Risk Management Symposium Session 3

Reconstruction and Challenges of the Japanese Economy after 3/11

Moderator and Speaker: Takatoshi Ito, Professor, The University of Tokyo

Speakers:
Junichi Mori, Vice Chair, USJI/Vice President, Professor, Kyoto University
Etsuro Shioji, Professor, Hitotsubashi University
Martin Neil Baily, Senior Fellow, The Brookings Institution

Summary

The topics of the third session focuses on the perception economist have of the March 11 disaster and what steps should be taken to alleviate the situation. Professor Ito gave the opening remarks and in his presentation he focuses on the narrow focus, disaster costs, reconstruction plan, financing reconstruction costs, and will put it all into perspective of the Japanese economy. There will also be a discussion of the fiscal problems facing the world today.

Professor Ito then made some comments on the cost and benefit of risk management. In general it is seen as worthwhile to put in counter measures to disasters to minimize the total affect they will have on the economy. The March 11 disaster is an opportunity to do a cost-benefit analysis without inertia and vested interest. Suppose we knew the probability of the disaster coming we could calculate the cost and benefits of whether it is worthwhile to put in counter measures. Since the disaster has happened with many towns being demolished we must also consider whether restoration is more important than reconstruction. Should we build the exact same towns that were there before or should we build them in locations safer from being destroyed again. This is one of the difficult aspects we have. The other consideration is to look into why only Daichi suffered problems as other nearby reactors were stable. The reason is because the emergency generator was on the coastline side of the building. In Daini the emergency generator was in a house and Onagawa had theirs on a higher ground. With the example of Daini and Onagawa exhibiting no problems we can then conclude that if Daiichi had relocated its emergency generator to a safer location it would have prevented the disaster. So the question is what was the cost benefit analysis of saving money and not re-locating the generator verses spending the money and preventing the disaster from happening.

The rest of the Professor Ito’s talk focuses on macroeconomics in how the economy responded to the disaster. In a disaster we loose assets and there has been a big drop in the stock of natural assets. Japan is now Poorer by some trillion yen but hopefully we can accumulate back to where we were. The way we have to accumulate back is by spending a lot. This way Japan will have a higher economic growth rate but it will still be poorer then when we were at 3/11. The government has had three percent of GDP worth of stock disappeared
and that is what we call the damage. The three percent does not include the nuclear cost. No one knows what the nuclear costs are yet. Overall Japan has to pay for it as a society.

Productivity will have to increase in the investment because we have to reconstruct. There is a big debate of what kind of reconstruction should begin. One aspect we have to be careful of is that this is a region that was already loosing a population and this would have continued without the disaster. Will they come back if they restore the towns and cities is the question. We need to build towns that are friendlier to elderly people. When reconstructing these towns we must also look at how they will be financed and most of the cost will have to come from the government. Reconstruction needs government spending in the areas of the social infrastructure, subsidies to the private sector and grants to local governments. There needs to be a reduction in public funds that are no longer necessary such as education and city employees so more focus can put on rebuilding the infrastructure. There should also be a consideration of increasing taxes to bring more revenues but what taxes should we increase? Since Japan is becoming an elderly population we should look into ways were we can tax them more so the youth does not end up paying for everything. An example of this would be lowering the income tax and raising the consumption tax.

Japan’s Challenge after 3.11

Junichi Mori

Dr. Mori’s presentation was a comparison of the March 11 disaster with previous disasters that took place in Japan. To start Japan is located on the “Pacific Ring of Fire” and this has made it susceptible to various disasters. In comparison the amount of damage that was caused by March 11 was not particularly large. The damage cause by the 1923 Great Kanto Earthquake totaled approximately one third of Japan’s GNP at the time. The 2011 earthquake was roughly around 3-5 % in GNP loss. Many research institutes predict the Japanese economy will have positive growth during the reconstruction but there are many problems to be solved. This is the first time Japan has experienced a serious accident at a nuclear power plan. Dr. Mori then went on to explain what he thinks are the three major challenges for Japan.

