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Political Economy of the Financial Crises
in Japan & the United States

— A Comparative Study on the Bailout of Financial Institutions —

Hirofumi Takinami

Visiting Fellow

Shorenstein Asia-Pacific Research Center (APARC), Stanford University

Visiting Scholar

Policy Research Institute, Ministry of Finance

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The views expressed in this paper are those of the author and not those of the Ministry of Finance or the Policy Research Institute.

Research Department, Policy Research Institute, MOF
3-1-1 Kasumigaseki, Chiyoda-ku, Tokyo 100-8940, Japan
TEL 03-3581-4111

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Hirofumi TAKINAMI

**Visiting Fellow, Shorenstein Asia-Pacific Research Center (APARC), Stanford University
Visiting Scholar, Policy Research Institute, Ministry of Finance, Japan**

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ABSTRACT

Currently, the United States is suffering from a financial crisis. Japan also struggled with a financial crisis from the late 1990's to the early 2000's. What implications can be drawn from these crisis experiences of the two largest economies in the world? This paper examines, from the viewpoint of political economy, which elements are crucial in the use of bailout of financial institutions as a means to address financial crises. By analyzing these crises through the balance sheet of financial institutions at stake under the political economic condition of the advanced democratic countries, it became clear that taxpayers'/ opinion leaders' understanding and market sentiment are the keystones for a successful bailout of financial institutions. This observation leads to the two central arguments of this paper as the implications of the Japanese and US crises: (1) There is a "learning effect" of Japanese financial crisis, which helped the US take quick move in addressing its crisis, an effect which should be crystallized into economics textbooks in case of future financial crises, and (2) It is significantly important that direct and swift actions are taken by the national leader and his/her secretarial organizations so that the 'bully pulpit' is effectively utilized to overcome financial crisis.

1. Introduction

In this paper, I will examine what implications can be drawn from the experiences of Japan and the United States during the financial crises of the 1990s and 2000s. We cannot stress enough the importance of analyzing these gigantic financial crises that happened in the two largest economies in the world, both triggered by the collapse of financial institutions, unlike those crises in developing countries that started with depreciation of currency. While many economical and financial discussions have been held on each financial crisis in Japan and in the US, this paper is attempting to study on these experiences more from the viewpoint of political economy. My purpose is to increase the understanding of how a government can better address a financial crisis, given the political economic conditions of advanced democratic countries.

First, I will take a close look at the Japanese financial crisis by reviewing what happened between 1995 and 2003. Then, by comparing the Japanese experience to current US responses to the 2008 crisis, I will analyze which elements are crucial in the use of bailouts of financial institutions as a means to address financial crises in advanced democratic countries, such as the US and Japan.

By analyzing the financial crises through the balance sheet of financial institutions at stake, I will stress the significance of taxpayers' and opinion leaders' understanding and of market sentiment for a successful bailout of financial institutions, which leads to my two central arguments:

I. The experience of the Japanese financial crisis and the 'lost decade' highlighted the

necessity of public money injection as a means of overcoming a financial crisis. This ‘learning effect’ has helped the US government take swift steps to tackle the financial crisis with sufficient support from opinion leaders and the public. From these experiences, the necessity of bailout in order to solve financial crises which should be understood as one significant kind of ‘market failure’ has been made clear, and should be crystallized into economics textbooks.

II. To improve market sentiment, the government must establish the credibility of its commitment to solving the financial crisis. The importance of direct and swift action by the national leader and his/her secretarial organizations in addressing financial crises was suggested in the Japanese experience. Recent actions taken by President Obama and the White House, which have led to improvement in the US economy during relatively early stages of the crisis, have supported this theory.

2. The Financial Crisis in Japan

(a) 1995 Jusen Problem

While the fatal crisis in Japan comparable to the 2008 US crisis happened in 1997, the 1995 Jusen Problem is very important from the viewpoint of political economy as an initial stage leading to the 1997 crisis. The ‘Jusen Problem’ was the failure of the housing loan company Jusen. This event coincides with the subprime loan problem which led to the

current financial crisis in that both of them were contingent on housing loans.

During the following year's Diet session (the so-called 'Jusen Diet'), the Japanese government prepared plans to spend 685 billion yen of public money to solve this issue. The Ministry of Finance, encompassing both the Banking Bureau and the Budget Bureau at the moment, was mainly in charge of this task. This first injection of public money was technically neither the public recapitalization of financial institutions nor the buying out of toxic assets. Rather, it was done in the form of spending public money for the liquidation of Jusens, helping those banks and agricultural financial institutions which had lent money to Jusens and become weak due to asset deflation and overall troubled assets including toxic non-Jusens loans. Namely, public money was used to fill the gap between the whole loss of Jusens at the time of liquidation and the money that those lenders could afford to give up.

