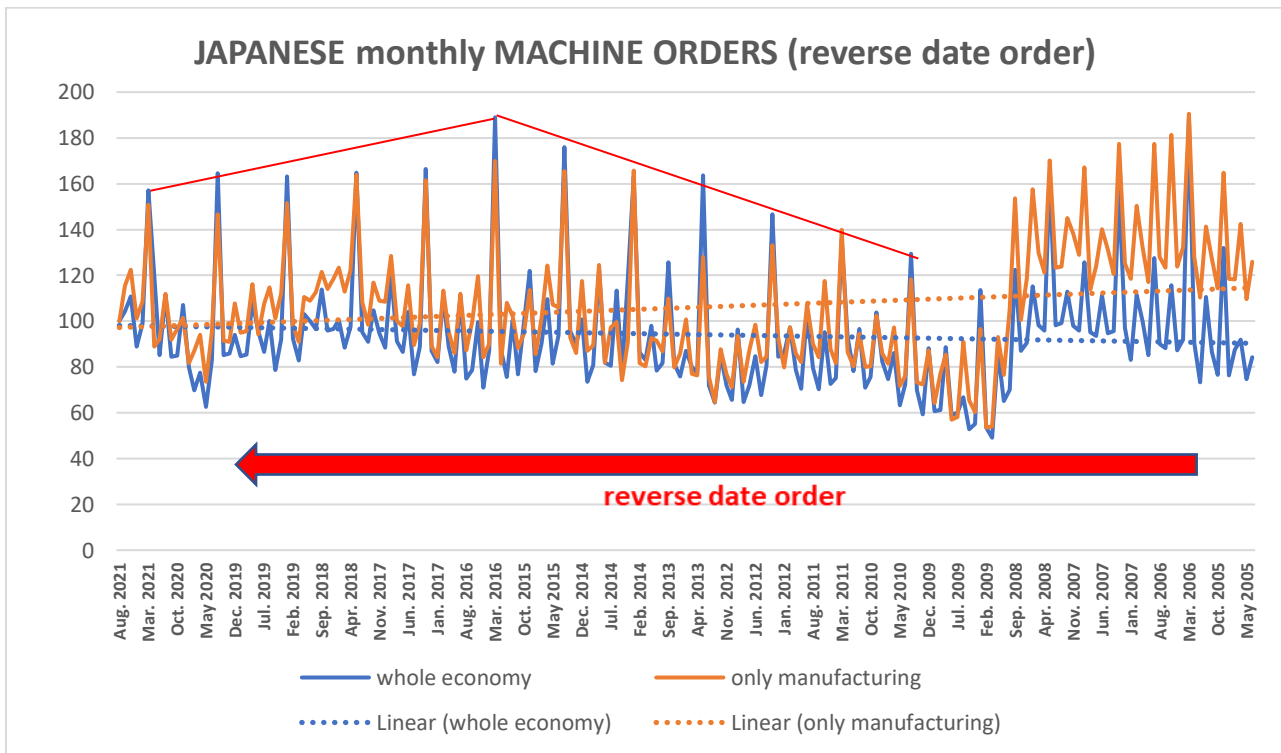


**Graph 10.**



We note the rate of exploitation rose between 2008 and 2015 which when combined with a deceleration in accumulation served to raise the rate of return. Accumulation then accelerates after 2015 only to be met with a fall in exploitation which is unusual but may be explained by Japan’s deteriorating international competitive position. It is also likely that post 2015, the profile of trends in Japan was heavily influenced by China starting to compete more effectively with Japanese producers.

