Parallels in Financial Crises:
Lessons from the Japanese Experience

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What Just Happened?

- First: Big rise in home prices
- Then: Modest fall in home prices
- Now and Future: Some people walking away from “underwater” mortgages
- Conclusion: Somebody won’t get paid

Ours is not an “unprecedented crisis.”

- Japanese government responded with massive bailouts and regulatory interventions:
  - Bought bad loans
  - Bought shares in troubled banks
  - Rewrote accounting rules to help banks
  - Unwilling to let bad banks fail
  - *Bad for “confidence”*
- Sound familiar?

- *Net result: “Lost Decade” of 1% average growth, far below old 4% average.*
How did the bursting bubble create a “lost decade” for Japan?

- **Japanese government created zombies**
  - [Zombie Japan Bank] gets 1400 hits on Google Scholar

- **Zombies**: Banks or businesses with huge debts and low productivity, kept alive through government support.

- Zombie banks “kept hope alive” by renewing old loans, creating zombie firms:
  - *Why tell stockholders you made bad loans?*
The importance of killing zombies (eventually)

- **Problem:**
  - Job destruction is a big part of economic progress
  - In average U.S. month, 2M jobs are destroyed and 2.1M jobs created: Lots of *churn*
  - Net rise averaging 100K/mo: What we get excited about

- 60% of long-run growth due to *churn*
  - New firms: 25% of growth in living standards
  - More output at better firms: 35% of such growth
  

- If zombies persist, too many people work at low-productivity businesses: Lower living standards
  - But no one wants to issue pink slips....
Why it’s hard to kill zombies

- The right time to be the bad cop: *Later*
- Especially when innocent bystanders will be hurt
- *Especially* right before an election
- Finn Kydland and Ed Prescott’s Nobel-winning story: *Time Consistency* of delay
- *Lesson: if Congress could sign a binding contract to “get tough later” it would—but Congress can’t sign binding contracts*...
Will the U.S. create zombies?

- **Pro-zombie:** Big decline in U.S. stocks
  - Markets foresee future imperfectly
  - Perhaps they foresee a lot of zombies
- **One possible reason for massive fall:**

  - Bad ideas flourish in bad economic times
  - Result: More bad economic times
  - **Examples**
    - FDR’s pro-cartel policy (Cole and Ohanian (2004))
    - Peron in Argentina (formerly 4th richest country)
    - Obviously, Hitler.
Regulations: An “Idea Trap?”


- Rough estimate:
  
  *Average American would be 10% richer if CFR stayed same length since 1955.*
  

- *In line with estimates by other scholars.*

- *So if government is efficient, non-economic benefits will average more than $9.2M per page...*
What eventually happened in Japan?

- Leading economists advised Japanese government (e.g., Hoshi and Kashyap)
- Advice ignored for years
- *No one wants to give pink slips*...
- Prime Minister Koizumi (2001-2006) implemented some reforms at great political cost
- Better growth since 2001

Prime Minister Koizumi
Will we do better?

- That’s up to your bosses...