The government stressed that this plan was indispensable for protecting the financial system and the Japanese economy; however, harsh public criticism was made against this 'special treatment of the financial sector'. The results of a survey done by Asahi Shimbun, one of the leading newspapers in Japan, showed that 87% of the public was against public money injection.¹ Public criticism, in coincidence with scandals among financial institutions and bureaucrats, led to a great deal of difficulty in getting permission from the Diet for this plan, despite the fact that it was 'just' 685 billion yen, as compared to the gigantic size of later bailout frameworks. Due to this 'allergic reaction' from the public, the Minister of Finance could not help but promise during the Jusen Diet that the government would not inject public money into a non-bank/etc., beyond solving the Jusen

¹ Asahi Shimbun, February 28, 1996

problem.² As a result, the bailout of financial institutions became a ‘political taboo’, creating serious constraints for addressing the later financial crisis.

(b) 1997 Crisis

With this political constraint in place, the downturn of the real economy and the deterioration of the financial environment continued. In 1997, Japan experienced a series of massive bankruptcies, beginning with Sanyo Securities. Even Hokkaido-Takushoku Bank, one of the major commercial banks, and Yamaichi Securities, one of the big 4 securities firms, collapsed. Some may think ‘The financial crisis in Japan was gradual, while the US crisis came in so fast. That makes a major difference between these two.’ However, that is not quite true. Although there were different economic stories and situations ahead of each crisis such as, in Japan, the appreciation of the yen due to the Plaza Accord in 1985, following the ‘bubble economy’ and its collapse around 1990 and the beginning of the ‘lost decade’, vs. ‘dot.com/new economy’ in the US in the 1990s, the 1997 financial crisis in Japan itself happened suddenly, just like the 2008 crisis in the US. We lost the above three large financial institutions within a month consecutively.³ Both crises had an initial stage leading to each crisis – the Jusen problem and the subprime loan problem. The Japanese

² February 8, 1996 at Lower House Budget Committee, June 10, 1996 at Upper House Plenary Session, etc.

³ The day each bankruptcy determined in 1997: Sanwa Securities - November 3 (Monday: Holiday), Hokkaido-Takushoku Bank – November 17 (Monday), Yamaichi Securities – November 24 (Monday)

crisis just lasted a long time, which could be the difference between these two, if the US government can really solve their crisis quickly.

In Japan, the disastrous situation and fear of financial catastrophe in 1997 reopened the bailout discussion.⁴ The Hokkaido-Takushoku Bank was one of twenty major banks whose continuation the government insured in an ‘international promise’ that the Minister of Finance made at the G7 meeting.⁵ While the collapse of this bank meant the failure of government to keep its promise, finally many opinion leaders, including professors and businesspeople, had begun to voice the necessity of a bailout as a means to address the financial crisis. The public, witnessing this tremendous financial unrest, also gradually began to admit the need for a bailout.

Thus, with the proposal and passage of Two Acts for Financial Stabilization⁶, the government returned to its strategy of injecting public money. These acts involved the preparation of 10 trillion yen in demand bond and 20 trillion yen in government guarantees. In February 1998, the Financial Crisis Management Committee (named ‘Sasanami Committee’ after its chairwoman⁷) was established within the Deposit Insurance Corporation of Japan (DICJ), a semi-governmental organization. The committee was not established within the government itself. As implied by the fact that one of the Two Acts was to amend Deposit Insurance Law, the implementation of public money injection to

⁴ See the retrospective article in Asahi Shimbun, December 15, 2007.

⁵ See the discussion at Lower House Budget Committee, February 10, 1997 as well as at Finance Committee, April 11. Also, Karube and Nishino, “Kensho Keizai Shissei : Dare ga, Nani o, Naze Machigaeta ka” p 66.

⁶ Established in February 18, 1998.

⁷ For example, see Asahi Shimbun, May 19, 1999.

financial institutions was left to the DICJ as an extension of their business to protect depositors. The committee assessed financial institutions and decided to inject about 1.8 trillion yen in public money as capital to 18 major banks and 3 local banks the following March.⁸

(c) 1998 Finance Diet

Despite these efforts, financial unrest stayed in Japan, as the financial difficulties of the Long-Term Credit Bank of Japan⁹ etc revealed. Following the defeat of the ruling LDP (Liberal Democratic Party) in the Upper House election of July 1998, legislation to address the financial crisis was again discussed in a special autumn Diet session (the so-called ‘Finance Diet’). Since the LDP did not have a majority in the Upper House, they needed to make concessions to opposing parties in order to move forward. Although there were differences in opinion over how aggressively to treat troubled banks, the largest opposing party, DPJ (Democratic Party of Japan) took the role of ‘responsible party’ and, rather than simply oppose all differing viewpoints, took the chance to constructively respond to other ideas. By doing this, DPJ hoped to improve its image as part of its goal to take over the administration.¹⁰ This time, there was a campaign by many people, including

⁸ Deposit Insurance Corporation of Japan, “Annual Report 1998”. Decided on March 10 (4 banks) & 12 (other 17 banks).

⁹ Reported in the *Gekkan Gendai*, Kodansha, July 1998 Issue (published June 5).

