

# The NBER Digest

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## Is the Japan Problem Over?

Trade conflicts between the United States and Japan have been a source of serious tension for several years. But according to NBER Research Associate **Paul Krugman**, with the recent decline in oil prices and the fall in the value of the dollar relative to the yen, this problem may be nearly over. Krugman predicts that during the next few years the growth in Japanese exports will be much slower, and the growth in imports will be higher, than during the past decade. Since he believes that trade frictions with Japan are primarily the result of the rapid growth of her exports of manufactured goods, he is optimistic that these frictions will largely disappear.

In *Is the Japan Problem Over?* (NBER Working Paper No. 1962), Krugman attributes the rapid growth of Japanese exports in recent years to two factors: the increase in the price of oil, and the emergence of Japan as a creditor nation. Between 1973 and 1984, the price of oil shot up dramatically, and Japanese import prices increased at an annual rate of 8.6 percent. However, the prices of Japanese exports rose by only 4.2 percent per year.

In addition, Japan began this period as neither a borrower nor a lender in world capital markets. Overall, her trade was roughly in balance. But during the early 1980s Japan began to invest heavily abroad and by 1984 was sending 2.8 percent of GNP into foreign capital markets.

To pay the higher oil prices and to finance foreign investments, Japanese exports grew much faster than imports. Between 1973 and 1984 the volume of

Japanese exports grew by 8.5 percent annually compared with annual growth in the volume of imports of only 1.6 percent. Now that oil prices have come down and Japan's capital outflows have stabilized, though, Krugman predicts that her export growth will also decline. Moreover, he believes that Japan's capital outflows as a percentage of GNP will fall once U.S. trade deficits decline.

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Krugman predicts that if the price of oil is \$11 per barrel and capital outflows fall by \$6 billion, or 0.5 percent of GNP, Japanese export growth will actually cease, while imports will grow by about 6 percent annually. If oil goes up to \$17 per barrel but capital outflows decline by \$15 billion, the same growth in exports and imports will occur. Even if oil prices return to \$22, and Japanese capital outflows fall by \$6 billion, Krugman estimates that Japanese exports will grow by only 2.3 percent annually, far below the growth rates of earlier years.

Krugman believes that this much slower growth in exports will lead to reduced frictions between Japan and her trading partners. He notes that West Germany and Japan had very similar trade patterns in 1984. Both countries had large imports of primary products, surpluses in manufactured goods of about 9 percent of GNP, and overall trade surpluses of almost 3 percent of GNP.

The most important difference in trade patterns between Germany and Japan, according to Krugman, was the rate of growth in exports. While the volume of German exports grew by about 60 percent in total between 1973 and 1984, Japan's exports grew by over 150 percent. It was this extremely rapid rise in exports rather than Japanese import protection, unfair trading practices, or its larger size that explains why Japanese trade frictions are so much more serious than German trade frictions.

## Homelessness in America

According to a recent NBER study by **Richard Freeman** and **Brian Hall**, "... in the absence of changes in the housing market or in the economic position of the very poor, the United States will continue to be plagued with a problem of homelessness for the foreseeable future." That conclusion is based on a survey of over 500 homeless people conducted in New York City in the summer of 1985, reported in **Permanent Homelessness in America?** (NBER Working Paper No. 2013).

There has been substantial controversy in recent years concerning the number of homeless, with estimates ranging from 250,000 to well over 2 million. Freeman and Hall estimate that there were between 250,000 and 300,000 homeless in the United States in 1983. Most of the homeless individuals are men between the ages of 30 and 60. On the other hand, homeless families are typically headed by a woman, and about half of the family heads are under age 25.

Blacks are at greater risk of becoming homeless than whites are, Freeman and Hall find, and homeless families are predominantly black. Over half of the homeless did not complete high school, and one in three has a mental illness (compared to an estimated fewer than 2 percent of the U.S. population).

Of the homeless surveyed for this study, 39 percent admitted to having spent time in jail, averaging two years. They served 61 percent of their jail time before they became homeless.

Despite the fact that 29 percent of the shelter residents interviewed, and 44 percent of the street residents, reported themselves unable to work, few homeless individuals receive welfare or general assistance, Freeman and Hall report. Moreover, they find that homelessness on average lasts six to eight years.

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To prepare this study, Hall interviewed 516 homeless people in New York: 210 staying in shelters; 101 family heads staying in welfare hotels; and 205 from the streets. He asked how much time each individual had spent in shelters and how much time on the streets since becoming homeless; he found that people interviewed in shelters had spent 55 percent of their homeless time in shelters, while people interviewed in the street had spent 20 percent of their time in shelters. Based on these responses, Freeman and Hall estimate that the flows of people back and forth between shelters and the street will be in balance when 31 percent of the homeless individuals are in shelters. Put differently, they estimate that there were 2.2 people living in the streets for every person in a shelter in New York in the summer of 1985.

