



A New Direction for Japan? Part I

Adam S. Posen says that with the Liberal Democratic Party's return to power, Japan may embark on a program of monetary stimulus that could reverse its deflation and stagnation. Part II: how economic policy is affected by Japan's concerns over China.

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Steve Weisman: The return to power in Japan of the Liberal Democratic Party and of Prime Minister Shinzō Abe has brought declarations of a new economic set of policies. Adam Posen, now President of the Peterson Institute for International Economics, is making his debut as President in a two- part interview today with me, Steve Weisman, to talk about the direction that Japan is taking. Adam, what has Prime Minister Abe said he intends to do to change economic policy?

Adam Posen: Prime Minister Abe is somewhat radicalized. While he is talking about doing some fiscal policy expansion plans of the sort that the Liberal Democratic Party is famous or infamous for, he is also putting a great deal of pressure on the Bank of Japan to do something about the overly strong yen and more importantly, about the ongoing deflation in the economy. And thirdly, he's talking about doing some things to stimulate private investment, which has been down as well. The really fresh stuff is the monetary side, and frankly, I think it's justified.

Steve Weisman: As in the United States, the Bank of Japan is independent. How can a new political leadership change the policy, and what direction does he want to take it in?

Adam Posen: Well the BOJ—the Bank of Japan—is indeed independent by law. What independence means, here at the Fed or in Japan or in Europe, is that the government doesn't month to month sit there and say, "You're going to vote this way this time." And most importantly, it means they can't fire the governor—whoever's sitting there—and they can't force the central bank to buy bonds directly.

That's what defines central bank independence. But once you get past that, you are of course, allowed to say, "I like or I don't like this policy," the same way you would about a general or the FBI or about the Food and Drug Administration, which are independent agencies as well. You are allowed to comment on their performance. And particularly with central banks, you're allowed to evaluate what their goals are. Most central banks have, at the moment, some form of what's called inflation targeting -- whether explicitly or not. And as the great Stan Fisher [former First Deputy Managing Director of the International Monetary Fund] pointed out, nearly twenty years ago now, you can reconcile it by having goal dependence, meaning that the elected officials every few years tell you what the goal of your target should be for a central bank, but leaving them instrument independent, the thing I was talking about, that you don't interfere with what they do day to day.

Steve Weisman: What instruments, however, would be advisable for the Bank of Japan to undertake to inject monetary stimulus and reverse the deflation?

Adam Posen: It's a fair question. There's this widespread perception, in fact promoted by the current governor and others at the Bank of Japan, that they've tried everything and it hasn't worked.

So if you just ask us to shoot for a higher inflation rate, we're just going to fail. That prediction of despair has been widespread in the markets.

And I and several leading economists in Japan, frankly, view this as erroneous because when the Bank of Japan engaged in quantitative easing early last decade, well before the global crisis led to other central banks doing it, they tended to buy very short duration Japanese government bonds, which is essentially taking cash and buying other cash, and so it had very little effect on prices in the market. It had very little effect on other peoples' behavior. It's exactly what you would not want to do if you're doing quantitative easing. They also spent a lot of time talking down the economy, saying, "Well, maybe deflation was inevitable." So, you put those two together, it's not a surprise that they were relatively ineffective.

What Prime Minister Abe seems to be promoting – and various economists, like Takatoshi Ito, Kazumasa Iwata, Koichi Hamada, are promoting, and I would support—is some kind of [policy in which] you announce a higher inflation target and you stop talking it down. You start buying other things than short-term JGBs, Japanese government bonds. You buy corporate bonds. You buy long-term Japanese Government Bonds. You look at buying things in a foreign currency because the yen is overvalued and Japan has just sat there and taken it for several years. So you look at buying things like U.S. government bonds or European government bonds, and you are much more aggressive about your communications policy, about tracking what's going on in the economy. And I think that combination isn't going to fix everything in Japan, but it's going to have a lot more impact than people think.

Steve Weisman: When are we going to see whether these steps are being taken?

Adam Posen: We should see very quickly. The BOJ has their next monthly meeting, I believe the 16th of January—roughly around then—and it is expected that they will announce something. Whether it's an actual rise in the official inflation target or whether that waits another couple months, I don't know. They will almost certainly start buying more aggressively Japanese government bonds and buying things that are not just substitutes for cash, and I think that will immediately have an effect. It won't solve everything, but it will make things better.

And then you're going to have a new governor of the Bank of Japan come the start of April. And there is precedent, both in BOJ history and in Japanese economic policy more generally, that when you change one of the ministers' governor, they make very radical changes in policy, so it's possible we could see a very different policy by May.

Steve Weisman: The Japanese leadership has always been opaque. Isn't it true that what we're seeing here is a shift of the consensus in that leadership, affecting both the political leadership and the Bank of Japan leadership?

Adam Posen: I think that's right. Again, going back to independence, there was a time at which the Ministry of Finance, the top civil servants of the kind of which you spoke, controlled the Bank of Japan. For more than 10 years, that hasn't been the case. But it was all part of one culture, and many of the people came from the same areas, whereas now, I think there's been a generational shift, not just in Japanese politics, but in officialdom in the Ministry and the Bank of Japan. It's not that apparent because the top people are still quite elderly people we've all seen before. But at lower levels, but still senior, there's been a lot of change. And I think there's been an ideological shift in Japanese society.

I just rattled off three very prominent Japanese economists, all of whom have done things with Peterson before. We know well and all of whom are now taking a public role that, before Heizo Takenaka did in 2001, very few academic economists had a public role in Japan the way we have public roles for people from our institute or from universities in the U. S. So I think there have been a lot of shifts going on. That's why I think people are going to be surprised by how much Japan moves in the next year or two.

A final point, though, Steve, is that you also have to understand, for all the talk Westerners have made about what's called high level stagnation, as though the Japanese people and leadership were very comfortable with the fact that they were in this sort of slow decline. The rise of China in both foreign policy and economic terms has really spooked a large number of Japanese people and the Japanese leadership. I think that's also an impetus to them changing.

Steve Weisman: Let's stop there but pick up on that very subject in the second part of this interview.
Thanks.

Adam Posen: Thank you.