Japan's Great Stagnation: An Intellectual History Perspective

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I. Introduction

During the 1990s and up to the present, Japan experienced a slowdown in economic growth and deflation. These periods, often dubbed as "Japan's Lost Decades", became a puzzle for economists all over the world and a great deal of literature has been generated. Much less has been written about the controversies and debates among the contemporary policymakers, economists, academic and otherwise, and journalists during, and on the period. Wakatabe 2015 offers an intellectual history perspective on it, chronicling what happened in the Japanese economy and what was argued in a series of controversies and debates.

This paper summarizes the main arguments of my book and reflects on and discusses several related issues. The paper is organized as follows. Section II presents the argument in Wakatabe 2015. The main premise of the argument is the role of ideas in the policy-making process. Japan's Great Stagnation was caused by idea policy trap in which bad policy sets in motion a cumulative change reaction on ideas and policy. Section III discusses two issues associated with the book including the basic premise of idea-based explanation and persistence and recurrence of ideas. Section IV concludes with implications of the study for the study of the history of economic thought and economics.

II. The Argument

II.1. Ideas vs. Interests in the Policymaking Process

There has been a great debate about what determines economic policy, or any policy for that matter. One side emphasizes the role of interests among other possible explanations. It has been the mainstream position on the issue as the flourishing subfield of public choice and new political economy testifies. Economics starts from the rationality of individuals, and the idea that political outcomes are determined by game-theoretic interactions between purposive behaviors of rational individuals rings true to many economists (Stigler 1971; Acemoglu and Robinson 2013). On the other hand, there is a view that emphasizes the role of ideas in shaping economic policy. This line of research is gaining some reception among social scientists. Dani Rodrik at the Institute for Advanced

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[*] E-mail address: wakatabe@waseda.jp. This is a part of my project on "Economic Crises and Economics during the 1990s Japan." I would like to thank the Japan Society for the Promotion of Science (Grant No.25380257) for indispensable financial assistance.

Studies at Princeton University argued that three elements of the optimization problems—preferences, constraints, and choice variables—depend on “an implicit set of ideas” (Rodrik 2014, 191). [1] Even though, or especially when, we assume that a person is making a rational calculation, ideas and perceptions matter. Wakatabe 2015 emphasizes the role of ideas as opposed to that of interests in the economic policymaking process, sharing a similar perspective as Blyth 2002, Blyth 2013, Hamada and Noguchi 2007, and Noguchi 2007.[2]

II.2. What Went Wrong In Japan

What went wrong in Japan? The answer to this question hinges on a particular set of ideas which one holds, and the policymakers, economists and journalists, and there is not clear consensus on the exact causes and remedies of Japan’s Great Stagnation: on the contrary, the period was characterized by a series of great controversies and debates and, broadly speaking, there has been a stark contrast between the macroeconomic view and the structural view on Japan’s Great Stagnation. Indeed, as I argue, the lack of consensus is precisely one of the major reasons why Japan has been stagnating for a long period. Nevertheless, there is an important consensus among the proponents of different views, that is inadequate policy responses on the side of the policymakers.[3]

Wakatabe 2015 identified four mistakes: the ever-higher Yen Syndrome, policies toward the Bubble, “too tittle, too late” and uncoordinated macroeconomic responses, and other mistakes in regulatory matters including dealing with the bad loan problem and deregulation (Wakatabe 2015, 142-147). Once Japan used to be among the best performers of the world, and now it has become the showcase for all sorts of problems. What characterizes Japan’s Great Stagnation, however, is its series of macroeconomic mistakes. The logic behind this policy dynamic can be summarized as follows. Japan’s Great Stagnation started with one policy mistake, but that mistake was followed by a series of mistakes. The Plaza Accord brought the precipitous appreciation of the yen, which had negative consequences for the economy. To counter these negative impacts, the government and the BOJ changed their policy stances, which generated asset price booms. To “correct” this mistake, they completely reversed their policy stances once again, this time to prick the bubble. Then came the lesson of the recent experience: the government and the BOJ should have responded to asset price deflation with expansionary policy, but they chose not to repeat the same mistake. Instead, they tried another solution, deregulation and liberalization, which eventually evolved into a policy slogan, “structural reforms.” However, those structural reforms could not deliver the recovery without macroeconomic policy: the Koizumi-Takenaka recovery succeeded, albeit short-lived and