Based on other estimates of street-to-shelter ratios elsewhere in the country, as well as regional data on the number of people receiving federal surplus food, Freeman and Hall conclude that their estimate for New York City is reasonable for other areas as well. They then use a government survey of individuals in shelters and homeless families in welfare hotels to estimate the total number of homeless—about 280,000 in 1983.

## Unemployment Flows

What causes unemployment to increase during recessions: a rise in the number of people looking for work, or a fall in the number of people who find jobs or leave the labor force? A new NBER study by **Michael Darby** (formerly an NBER Research Associate and now Assistant Secretary of the Treasury),

**John Haltiwanger**, and **Mark Plant** concludes that an increased flow of people into joblessness is the source of rising unemployment during recessions. In fact, the flow *out* of unemployment also rises during recessions, but not fast enough to offset the greater inflow of people looking for jobs. The result is an increase in the total number of people looking for work.

The three economists calculate that the upturn in unemployment during the last recession, for example, began when the number of people who were newly unemployed each month rose from about 2.8 million in late 1980 to about 3.6 million in mid-1982. During this period, the number of people finding jobs or leaving the labor force also increased, but this occurred somewhat later and at a slower rate than the inflow. In mid-1983, when outflow exceeded inflow, the unemployment rate fell sharply.

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In **The Ins and Outs of Unemployment: The Ins Win** (*NBER Working Paper No. 1977*), the authors also report that the unemployment rate rises during recessions because types of workers who take longer to find a job make up a higher percentage of the unemployed than during booms. They estimate that 50 percent of unemployed teenage boys find jobs or leave the labor force each month, compared with only 33 percent of unemployed men aged 25 to 34. Since the percentage of the unemployed who are youths falls during recessions, while the percentage of the unemployed who are young men rises, the unemployment rate as a whole tends to rise.

Darby, Haltiwanger, and Plant also examine a third source of rising unemployment—longer spells of joblessness for individuals in each demographic or economic group. They find that this source is less important than the other two in explaining fluctuations in the unemployment rate over the business cycle.

To clarify their analysis of changes in unemployment, Darby, Haltiwanger, and Plant offer an analogy: the number of people traveling by air at any given moment. During major holiday periods, the number of people taking off from airports rises. Within a short time, the number landing at their destinations and leaving the air also rises. For a while, the number taking off, landing, and actually in the air can all be rising, just as inflows, outflows, and the total number of unemployed can all rise during recessions.

Furthermore, the average distance covered by a flight, as well as the time required to make a certain trip, may also rise during holidays. The change in the average distance of a trip may contribute more to the increased number of flyers than the change in the flight time required to make each type of flight. Similarly, Darby, Haltiwanger, and Plant find that a shift in the unemployed toward groups who find jobs slowly is more important in explaining the rise in the unemployment rate during recessions than an increase in the average duration of unemployment for each group.

## **Are Output Fluctuations Transitory?**

According to the standard view of the business cycle, fluctuations in real GNP are largely transitory. This view holds that the natural rate of output grows at a more or less constant rate, while fluctuations in output are temporary deviations from this trend. That is, recessions do not cause any long-term loss of output. However, a recent study for NBER by researchers **John Campbell** and **Gregory Mankiw** challenges this conventional view and finds that fluctuations in real GNP result in permanent changes in the level of production.

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In **Are Output Fluctuations Transitory?** (*NBER Working Paper No. 1916*), Campbell and Mankiw ask how much output will change in the long run when current output declines. If fluctuations in output are transitory, then a decline in output today should have little effect on output in five or ten years. Examining quarterly data from 1947 to 1985, however, Campbell and Mankiw find that a 1 percent decline in real GNP in one year has been associated with a decline in real GNP of at least 1 percent over all foreseeable horizons. Hence, they conclude that real GNP in general does not return to its long-term trend once a recession is over but rather begins to grow again starting from a new, lower level. Fluctuations in output thus appear to be permanent rather than transitory.

Campbell and Mankiw's findings are consistent with several views of the business cycle. One view holds that changes in the demand for goods and services, such as those caused by monetary policy, cause fluctuations in output, and that these fluctuations are more persistent than is widely recognized. Therefore, the permanent effects of recessions that Campbell and Mankiw observe may reflect monetary policies and other fluctuations in demand.

A second view holds that business cycles are caused primarily by supply-side factors, such as large oil price increases or fluctuations in technical progress. The shifts in output and productivity that result from such changes could have long-lasting effects on output. The permanence of output fluctuations documented by Campbell and Mankiw may reflect such supply-side factors and need not imply permanent effects of monetary policy.

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