

## “The Realities and Relevance of Japan’s Great Recession”

### Event Summary

On April 13, 2011, the Center on Japanese Economy and Business at Columbia Business School hosted the 12<sup>th</sup> Annual Mitsui USA Symposium, which featured Adam S. Posen, Senior Fellow at the Peterson Institute for International Economics and External Member at the Monetary Policy Committee of the Bank of England. Dr. Posen’s talk focused on the realities and relevance today of Japan’s Great Recession of the 1990s. In particular, Posen countered several strongly held perceptions about Japan’s recession which he believes are not only inaccurate but also continue to impact policy debates in destructive ways. Posen, inspired by several of Akira Kurosawa’s legendary films, drew parallels of the three sections of his talk with the films *Ran*, *Rashomon*, and *Seven Samurai*.

First Posen described the image of the King Lear character from *Ran* as looking old and weary after having made colossal mistakes. This, Posen argued, is how the rest of the world viewed Japan in the 1990s, the fundamental mistake being the nation’s series of policy errors which exacerbated and lengthened the recession. Yet Posen believes society must overcome the stereotype that there is a tragic inevitability to Japan’s economic situation, since that certainly is not the case.

Examining Japan’s growth rates since 1992, Posen observed a saw-tooth pattern, which shows that there was a period of growth in 1994 and 1995. While growth rates dipped in 1996 and 1997 due to excessive tax policies, passive monetary policy, and the accumulation of banking problems, Japan bounced back and averaged a 2% growth rate from 2002 through 2008.

Against common perception, Posen argued that Japan’s recovery was not being supported solely through fiscal stimulus. In fact, Prime Minister Koizumi’s administration was able to reverse many of the policy errors enacted in the 1990s, leading to an economic upswing starting in 2002. Unfortunately, however, this growth was not sustainable past 2008 following the global recession, which severely contracted global trade.

Next, Posen discussed the idea of the “Rashomon Effect,” which states that observers of the same event actually generate substantially different yet reasonably acceptable accounts of it. Posen related this concept to the fiscal stimulus policy of quantitative easing (QE). Currently, the U.S. Federal Reserve and the Bank of England are pursuing QE and believe that the results of their actions will be quite different from the results of similar policies in the past. However, the Governor of the Bank of Japan has stated that these efforts are simply the next iteration of what Japan had attempted from 2003 to 2006.

Posen asserted that, while we do not know the size of QE’s impact, we do know that the effect is intimately related to the transmission system in place (i.e. the level of investor confidence in the financial system and how difficult it is to get credit out into the economy). Although the United States and United Kingdom have made an explicit attempt to ensure that they do not utilize QE in the same manner as the Japanese, this may not be true. There are parallels between the United Kingdom and Japan in that small-and medium-sized businesses are dependent on a few large, specialized banks and have few alternative channels. Moreover, while the United States does have deeper bond markets and thousands of community banks that can lend to businesses even when larger banks are impaired, the nation continues to struggle with systemic issues in its banking sector. As a result, Posen does not believe that it is clear that QE efforts have significantly helped deal with the broad money and banking sector problems within the United States and United Kingdom.

Lastly, Posen likened Japan’s outlook following the Great Recession and recent earthquake and tsunami to the outlook of the central characters in the *Seven Samurai*. In the movie, farmers were attacked by marauders, enlisted the help of samurai, and were able to repel the invaders and return back to their original lifestyle. In Posen’s analysis, the farmers are Japan, the marauders were the mistaken policies, and the samurai were a combination of private sector leadership, Diet members, and regulatory supervisors. The heroes embodied by this small subset of Japanese society were able to restore Japan back to normalcy by cleaning up the banking system and engaging in other policy interventions.

Now, after the recent earthquake and tsunami, Posen believes that Japan can and will become a normal economy again. He asserted that the world cannot lose sight of the fact that, despite Japan's cultural distinctiveness, the country still has the same economic prospects as any advanced economy. Japan's economy is at the edge of the technological frontier, maintains a significant amount of savings, and has rule of law and relative price stability. Moreover, Japan's demographics will not keep it from growing at the rate of productivity growth. Posen observed that when physical capital is destroyed, as was the case during the recent disasters, capital investment and growth accelerates in the short term once rebuilding gets underway.

Posen also observed that the Japanese government has reacted with speed and constructive action, revealing that it has taken lessons from the Great Recession and the massive economic action the United States and United Kingdom undertook in 2008-09. Additionally, he believes that Japan will greatly benefit if its business leaders can overcome the historical distrust they have had with regional neighbors and continue to move some production abroad while maintaining intellectual capital. In the end, the earthquake and tsunami may be the catalysts that drive Japan to undergo necessary structural changes and further the vision of "Made by Japan" rather than "Made in Japan," a development that Posen believes will bring Japan into the next era of growth.

This symposium was co-sponsored by the Mitsui USA Foundation. It was introduced by David E. Weinstein, Carl S. Shoup Professor of the Japanese Economy at Columbia University and Associate Director for Research at CJEB, and moderated by Hugh Patrick, R. D. Calkins Professor of International Business Emeritus at Columbia Business School and Director of CJEB.