¹⁰ This ‘responsible party’ strategy was to avoid the lasting image of opposition party, created during the long rule by the LDP, that opposition parties are just opposing, hence, do not have the ability to hold the reins of government. However, Naoto Kan, head of the DPJ at the moment, later

businesspeople, calling for public recapitalization.¹¹

Under such circumstances, after complicated negotiations by various actors from every party, the Financial Function Reconstruction Law¹², stipulating the forced nationalization of collapsed financial institutions, was approved by ‘swallowing whole’ the ideas of the DPJ. Next followed the approval of the government draft for the Law Concerning Emergency Measures for the Early Strengthening of the Financial Function, which set forth new frameworks for injecting public money before bankruptcy. Based on this law, the newly established Financial Reconstruction Commission assessed the health of various banks and injected public money totaling about 8.4 trillion yen as capital into 25 banks between March 1999 and October 2000.¹³ The chairman of this committee was a

said this strategy did not attract the support of the public. See Toya, “Kinyu Biggu Ban no Seiji Keizaigaku : Kinyuu to Kokyo Seisaku Sakutei ni okeru Seido Henka - The Political Economy of the Japanese Financial Big Bang : Institutional Change in Finance and Public Policymaking” (Japanese version) p 281.

Note that the organized constituencies of the DPJ were unions belonging to Rengo (Japanese Trade Union Confederation), who did not have specific interest with regard to public money injection into financial institutions. (Those unions in Rengo prefer to use those taxes for other purposes and tended to be against the bailout. Although there are some unions in financial institutions belong to the Rengo, those institutions are at the local level and not major enough to be the target of a bailout. In general, unions in major financial institutions had a close relationship with the management, and did not belong to DPJ’s constituency.)

¹¹ Toya, “Kinyu Biggu Ban no Seiji Keizaigaku : Kinyuu to Kokyo Seisaku Sakutei ni okeru Seido Henka - The Political Economy of the Japanese Financial Big Bang : Institutional Change in Finance and Public Policymaking” (Japanese version) p277

¹² Based on this law, the Long-Term Credit Bank of Japan and Nippon Credit Bank, found to be insolvent, were nationalized in October and December of 1998, respectively.

¹³ Press releases from the Financial Reconstruction Commission on March 12, September 13 and

cabinet minister. The committee itself was an external organ of the Prime Minister's Office. It is important to note that the Prime Minister's OFFICE ¹⁴ is not the 'Prime Minister's HOUSE' (i.e. the Cabinet Secretariat) itself; rather, it is a 'residual ministry' offering an organizational 'umbrella' under which entities of a 'quasi-ministry' level are established, such as the Fair Trade Commission, the National Public Safety Commission, the Defense Agency and the Environment Agency (the latter two became ministries later). Like these, the Financial Reconstruction Commission was positioned as a quasi-ministry.

(d) "Lost Decade"

Unfortunately, these measures were not sufficient to curtail the economic stagnation and financial unrest occurring at the time; A 'lost decade' was in the making and the stagnation continued into the early 2000s. The stock market stayed in its long slump. The Nikkei Average, whose highest point within 1994 was 21,573, sank to under 10,000 at its lowest point within 2001 and continued falling in subsequent years. The economic growth rate¹⁵ showed a one-time recovery, reaching a mark of 2.9% in 2000, but stagnated afterwards with 0.2% and 0.3% in 2001 and 2002, respectively. (See Figure 1 and 2)

December 9 in 1999 as well as March 14 and September 12 in 2000.

¹⁴ This Prime Minister's Office was abolished at the time of central government reorganization in 2001, and the Cabinet Office was established as the replacement in general.

¹⁵ Real GDP, calendar year, from SNA(System of National Accounts) Statistics from Economic and Social Research Institute, Cabinet Office

(e) 2003 Public Money Injection into Resona Bank

With these events in context, we cannot neglect the significance of the 2003 public recapitalization of Resona Bank. The decision-making entity of this injection of about 2 trillion yen into one of Japan's five largest banks was a Minister-level 'Meeting of the Financial System Management Council,'¹⁶ which was held at the Prime Minister's House and organized by the Cabinet Secretariat.¹⁷ The Prime Minister was the chairperson of this council. Other members included the Chief Cabinet Secretary, the Minister of Finance, the Minister of State for Financial Services, the Commissioner of Financial Services Agency¹⁸ and the Governor of the Bank of Japan. The Prime Minister, in a statement¹⁹ specially issued for this public recapitalization, stressed that although Resona was still solvent, recapitalization was done as a preventive action since its capital asset ratio was below the required 4% rate for domestic-only banks, and the economy was not in the situation that the stability of the overall financial system would be harmed.²⁰

Along with this public money injection, the stock market finally recovered. The Nikkei Average hit the bottom point of 7,608 and then began to rise steadily. The economic growth rate rose to 1.4% in 2003 and then remained around 2-3% until 2008, the advent of

¹⁶ Established by Article 42 of the Law for Establishment of Cabinet Office.

¹⁷ At the first meeting of this council, May 17, 2003

¹⁸ Financial Services Agency is an external organ of the Cabinet Office and in charge of overseeing financial sectors and financial markets, which used to be done by the Ministry of Finance.

¹⁹ "Naikaku-Souri-Daijin no Danwa" May 17, 2003.

²⁰ This 4% capital asset rate rule was set by the Japanese government. If the bank deals with international business, 8% requirement of BIS (Bank of International Settlement) applies.

the current US financial crisis. (See Figure 1 and 2) We may call this an effective and successful bailout of financial institutions.