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[1] Wakatabe 2007 and Wakatabe 2015, chapter 2 review the literature. Also see Belánd and Cox 2011, Gofas and Hay 2010 for contributions to the “ideational turn,” reemphasis on the role of ideas, in social science.

[2] Von Staden 2012 explored how Japanese policymakers could not form a coherent ideology to push through reforms. Wakatabe 2015 focuses on ideas on macroeconomic policy.

[3] Although Shin-ichi Fukuda of the University of Tokyo emphasizes institutional and structural factors behind Japan’s Great Stagnation, he points out the delayed responses by policymakers, financial institutions and firms (Fukuda 2015 6-7).

half-hearted, precisely because it was supported by an expansionary monetary policy. Lamentably, macroeconomic failures such as doing "too little, too late" and an uncoordinated policy mix created the perception among the public that macroeconomic policy did not work. The Japanese policymakers should have corrected macroeconomic mistakes with proper macroeconomic policy.

II.3 Ideas as Problems

Behind this failure lies policymakers' economic thought, or more precisely, lack thereof. First, they were concerned with international pressures at the cost of the domestic economy. Admittedly, some of these pressures, mainly from the United States, were not based on sound economic logic. But the Japanese policymakers were concerned not as much with the lack of logic as with the demands from foreign countries. More specifically, the policymakers could not see the connection between the exchange rate policy and the domestic economy. Second, policymakers did not seem to understand basic macroeconomics. Former prime ministers, powerful politicians and even high-ranking bureaucrats did not have a good understanding of the macroeconomy and macroeconomics.[4]

Among the so-called experts, a series of controversies erupted: they were divided on their emphasis on macroeconomic policy or the "structural forces" of the Japanese economy; they were also divided on their emphasis on demand side or supply side considerations (Noguchi 2005-6, Noguchi 2014, Wakatabe 2015, chapter 3). As the stagnation prolonged, the proponents of macroeconomic view became smaller and less influential, those of structural view influenced the policy discussions. Wakatabe 2015 lists the major arguments presented during the period as follows:

1. Liquidationism, or policy nihilism: A boom needs the subsequent recession to "cleanse" the economy of bad projects, firms, and industries through natural selection; therefore, countercyclical policy is not desirable.
2. Macroeconomic ineffectiveness doctrine or structural reforms ideology: Japan's stagnation is structural in nature and could not be solved with macroeconomic policy; therefore, the restoration of the economy requires measures other than macroeconomic policy—that is, structural reforms.
3. "Only fiscal policy works" doctrine: When macroeconomic policy works, the main tool must be fiscal policy, and public works are preferable to tax cuts. This is likely to be combined with the

[4] Koichi Kato, a powerful LDP politician who was once considered a candidate for prime minister, candidly recalled that he believed that bureaucrats always came up with an idea to deal with macroeconomic issues: "At that time I believed that politicians should not be involved with matters of financial sector . . . After the War up to the present time, we thought that macroeconomic management was left to someone else to contemplate. We used to have a vague trust in the bureaucrats. Perhaps, apart from us politicians, someone like administrative vice minister of the MOF, governor of the BOJ, or administrative vice minister of the Ministry of Trade and Industry, got together, in the night somewhere like the BOJ's Hikawa guesthouse at Akasaka, to come up with a brilliant plan, and informed us later. We were to modify a little bit and implement it. That kind of trust began to collapse after the burst of the bubble. And there was an outcry that politicians should exercise leadership, but we were not prepared for it" (Naikakufu Keizaishakai Kenkyusho 2001, 3, 432).

old understanding of the liquidity trap and the argument in item eight.

