

Unmaking the Japanese Miracle: Macroeconomic Politics, 1985–2000. *By William W. Grimes.* Ithaca, N.Y.: Cornell University Press, 2001. xix + 254 pp. Index, notes, bibliography, figures, tables. Cloth, \$45.00. ISBN 0-801-43849-7.

Reviewed by W. Miles Fletcher

As the title suggests, *Unmaking the Japanese Miracle* by William W. Grimes examines one of the most dramatic developments in post-1945 Japan. If the nation's rapid economic recovery after total defeat in the Pacific War and later surge to become the world's second largest economy amazed observers from the 1950s to the 1980s, Japan's economic swoon since 1989 has stunned them. What happened? How could a nation so quickly switch from being a model of economic success, Japan "as number one," to becoming a lesson of mistakes to avoid? This book examines the causes of the speculative "bubble economy" of the late 1980s as well as the abrupt and persistent downturn in the 1990s, what some Japanese now call the "lost decade."

Grimes focuses on governmental policies in that period. He agrees with the general view that in response to the Plaza Accord of 1985, which led to the rapid appreciation of the yen and potential difficulties for exports, the Japanese government stimulated the economy too much and then in 1989 deflated it too quickly. (For example, see David Flath, *The Japanese Economy* [2000], pp. 132–3.) The new contribution of the study is its analysis of the "power structure in macro-economic policy making" (p. 130) to uncover the reasons for these disastrous policies. In brief, Grimes attributes most of the blame to the dominance of the Ministry of Finance in determining macroeconomic policy. As explained in the first half of the book, which sets up his model of macroeconomic policy making in Japan, the ministry had important advantages over the other two major institutions that could have influenced policies, the Bank of Japan and the Diet. Regulations gave the ministry considerable power over the bank, and elected politicians lacked the expertise to challenge officials. The second half of the book analyzes the major policies enacted after 1985. In brief, the Finance Ministry's bias toward monetary policy favored the lowering of the discount rate by the Bank of Japan after 1985 to ward off any negative domestic effects of a slowdown in Japanese exports. This loose money policy sparked speculation in the stock market and real estate. In 1989, when officials became worried about soaring prices in those sectors, they raised the discount rate too quickly, from 1.5 percent to 6 percent within one year. After the "bubble" burst, the stubborn fiscal conservatism of the Finance Ministry blocked early attempts by politicians and others to prime the economic pump by expanding the national budget.

Relying on the extensive use of both Japanese and Western sources, the analysis reflects an impressive grasp of the complexity of Japanese politics. For example, the point that “supplemental budgets” proposed by the Finance Ministry actually involved little new spending is important to understanding the extent of the ministry’s fiscal conservatism and political savvy. The emphasis on recent legislation that limits the powers of the Finance Ministry and strengthens the autonomy of the Bank of Japan provides a new perspective on progress toward economic reforms in Japan during the past decade. Although the difficulties of effecting meaningful economic change there often grab the headlines, substantial reforms are occurring. Politicians can defy the vaunted bureaucracy.

Although the study clearly illustrates the power of the Ministry of Finance, the examination of the decision-making process could be more comprehensive. For example, the business community, which has been a powerful interest group vitally affected by macroeconomic policies, receives just a few brief references. The Federation of Economic Organizations (*Keidanren*), in particular, merits attention as the major supporter of the largest political party, the Liberal Democratic Party, and as an organization that has forged close ties with the national bureaucracy.

Grimes also strains at times to fit all the evidence into his interpretation that exonerates the Bank of Japan from responsibility for any mistakes. For example, he argues that pressure from the Finance Ministry forced the bank to lower the discount rate rapidly in 1986 (p. 131), yet, as he admits, the bank on its own acted very swiftly to raise the discount rate after 1989. This action might serve as proof of the bank’s occasional assertion of independence, but the Finance Ministry again is depicted as the villain, because it prevented the bank from starting to raise the rate in 1988 and thus, according to Grimes, led bank officials to believe they had to act with unusual speed in 1989 (pp. 157–9). Grimes can only speculate that if the bank had had more autonomy, it would have acted more cautiously (p. 227).

To understand Japan’s sudden fall from economic stardom, one should read this book, especially the second half, together with a broader study of the Japanese economy, such as *Japan, the System That Soured: The Rise and Fall of the Japanese Economic Miracle* by Richard Katz (1998). Katz stresses flaws in what he calls the Japanese economic “system,” while contending that the government’s strategy of sheltering and nurturing promising industries, which succeeded brilliantly for decades, had by the 1980s turned into a business welfare program to protect inefficient sectors. To him, the lack of consumption and of sound investment opportunities caused both the bubble in stocks and real estate and the slump of the 1990s. In contrast, Grimes justifies his emphasis on fiscal and monetary policies by arguing that “while overregulation and

political compensation have undoubtedly hurt the Japanese economy over the past couple of decades and have probably made recovery from the bursting of the bubble much harder, they did not actually cause or puncture the bubble” (p. 226). One can question, though, whether the “bubble” and the “lost decade” resulted just from mistaken monetary and fiscal policies and whether a more vibrant economic system would have responded quite differently to the decisions that officials made.

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