

Economic and Policy Lessons of Japan

GLBL312, ECON474, EAST 454

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This is a seminar in forensic macro, aimed at addressing the following questions:

- Do the “lost decades” of post-1990 Japan provide a useful template for post-crisis macro afflictions of other major economies in the world?
- Can broader policy lessons be drawn from the successes and failures of the Japanese experience? Are these lessons relevant in coping with GFC- and COVID-related shocks and aftershocks?

In an effort to answer the questions above, we first examine the extraordinary compression of the modern-day Japanese economy — a growth trajectory that has gone from a stunning post-World War II resurgence to three decades of near stagnation. Taking Japan’s rise and fall as a benchmark, we then explore whether other economies are vulnerable to “Japanization.” As underscored by decidedly subpar recoveries in major developed economies following the Global Financial Crisis (GFC) and now quite likely in the aftermath of the COVID-19 shock, this is hardly idle conjecture. We also assess the vulnerabilities of export-led developing economies, such as China, through the same lens — evaluating the implications of collateral damage from lasting post-crisis aftershocks of external demand from a crisis-battered developed world.

Drawing on the comparison between the so-called Japan syndrome and risks of comparable outcomes in other major economies, this seminar will pay special attention to pre- and post-crisis policy implications. That will entail a deep dive into the new and creative policy remedies, including Japan’s “Abenomics” program, unconventional monetary policy strategies of quantitative easing in the United States and Europe, as well as fiscal “big bazookas” — approaches aimed at breaking the daisy chain of crisis- and debt-impaired growth cycles in major economies around the world. The seminar concludes by pondering the inevitability of the “next crisis.”

The course will have primarily an economics focus — although we will also delve into the political economy and socio-cultural aspects of struggling post-crisis economies, as well as regulatory and policy-design considerations that lie behind bubbles and the contagion of their aftershocks. A basic undergraduate course in macroeconomics (Econ 111b, 116a, or 116b) is the only **pre-requisite**.

▪ Paper Structure

An analytically based, empirically grounded research paper is a major focus of this class. Over the course of this term, you will be exposed to tools and insights that should be germane to your assessment of a lesson from Japan that was either learned or not learned by another economy in coping with actual, or potential, crisis-related dislocations. You will need to diagnose the problem as well as examine what the authorities should have done – or actually have done – to prevent a Japanese-like outcome from occurring in the economy you have selected. Topic examples will be provided in class. Narrowing the focus to a specific lesson is often the key challenge of this assignment. The midterm assignment – a 3-5 page proposal for your research paper – is aimed at addressing the focusing issue.

▪ Classroom participation and Critical Questions

Classroom participation is expected to be an active and engaging aspect of this critical-thinking seminar. The critical question requirement is aimed at enhancing seminar discussion. The day before each class meeting, you are required to submit **3 critical questions** or discussion points based on the weekly reading assignment. Three of the questions will then be selected each week to form the basis of discussion.

▪ Description of Op-Ed Homework Assignments

There will be two short essay homework assignments — the first due on **March 14** and the second due on **April 25**. Topics will be posted on the class website approximately 10 days prior to the due date. The assignments are designed to sharpen your macro-analytic reasoning, as well as your debating and writing skills.

Each homework assignment will consist of **2 (two) single-spaced pages**:

1. A short op-ed-like "opinion piece" on a designated macro/ policy theme (one page).

Example: *"The Plaza Accord of 1985 led to a major policy blunder by the Bank of Japan that set the stage for Japan's first 'lost decade.'"*

- Your answer should take a **clear-cut position** – pro or con – on the issue assigned.
- Support for your answer should be broken down into **three focused paragraphs**, beginning each paragraph with a bullet point.
- The position you take should be based on analytics, supported by empirical evidence and/ or a graph(s).

2. Follow the same structure as in #1 above but frame a counter-strong argument in support of the **opposite point of view** relative to the position you took in the

first page (**one page**). End with a short paragraph describing which point of view you endorse — and explain why.

▪ **Course Readings**

There is a demanding reading list for this course. At the end of each class, we will go over and prioritize the readings for the upcoming week. Shorter readings (i.e., articles, speeches, and interviews) are available on the *Canvas* website (under the “files” tab).

NOTE: *PS* = *Project Syndicate*; *FT* = *Financial Times*; *BPEA* = *Brookings Papers on Economic Activity*; *NBER* = *National Bureau of Economic Research Working Papers*; *MPR* = *Monetary Policy Report of the Fed*; *JEP* = *Journal of Economic Perspectives*.