3. Analyses and Inferences

(a) Analyses through the Balance Sheet of Financial Institutions at Stake under the Political Economic Condition of an Advanced Democratic Country

The Japanese experience highlighted the necessity of quick and effective public money injection as a means to address financial crises. Although there are numerous ways to spend public money for this purpose, including the use of funds to bridge financial institutions after bankruptcy, here, I consider the bailout of financial institutions before their bankruptcy in the interest of protecting the financial system.

If the real value of a financial institution's assets is greater than its debt, the institution at stake²¹ is still solvent. In this case, public money is used to supply liquidity and guard against fear. This can be done by buying the financial institution's toxic assets, allowing it to replace the toxic assets with stable cash. (In each case, the price of assets to be bought will be difficult to determine. It should strike a balance between the need for bailout and the burden on taxpayers.)

²¹ We can think such a financial institution at stake is representing the seriousness of each financial crisis.

On the other hand, if the real value of a financial institution's whole assets is less than its debt, the institution at stake is already insolvent, and supplying liquidity by buying out toxic assets is not necessarily sufficient. If the government does not accept the institution's bankruptcy, a capital infusion should be needed.²² (See Figure 3)²³ However, although public injection is the most direct measure for addressing such a serious financial crisis case, based on economics and financial thinking, it is also the most vulnerable to public criticism for its strong image of affirmative relief. Additionally, public recapitalization has direct relevance to the sensitive ideological discussion regarding big government vs. the free market. Even buying toxic asset as one form of bailout does not easily gain support from free market advocates—who are against government's 'intervention' unless there is a market failure—and hence understanding of the public. It is much more difficult for public recapitalization i.e. 'owning a bank, etc by government', which causes opinion leaders, including economists and politicians, to engage in the ideological discussion above.

The major issue here is that we cannot easily confirm how far the value of an institution's assets, which is continually in flux, has declined. At the time of the financial crisis in Japan, there was criticism against the government for the growing number of total non-performing loans (a kind of 'toxic asset' in the sense that the real value is damaged)

²² There is still the chance that buying out toxic assets can work in an insolvency case, i.e. if the government buys the assets with the price sufficiently over their real (= market) value. However, it depends on the price determination. On the other hand, recapitalization works in an insolvency case directly and unconditionally.

²³ These analyses on solvency and bailout are based on Admati, Lecture Note for the class of Finance, Stanford Graduate School of Business, 2009.

being reported.²⁴ During the current US crisis, the government instituted the Troubled Asset Relief Program 1 (TARP 1), which was to buy out toxic assets from financial institutions. However, the program failed due to further than expected declines in asset values. The government had no choice but to institute public recapitalization through TARP 2. These examples illustrate the difficulties present in determining the value of shrinking assets.

Does this mean governments should proceed directly to public recapitalization, and skip the stage of buying toxic assets? Actually it happened in the US this time. While TARP 1 was formulated, the situation got worse quickly. So, the US government stepped up into TARP 2, before they actually began to buy toxic assets. It was possible because the legislation for TARP 1²⁵ gave the government wide flexibility with open ended terms in the

²⁴ During the Japanese financial crisis, there was discussion that the accounting system, which did not require enough disclosure, concealed non-performing loans and made it difficult for the Japanese government to address financial crisis. Of course, the accounting method did influence each stage of the Japanese financial crisis, and was reformed accordingly, though it might be too slow.

On the other hand, in the case of a financial crisis, sharp decline of real asset value would happen, irrespective of the accounting method. Facing such decline, differences in accounting methods could be minor, especially in the short run. We must notice that the accounting method is, in the end, a way to show a company's financial situation. To find the current situation, an appropriate accounting method is important. However, it itself does not show the way to solve the financial crisis. Moreover, what is the 'appropriate' method is still under discussion in the accounting society, especially in the context of international convergence of accounting standard and following the US 2008 financial crisis. (eg. 'Whether radical Mark to Market, which may cause downward spiral, is really good or not, considering the current financial crisis.')

Thus, in this paper, I pay more attention to what is the key for a government to solve the financial crisis, given the accounting method.

²⁵ Emergency Economic Stabilization Act of 2008

definition of “Troubled Asset” that government can buy: “Sec.3.(9) (B) any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability...” They interpreted that equities of financial institutions are one of “any other financial instrument” here. The US was fortunate in this context. However, usually it would be difficult to skip the stage of buying toxic assets, because of the need to win over opinion leaders – especially free market advocates – and taxpayers.

In any case, what is at stake is how quickly a government can move even to the stage of public recapitalization, if the crisis is that serious, with understanding from opinion leaders and taxpayers alike. The importance of quickly moving to capital infusion is highlighted by the successful public recapitalization of the still-solvent Resona Bank in 2003. Also, the government needs to improve the market sentiment in order to stop and reverse the decline of asset value and the economy.