The first major challenge for Japan is to address where it will take its energy policy after the Fukushima accident. Establishing a clear and stable energy policy is necessary for the economic growth of Japan. The problem that Japan faces is that 97% of its energy comes from abroad. Originally Japan had great prospects in its nuclear energy but this changed after the Fukushima accident. After the earthquake Japanese lost the prospects of nuclear energy development and started to reassess its nuclear energy policies. Regional governments cannot permit the reopening of nuclear power plants without the consent of the federal government. From Dr. Mori’s analysis Japan does not need nuclear power plants. In the viewpoint of national security it is better not to have nuclear power plants due to the vulnerability of nuclear power plants to
terrorist or missile attacks. In the long term Japan needs to secure a more stable energy supply. There is a concern of the Fukui power plants affecting the city of Tokyo and causing that whole area to evacuate. The economic loss of evacuating the entire city of Tokyo would be catastrophic.

The second challenge is how to maintain the Japanese economy so it is still competitive. This brings us to the topic of National Government Bonds. It is not only the recovery cost but also the cost of social welfare that will be financed with the consumption tax. There is no other way but to raise the consumption tax and to reform the social welfare system. Japan is about nine hundred trillion yen in debt. Deflation is the number one problem facing Japan. Japan needs to re-adjust it’s monetary policy so that it reaches the goal of achieving 1% inflation. This will help Japan in making it a more appealing market to invest in. At the moment the currency is seen as a safe haven but the economy lacks future prospects of foreign investment. Once the yen is inflated more the Japanese economy will begin to recover.

The final challenge mentioned by Dr. Mori is the education for future generations. Globalization demands great changes in every country. In the past there has been a lack of innovation in Japan. During the 1980s Japanese business thought they could conquer the whole world market but because they stuck to their traditional methods they could not adapt to the evolving economy. Increasing frequent discussions in Japan about Global Human Resources are an indication of growing awareness. Global Human Resources are required because of the shifting focus of Japanese corporations towards international markets. There is now an importance for providing you with more creativity and international exchange.

Economic Policies for the post 3.11 era in Japan

Etsuro Shioji

Dr. Shioji began his remarks highlighting that the economic recovery was relatively fast during the first three months after the disaster, but then the pace of the recovery slowed down. The debt of the Japanese government is expected to be well over 200 percent of GDP in year 2012. The scary part of this story is that whether Japan will fall into a debt crisis all depends on the expectation of people. That is, if the expectation is to believe the budget will be unsustainable some time in near future, then people will stop buying government bonds now: thus the crisis expectation will be realized today. To be in such an expectation sensitive region is already dangerous. Our primary goal now is to convince the market that the government is committed to a feasible plan for restoring a fiscal balance. A tax increase is inevitable in order for this to work. The important thing is to convince the market that the government has a plan that will work. At the moment it may not be a great idea to raise taxes this year or next because we already have a serious short-term concern, as will be discussed below.

At the moment Japan is facing a possibility of losing all the nuclear power generators, which used to account for 24% of electricity production in the
country, for safety concerns. A large economy like Japan cannot take such a big short-term adjustment. Many of the firms might consider moving their business operations to, say, Southeast Asia. Another concern is that some of the nuclear power plants are becoming old: if we stop building new plants now due to safety concerns, there could be a pressure to prolong the lives of those old ones, which could actually give rise to a more hazardous situation. Another important concern is the fear of food contamination due to nuclear radiation. The regulation by the Japanese government relies heavily on random sampling. Unfortunately, they have failed to restore the consumer confidence in food safety. Blaming the consumers for not being “scientific” does not help the situation. As a consumer you usually think about the worst-case scenarios. Tougher regulation needs to come through to restore confidence to the consumer. The farmers should be compensated for resulting losses, because they did not cause the problem.

The next phase looks at the reconstruction of Tohoku. In Dr. Shioji’s assessment compact cities is a valuable solution worth the cost. The idea would be to consolidate several local towns and villages at higher places. The reason being with an aging society it would be too costly to have the elderly scattered around. It should however be noted that opinions of well-informed scholars are split on this issue. The opposing view is that compact cities are too costly to build and that they destroy existing communities. They also argue that proponents of compact cities ignore the reality of motorization. The reality is that it has been proven to be extremely difficult even to move existing communities slightly inland.

Fiscal spending increases are needed to resolve both the short run and the long run problems that Japan faces. On the short run or business cycles issues, deflation has proven to be very persistent and Japan appears to be in a deflation trap. The BOJ keeps the nominal interest rates low but when the nominal interest rates are low inflation is hard to generate. On the other hand, the same situation implies that there is a room for a fiscal stimulus to work quite effectively. On the long run issues, Japan is lagging behind many other countries in productivity growth. This is because structural changes of its economy have been slow. Fiscal policy could change this by encouraging reallocation of resources to, for example, health care and elderly care sectors, where there is a strong demand.

