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Book Review


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I can only give you this refrain:

Where are the snows of yesteryear?

(Françoise Villon c.1461)

The reported demise of the Japanese economy is a classic case of every cloud having a silver lining. The Japanese may not be delighted, but Japan's decade long experiment with economic narcolepsy has yielded undoubted benefits for a breed of professional chatterers, particularly for a group of select economists. The wider world (outside Japan) has become bored with the issue as the Japanese economy has had the bad grace neither to collapse in a spectacular way nor entirely to revive. Nonetheless amongst academic specialists, Japan's record of non-achievement has created a cottage industry of conferences and symposia, all carrying the brief of explaining either why the Japanese growth machine collapsed, why it has failed to revive, or more ambitiously, what can be done to solve Japan's economic problems. Organisers tap into foundation funds, fly academics in from around the world and after housing and feeding them, publish the results of these days of talk and speculation. The result is often an overpriced volume destined only for library shelves, containing little or no original work. Moreover the long gap between conception and publication often renders them dated upon arrival.

Since the invitees usually are chosen from a fairly limited pool, much of the work presented is at best derivative. Any hypothetical reader drawn to this volume would be familiar with these well-known players. The chance of gasping with surprise at the arguments made or the conclusions reached are minimal. Economists are often great conservationists, more adept than most other academics at recycling any idea they may have had in the past. Conference papers at such events bear a distinct resemblance to previously published work by these authors, more variations on a theme than legitimate contributions. If you know the players, you often know what to expect before even reading their latest efforts.
Reviewers then have every reason not to look forward to the fruits of such projects. Given the natural handicaps that volumes of this type are hobbled with at conception, this particular example of a usually unanticipated category is clearly above average. It inevitably does share all the expected weaknesses. There is definitely a feeling of *déjà vu* surrounding these contributions in light of the authors' previous work cited in these papers. But for the most part the papers are carefully crafted and do an efficient job of summarising the authors' long-held positions. It is, however, unfortunate that two years were allowed to lapse between the initial symposium in 2002 and publication in 2004. Only a most self-disciplined reader will be able to withstand the temptation of reading the work in light of the current situation in Japan rather than the one that prevailed in 2002. There is no seeming reason to allow such a long time to elapse. Given the marginal contribution that many such volumes make, editors should allow themselves a maximum of one year to see the publication out.

Accepting such mundane frailties, the strength of this work clearly lies in delineating its objective and not muddling together two or more issues. In the endless forensic autopsies concerning aspects of Japan's recent economic woes, short-run and long-run considerations are not always sufficiently separated. Recommendations of a structural nature deal more with issues of long-run growth rates. However, if the focus is in escaping the sustained economic morass of the past decade, short-run issues of aggregate demand and supply need to dominate. Both are policy issues, but they are clearly separable matters. Here the clear focus is on fiscal and monetary approaches to Japan's particular economic slump.

Perfection, however, is not easily achieved, nor should it be expected. The contributors while doing their best to keep this short-run/long-run distinction clear do at times stray into structural areas. This is perhaps inevitable when dealing with financial matters since the institutional players in these markets played a role in facilitating the asset bubble and subsequently in impeding potential corrective measures. Nishimura and Kawamoto (2004) as well as Fukao (2004) look more at this side of the problem rather than adopting a strictly government policy focus for their analysis.

Like most work done on Japan's lost decade, this volume never considers whether the specified decade was in fact lost. There is a standing assumption that a decade that averaged less than 1 percent
growth is clearly undesirable. Considered objectively, this assertion is undeniable only if the opportunity cost of shifting to higher growth during this period was trivial. Here we should remember one of Japanese Prime Minister Koizumi's more memorable sound bites, 'No gain, without pain'. The idea behind this political platitude is that, to regain economic health, the Japanese would need to sacrifice current comforts for future benefits. For instance, if the overhang of non-performing bank loans was hindering economic recovery, rehabilitating the financial structure demanded sacrifices not only from shareholders of those institutions but from taxpayers in general. If the Long Term Credit Bank (now the Shinsei Bank) is one model to follow, only government funds could accomplish nationalising then selling off insolvent banks.

