International Political Economy:

The Japanese Asset Price Bubble

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This paper will discuss and analyze the onset of the Japanese Asset Price Bubble in the late 1980s. It will also discuss how the perspectives of IPE—specifically Economic Liberalism and Constructivism—can be observed in the Japanese Asset Price Bubble. Looking into events, actions, and norms; discussion on how such an event came to fruition will be the centerpiece of this paper. More so, a connection between how such behaviors and actions relate to the specific perspectives stated led to a complete breakdown of the economic system of the Japanese market. This paper will primarily focus on how Economic Liberalism played a substantial role in creating the crisis as we know it.

Introduction

Understanding Japan's main actions throughout the 1980's is especially key when relating them to the massive events that influenced such a crisis. Beginning in the early 1980's, the Japanese economy began to experience significant growth. In this period of time, real estate and stock market values began to skyrocket (Allen & Gale, 2000). The Bank of Japan (BOJ) acknowledged the ongoing explosion in wealth, but deemed it was in no place to regulate the open market compared to previous events. Instead, the BOJ relied on the market setting the tone for the entire economic situation. More so, a complete transitioning from state interference to that of non intervention was the primary objective of the BOJ. The simple goal of the Japanese financial system was to deregulate its own hand and allow the market to experience true freedom, one not burdened by government oversight (Hossain & Rafiq, 2011).

It's important to note that the Japanese financial system is bank-based but extremely regulated by the BOJ (Hossain & Rafiq, 2011). The variables inside this system center around heavy intervention by the BOJ and its participants. Ranging between the relationships of borrowers and lenders, to guidance conducted by the BOJ to ensure financial success; the entire banking system was not its own entity in any way shape or form (Clairmont, 1993). For the most part, it was just an extension of the BOJ and to an extent, the government's goal in economic activity. More importantly, this system's entire goal was put in place following World War II with the priority of rebuilding the Japanese financial system. It was never intended to face the brute globalized world where variation was to acquire. It was meant to rely on the domestic market first, and the international community second (Clairmont, 2001).

Where did this "decision" to liberate the markets come from? In 1985, Japan met with the United States to discuss trade imbalances regarding both economies. Throughout this time, the Japanese yen was significantly weaker in comparison to the U.S. dollar and as a result, led to the Japanese having much success overseas regarding their products. After intense pressure from the United States, Japan agreed to open up its currency regarding value between the two nations; setting up a system among all nations involved in what would eventually be known as the Plaza Accord (Goyal & Yamada, 2004).

Unknown to Japan at the time, the aftermath of the Plaza Accord would practically cement Japan's immediate future to a recession and economic bubble. The demand for yen across the world skyrocketed and Japan's ever dominant trade surplus would halve in less than five years; all but spelling the downfall of the Japanese economy. This sudden burden crippled numerous Japanese companies and resulted in many companies needing immediate assistance from financial institutions across Japan. This high-level demand for such assistance devastated the banking system across Japan and called for extensive reworking of the monetary policies within Japan. More so, this triggered a response in the Japanese monetary system that also aided the bubble forming inside Japan.

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With so many companies posting record losses, Japan began allowing financial institutions to borrow far larger amounts of money in order to meet liquidity goals. The demand for yen across the world launched the value of the currency to unprecedented heights (Clairmont, 1998).

Understanding the events and actions conducted by the Japanese is essential to understanding how the basic development of such a crisis came to be, but underlining those principles is only one piece in the grand scheme. At this point, the notion that Japan's reluctance to interfere with the economy as well as decisions made in previous years played a significant role in helping to create the perfect environment for such a bubble is central. However, another key point that cannot be overlooked is the fundamental actions conducted by individuals and institutions across Japan. A break from common tradition among the Japanese regarding economic activity is without a doubt a significant reason for such a crisis (Hossain & Rafiq, 2011). Throughout the course of Japan's history regarding financial institutions, Japan had established itself predominantly as an especially reserved banking system. One that catered more to despots rather than capital markets. This transformation from a reserved system to one that aggressively pursued capital is an extremely stark variation that had a domino effect on the entire system itself.