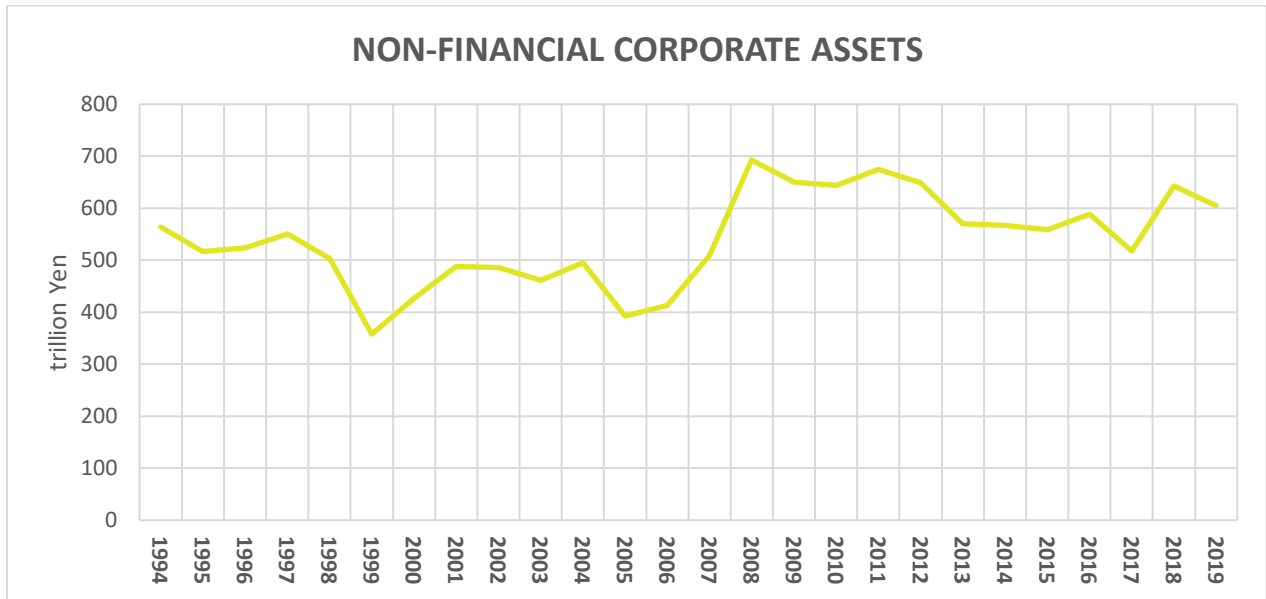
**Graph 11.**



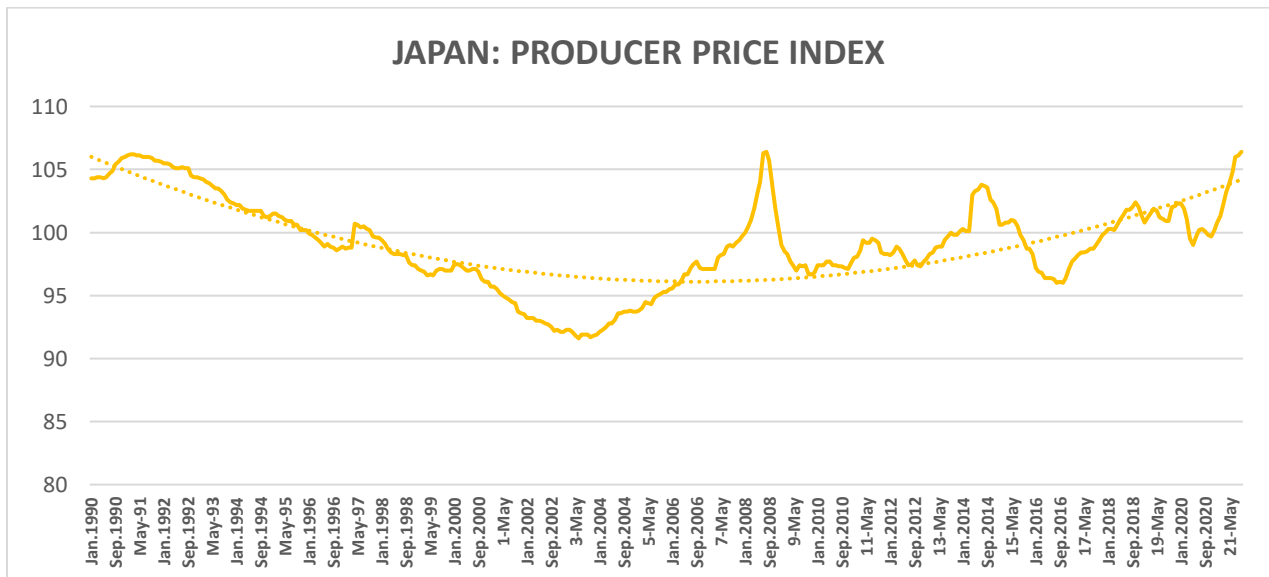
The above graph should be read right to left. On the left is the 2021 data and on the right is the 2005 data. The series only extends to 2005 unfortunately. In the 3 years up to 2008 there is a sharp rise in investment which is replicated by Graph 8 with its rise in the capital to output ratio of 10%. From the end of 2009, measured by peaks, orders rise up to 2015 followed by a fall, once again replicated by Graph 8.

Over the longer term, the data on fixed assets and inventories is available only for the whole economy. (The data from 1994 for industrial assets does not separate out non-produced assets from produced assets.) This longer perspective reveals the full extent of the ailing Japanese economy. Over the entire 25 years, the value of gross produced assets in Japan and abroad rose by only 7% in nominal terms (Graph 12) but fell by 9% when adjusted by the Producer Price Index (Graph 14).

