MACROECONOMICS OF WEAK CORPORATE GOVERNANCE:
AN ALTERNATIVE THEORY OF JAPAN’S LOST DECADE

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SUMMARY

This paper offers a theory to simultaneously explain the facts of Japan’s lost decade. The focus is on the profit-squeeze problem of Japanese firms. Reacting to this problem, households substitute money for capital in their portfolios. This reaction is supported by a low nominal interest rate, but at the same time supports it. Specifically, when the problem is aggravated beyond a critical level, this self-reinforcing loop can severely depress capital accumulation, which may trap the economy in a prolonged stagnation.

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