For the more technical papers, you will need to grasp the basic thrust of the analysis rather than the theoretical/ empirical details of the research. **For optional readings (*), please read the introduction and conclusion.** You will also be assigned selected chapters from several books; THE FOLLOWING BOOKS ARE RECOMMENDED FOR PURCHASE and will also be available on course reserve:

* A. Mikuni and R.T. Murphy, *Japan’s Policy Trap: Dollars, Deflation, and the Crisis of Japanese Finance*, The Brookings Institution, 2002

* F.M. Rosenbluth and M.F. Thies, *Japan Transformed: Political Change and Economic Restructuring*, Princeton University Press, 2010

Special note on readings: The debate raised in this class is far from settled. Breaking developments can and will occur during the semester that are pertinent to our classroom discussions and your research papers. Recently published articles and news accounts germane to the debate will be posted to the class website as they become available. Unless otherwise indicated, such readings will be considered optional.

COURSE SYLLABUS

I. The Japanese Experience

The ascendancy of the modern Japanese economy was one of the great miracles of post-World War II reconstruction. But Japan ultimately encountered enormous difficulty in sustaining that miracle. By the mid-1980s, its mercantilist growth strategy encountered the pressures of an intense global backlash that, in turn, evoked destabilizing shifts in Japanese currency and monetary policies. Japan's surprisingly fragile economic model subsequently proved highly vulnerable to a subsequent series of policy blunders — leading to bubbles, an insidious balance-sheet recession, deflation, and now three “lost decades” of near stagnation in the real economy. This first block of classes focuses on the rise and fall of the modern Japanese economy and attempts to establish the benchmark for what can – and did—go terribly wrong. We also examine Abenomics as a possible litmus test of a lasting remedy to “Japnization.”

February 2

Forensic Macro: Learning from Japan

Readings:

- T. Ito, “Japanization: Is it Endemic or Epidemic?” *NBER* 2016
- R. Levin, “Reform, Innovation, and Economic Growth in Japan ” 2005
- A. Otani, “Lessons from Japan’s ‘Lost Decades,’” *Wall Street Journal*, Jan 1, 2020
- S. Roach, “The Japan Syndrome Goes Global,” *PS* 2010
- TIE Symposium, “Is the World at Risk of the Japanese Disease?” Summer 2017

February 9

Postwar Japan: Miracle Lost

Readings:

- *R. Beason and D. Weinstein, “Growth, Economies of Scale, and Targeting in Japan (1955-90),” *The Review of Economics and Statistics* (May 1996)
- *T. Ito, “Japan and the Asian Economies: A ‘Miracle’ in Transition,” *BPEA* 1996
- C. Johnson, *MITI and the Japanese Miracle*, 1982 (Ch 1 and 9)
- F. Rosenbluth and M. Thies, *Japan Transformed*, 2010 (Ch 4-7)

February 16: WEEKLY CRITICAL QUESTIONS AND TEAM PRESENTATIONS START
Policy Traps and Bubbles

Readings:

- *P. Krugman, "It's Back: Japan's Slump and the Return of the Liquidity Trap," *BPEA A. Mikuni and R.T. Murphy, Japan's Policy Trap*, 2002 (Ch 1-3 and 10)
- W. Tsutsui and S. Mazzotta, "The Bubble Economy and the Lost Decade," 2014

Student Presentation: Liquidity Traps: Pushing on a String

February 23

Post-Bubble Aftershocks: Stag-Deflation

Readings:

- F. Hayashi and E. Prescott, "The 1990s in Japan: A Lost Decade," 2002
- T. Hoshi and A. Kashyap, "Japan's Financial Crisis and Economic Stagnation," 2004 (esp. pp. 137-45 and 165-83)
- R. Koo, *The Holy Grail of Macro Economics: Lessons from Japan's Great Recession*, 2009 (Ch 1-2)
- K. Nishimura, "This Time May Truly Be Different...," 2011
- *J. Peek and E.S. Rosengren, "Crisis Resolution and Credit Allocation: The Case of Japan," 2003
- *U. Schaefer, "Show Me the Money: Japan's Most Profitable Companies," 2011

Student Presentation: The Balance Sheet Recession

March 2: Homework Assignment #1 Posted

Lessons Learned: Take One

Readings:

- *D. Andrews, et. al., "Confronting the Zombies," OECD, 2017
- R. Caballero, T. Hoshi, and A. Kashyap, "Zombie Lending and Depressed Restructuring in Japan," 2006
- S. Fukuda and J. Nakamura, "Why Did 'Zombie' Firms Recover in Japan?" 2010
- A. Posen, *Restoring Japan's Economic Growth*, 1998, Ch 1
- S. Roach, "Asia's Sleeping Giant," 2011
- M. Shirakawa, Interview in the *Wall Street Journal*, 2011

Student Presentation: Zombie Congestion

March 14: Homework Assignment #1 (due by 11:59 p.m.)

March 16

Abenomics: Japan's Great Policy Experiment

Readings:

- D. Botman, et. al., *Can Abenomics Succeed?* IMF, 2015, (Ch 1-2, 6) [*Optional: Ch 3-5]
R. Feldman, "Abenomics Meets the CRIC Cycle," 2013
_____, "Can Abenomics Survive?" 2017
R. Harding, "Six Abenomics lessons for a world struggling with Japanification," *FT* 2020
*J. Hausman, "Abenomics: Preliminary Analysis and Outlook," *BPEA* 2014
H. Kuroda, "Re-anchoring Inflation Expectations via QQE and NIRP," 2016
S. Roach, "Last Chance for Japan?" *PS* 2014

Student Presentation: Abenomics in Context: Comparing Stimulus Packages

II. Japanization as a Global Disease

While there was widespread agreement that the Japanese disease was to be avoided at all costs, comparable outcomes surfaced in the United States and Europe. In both cases, the political imperatives of growth played a key role, with the tools of financial engineering ultimately supporting a "false prosperity" that led to bubble-dependent growth in the U.S. and a flawed currency union in Europe. In this block of classes, we assess the similarities and differences between Japan's wrenching experience and that of other major developed economies. We also explore the ramifications for export-dependent developing economies like China that are tightly linked to the false prosperity of unsustainable external demand in the developed world.

March 23

The Japanization of America: A Play in Three Acts

Readings:

- B. Bernanke, *The Courage to Act*, 2015 (pp. 398-424 and Epilogue pp 565-79)
* _____, "The Effects of Disrupted Credit: Evidence from the GFC" *BPEA*, Sep 2018
BIS, 84th Annual Report, 2014, (Ch 1, pp 7-21)
* S. Claessens and M.A. Kose, "Asset Prices and Economic Outcomes," Nov 2017
A. Greenspan, "The Challenge of Central Banking in a Democratic Society," 1996
*E. Kharroubi, et. al., "Consumption-led Expansions," *BIS*, Mar 2017
*A. Mian, K. Rao, and A. Sufi, "Household Balance Sheets, Consumption, and the Economic Slump," 2011
S. Roach, "America's Zombie Consumers," *FT* 2011

Student Presentation: The Asset-Dependent U.S. Economy

March 28: Paper proposals due

March 30

Lessons Misread: Take Two on Policy

Readings:

- A. Ahearne, et. al., "Preventing Deflation: Lessons from Japan ..." 2002
- B. Bernanke, "Deflation: Making Sure 'It' Doesn't Happen Here," 2002
- _____ , "Some Reflections on Japanese Monetary Policy," 2017
- T. Hoshi and A. Kashyap, "Will the U.S. and Europe Avoid a Lost Decade?" 2013
- IMF, "The Global Economic Recovery 10 Years After," *WEO*, Oct 2018
- J. Taylor, "Getting Back on Track: Macro Policy Lessons from the Financial Crisis," 2010
- *W. White, "Should Monetary Policy Lean or Clean?" 2009

Student Presentation: Policy Strategies: Pre-emptive or Reactive?