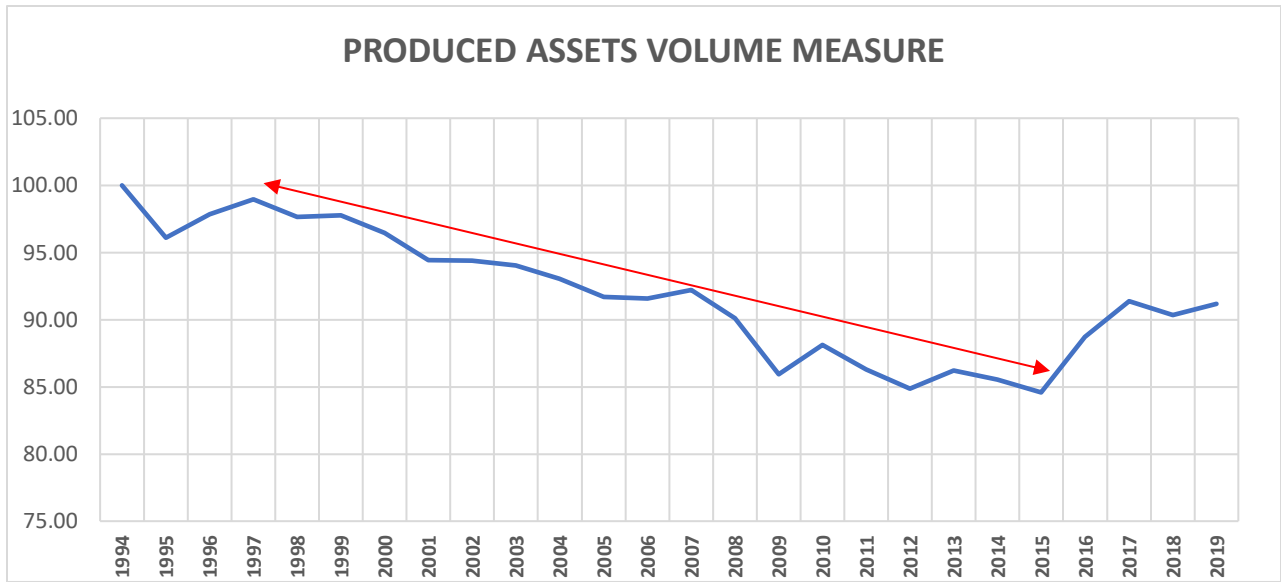
**Graph 12.**



**Graph 13.**



Graph 14.



The red arrow (Graph 14) encapsulates the period of globalisation proper. This was a period characterised by the rapid cheapening of means of production which reached its nadir in 2004. The total fall in producer prices was 15%. Thereafter prices increase but remain below mid-1990 levels until they spike during the pandemic. The fall in 2016 coincides with what I called the pseudo recession when Chinese and global production fell sharply at the end of 2015. Had it not been for central bank interventions preventing a curative rise in interest rates caused by economic stressors at the time, a full-blown recession would have developed. The Bankers may yet rue the day they prevented such a purging recession.

The red arrow also indicates the period when Japan outsourced production and relocated production to cheaper waged countries especially China. In the 2021 Yearbook external direct assets rose ten-fold from 17 trillion Yen to 184 trillion Yen. (Table 8.1) Thus in 1994 external assets as a percentage of internal assets amounted to 3.2% compared to 16.5% by 2019 or a five-fold increase. In the USA the comparative figures were 6.4% in 1994 rising to 19.8% or a three-fold increase. Thus while US foreign assets exceed ¥600 trillion or 3 times that of Japan, it must be remembered that Japan's 16.5% contains a higher proportion of external industrial assets than does the USA.

The capital to output ratio combined with the price index post 2008 showed that Japan in common with its major competitors was sweating its assets, that is a period marked by slowing investment, rising exploitation and rising prices. As a result of the absence of recession in the post 2015 period exploitation fell and the employers globally sought to improve their margins through price increases. With regard to productivity, another factor should be borne in mind. Productivity data relates to production within Japan only. But the total assets employing workers covers both national and foreign. Deducting the rising element of foreign based assets turns the real fall of 9% into a fall of 19% within Japan, unlike the number of employed workers which increased from 66.51 million in 2005 to 68.6 million in 2019. (Note 1.)

Of course this is a quantitative analysis. Ten million Yen in 1994 could have purchased a lathe while in 2019 it could have purchased an industrial robot representing a much more advanced technique of

