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Japan's Struggle for Economic Recovery—Chapter III



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On February 5, 2003, the Center on Japanese Economy and Business, together with the Weatherhead East Asian Institute of Columbia University, continued its lecture series featuring Mr. Shijuro Ogata. Mr. Ogata provided an update on the economic and political climate in Japan as the country struggles for economic recovery. His presentation addressed the delayed and inadequate policy responses by the Japanese government and its financial institutions to sustain economic growth, combat persistent deflation and implement structural reforms. He discussed the policy gridlock between Japan's conservatives and reformers, and he proposed economic policy solutions to resolve Japan's major economic problems. Following is a summary of his presentation.

Since 1986 the Center on Japanese Economy and Business, in cooperation with the student-run Japan Business Association (JBA) at Columbia Business School, has brought distinguished Japanese and American executives and government officials to Columbia University through the Distinguished Lecture Series. For more information on Center programs, see our website at: <http://www.gsb.columbia.edu/japan/>.

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Japan entered 2003 with another economic slowdown. Early last year, the Japanese economy seemed to be bottoming out, mainly due to the growth of exports. Since then, exports have started to slow down while domestic prices continue to decline for the 40th month in a row. Unemployment stands at 5.5 percent, and bankruptcies are high.

The development of financial markets has not been very encouraging, and stock prices are barely above 8,000 on the Nikkei. Ten-year bond yields remain under one percent, reflecting the weak demand for credit and the abundant liquidity, including funds outflowed from bank deposits and equity markets, despite large fiscal deficits, lower credit rating and the downward risk of bond prices. The Yen has strengthened to about 120 yen to the dollar.

On the domestic scene, the most frequently discussed topic is who will be appointed the next governor of the Bank of Japan (BoJ). Since I joined the central bank in 1950, there have been 11 governors, including Mr. Hayami, but the appointment of the BoJ governor has never been so widely speculated, both at home and abroad. There are two reasons for this. First, I think it is more important to discuss who the next prime minister will be since Koizumi has not been successful, at least economically. His popularity, particularly among professionals and intellectuals, also seems to be eroding. There is no appropriate replacement for Koizumi, although some

have mentioned Governor Ishihara of Tokyo as a possibility. Political speculation seems to focus more on the timing of the next general election rather than the next prime minister. On the other hand, the BoJ governor will have to be replaced at the end of his five-year term, March 19, 2003. Second, there seems to be little room to maneuver for further economic policies (such as fiscal and structural policies). As a result, excessive expectations have been placed on monetary policy. The public's interest in the BoJ and its governor is very unusual, and it symbolizes the present political and economic confusion in Japan.

Why are non-monetary policy measures so deadlocked? In the area of fiscal policy, stimulative measures with an emphasis on public spending increases have been implemented several times. Although they have not been successful in sustaining economic recovery, fiscal deficits have increased. According to the OECD, in 2002, the fiscal balance was minus 7.3 percent to GDP, and the central and local public debts reached 141.5 percent of GDP. This is probably the highest among developed countries. The prime minister's repeated commitment to cap public borrowing within 30 trillion had to be abandoned in the 2002 fiscal supplementary budget as well as the 2003 fiscal ordinary budget.

Public spending projects have often been ineffective, sometimes even wasteful, and have maintained a large and inefficient public sector, and an equally inefficient over-protected private sector. Tax

reforms, including extended tax credits, are increasingly advocated. However, those who seek tax revenue neutrality (by insisting that any reduction of certain taxes should be covered by an increase in other taxes) in view of the large fiscal deficits are powerful. Tax revisions are insufficient and are coming too slowly.

In the area of structural reform, many private companies have been forced to restructure in one way or another, but the restructuring of the financial sector has been delayed since persistent deflation makes it difficult to solve the non-performing loan problems.