The alternative approach, forming the implicit agenda of a number of Japanese governments, including the current one, is a policy of muddling through until economic growth reduced the urgency of such non-performing loans. The beauty of a non-directed approach lies in generating an extended process that resembles something like a golden recession. In a wealthy country, the pain of slow growth can be spread widely. No one segment of the population needs to be inordinately discomforted. The resultant economic and political malaise then is never sufficient to dislodge the political or economic status quo in any radical manner.

The danger of this approach is more long-run, with the bill potentially coming at a later date. Clearly higher growth during that lost period would translate into a wealthier Japan today where the burden of future obligations due to demographic changes (the medical costs of an ageing population) would be somewhat less. In the same way, a generation of job entrants may be less productive in the future given the current rise of part-time and casual employment. As the baby boom generation retires, will the existing pool of experienced, productive employees be able to appropriately replace them? Again this may be yet another issue largely generated by the media and other 'talking heads'. Training in Japan may no longer need to be as firm specific as previously. In any case, the employment market itself may currently be moving to a different and more appropriate structure that will serve to alleviate any potential labour supply problems. In the same way, market imperatives may irresistibly be moving business interests toward a more effective corporate restructuring than the
Japanese government could ever have encouraged. My contention is that we will not know the cost of Japan's deliberately fumbling approach to economic failure until sometime sufficiently removed. It may become one of those constantly argued but never resolved issues that plague the study of economic history. It is safe to say then, that the label 'Lost Decade' has more to do with marketing than with economics.

It is, however, far more important to discuss what a book intends to do rather than the reviewer's own obscure desires. What the editors (Saxonhouse & Stern) provide in a very serviceable introduction makes clear the nature of the book (and its seed symposium) as well as its underlying objectives:

1. whether the bubble could have been prevented;
2. how much of the economic pain that Japan faced during the 1990s was the result of the bubble's collapse; and
3. what can be done today to help resolve Japan's continuing economic problems (Saxonhouse & Stern 2004, p. 2).

Besides the expected summaries of the five featured papers in the volume, the editors make some insightful, though at time far too limited points, about the Japanese economy. Introductions are prone to this failing. Some editors are simply lazy and clearly do the minimum possible in putting out a given volume. In the worst case, a few pages of volume highlights, devoid of any analysis, is deemed to be a sufficient gesture. Few however make the jump required to use a standard introduction as an occasion for offering a chapter which stands on its own strengths. Such aspirations are constrained by an obligation to preview the contributed chapters. Some might see these more ambitious attempts as a form of bad manners. The organisers of events and editors of volumes should be the equivalent of professional waiters, invisible facilitators of an objective rather than spotlighted performers. Saxonhouse and Stern adopt a fairly successful compromise, raising some interesting issues without embarking on any serious analysis. The introduction serves more as an appetizer to the rest of the volume, perking interest without attempting to supply any substantial answers.

What is of interest is the stated consensus view formed in these papers and very clearly set forth by the editors.

From the perspective of a decade ago, what is remarkable is that no one is recommending the use of conventional monetary and fiscal policies to solve Japan's problems. There is a consensus
among the papers that using fiscal policy to stimulate the economy is not an option because the government's deficit and outstanding liabilities are already so high. There is also a consensus that, whatever the causes, Japan is facing a liquidity trap, and that conventional monetary policy will not restore Japan's economic health (Saxonhouse & Stern 2004, pp. 8-9).

A careful reader should be spooked by the announcement of any consensus. It was during the same decade of the nineties that the Washington consensus determined the necessary conditions for economic growth and development to flourish. Like most other common wisdom of this sort, what everyone knows to be true (at least if everyone is limited to the international agencies and excludes the views of economists like Dani Roderick (1996) does not necessarily yield reliable policy.