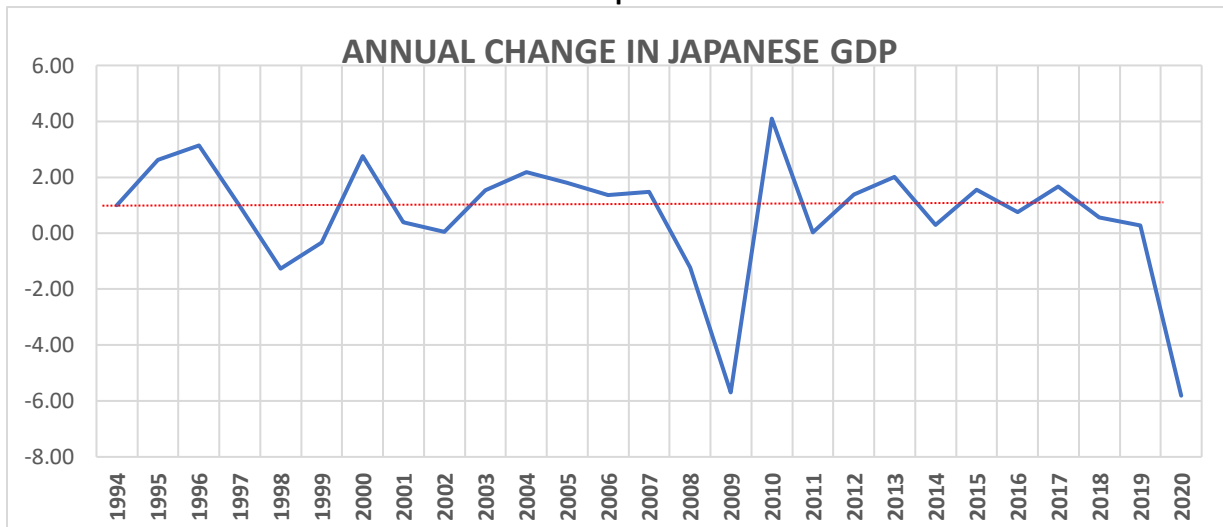


production. Nevertheless, the slow investment rate implied by the data goes a long way to explaining why Japanese productivity improvements, where they occurred, have trailed that of its major competitors.

**Further data on Japan.**

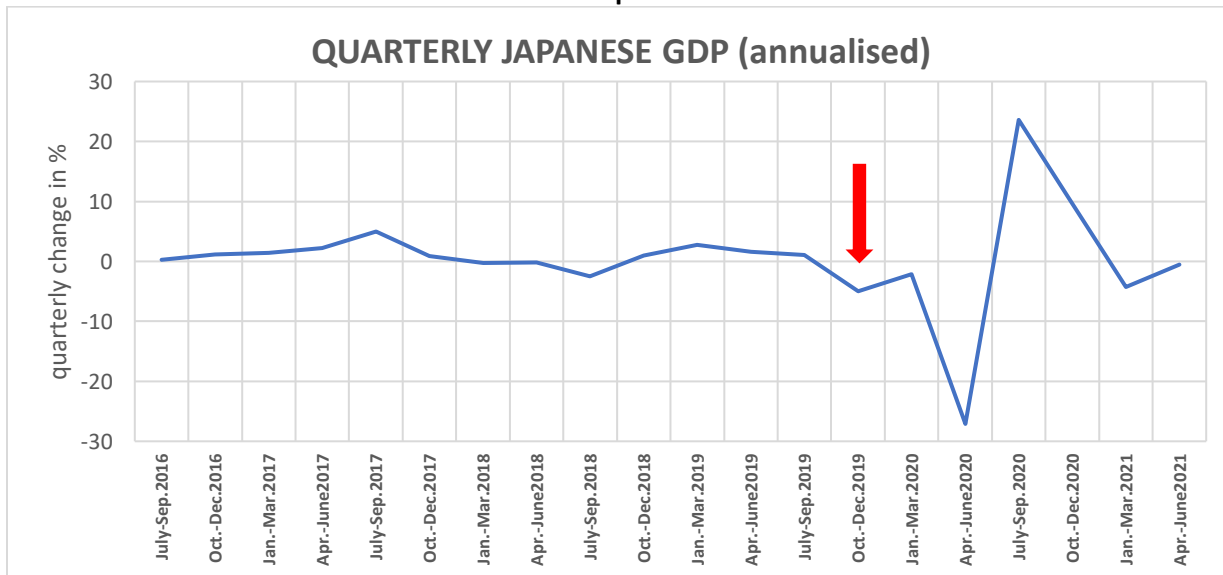
Over the period 1994 to 2019 the Japanese economy grew by 0.9% on average, below the increase found in its major competitors, hovering just above stagnation despite all the arrows fired at it.

**Graph 15.**



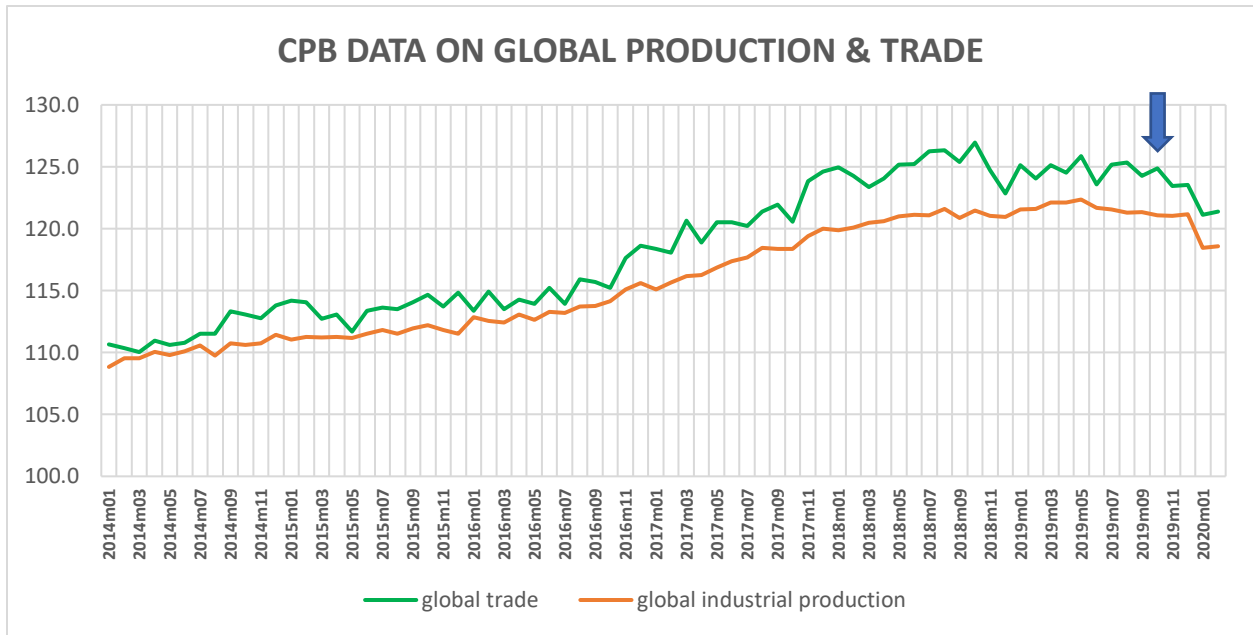
I have included a quarterly summary to show that the Japanese economy actually contracted in the last quarter of 2019. (2020 is not discussed because of the pandemic effects.)