In conclusion, for Japan’s long-term prospects, future tax hikes are inevitable but will probably happen after we resolve the issue of electricity shortages. Japan’s fiscal spending is extremely important to jump-start the economy that is stuck in the deflationary trap. Huge spending is also expected to be needed with reconstruction of Tohoku, de-contamination of land and water, and better regulations for food safety. Fiscal spending is also needed to encourage structural changes of the Japanese economy, though this can be partially achieved through redirecting resources from public investment to government consumption. Perhaps Japan can provide the elderly better quality of life instead of pension money. Thus, tax increases are needed not only to
restore long run fiscal balance but also to finance valuable new fiscal expenditures

**The Economic Situation in the United States**

**Martin Neil Baily**

The United States as you know suffers frequent disasters but has never had a disaster that has registered large enough to have an affect on the economy. Even the Katrina disaster did not pose much of a threat to the US economy. So in lack of natural disasters we have created an unnatural disaster that has managed to affect the global economy. Mr. Baily said that his presentation will not focus on what caused the global recession but instead the aftermath and the policies being implement to solve it.

The initial response of the US government during the Bush administration started with helping with the top level of the economy and the Obama administration continued this policy. The question was did this actually work and the answer is yes. If nothing else was done the economic situation would have evolved into a catastrophe and instead of a recession we would have been left with a depression. Letting the private sector fail was really not an option. We went from a growth of negative nine percent up to three percent because of the policies enacted. A lot of credit should go to those who initiated the idea to have the banks be stress tested and given capital injections. Mr. Baily then commented that there should be a lot of people in Japan who should say “I told you so” because Japan came warning in the early 2000s that the US has an unstable real estate boom. Japan went through the exact same scenario in the 1980s and they warned the US this could lead to slow economic growth.

This recession is different and we have not had the immediate bounce back we have had in the past. It has taken awhile but it looks as if now that economic growth is getting a little bit stronger. Many have asked why is the economy recovering now instead of sooner and the reason is that consumers are spending again. The recovery has been slow because of the continued weakness in the labor market, the loss of household wealth and the overhang of mortgage foreclosures and underwater mortgages as well as the decline in government spending. The US government has been basically on full throttle in assisting with the economic recovery. The government has kept the interest rates low and the federal fund rates close to zero.

The decline in employment is much larger than anything we have had in this recession. It will take around four to six years for the unemployment to go back to where we had it in 2007. We have got a long ways to go before we get back to the level of employment we want to receive. In a sense the United States is experiencing a lost decade. Consumers are not consuming as much as they used to because we have experienced a huge loss of wealth. The wealth has come back a bit but most of the loss has been associated with housing. Housing prices has lost more than thirty percent and nationally housing prices are still declining. Most of people’s net wealth is very focused in their house and this is
why it is such a blow to the economy. Out of fear of loosing their jobs and the loss of their net wealth people cut back on consumption. Right now though households have been consuming according to the disposable income.

Right now there is a concern with Europe going into a recession that it will be hard for the US to expand by not going into a trade deficit. The US had a huge trade deficit going into the recession but recovered slightly. The concern is now with imports growing we will begin to move into a trade deficit. In terms of housing we are still paying the price of loosing value because we built too many houses and the prices started off too high. Residential construction is beginning to creep up but the US is still in sort of a stale mate.

In terms of monetary policy there are folks that feel the Fed is doing way too much and as a result we will get a hyperinflation of our currency. On a chart we can see that inflation has gone up from year to year more than the goal of 1% inflation. Mr. Baily mentioned for him this is not a concern because it excludes food and energy. Right now we do not have excess demand in the US economy and therefore there is no concern. The expected inflation in the US at the moment is about 2.25% and that is reasonable.

Something that we should worry about is the fiscal policy responding to the situation. There was a substantial fiscal surplus in the late 1990s and the Bush administration squandered the surplus built by the Clinton administration by slashing taxes and fighting two wars. So the US went into this crisis in a poor fiscal state and this is why the stimulus was only 800 billion dollars. The deficit just went way out of control because the tax revenues plummeted and spending soured. So the question is what do we do right? We should not try and balance the budget right now because the economy is too week. We want to do is get the economy going and we should be focused on increasing demand. The problem we have is that we are not raising enough taxes in the long run.