The consensus put forward in the Saxonhouse and Stern volume is potentially flawed in at least three ways. Despite the claims of Toshihiro, Nakazato and Kawade (2004), others have argued that fiscal policy, especially after 1996 was too tight. Even in the immediate years after the bursting of the bubble, Japanese fiscal policy focused more on shoring up vulnerable LDP constituencies (rural areas through road construction) than in aiming for the most expansionary category of spending.

Despite the poorly directed nature of fiscal policies in the first part of the decade, by 1996 the Japanese economy showed distinct signs of recovery. I would say that the subsequent collapse was due to a concatenation of poor luck and poor planning. Economic intuition should clearly question any move toward fiscal rectitude at the early stages of economic recovery especially unaccompanied by price or asset inflation. The bad luck was to combine this ill-timed policy move with the onset of the Asian crisis. This not only constrained export and investment possibilities but laid bare the inherent fragility of the banking sector which had tried to recoup its financial health by betting heavily on Asian development. Without this *deus ex machina*, banks were no longer able to bury their mountains of non-performing loans with anything resembling their previous finesse.

Ignoring historical events, Ihori, Nakazato and Kawade (2004) take great pleasure in empirically demonstrating quite counter-intuitive results. These authors want to discount the impact of the 1996 tax increase and emphasise the dangers of fiscal deficits as the result of their quantitative findings.
This leads them to conclude that the Hashimoto fiscal reconstruction was not poorly advised but poorly executed. As Saxonhouse and Stern point out (2004, p. 5) the authors use quarterly data with a level of confidence not justified by the reliability of the data itself, but what is more disturbing is that the piece itself is almost a-theoretical. They live and die by their empirical work without providing a sufficient economic basis for their results. This however doesn't inhibit them from prescribing policy based solely on their empirical analysis. The nub of their recommendations seem to depend on manipulating fiscal expectations by establishing a credible commitment to fiscal reconstruction, a variant on the traditional problem of time inconsistency which favours rules over discretion. In particular, raising taxes pose no problem for them despite offending basic economic intuition. This demonstrates an all too common weakness amongst economists. It is a discipline that seemingly thrives on confounding expectations with counter-intuitive results, but at least sometimes results and policy recommendations are counter-intuitive because they are wrong. Given the results presented in their contribution, my immediate reaction would be to re-evaluate my work. For instance, how sensitive are these results to the data used and the technique applied. I certainly wouldn't simply swallow whole what remains inexplicable in their work.

Perhaps amongst a standard conclave of economists, there would be more agreement on the contributors’ second point of consensus. It is only true that traditional monetary policy has failed, if you limit monetary policy to simple interest rate setting. The idea here is to set the price of credit rather than attempt to manipulate the quantity of credit. If we limit analysis to this narrow role for monetary policy, the consensus holds. However, once we take a closer look at credit creation, as Richard Werner (2003) has, the issue loses some of its crystal clarity. It is quite a stretch to claim with any degree of justification that the Bank of Japan pursued an expansionary monetary policy. Until deflation settled in to stay, the Bank of Japan insisted that an expansionary policy presented an unwarranted risk of inflation. As Saxonhouse and Stern (2004, p. 11) point out, 'Yet, if the government opts for a third way and prints money, the public might be altogether too ready to spend and more inflation than is desired might ensue.' Given a sluggish economy and deflationary expectations there is something distinctly 'Through the Looking Glass' about this claim. Its very Humpty Dumpty nature leads one to believe that the
Bank of Japan was aiming for a quite different objective. There is sufficient evidence, based on its own statements, that the Bank of Japan believed the creation of any inflationary expectations might let troubled firms and weak banks off the economic hook. These organisations would no longer feel the necessity to undertake a full-hearted restructuring program. Given that central banks traditionally are concerned with credit creation and price stability, the Bank of Japan would seem to be abrogating its implicit contract with the Japanese public by holding monetary policy for ransom to its own restructuring agenda.

As a result, credit creation has been largely ignored during this lost decade. Deficits were not monetised but rather financed through bond sales. In this way, instead of lending to private borrowers, banks used any increases in the high powered money to finance government debt. By doing so, the Bank of Japan ensured that fiscal policy would not be expansionary and credit creation would largely not occur.