**Graph 16.**



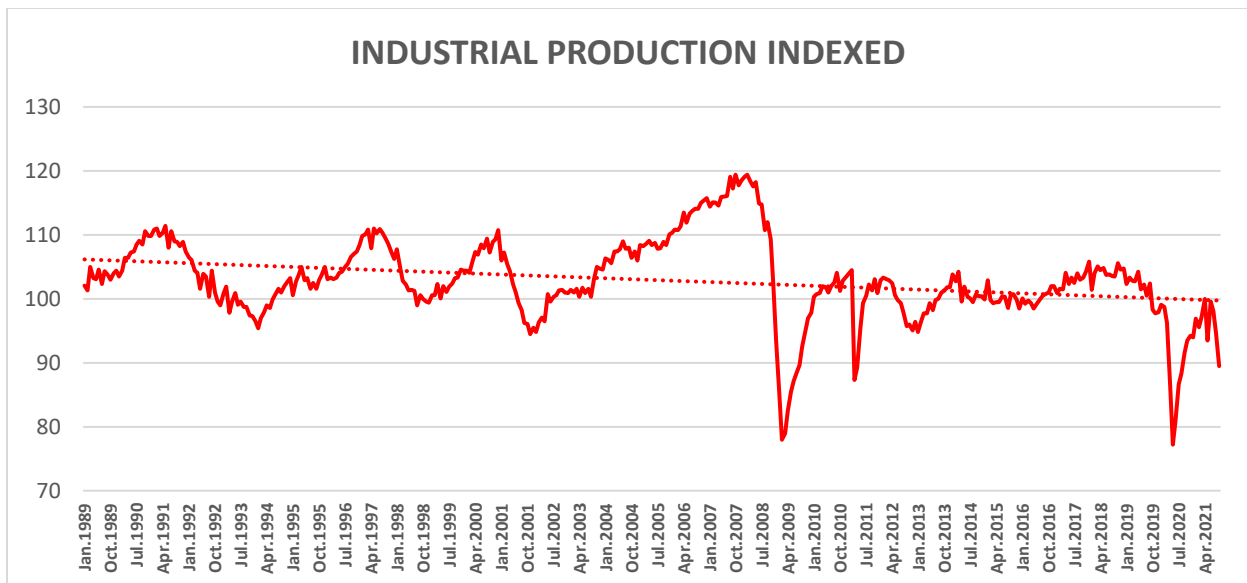
This coincided with a fall in global production and trade in the second half of 2019 as Graph 17 below shows. 2019 together with late 2015 and early 2016 were the two weakest periods of growth post-2008. It is unusual for two near recessionary periods to occur in such proximity to each other despite Central Bank largesse. It points to fragility in the world economy post-2014, the last peak.

Graph 17.



In Japan, manufacturing, despite part of it being relocated abroad, is still a significant part of the economy amounting to 20.3% of GDP in 2019 almost double the figure of 11.1% for the USA. It has fallen only by 3% (GDP) from 1994 and by 1.5% since 2007. The world figure for 2019 is 15.5%. (Worldbank Data.) Thus the movement of industrial production in Japan influences GDP more strongly. (Note 1, at end.)