Thus, the keystones for a successful bailout of financial institutions during financial crises are gaining the understanding of taxpayers/ opinion leaders and improving market sentiment under the political economic condition of an advanced democratic country such as the US and Japan. Here, ‘advanced’ means both politically and economically advanced, in the sense that the general public has more democratic influences on policy making significantly and wider freedom in their economic activities under a highly industrialized environment. Without sufficient understanding from taxpayers, i.e. the general public, and from opinion leaders who direct the general public’s thinking, the government of such an advanced democratic county cannot proceed with a bailout policy that is basically

unpopular and controversial in nature. If the government is not tactful enough to improve market sentiment, the bailout will be in vain with unresponsive, or in an even worse case, further declining asset value and economy. Of course, taxpayers'/ opinion leaders' understanding and market sentiment's improvement are always important considerations for any economic policy, but the struggles of the Japanese government during its financial crisis illustrate how they are particularly critical for the bailout of a financial crisis. In this regard, we must pay attention and consider:

- A) How widely understood the necessity of public money injection is among taxpayers and opinion leaders, as a basis for gaining their understanding and allowing government' to move quickly.
- B) The credibility of a government's commitment to solving the crisis, which leads to improvement in market sentiment and assets value/ economics.

(b) Inferences

⟨i⟩ Argument I: Learning Effect

With regards to A) "How widely understood the necessity of public money injection is among taxpayers and opinion leaders, as a basis for gaining their understanding and government's quick move.": At the time of the Jusen crisis in Japan, although the government referred to the public money injection experiences of the US during the S&L (Saving and Loan Association) bankruptcy around the late 1980s and of Sweden during the

early 1990s, these were not accepted as acceptable precedents by the public.²⁶ This could be because in the US, public money injection was done in the form of purchasing S&L's toxic assets, different from the plan for the Jusen problem as well as public recapitalization done later in Japan, and Sweden was seen as a country with a relatively small economy and a 'big government' that Japan may not simply follow. In any case, these examples as well as Japanese experience during the Great Depression were not enough to persuade the public. Under the pressure of harsh public criticism and continued silence from opinion leaders including academics who could have helped sway taxpayers, the government could not move swiftly.²⁷

On the other hand, during the current US crisis, I infer there is a 'learning effect' from the experience of the Japanese financial crisis and lost decade, which have been studied by opinion leaders in the United States, and the necessity of public money injection was well known from the experiences of the Japanese 'failure.' President Obama referred to the Japanese experience at his first news conference in the White House, saying "We saw this happen in Japan in the 1990s, where they did not act boldly and swiftly enough, and as a consequence they suffered what was called the 'lost decade' where essentially for the

²⁶ They are referenced in many explanations provided by the Japanese government (for example, see the discussion at Upper House Special Committee on Financial Problem, June 11, 1996), but did not gain public understanding.

²⁷ In order to facilitate an understanding of the bailout policy, the Japanese government actively briefed opinion leaders as well as made PR efforts. Although it is customary that officials who are politicians such as the Minister show up at mass media events to explain policies, during the financial crisis including at the time of the Jusen Problem even officials who are not politicians often showed up at TV events etc. to explain the need for bailout of financial institutions.

entire '90s they did not see any significant economic growth.” He announced that his economic officials were hard at work to prevent such long-lasting stagnation.²⁸ Treasury Secretary Timothy Geithner, who speaks Japanese, once lived in Japan as an attaché at the Embassy of the United States in Tokyo, and, during the Japanese financial crisis, worked at the US Treasury in charge of international affairs and G7 issues under Lawrence Summers, Director of the National Economic Council. Dr. Summers was known as Treasury Secretary for urging the Japanese government to take faster and bolder steps towards addressing the financial crisis and the lost decade, which as a result made Japan a big ‘experiment site’. Federal Reserve Chairman Ben Bernanke, known as a special researcher on the Great Depression, also wrote a paper on Japanese monetary policy during the financial crisis in Japan.²⁹

Although the US government has received some criticism from the public against the bailout of financial institutions, the bailout seems to be firmly supported by opinion leaders, i.e. professors, businesspeople, journalists and politicians. This represents a clear difference from what happened in Japan at the time of the Jusen problem. Thus, I believe that there is a ‘learning effect’ from the Japanese experience, which has helped the US government take swift steps in tackling the financial crisis with sufficient public support. (The ‘learning effect’ could be seen as one of the few positives to come from the Japanese financial crisis.)

²⁸ President Obama’s Press Conference at the White House, February 9, 2009.

Cf. “Obama Warns of 'Lost Decade' - President Says Federal Government Is the Only Remaining Option to Jolt Economy” The Wall Street Journal (online), February 10, 2009.

²⁹ Bernanke, “Japanese Monetary Policy: A Case of Self-Induced Paralysis? ”

Some people in US may argue that the strong presence and political influence of financial institutions in the US made the bailout quicker than what occurred in Japan. However, Japanese financial institutions did have a strong presence and political power in Japanese society, at least at the time the financial crisis began. Therefore, such an argument does not hold. Actually, Japanese financial institutions, especially strong ones, did not want to have public money injection at the early stage of the financial crisis. They were afraid of government control and criticism from the public. This fact supports my argument of a ‘learning effect’; the Japanese crisis experience made it easier for the US financial institutions, as one of society’s opinion leaders, to think that it would be better to opt for the bailout, in spite of government control and public criticism.

