THE JAPANESE ECONOMY

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Main Cause of the Current Recession

- Policy failures of the Japanese Government
- Overly expansionary monetary policy during the late 1980s
- Overly tight monetary policy during the early 1990s
- Inadequate fiscal stimulus during the late 1990s
- Inadequate response to the bad loan problem
- Inadequate employment policies
- Inadequate social security programs
Problems Caused by These Policy Failures

- Stagnant household and corporate incomes
- The collapse of asset (land and equity) prices
- Deflation (falling prices)
- A shortage of bank credit
- Increased uncertainty about the future—in particular, about employment, public pensions, and old age
Fiscal Policy Recommendations

• More fiscal stimulus but…
• Avoid broad personal/corporate income tax cuts because they will increase the government debt without having much impact
• Introduce targeted and temporary tax breaks on consumption, housing investment, plant and equipment investment, and research and development because such tax breaks will be much more effective and less costly than broad income tax cuts and will bring about inflation if phased out gradually
Monetary Policy Recommendations

- Maintain the current expansionary (zero interest rate) policy until the economy recovers.

- Inflation targeting: The Bank of Japan has already implemented inflation targeting, in effect, because it has pledged to continue its zero interest rate policy until prices stabilize but it should go a step further and pledge to continue it until prices start rising.
Other Recommendations

- The government should resolve the bad loan problem immediately, injecting public funds into the banking system if necessary.
- The government should increase employment opportunities by creating incentives for workers to obtain job training and new employment and for private firms to hire more workers and by hiring workers itself as a last resort.
- The government should reform social security.
- The government should delay structural reforms until the economy recovers.