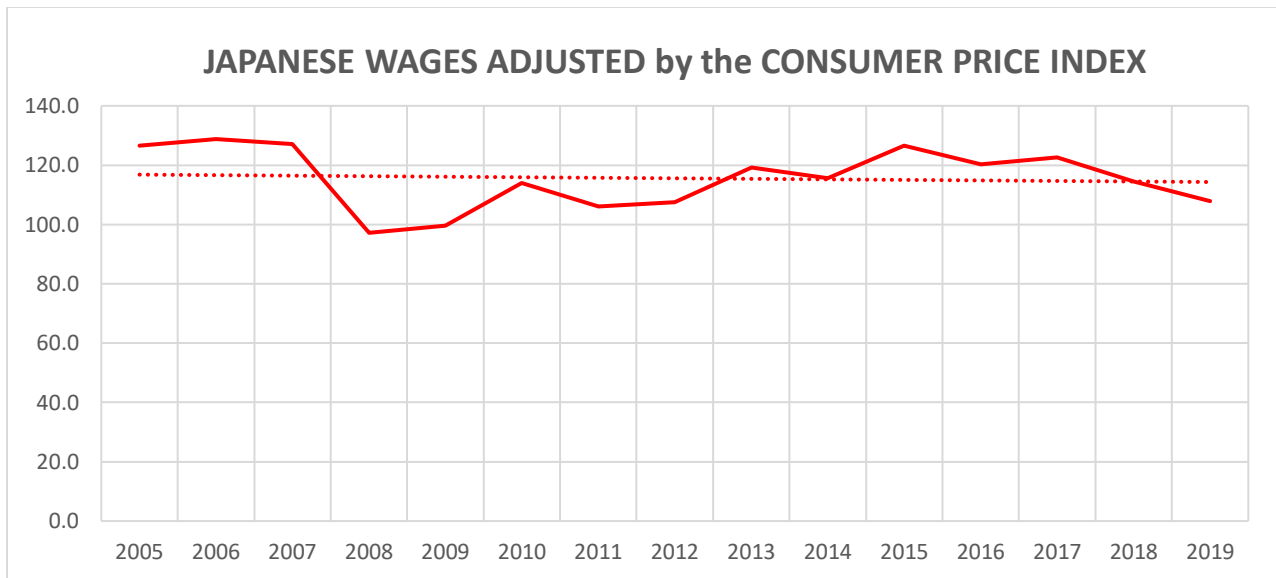
Graph 18.



After 2008 the highest peak was below 105 compared to 120 pre-2008. By December 2019, the index had fallen below 100, to 97.9. The same downward trend in 2019 as found with GDP is found here as well.

**Japanese workers.**

**Graph 19.**



What is interesting about the above graph when compared to Graph 8, is that whereas the rate of exploitation fell in the latter graph post-2015, in real terms, wages fell too. This expresses a fall in the competitive position of the Japanese economy which was not able to raise exploitation despite the fall in real compensation. It is axiomatic to infer that wages are tied to militancy. Japanese workers have some of the lowest strikes ratios globally. Below is the data for the period 2009 – 2018 for selected countries. <https://ilostat.ilo.org/topics/work-stoppages/#> (International Labour Organisation data). (Note 2.)

**Table 1.**

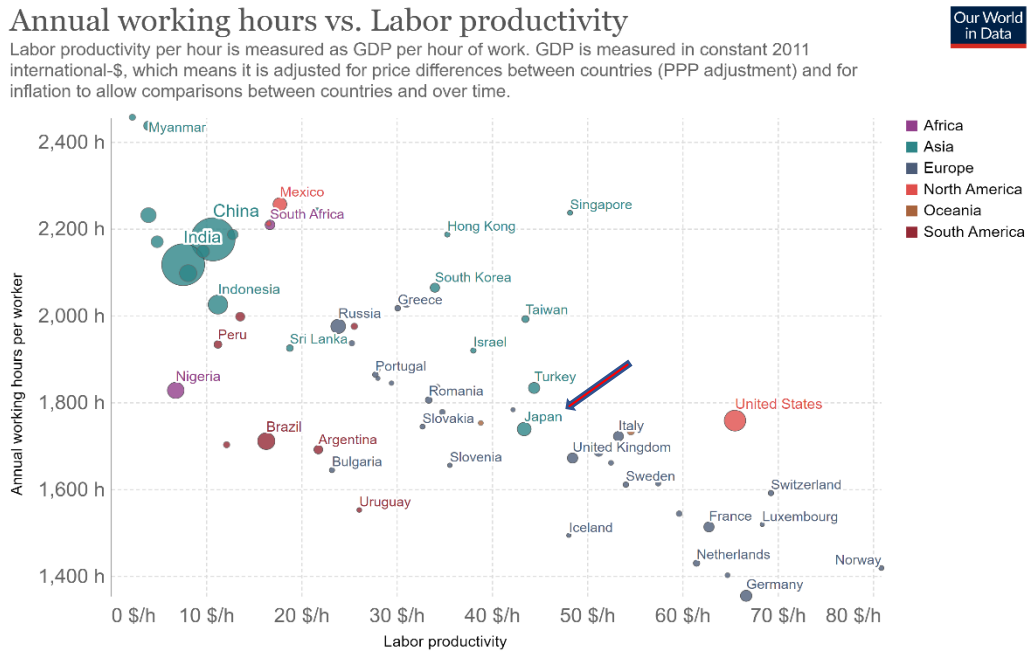
Country	No. of strikes
Germany	817
Spain	813
U.K.	111
S. Korea	102
Japan	<b>74</b>
USA	13

From this short list there appears to be an association between worker militancy focused on the workplace and electoral politics. Countries with the lowest average strikes tended to end up with right-wing bourgeois parties or even populist governments. Other countries such as the Netherlands and Russia also confirmed this association. On the other hand countries like Spain and Portugal which saw high rates of strikes also saw the emergence of mass left-wing parties.