Too many of the resulting policy recommendations displayed in this volume depend, in almost a cavalier manner, on the government’s ability to manipulate expectations. This is truly a road composed almost entirely with pitfalls. It is almost definitional that changing people’s expectations changes their beliefs and actions. The ability of any government actually to change these key perceptions at will and in any given desired direction remains problematical at best. Techniques are certainly more sophisticated than the issuing of WIN (Whip Inflation Now) buttons during the Ford Administration, but not much more effective. Thus Goyal and McKinnon (2004) opt for reducing the variability in Japanese/US exchanges rates, but how that is to be done (outside of fixed rates) remains a mystery.

The last piece of common wisdom enunciated by the writers is the undeniable existence of a liquidity trap. Clearly we are not talking about anything Keynes would recognise, especially since he ascribed only a theoretical existence to such a phenomenon. Given the feeble nature of Japanese monetary policy during this fatal period, no compelling evidence would seem to exist which supports such an assertion. Yet the existence of such a trap in Japan is taken for granted by the contributors to this volume. The conviction seems to spring simply from the Bank of Japan’s zero interest rate policy coupled with a narrow definition of monetary policy. Opposed to this definitional assertion are a few
pertinent observations. Banks are desperate to improve their equity position. Borrowed funds can secure low risk government security with an almost guaranteed margin. This poses a more attractive alternative than lending to dubious borrowers or even the more frustrating task of trying to lend to those without any interest in borrowing. In this case, pronouncing monetary policy dead by delineating the nature of a liquidity trap provides little or no insight for the serious analyst.

Despite the bogus consensus, and the derivative nature of many of these chapters, the contributors do provide some useful insights to the interested reader. (It goes without saying that the uninterested reader has long ago tossed this book into some distant corner.) In particular, Goyal and McKinnon (2004), despite their cavalier dismissal of both monetary and fiscal policy, provide a valuable examination of interest rate setting in an international context. Low US rates constrain Japan's ability to increase its own rates. Japan's negative risk premium limits Japanese flexibility in this respect. The premium in turn is a reflection of the net foreign assets held by each country. The analysis is marred only by the authors' insistence on reducing Japan's policy options to one simple issue. Yes, there is something to what Goyal and McKinnon insist, but like plumbers who see themselves as the fulcrum of all important construction and town planning issues, MacKinnon's long and distinguished career has somehow managed to blind him to anything not immediately connected to exchange rates. In some sense the asset bubble, and its aftermath, are of only peripheral concern given the reductive approach offered here.

Equally of interest for quite different reasons is the paper by Nishimura and Kawamoto (2004). Their approach is reminiscent of earlier strands of analysis that defined Japanese economic literature. Readers may recall this development during the brief Japanese moment in the sun, one which attempted to explain the rationality behind Japan's institutions. Dore's (1986) idea of 'flexible rigidities' explored how Japan managed to turn inherent weaknesses into advantages. In this view there were other available paths toward efficient outcomes other than standard market adjustments. As a counter-balance, post-bubble literature like Hamada (2001), Ikeo (2001), or Noguchi (1995) analysed how institutional solutions (in the corporate or financial sector as well as economy wide) can become impediments to future success. In this contribution, the authors explain how banks were able to provide a substitute for
many market adjustment processes prior to the bubble period. For Nishimura and Kawamoto (2004) their idea of 'rational rigidities' translates into a community-banking-business-model, which guided resources to areas of economic growth and subsidised business risk depending on an economy which expanded in a reliable manner and where asset prices rose. The model proved ill suited to an environment of sluggish growth and asset price deflation.

However, we have also found that banks continued their community banking role into the 1990s at least partially, although there are also indications that they failed to restructure failing enterprises in industries such as construction and real estate. So, the problem was not that paralysed banks were blocking recovery (although this might be true in some of the industries mentioned above), but that the current community-banking-business model is no longer sustainable as private enterprises in the market economy now suffer from asset price deflation and economic stagnation (Nishimura and Kawamoto 2004, p. 57).