In addition to this, Japan saw an influx of loans backed by its ever-expanding property values. An average worker in Japan could borrow up to millions of yen for any purpose as long as property was put up as collateral (Noguchi, 1994). This ability for individuals to take such radical loans only fed into the ever-expanding bubble that was already forming in Japan. No concern was put forth that an individual could purchase property worth more than one's entire life earnings. Even worse, loans were welcomed with open arms and promoted strongly for growth.

The perfect storm for a bubble in Japan had formed and worse, instead of controlling the ever-growing bubble that kept expanding, the BOJ instead relied on natural corrections to stimulate the market. Japan's actions following the Plaza Accord played a major role in disrupting the natural flow of its financial institutions as well as its currency. This combination combined with that of financial liberalization across the Japanese financial system created an environment that not only fed off false realities, but one where growth was pursued without concern of the possibility of failure of the market itself.

Economic Liberalism on The Japanese Asset Bubble

"Wealth accumulation is best achieved without state intervention"

Throughout the course, the principle foundations of liberalism across the economic institutions that encompass our society has been extremely prevalent. One could even go as far to say that this idea of liberalism is almost always in consideration in economic decisions. In the case of Japan's crisis, it is without a doubt the single most important reasoning as to why such an event became a crisis in the first place. Across all lectures and discussions, the simple notion that the market is best when unregulated was almost always uttered in every example we discussed.

And in this case, that simple notion was taken into practice. From our basic analysis of the crisis itself, it is apparent that financial liberalism was primarily the main reason why Japan experienced a crisis in the first place. At every level of analysis, one can conclude that economic liberalism and its ideas were fundamentally responsible for the actions that led up to the formation of the bubble.

We can clearly see this individually at the time in the influence and perceptions that were held specifically by the 25th governor of the BOJ, Satoshi Sumita. Sumita believed easing regulations across Japan financially was the key in allowing Japan to escape its bubble while simultaneously avoiding the possibility of recession. This notion was widely accepted at the time across many individuals within the Japanese government and financial institutions (Hossain & Rafiq, 2011). The BOJ, at the hands of Sumita and other government officials, called for the easing of regulations across the nation. With the ability to finance with such ease, companies and individuals found themselves transforming from a conservative nation of finance, to one that openly expressed a predatory approach to acquiring wealth. More so, this allowed the influence of economic liberalism to sweep across the nation and become part of the core identity of the BOJ at the time.

State wise, the influence of Sumita at the BOJ had a direct correlation to the monetary policies that would eventually come to fruition domestically. A cutting of interest-rates followed by the easing of loan restrictions were some of the more dominant actions conducted by the BOJ. More so, the BOJ had sporadically become far less interwoven within the economy itself. Erasing its traditional motives and replacing them with less interference from state entities themselves. The BOJ had taken its role economically and decided that the best outcome for the state was for the market to decide with no intervention from the BOJ. Politically speaking, the ideas of economic liberalism had become increasingly popular among Japanese society (Hossain & Rafiq, 2011). This combined with the growing interest among other individual actors to shift Japan from intervention to non-intervention ideology is the most important aspect in terms of statewide recognition regarding the policies of economic liberalism. This is where such influence became dominant among Japanese society, but more importantly, it became the state's main core belief regarding its economic philosophy.

Domestically, the shift from intervention to none is key, but it's important to note the influence of economic liberalism was also found abroad. As noted, Japan participated in the Plaza Accords with numerous nations; specifically, the United States. Upon this meeting, Japan and the United States came away deregulating their currencies among one another. Under the influence of the BOJ, and the notions of economic liberalism, Japan opened its markets in regard to its currency. Not only do we see the ideas of liberalism occuring domestically, but we see it happening in formal agreements among other states. This stance among liberalism wasn't something that was unique to domestic issues, but something Japan aimed at every level of its interactions. Japan was aiming for as little intervention as possible.