Another sign of worker passivity is the length of the working week. Though the official data in the graph below, which combines hours worked and productivity, shows Japan to be around the average in terms of annual hours worked, the unofficial figures imply a higher rate of 2000 hours putting Japan in proximity to India and China. One of the oddities about Japan is, that whereas in most metropolitan areas the last

underground trains are fairly empty except for party goers, in Japanese cities they are packed with office workers leaving work at the last minute. In fact, the Japanese government in 2018 was moved to pass a law restricting overtime working, much of which is unpaid, because of its negative effect on society.

**Graph 20.**



Source: Feenstra et al. (2015) Penn World Table 9.1

OurWorldInData.org/working-hours • CC BY

<https://ourworldindata.org/working-hours>

Another indicator of worker passivity is the number of days of paid leave won through struggle. In Japan all workers are entitled to 10 days statutory paid leave after 6 months of employment. This rises to 20 days after 6.5 years of continuous employment. 20 days, but not 10, is about the average globally. For comparisons sake, the minimum of 10 days compares to 0 days for the USA and 5 days for China. However, this is only half the story literally, because unusually Japanese workers only use up half their allowances on average. The table below shows a list of countries where workers forsake paid days of leave in order to stay at work.

**Table 2.**

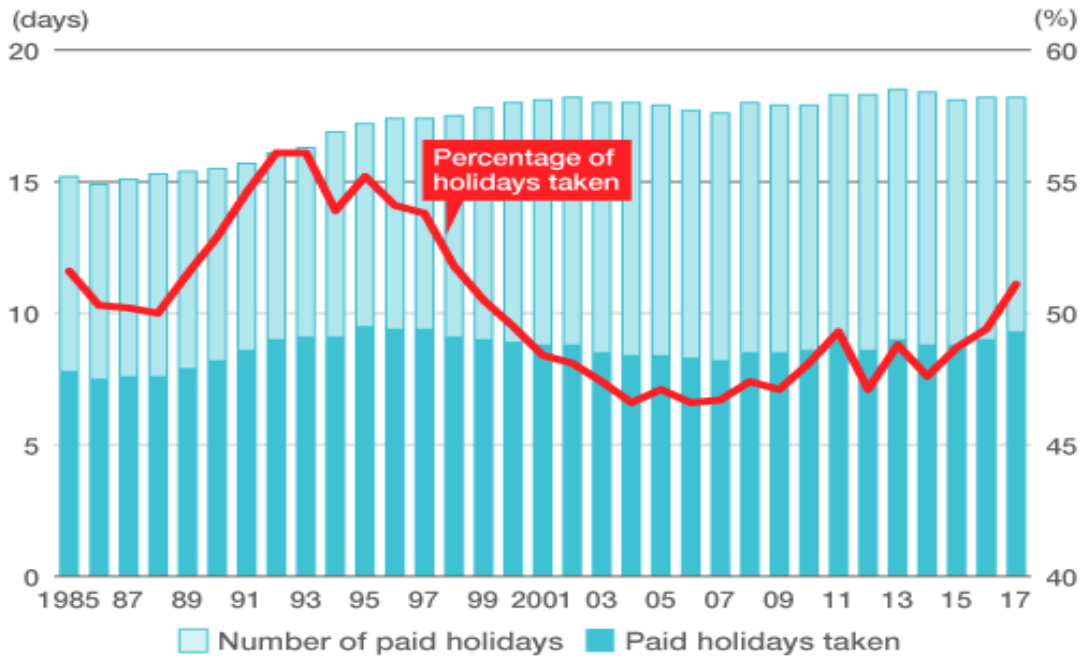
Country	Days
Japan	10
Italy	7*
USA	4
UK	1
France	0
Germany	0

(Source: <https://viewfinder.expedia.com/how-to-use-your-vacation-time/> \* Italy has more generous allowances.)

The graph below shows how many fewer days of leave were taken in the teens compared to the noughties.

Graph 21.

### Average Paid Holidays Taken in Japan



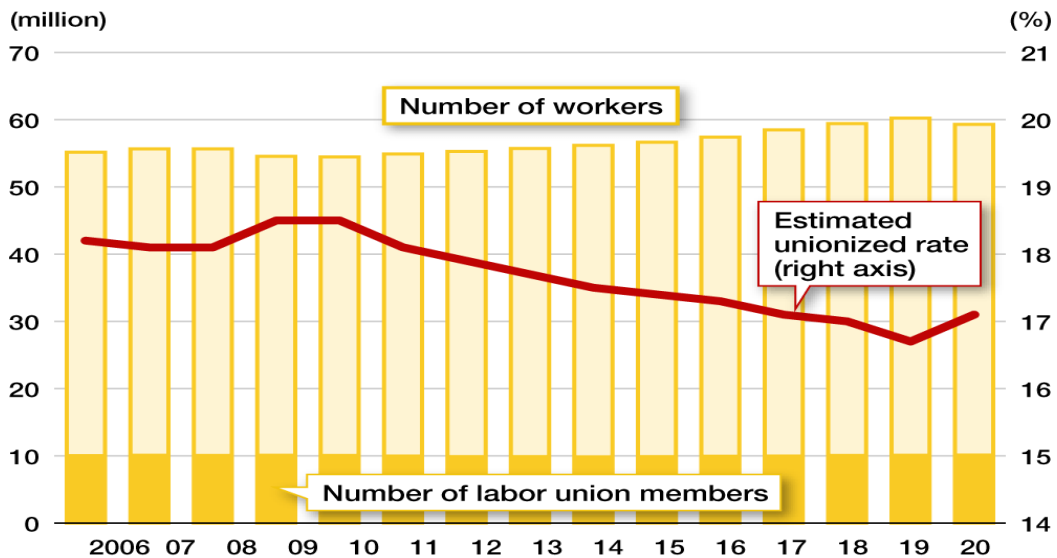
Created by Nippon.com based on data from the Ministry of Health, Labor, and Welfare.