Some others may argue that the 2008 financial crisis bears more similarity to the S&L problem around the late 1980’s than to the Japanese crisis of the 1997. However, as we saw above in the analysis through the balance sheet of financial institutions, both the 2008 crisis in US and the 1997 crisis in Japan reached a level where public recapitalization was needed, while the S&L problem was remained at a level where buying toxic asset strategy sufficed. Indeed the US government studied the experience of the S&L problem and came up with TARP 1, but now we know this was not enough to overcome the 2008 Crisis. Let me reiterate that the level of seriousness is not easy to determine, unless ex post facto. When US government faced the fear that the situation was more serious and that their prescription to the S&L problem would not work, the Japanese experience was sure to be very helpful for them. Especially since the next prescription was ‘unpopular and controversial’, namely public recapitalization.

As shown above, Japan's slow move for a bailout and 'failure', in conjunction with the US's swift move to public money injection and relative success in this early stage supported by the 'learning effect', have validated the necessity of government's quick action for bailout of financial institutions in the case of financial crises. In this context, the learning effect should be crystallized into economics textbooks. Namely, it should be clearly stated in the textbooks that the financial crisis is one of significant 'market failure' where government's action is needed³⁰, and in order to solve the crisis, public money injection into financial institutions may be necessary. Although there are contingent issues, such as how to prevent moral hazard by financial institutions³¹, such crystallization would help governments better address future financial crises, just like Keynesian theory helped governments better address recessions after the Great Depression.

³⁰ Van Binsbergen, Stanford Graduate School of Business, expressed the same conclusion in his class of Financial Markets and the Macro Economy, 2010, while he stressed the importance of banking regulation ex ante as the necessary action of government, rather than the necessity of public money injection ex post.

³¹ To avoid moral hazard, some criteria might be needed to determine which financial institution should be saved. In this context, we should note the US allowed wider coverage for bailout. Namely, while the Japanese government injected money only to depositary institutions such as commercial banks, hold deposits from the general public, the US government's bailout covered investment banks and insurance companies, too. If the US can overcome the current crisis quicker, that would be a rationale for such wider criterion, i.e. if failure of a financial institution leads to collapse of the financial system, that financial institution does not need to be a depositary institution to be saved by public money injection.

However, this wider criterion could be identical to "Too big, to fail". Further economic discussion, including examining the righteousness of the US government's selection during the 2008 crisis, might be needed for this issue.

〈ii〉 Argument II : National Leader & Secretarial Organization

Regarding B) “The credibility of a government’s commitment to solving the crisis, which leads to improvement in market sentiment and assets value/ economics.”: The public and market sense the credibility of government commitment to solving a problem especially when the leader of the country is directly involved. In this sense, the involvement of the Prime Minister and Cabinet Secretariat should have occurred earlier in Japan. As described earlier, the decision of public money injection had been left to the Ministry of Finance, the Deposit Insurance Corporation, and the Financial Reconstruction Commission, respectively, with financial unrest an unending specter. It was highly telling when, after the decision to inject money was made at the Prime Minister’s House at the meeting organized by the Cabinet Secretariat in 2003 with a special Prime Minister’s statement, the stock market turned around and economic recovery began. Of course, the Prime Minister and the Cabinet Secretariat cannot undertake the detailed and various tasks of financial rehabilitation by themselves. In fact, the actual working force during the public recapitalization of Resona Bank in 2003 was the Financial Services Agency, which had separated from the Ministry of Finance in 2001. However, in the context of market sentiment and political effectiveness, it was important that the Prime Minister’s House (Cabinet Secretariat) took ‘center stage.’ Therefore, I believe such direct action by the Prime Minister and the Cabinet Secretariat significantly contributed to the effectiveness and success of the 2003 Resona recapitalization.

In the US case, it is worth noting that President Obama has expanded his economic team at the White House. He has established the President's Economic Recovery Advisory Board (PERAB), chaired by Dr. Volcker, former Federal Reserve Chairman, to get direct reports on “policies to promote the growth of the American economy, establish a stable and sound financial and banking system, create jobs, and improve the long-term prosperity of the American people”,³² in addition to other existing economic entities in the White House, such as the National Economic Council (NEC), directed by Dr. Summers, and outside departments including the US Treasury, led by Mr. Geithner. The President attends PERAB meetings by himself and publishes his remarks.³³ He and his staff in the White House seem to be effectively exercising the power of ‘bully pulpit’.

These kinds of actions help establish the credibility of a government’s enthusiasm for addressing financial crises and improve the market sentiment on which solutions to financial crises depend. Indeed, at this early stage, the US is showing signs of a better recovery than Japan experienced. For example, some financial institutions have already begun repaying public money at a much earlier stage than Japanese recipients of public funds did.³⁴ The American and Japanese experiences prove the importance of direct and quick action by the national leader and his/her secretarial organizations in addressing financial crises.

³² Executive Order 13501 of February 6, 2009: “Establishment of the President’s Economic Recovery Advisory Board” Sec. 2 (b)

³³ For example, February 6, March 13, May 20 and November 2 in 2009.

³⁴ It took about 2 years for Tokyo-Mitsubishi Bank, the biggest and stable bank whose repay was fastest among public recapitalization of March 1998. (Cf. Asahi Shimbun February 22, 2000.)

