



Finding the Lessons of Japan's Lost Decade

By Michael Skocpol*

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When it comes to implementing an economic recovery, nobody wants to be Japan. The story of Japan's efforts to revive a sputtering economy during its Lost Decade of the 1990's has become a cautionary tale for those monitoring the current U.S. economic crisis.

Eying warily the similarities of the two crises — among them a credit squeeze, housing prices in freefall, and the stock market down sharply from recent record highs — both sides of the political spectrum can agree on at least one thing: We can't make the same mistakes as Japan.

Unfortunately, no one seems to agree on what those mistakes were.

One major component of Japan's efforts to bolster its economy in the 1990's was government spending on infrastructure. Small-government opponents of President Obama's proposed stimulus point to Japan's struggles as proof a New Deal-redux spending jolt is ill advised

A December report from the conservative Heritage Foundation, "[Learning from Japan: Infrastructure Spending Won't Boost the Economy](#)," provided a representative set of talking points — government infrastructure spending doesn't work, those who credit such spending with pulling the U.S. out of the Great Depression are wrong, and one only needs to look to Japan to see those lessons in practice. Citing Japan as "the last major country that tried to spend its way to 'stimulus'" in a Dec. 16 editorial, the Wall Street Journal editorial page cited its Lost Decade as evidence that the stimulus package now nearing Congressional approval was likely to be an economic dud.

But stimulus supporters contend Japan's spending efforts didn't go far enough and were undermined by fiscal timidity. Over the past several months, Nobel laureate Paul Krugman, of Princeton and the New York Times, has argued for a huge injection of government spending with a focus on infrastructure. He argues that Japan's infrastructure spending was the right approach, but that it was undermined by Japanese efforts to balance its budgets at the same time. In short, if you're going to try to spend your way out of a recession, you better go all out.

And Treasury Secretary Timothy Geithner recently told the Wall Street Journal he took his own lesson from Japan's crisis: Decisiveness is key.



Japan's infrastructure spending failed to spare that country a decade of economic malaise, but did it represent a failure of strategy or execution? There's evidence that the spending did have a positive influence on the Japanese economy when it was pursued most vigorously, but it was too haphazard and too quickly abandoned to help Japan avert the worst of its Lost Decade.

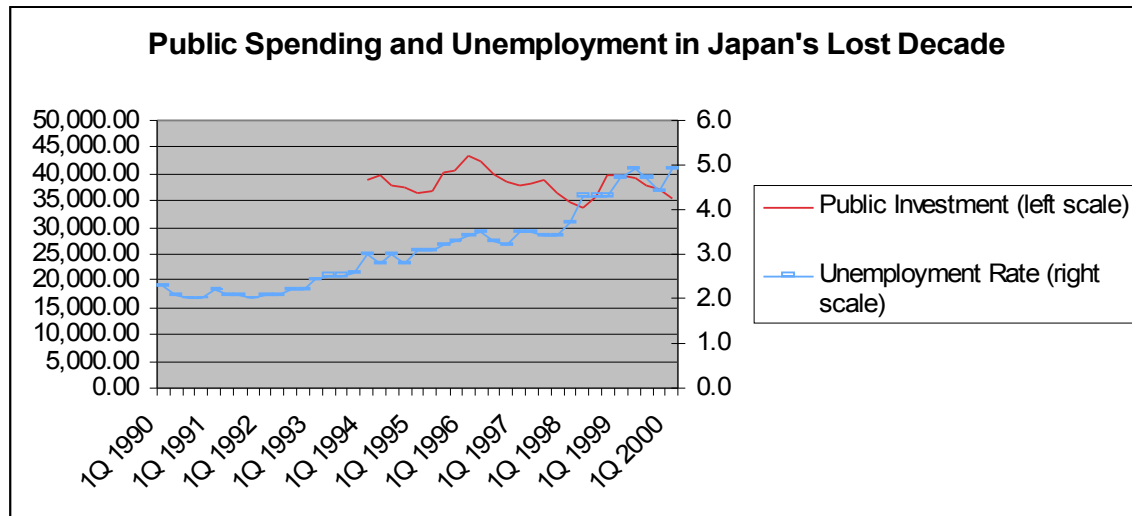
Jobless ranks grow

As Japan struggled to achieve sustained growth throughout the '90's, its traditionally low unemployment rate grew steadily. Japanese unemployment stood at just 2.3 percent at the beginning of the decade, but by January 2000 it doubled to 4.6 percent. It had reached as high as 5.0 percent near the end of the decade.

But while government spending did not altogether prevent the stagnant economy from leaving some out of work, it did in fact create enough jobs to hold unemployment growth down. Nearly 1,000,000 construction jobs were added in Japan between 1990 and the apex of government spending efforts in 1997 — the total grew from 5,880,000 million in 1990 to 6,850,000 in 1997. Construction workers, just over 9 percent of the workforce throughout the 80's, grew to comprise 10.5 percent over the same period.

In fact, Japan's investment in infrastructure construction probably shielded the country from some of the worst unemployment effects of its economic struggles, holding unemployment to just over 3 percent through 1997. But a drop-off in spending in that year accelerated rising unemployment, pushing it to new, higher levels that have persisted even as Japan's economy has returned to stable growth.