In the public sector, including the Zaito System (the fiscal investment and loan program), the privatization of the mail delivery system and the road construction agency, has been seriously debated but, so far, in my cynical view, the only visible step taken to promote deregulation has been the announcement of “special deregulated zones”. Incoming applications are from tiny local communities demanding very marginal deregulation. However, all of this may simply be window dressing by the reluctant bureaucracy. The delay in structural reforms is not only due to the strong opposition from vested interest groups, but also due to the reality that the initial effects of more drastic reforms tend to aggravate the current deflation. Prime Minister Koizumi keeps repeating that recovery cannot happen without reform, but it is also true that without some recovery reform is impossible.

In the monetary area, short-term interest rates are almost zero, with abundant liquidity in financial markets. However, the growth of monetary aggregates has been very modest, and bank loans have been decreasing for seven years in a row. There are two reasons for this; the weak demand for credit, and the cautious lending policy by the banks—which are in the midst of restructuring as well. Given this situation, why is the Bank of Japan being heavily relied upon? There are three reasons.

Institutionally, it is often assumed that, unlike fiscal measures, additional monetary measures can be taken without additional legislation. Although the BoJ is now an independent institution, the term of office for three members of the nine-member policy board will end soon. The new members will be appointed by the prime minister, but only with parliamentary consent.

Theoretically, it is often argued by many academics that deflation is primarily a monetary phenomenon, and that deflation will eventually be solved if monetary conditions are eased without restrictions.

Politically, many politicians and bureaucrats are neither willing nor able to push non-monetary policies through. Even those who do not subscribe to the theory that deflation is primarily a monetary phenomenon rely heavily on the BoJ and monetary policy.

The continuation, and even some strengthening, of a very easy monetary policy is necessary, but monetary policy alone is not

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sufficient to solve Japan's economic problems. Theoretically, deflation is not only a monetary phenomenon, but also a real economic occurrence resulting from factors such as excess capacity and deficient demand. Deficient demand is due to not only cyclical but also structural factors, such as demographic changes (a rapidly aging society) and an increase in importing less expensive goods manufactured in China.

Empirically, since the initiation of a full-scale easy monetary policy in March 2001, the prices of assets, such as stocks, land and currencies, have fallen. Stocks cannot increase without improvements in corporate performance; land prices cannot increase unless people believe that land has fallen enough since the high level they commanded during the bubble period; and, foreign currencies, particularly the dollar, were expected to strengthen if an easy monetary policy continued. However, under the present circumstances, changes in the euro-dollar relationship are affecting the Japanese yen.

INFLATION TARGETING

There are three kinds of targets. The first target is a certain situation, until whose emergence a certain policy is to be maintained. Such a target has already been adopted since the BoJ has committed to continue its present easy monetary policy until the year-to-year rate of decline of prices becomes zero.

The second target is that which should be achieved by all means. It is very difficult to have such a target since deflation or inflation is not only a monetary phenomenon, but also a real economic phenomenon. Even if the BoJ is forced to purchase any type of financial assets, inflation may not occur too easily. In the meantime, the BoJ banknotes will eventually be backed by financially inferior, or illiquid assets. If the BoJ is forced to purchase government bonds without restriction, bond prices will be supported. However, some people in the Ministry of Finance (MoF) in charge of national debt management are afraid that the impression of unlimited issuance of government bonds will depress the bond prices sharply. The targets that should be achievable are difficult to adopt.

The third target is the effort target. If it is possible to have an effort target, it is better to have nominal growth targets instead of inflation or deflation targets because business people and tax collectors are primarily concerned about nominal growth rather than its components, such as price changes or real growth. This type of target should be adopted by the government rather than by the central bank. One can argue that nominal growth targeting is not appropriate during a period of inflation. I support inflation targeting during a time of inflation, and nominal growth targeting during a time of deflation.

Since mid-January, Miyazawa, Nakasone, Komura, and other political

leaders have been criticizing simple-minded inflation targeting as a means to evade the responsibilities of other policy makers. Whether such a change in the political atmosphere will effect the Prime Minister's decision on who to appoint as the BoJ's governor remains to be seen.