(Source: <https://www.nippon.com/en/features/h00329/>)

Graph 22.

### Workers and Union Members in Japan



Created by Nippon.com based on data from the Basic Survey on Labor Unions of the Ministry of Health, Labor, and Welfare.



Graph 22 describes union density in Japan. Japan has the same union density as Germany with its comparable manufacturing base, it is higher than the 10% found in the USA but lower than the 23% found in the UK because of public sector unions. (For more information on EU workers follow this link <http://www.worker-participation.eu/National-Industrial-Relations/Across-Europe/Trade-Unions2>) (Note 3.)

It was not my intention to provide comprehensive reasons for the passivity of Japanese workers. This would require a great deal of research, which is beyond my reach. Instead this post provides a number of pointers and markers, that is all. However this does not diminish the importance of drawing lessons from Japan focusing on why Japanese workers have been so passive for so long in the face of a stagnant economy, despite its adverse impact on their conditions and standards of living, and, secondly, can any of these lessons be applied to Western workers who are now in the same vortex of worsening conditions and falling standards of living. Or is there something unique about the culture of Japan, namely “group think and approval” which means it cannot be readily translated to the West? These are questions which need addressing which I am sure must have intrigued scholars elsewhere.

### **Conclusion.**

The loyalty of Japanese workers to the system may be slipping forcing the government to beat the nationalistic drum ever louder to distract from eroding job security, wages, and pensions. The last two elections saw total voter turnout drop to 29.99% and 31.64% as the Japanese, who used to vote in droves, were repelled by a jaded government and not enticed by opposition parties which failed to inspire. Clearly voters did not take Kishida’s promises seriously as less than one in five voters voted for the ruling party. <https://the-japan-news.com/news/article/0007939109> In addition, all the recent economic indicators point to a further weakening of the Japanese economy.

The same applies to China. Interestingly and unusually, the CCP advised its citizens to stock up on essential supplies for the winter. This was variously interpreted as fears about COVID or alternatively possible conflict over Taiwan. It certainly indicates a pause for thought. Whatever the case it will further weaken consumer confidence already on edge over the crisis in the property sector. Despite slightly firmer economic indicators in the USA, the global economy continues to decelerate with profits under pressure. It now appears sagging demand has overtaken supply side issues as the main decelerator.

Note 1. I have not spent much time discussing Japanese productivity. Michael Roberts pointed to low Japanese productivity in a recent post citing a paper by REITI titled ‘*Japan’s Low Labor Productivity: The gap with the U.S. and complex causes*’ which seeks to explain why a country which dominated global production in the 1980s now lags the competition. Having examined Masayuki’s hypotheses and comparing it to the raw data, it appears that the reason for the lag is more straightforward, really a case of underinvestment in Japan itself. <https://www.rieti.go.jp/en/papers/contribution/morikawa/12.htmlcauses>  
<https://wordpress.com/read/feeds/313842/posts/3632611478>

The effect on productivity from the relocation of assets is not straightforward. In so far as there is less investment within Japan this will reduce productivity especially if investment is redirected towards the Tertiary Sector where productivity is much lower. However, in so far as foreign investment reduces the price of inputs it helps to raise productivity at home. This is a complex issue. If transfer prices are below value, that lost value is recaptured after the product is completed and sold. It is realised via the market price in the home market, in this case Japan. This absorption of some of the value produced abroad therefore increases the value added at home which is one part of the productivity equation. The BEA did research on this area and concluded that up

to 2014, around 25% of US productivity gains came from cheaper inputs courtesy of China where 50% of the value produced there was realised outside the country.

Note 2. The poverty rate in Japan increased to 15.7% in 2020 hitting the elderly particularly hard. <https://www.cnn.com/2020/07/03/japans-middle-class-is-disappearing-as-poverty-rises-warns-economist.html> As with many of the other major economies, the middle is being squeezed, erroneously interpreted as the demise of the middle class when really it is the section of better paid workers.

Note 3. The reader will no doubt be grateful that Graph 22 is the final graph on this post. It could be said that a Graph saves a thousand words because it presents in a simplified pictorial image, important trends and associations. It does. This post is an all-time record for graphs used.

Brian Green 3<sup>rd</sup> November 2021.