The year 1997 was the turning point in a number of ways for Japan's efforts to stimulate its economy through public spending. After maintaining public investment at a relatively high level for several years prior to 1997 — Japan's highest spending came in 1995 and 1996, peaking at over 43 trillion yen, or more than 8.9 percent of GDP, in first quarter 1996 — Japan began steadily closing off the spigot in 1997. (Public investment in Japan has since fallen to under 4 percent of GDP.) At the same time, Japan's economy fell into a year-and-a-half long recession that it did not pull out of until the end of 1998.



Japan “didn’t do a good job of timing the expenditures,” said Michael Smitka, a professor of economics at Washington and Lee University who has focused on Japan for nearly 30 years. Japan’s haphazard, poorly coordinated, and often ill-timed implementation of infrastructure spending prevented it from having more impact.

In fact, the drop-off in public infrastructure spending after 1997 was indicative of Japan’s larger failure to pursue a coherent and coordinated economic policy. It was also a clear case of politics trumping policy — a recurring theme of Japan’s stimulus mismanagement.

Timing is everything

By the end of 1996, Japan’s typically thrifty government had been running deficits for several years, and budget hawks within the government began advocating for a return to fiscal prudence. Japan’s most aggressive spending was curtailed under a series of measures that eventually coalesced into the Fiscal Structural Reform Act, passed in November of that year, which required a more balanced budget, and a key consumption tax reduction was allowed to expire. The combination of tax hikes and a sudden pullback of stimulative government spending shook consumer confidence in a still-fragile economy and contributed to the country’s 1997-1998 recession.

“The timing of these expenditures didn’t necessarily match very well with the underlying economic issues,” Smitka said. “Some of the timing matched the recession and some of it turned out to exacerbate other recessions.”



One problem was that Japan's various government ministries often make policy with little collaboration, meaning that the government doesn't always function in a coordinated way. Instead, bad overall policy often results — Japan's decision to raise the consumption tax at the same time it was pulling back stimulative spending was a textbook case.

The U.S.'s federal system and relatively strong executive branch represent a government structure far more likely to produce a coherent, and thus more effective, stimulus policy.

Japan's stimulus efforts were also poorly implemented on the ground. Japan has a relatively inefficient construction sector, meaning spending is unlikely to generate jobs on the same scale it might in a country like the U.S. (One source of construction inefficiency is that Japan's construction standards — high requirements for earthquake resistance, for instance — often result in unusual or high-cost buildings.) There was also a general failure to direct spending to the areas that needed it most.

Inefficient spending was often an outgrowth of the Japanese political system. The Liberal Democratic Party that was in power in Japan throughout the decade had a strong rural base, resulting in political pressure to ensure sparsely populated prefectures got their piece of the pie. Spending was not necessarily directed to the regions where economic needs were greatest; in fact, the procedure was to spread funds evenly across all prefectures, meaning there was no mechanism to target funds to projects in high-density urban areas. Instead, rural districts gained disproportionate funding, often to be spent on projects that were little needed — small-scale Japanese Bridges to Nowhere.

Indeed, the projects themselves were often ill conceived — designed with more of an eye on their political costs and benefits than on their societal and economic desirability. The result was expenditures that had almost no social value beyond the work created by the projects they funded. Infrastructure was built up in areas of the country that simply didn't need it. Other projects' benefits were hampered by an aversion to losing money — brand-new expressways, for instance, that were built but given tolls so high that truckers avoided using them.

The spending's rural focus also hampered the societal impact of its job creation — new construction jobs often went to farmers as night and weekend work. They benefited but it wasn't something they saw as reliable or even essential.

Combined with prevalent uncompetitive contracting and other forms of political largesse, the net effect was often wasteful spending that created jobs in the short term but did little to facilitate further economic growth. This may help explain why



economic benefits didn't persist much beyond the actual spending itself, and why its pullback so quickly erased any gains that were made.

Japan in the rear view mirror

The U.S., Smitka noted, is much better positioned to pursue such policies. Unlike Japan's in the 1990's, the U.S.'s transportation infrastructure is aging and in many places has been allowed to deteriorate. There are obvious areas of need where new construction could have a big impact going forward.

Even more important, perhaps, the federal structure of the U.S. government is much better suited to identify and tackle those areas of need in a systematic way. That the stimulus comes at a time when a popular president has just taken office with a Congress full of allies may help the U.S. pursue its stimulus more swiftly, decisively, and in a more coordinated manner than did Japan.

The \$819 billion bill that passed the house in late January, for instance, combined construction and tax cuts with health and education investments into one comprehensive stimulus policy. Whether it's the right one is subject to debate, but that sort of coordinated policy making was something Japan's governmental structure made very difficult.

And, in contrast to Japan's fiscal culture, large swaths of the American public and its elected representatives are, at least for the time being, willing to stomach the years of large deficits necessary to maintain the momentum of government stimulus.

Japan's experience certainly illustrates the pitfalls of using infrastructure spending as an anti-recessionary measure. But it also suggests that, even when conducted poorly, such policies have positive effects, and Japan's example is a veritable blueprint of where better choices might have produced better results.

Japan's experience should serve as a guide, not a red light, for the Obama administration.

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