4. Conclusion

By examining the Japanese financial crisis experience from 1995 to 2003 and the current US response to the 2008 crisis, especially through the analysis of the political economy of bailout of financial institutions, we can draw the following implications:

I. The essential role of bailout of financial institutions to address the financial crisis became clear. However, because of the bailout's unpopularity with the public and its controversial nature among opinion leaders, successful bailout policy requires sufficient tax payers'/ opinion leaders' understanding of the policy, so that a government can move quickly.

In this sense, there are evidences that Japanese crisis experience gave a 'learning effect' to the US, which helped the US government act relatively quickly. Such a learning effect should be crystallized into economics textbooks by describing public money injection to financial institutions as an essential means to address financial crisis at the section of 'market failure'.

II. Market sentiment is another curial key for successful public money injection. To improve market sentiment, we must pay attention to the credibility of a government's commitment to solving the crisis. In this context, the Japanese and US crisis experiences highlights the importance of direct and swift action by the national leader and his/her secretarial organizations in addressing financial crises. In other words, an effective use of

the 'bully pulpit' is indispensable to overcoming financial crisis.

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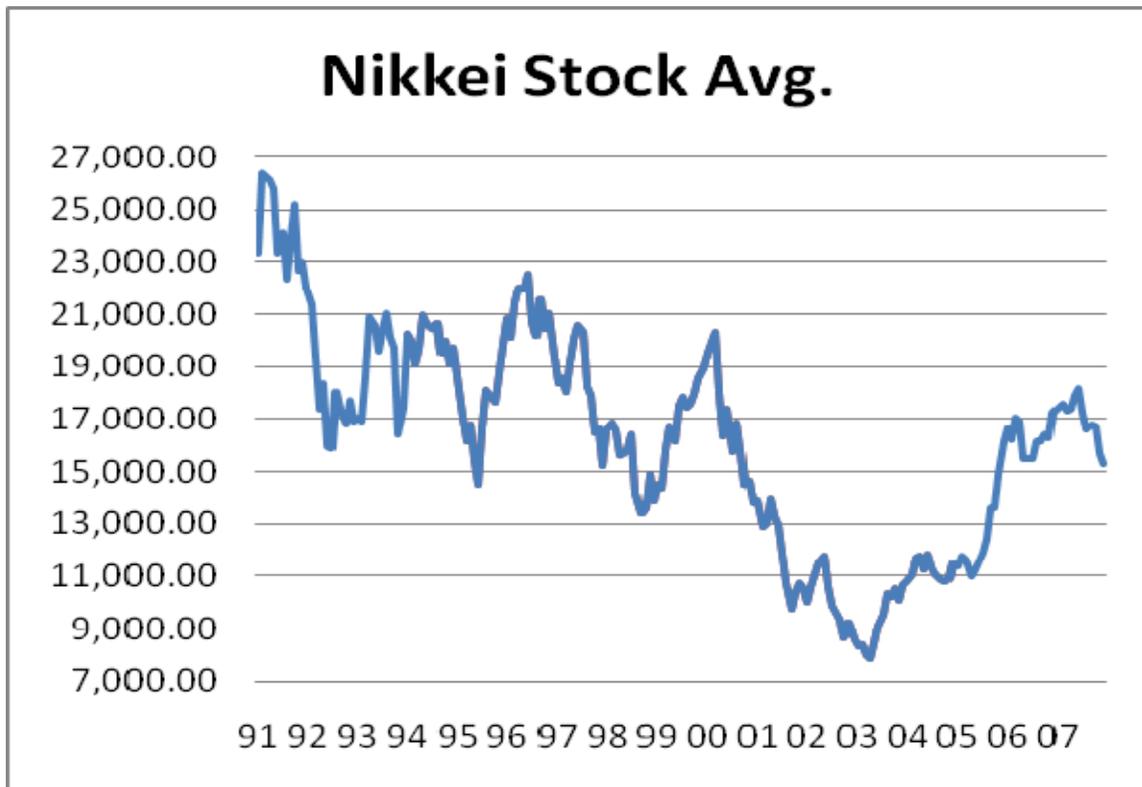
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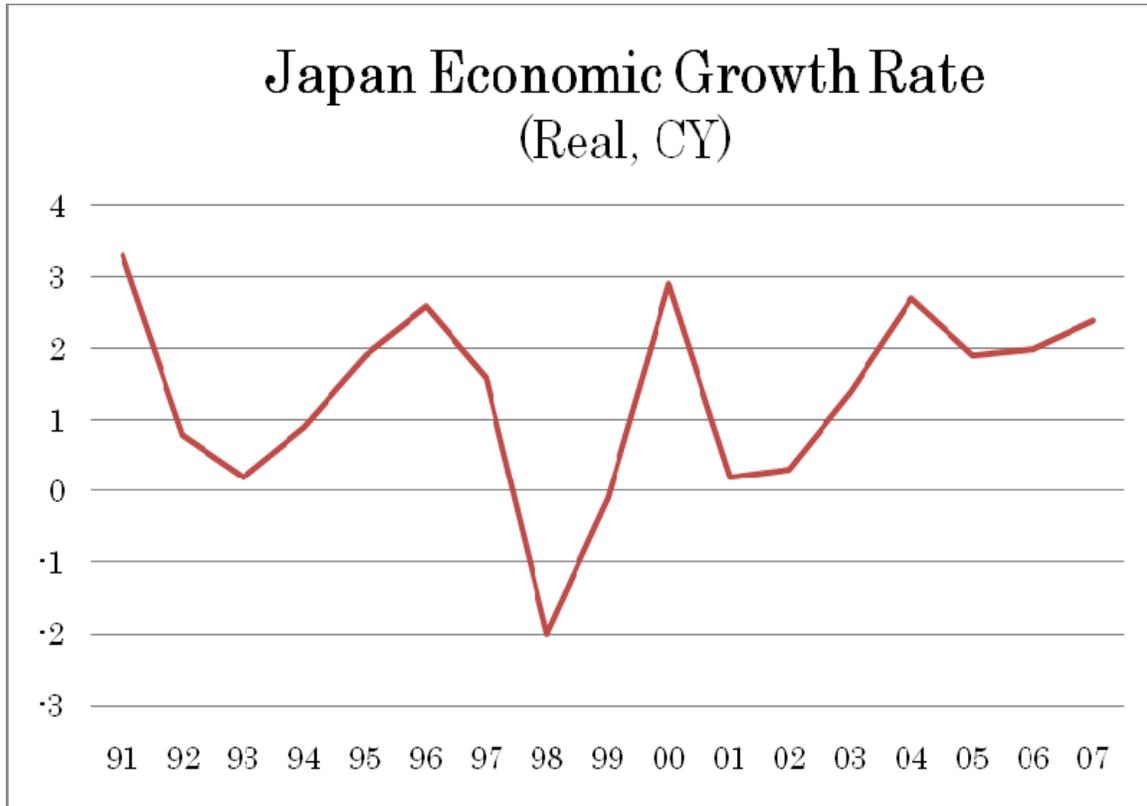
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Figure 1