April 6

Europe's Japan Problem

Readings:

- A. Alesina, et. al, "Is Europe an optimal political area?" *BPEA*, Mar 2017
- S. Borgioli, et. al., "European financial integration during COVID," *ECB Bulletin* (7/2020)
- M. Draghi, "Stability and Prosperity in Monetary Union," *PS* 2015
- ECB, "Slowdown in euro area productivity in a global context," *ECB Bulletin* (3/ 2017)
- P. Hartman and F. Smets, "First 20 Years of the ECB," *BPEA* Sep 2018
- M. Sandbu, "The Corporate Zombies Stalking Europe," Sep 2020
- Sinn, Hans-Werner, *The Euro Trap*, 2014 (Ch 2; Ch 1*)

Student Presentation: Systemic Risks of a Suboptimal Currency Zone

April 13: Homework Assignment #2 Posted

Spillovers to the Developing World

Readings:

- D. Botman, et. al., *Can Abenomics Succeed?* 2015 (Ch 10)
- IMF, *World Economic Outlook*, April 2014, Chapter 4, "On the Receiving End?"
- *S. Kalemli-Ozcan, "US Monetary Policy and Int'l Risk Spillovers," Sep 2019
- *W.R. Lam, et. al., "Resolving China's Zombies", IMF, 2017
- E. Prasad, C. Otrok, M. Kose, "Dissecting the Decoupling Debate," 2008
- S. Roach, *Unbalanced: The Codependency of America and China*, 2014 (Ch 11)
- A. Rose, "Debunking Decoupling," 2009

Student Presentation: Decoupling in a Globalized World?

III. Trapped in a Crisis-Prone Quagmire?

Pre-and post-crisis vulnerability is one of the more salient lessons of Japan. Could the Global Financial Crisis of 2008-09 have been avoided had the world paid greater attention to the Japanese experience? Similarly, did post-GFC sluggishness leave the world more susceptible to the COVID crisis of 2020? There were certainly other factors at work in both instances, especially the cross-border repercussions and financial linkages of an increasingly integrated, globalized world. But the failures of economic policy and the lack of regulatory oversight were all strikingly reminiscent of Japan's blunders. This raises profound questions about the interplay between politics, the policy architecture, and the commitment to politically-anchored policy mandates – underscoring the need for a new approach to escape from the insidious traps of asset bubbles, ever-increasing leverage, and widening global income inequality. Has a vulnerable world set itself up for a seemingly endless continuum of crises? Pondering the inevitable next crisis.

April 20:

Post-GFC Pitfalls: Inflation Targeting and Unconventional Policy

Readings:

- B. Bernanke, "The New Tools of Monetary Policy," AEA Pres. Address, Jan 2020
- H. Chung, "Considerations Regarding Inflation Ranges," FRB, Aug 2020
- T. Geithner, "Are We Safe Yet? How to Manage Financial Crises," Dec 2016
- S. Roach, "The Wrong War for Central Banking," *PS*, Oct 2015
- J. Taylor, "The Fed's Inflation Target and Policy Rules," *Economics One* blog, Jan 2018
- W. White, "The Dangerous Delusion of Price Stability," *PS*, Dec 2017

Student Presentation: Inflation Targeting in an Inflationless World

April 25: Homework Assignment #2 (due by 11:59 p.m.)

April 27

COVID Shock: The Downside of Vulnerability

Readings:

- R. Baldwin, et. al., *Mitigating the COVID Economic Crisis*, 2020, Intro
- E. Brainerd and M. Siegel, "The Economic Impacts of the 1918 Influenza," 2003
- D.M. Cutler and L. Summers, "The COVID-19 Pandemic and the \$16 Trillion Virus," 2020
- J. Furman, et. al., "Promoting Economic Recovery After COVID-19," 2020
- IMF, *World Economic Outlook*, Oct 2020, Ch 1-2
- O. Jorda, S. Singh, A. Taylor, "Longer-run economic consequences of pandemics," 2020

Student Presentation: "Sudden Stops"

May 4

**The Ultimate Lessons of Japan:
Mandates, Normalization, and Political Will**

Readings:

- B. Bernanke, "When Growth is Not Enough," Brookings, 2017
L. Brainard, "The Federal Reserve's Financial Stability Agenda," 2014
J. Furman and L. Summers, "A Reconsideration of Fiscal Policy in an Era of Low Interest Rates," Brookings, Nov 2020
R. Rajan, "How Much Debt is Too Much?" *PS* Nov 2020
S. Roach, "A Global Economy Without a Cushion," *PS* 2020
_____, "Another Lesson from Japan," *PS* 2017
_____, "Time to Revamp the Fed's Flawed Mandate," *FT* 2010
*J. Stein, "Incorporating Financial Stability Considerations into a Monetary Policy Framework," 2014
*J. Yellen, "Challenges Confronting Monetary Policy," 2013

Student Presentation: The Role of Policy Mandates

May 16

Final Papers Due