AFTERMATH OF THE TAKENAKA SHOCK

There have been two interesting events since Mr. Takenaka's double appointment as cabinet minister in charge of macro economic policy and as chief financial regulator. First, one month after Mr. Takenaka's appointment, the government announced that a new institution called the Industrial Reconstruction Corporation (IRC) would be established. Even now, the entire picture of the institution is unclear, including its size. The IRC purchases bad bank loans from companies still considered salvageable, and it helps to reconstruct the companies. The Seibu Department store is mentioned in the news as the first candidate. At any rate, new legislation must be approved before the IRC begins operation. The question remains as to why the government did not try to use existing government banks more effectively rather than establish the IRC?

Second, major bank groups are trying to avoid nationalization. Major banks have begun to perform strict in-house reassessments of its loan portfolios without waiting for special inspections from the Financial Supervisory Agency (FSA). They

have already publicized much larger loan losses than previously announced. In order to replenish their own capital damaged by larger loan losses, three major banks are trying to receive additional capital from investors by issuing either preferred stocks or subordinated loans, changing the existing subordinated debts (Tier II) to preferred stocks (Tier I), or selling bad loans. Investors include large American investment banks, Japanese life insurers and other corporate clients. The banks' determination to stand on their own two feet without government support is understandable, but the financial costs, interests or dividends payable to those investors, seem to be very expensive. In addition, Japanese life insurers themselves are in a difficult situation due to negative spreads between guaranteed interest rates on policies and actual investment returns. Since life insurers and banks have been financing each other, it is unclear whether "double gearing" will really strengthen the financial stability of Japan.

What will happen between now and the end of the current fiscal year? Watch the sticks and the carrots. Sticks are being applied to banks and borrowers after the Takenaka shock, although Mr. Takenaka's reform plans have been watered down; while carrots—in the form of new budgetary measures—the IRC, and tax incentives, will not be implemented without parliamentary approval, which will come by the end of March at the earliest.

The question remains as to why the government did not try to use existing government banks more effectively rather than establish the IRC?

Policy measures are announced and implemented in a very fragmented fashion.

JAPANESE ECONOMIC POLICY SOLUTIONS

I think Japanese economic policy-making has been very clumsy, and I have some suggestions for solutions to these problems. Some of my suggestions are immediately adoptable, but others require time to implement.

The first problem is the lack of a comprehensive policy framework, the confusion over policy priorities, and the absence of an effective macroeconomic policy coordinator. Policy measures are announced and implemented in a very fragmented fashion. The measures that require mid-term efforts are acted on first rather than crucial short-term ones. I also believe that macroeconomic policymaking is not integrated into the political process. I suggest that anti-deflationary measures and banking reform should come first rather than privatization and fiscal consolidation. Anti-deflationary measures should focus on tax credits and further deregulation in addition to easy monetary policy. I also think the government should appoint an influential political leader as Deputy Prime Minister in charge of economic policy coordination.

The second problem is sectionalism, particularly in the bureaucracy, which is getting worse. My suggestion is long-term, but I think top civil servant recruitment should be centralized rather than done by individual ministries, and civil servants should be given rotating assignments.

The third problem is the erosion of public confidence in politics in general, and in party politics in particular. This is due, in part, to the seniority system, which has been gradually built up in the conservative political parties, and the subsequent increase in hereditary successions of constituencies by conservative politicians. My suggestion is to assign descendants and close relatives of politicians to constituencies other than those of parents or grandparents.

The fourth problem is the ironic impact of the priority placed on job security. Even now, the trade unions are demanding job security rather than an increase in wages. Job security is a cause of social stability, but also a cause of complacency. Job security should be left in the hands of the employers and employees, and it should not be destroyed through legal means. One way out is to introduce a merit system instead in place of the seniority system. This is already being implemented in many work places.