Source: Yahoo Finance

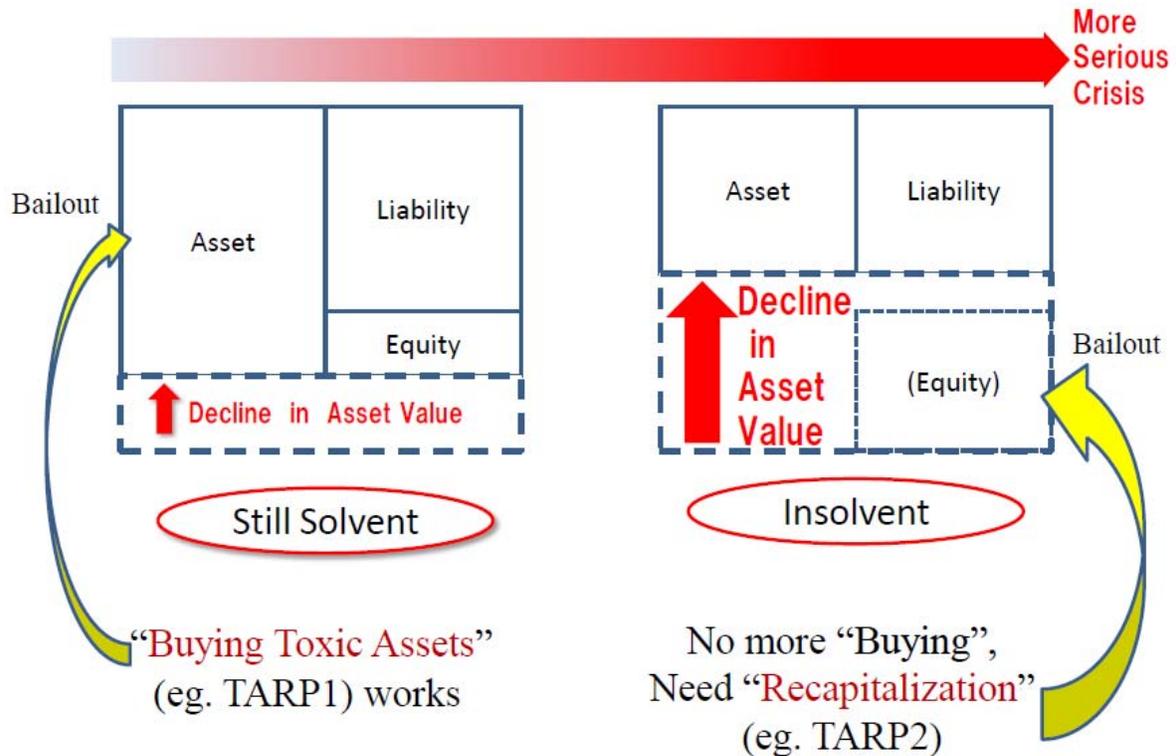
Figure 2



Source: SNA Statistics from Economic and Social Research Institute, Cabinet Office

Figure 3

Analysis through the Balance Sheet of Financial Institutions



< Case > **S&L Problem**

1997 Crisis in Japan
2008 Crisis in US

* TARP: Troubled Asset Relief Program

Source: Author's analysis based on Anat Admati, Lecture Note for the class of Finance, Stanford Graduate School of Business, 2009