I am inevitably drawn more to this approach than that offered by Fukao (2004) which is long on description and provides insufficient analysis. What he argues is not of course unimportant. Every instance of financial deregulation seems to engender some type of financial crisis. No doubt whisking away the secure environment created by post-war regulation while keeping in place government subsidised competitors only makes sense given the vested interests dominant during this period. But here Fukao (2004) could wisely take some pages out of the Nishimura and Kawamoto (2004) playbook. These methods and institutions did not necessarily start out dysfunctional. I am left longing for a deeper understanding of why financial deregulation led to this sorry end. I can of course provide my own explanation but that undercuts the reason for reading, or certainly publishing, volumes of this type. Contributions which demand that others insert an appropriate economic framework are not unlike restaurants where you are asked to construct your own sushi.

It is only fair to point out that I have had nothing to say about the Ito (2004) article. Competency and familiarity distinguishes his effort. This contribution ably serves to kick off the symposium papers by providing suitable information and background. But any venturesome reader will find the article self-explanatory and definitely not in need of any random comment I might feel the urge to provide.
Anyone interested in the Japanese economy or issues dealing with asset bubbles and their aftermath could do worse than pick up a copy of this volume at a nearby university library. In fact, at least one of the contributions is bound to be intriguing to such a reader. However, I can think of no reason for actually purchasing an individual copy unless one wishes to experience firsthand the attendant woes of asset inflation.

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i Even by the robber baron standard established by academic publishers, Blackwell manages to surpass all reasonable expectations. For a paper back consisting of six chapters and 124 pages, many readers would find the retail price of $69.30 risible at the very least. Compounding the fanciful arithmetic behind such pricing, buyers of this edition would experience the peculiar pleasure of having the pages threaten to fall out with the very first reading.

ii We can clearly recognise the dangers of delayed publication here. As this volume saw light, Japan may have already escaped its unenviable economic position. Growth in 2004 is expected to top that of other OECD countries. This transforms the papers considered into two less compelling categories: what could have been done to spur the economy sooner, or what can be done to prevent a future relapse into sluggish growth.

iii I would argue that Koizumi's greatest reform is the introduction of the sound bite into Japanese political discussion. A major mistake is to see Koizumi as an economic reformer, simply on his own say so. If we are to judge on actions and accomplishments, Koizumi is clearly a political reformer, aiming to dramatically change the Liberal Democratic Party in order to entrench his own power. He also seems keenly motivated to alter the nature of Japan's defense profile. Economic reform has been undertaken with any degree of seriousness only if by doing so Koizumi managed to undermine LDP factions opposed to his own authority. The Prime Minister's fixation on postal reform makes sense only in this context. Why privatize the post office when it would be far simpler to simply close down the financial aspects of that institution by not renewing saving vehicles or insurance policies? The aim seems more to weaken the political base of opposing factions in the LDP.

iv A recent paper by Broda and Weinstein (2004) defuses some of the more dire pronouncements concerning Japan's unsustainable levels of government debt.

v In a Tokyo speech, Governor of the Federal Reserve Bank, Ben Bernanke, suggested tax cuts financed by monetizing the resulting debt (see www.federalreserve.gov/boarddocs/sp eeches/2003/20030531/default.htm). It is difficult to devise any policy more traditional than that. Similarly, Aherne
et.al. (2002) take issue with the claim that fiscal policy was ineffective. Moran and Ogata (2003:1) sum up, '…fiscal policy has been much less expansionary than the OECD's estimate, almost all of the deficit reflects the weakness of the economy, and there is substantial potential to ease policy.'

Vi Auerbach and Obstfeld (2003) justify using open-market purchases in a liquidity trap.

Yet, our analysis shows that this same reasoning implies that open-market operations will be beneficial as a stabilization tool as well, even when the economy is expected to remain mired in a liquidity trap for some time. That is, under the same conditions on interest rates that make open-market operations attractive for fiscal purposes, a monetary expansion will affect prices and output, with the short-run output effect larger under sticky prices (p. 5)

References

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Editors' note: The views expressed in this review are those of the author and not necessarily those of the Journal.