4. Austerity doctrine—modern treasury view: Fiscal consolidation should be the first and foremost goal of economic policy. In its extreme version, this entails fiscal policy ineffectiveness, and monetary policy would not solve the consolidation problem.

5. Good deflation doctrine: Deflation is good since the prices are decreasing.

6. Structural explanations for deflation: The causes of deflation are globalization, economic integration with China in particular; decreased population or working population; or stagnant bank loans due to the bad loans problem.

7. Monetary policy ineffectiveness doctrine—the BOJ doctrine: The money supply cannot be controlled, the price level cannot be controlled, the concept of real interest rate is useless, or the quantity theory of money cannot hold since there is an infinite demand for money under the zero interest rate environment (the money supply would be sucked into the hands of households and firms like a star would be sucked into a black hole).

8. Belief in industrial policy—modern MITI view: The government has to, and can, effectively target and support specific industries for economic growth.

9. Antigrowth sentiment—limits to growth doctrine: Economic growth is undesirable and impossible for the Japanese economy.

III. Reflections and Discussions

III.1 Ideas or Interests

The premise of my analysis is the determining role of ideas in economic policy-making. Barry Eichengreen, of the University of California Berkeley, however, questions my emphasis on the role of ideas over interests in his review of my book (Eichengreen 2016). For example, "Japan was slow to resolve its banking crisis, the latter would argue, because powerful financial interests with close connections to government could lobby against closing down insolvent financial institutions. Opposition to inflation was effective because a large elderly population on fixed incomes was able to make its objections heard, even more loudly than otherwise, given the peculiarities of the country's electoral system" (Eichengreen 2016, 129). I do not take the role of interests lightly; rather, I maintain that interests and ideas are interwoven. Any agent must perceive and understand interests, and that agent must possess framework to perceive and understand her interests. Furthermore, it is often the case that those who would feel pain through deflation would succumb to the good deflation argument. The most curious example is about the economists. Do the economist proponents of the good deflation argument pander to the interests of a "large elderly population on fixed incomes"?

III.2 Persistence and Recurrence of Ideas

Wakatabe 2015 points out similarities between the old controversies and the recent ones during crisis period. The policy discussion during the Great Depression period of the 1930s was cunningly similar to that during Japan's Great Depression (Wakatabe 2014, Wakatabe 2015, chapter

4). In both periods, liquidationism, austerity doctrine, and monetary policy ineffectiveness doctrine gained strength. One is struck by persistence of the old ideas. What explains this persistence and recurrence of ideas? I have argued elsewhere (Wakatabe Forthcoming) that the reception of Keynesian economics in Japan has been strongly influenced by Marxian economics, and hence economics academia and journalism in Japan became compatible with the structural view, but this does not fully answer the question since one can see the rise of austerity doctrine elsewhere. Blyth 2013 traces the intellectual origins of austerity to a lineage of liberalism embedded in mainstream economics from classical to neo-liberal and Ordo-liberal, but this is not also satisfactory since Keynesian economics was once became dominant. The question remains.

IV. Concluding Remarks

Japan's Great Stagnation offers us an excellent example of the role of economic ideas during crisis time. Economic Crisis entails crisis in existing knowledge, which compounds policymakers' responses to crisis, generating more crisis if responses are not corrected. Japan went through this policy dynamics, being locked in a policy idea trap. In this trap, bad economic ideas loom large.

David Laidler once argued that every economic agent has a "model" about how the economy works, as the rational expectation or behavioral economics show us, and policy policymakers must also have models, however crude or unsystematic they are. Therefore, the historians of economic thought can shed a light on the policy making process by examining the models which policymakers have (Laidler 2003). Also, as the Great Stagnation period was rife with controversies among the so-called experts, one must take the uncertainty of a "model" during economic crisis should be taken seriously. There are more than antiquarian interests to be interested in the history of economic thought.

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