The fifth problem is the ironical impact of Japan's egalitarian society. In my view, Japan is the most egalitarian society among the developed countries in terms of the distribution of wealth and income, but also in terms of perceptions. This is one cause of social stability but, at the same time, has resulted in a very standardized education system that has not encouraged talented and ambitious students. The system has led to a lack of creative leadership in Japan. This is a difficult dilemma and a great challenge. How do we improve

creativity while maintaining the benefits of an egalitarian society

The sixth problem is the coexistence of pessimism and complacency. If you ask many Japanese about the future of Japan, its economy and its society, you receive a very pessimistic reply. Usually, pessimism is accompanied by a sense of crisis, so why is it possible to have pessimism and complacency? My answer is twofold. First is the high standard of living and comfortable life attained by Japanese based on excess savings and Japan's trade surplus. Second is the absence of a strong desire to organize the unsatisfied, underprivileged people. This is due to the declining rate of unionization after the Miike Mine closure in the 1960s and the privatization of the National Railways, and the fact that students were depoliticized after the 1960 Security Pact revision struggle and the 1967 students movement.

Another question I am often asked is—why does there not appear to be much capital flight despite almost zero interest rates in Japan? First, I think there is a lack of financial sophistication. Ironically, this is due to our long history of financial regulation. Second, there are great exchange risks due to the volatile nature of exchange rates; and third is the confidence people still have in government papers despite the large fiscal deficits and downgraded credit ratings.

When will Japan be seriously awakened? Many people say when Japan has a crisis, but time after time, Japan has been having crises.

Most likely, Japan will awaken when massive capital flight takes place for one reason or the other. There are those in Japan who strongly advocate the deliberate depreciation of the Japanese yen, but that may be dangerous because it could cause a trade war and capital flight could become uncontrollable. It is very difficult at this time to say when Japan will be awakened. How to increase the sense of crisis without creating a real crisis continues to be the most important problem for Japan.

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財界著名人講演シリーズ

続・日本景気回復へむけて 元日本銀行理事、元日本開発銀行副総裁 緒方四十郎

2002年春、コロンビア大学ビジネススクール日本経済経営研究所とコロンビア大学ウェザーヘッド東アジア研究所の共催で、緒方四十郎氏によるレクチャーシリーズがスタートしました。2002年秋学期に引き続き、2003年2月5日に講演会が開催されました。緒方氏は、最新情報を踏まえ、日本の政府・民間部門が景気回復にむけて直面している問題、また問題解決にむけての方策について講演されました。以下は講演の抄訳です。

2003年に入っても日本経済は依然として低迷している。昨年は、輸出が伸び悩む一方で、物価も下降し続けた。失業率は5.5%を記録し、高水準の企業倒産も続いている。株価は8000円に迫っており、為替も1ドル120円を上まわっている。未だかつて、これほどまでに日銀総裁の人事が国内外において話題となったことはない。他の政策よりも金融政策に対して過大な期待が高まって、日銀および日銀総裁に興味を持たれている現状は、今日の日本にける政治・経済の混乱を象徴している。単純なインフレ・ターゲットについての批判が政界指導者の間で高まってきたが、このような動きが日銀総裁人事にどう反映するかは未知数である。

竹中大臣が、マクロ経済政策と金融監督を担うポストを兼任した後、政府は、産業再生機構を政府の機関として設立することを発表した。なぜ政府が、現存する政府系銀行を有効活用しないのかという疑問が残る。また、大手主要銀行は、国有化を何としても避けようとしている。

それでは、どのような経済回復に向けての方策があるのだろうか？ 1つには、政府は、有力な政治リーダーを副首相に任命し、様々な経済政策をコーディネートさせ、総合的な政策枠組みを立てることである。第2に、各省庁のセクショナルリズムを克服するよう努力しなければならない。第3に、国民の政治・政党に関する不信を解消するために、議席の世襲化を是正することが必要であろう。第4に雇用に関していえば、年功序列制度よりも成果主義を取り入れていくべきであろう。第5に、平等化社会の利点を持続しながら、創造力のある人材が育つような教育制度を打立てることが大切である。いずれにしても、どうしたら真の危機の到来を待たずに、危機感を強めることができるか、という問題がある。

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