Essentially, Japan got what it wanted. As little economic intervention as possible. With the hopes of allowing the market to determine the true aspect of the economy, Japan found itself in a position where it sought true freedom from any form of economic intervention. Individuals with the ability to influence state actions found themselves in positions of power. In the case of Satoshi Sumita, the ability for him to hold such a powerful position allowed him to greatly influence the state of Japan with the ideas of economic liberalism. These notions seeped into the society of Japan and allowed for those ideas to become the core essence of the BOJ and society at the time. Domestically and internationally, Japan found itself using such ideas to conduct itself. With these beliefs, it's no surprise to see actions conducted domestically and globally to mirror the fundamentals ideas of economic liberalism. The Japanese asset price bubble was a direct consequence by the policies and actions conducted by the BOJ; but more so, the limited intervention of BOJ greatly played a role in the escalation of the bubble. With notions already perceived that state interference was not to occur, it is of no surprise to see Japan experience such a crash due to the little intervention that was aimed at from the ideas they believed to be true from liberalism.

Constructivism on The Japanese Asset Bubble

"Interactions create meanings about their identity and purpose"

Another way of viewing the crisis takes us approaching the bubble from the viewpoint of constructivism. Interestingly enough, one could argue that the basic principles that enshrined the Japanese society were dramatically altered throughout the period leading up to the crisis. The beliefs that Japan held throughout this time could be evident of such a disaster before taking on the notion of any other perspective. Through our lectures and class discussions, constructivism focused more around the norms and beliefs that encompassed a state at the time of said event and in that case, the Japanese asset bubble would fit perfectly.

Japanese society as a whole had always been known for its conservative financial outlook in regard to its economy (Hossain & Rafiq, 2011). Essentially concerning itself more around a structuralized development rather than one compromised with zero structure. With this in mind, the norm regarding Japan's economic development centered around a conservative viewpoint where growth and borrowing were to be held steadily by the BOJ. More importantly, government intervention was something that was widely accepted and practically cherished. Understanding the basics of Japanese society, where did this transformation come from where society began to shun intervention?

Satoshi Sumita is a great example due to his influence on Japanese society as a whole. When Sumita became governor of the BOJ, he insisted on transforming the traditional values of Japanese society to that of its various trading partners. This change in belief played a significant role in altering the norms that were found around Japan at the time. More importantly, Sumita's influence on the Japanese society is something we can see in almost every aspect. Individually, Sumita's views regarding less government intervention were accepted around the nation. The BOJ eventually accepted these notions as well and played a role in changing the common norms that had been held. Deregulating many financial restrictions in favor of less interference while also changing the monetary policy on the domestic side during the 1980s. Internationally, Japan's changing norms played a major role in its decisions regarding the Plaza Accord and trade deals. Opening up its markets for what would be a first. Globally, Japan's changing norms bring forth a far more open Japanese economy that is accessible to all nations around the world for trade.

In total, we see a complete backtrack from traditional financial values to that of newly created norms and beliefs. Instead of relying on previously held beliefs, the Japanese society aided by strong figures shifted its society into a far more aggressive economic state. Favoring less government interference while throwing away its reliance on such heavy oversight. This shift was something that came to fruition due to the many figureheads that influenced Japanese society. Although Satoshi Sumita is the key figure, it's important to note that many financial institution heads were also aligned with these beliefs (Hossain & Rafiq, 2011). This radical shift in beliefs helped pave the way for the change that would eventually come to the Japanese society. The shift from government intervention to one without is the key difference in norms.

The various actions that influenced such change can be identified as the success that Japan found before the crisis itself. This confidence in the market led many within Japanese society to accept a transformation from its previously held beliefs. With it, came the idea that government intervention was slowing down the growth of the Japanese economy. This is why the changing of norms came to affect not only domestic monetary policies, but interactions that occurred at the international level. The crisis itself was fueled by policies, but those policies were shaped by society wide based beliefs; those being less intervention. And that's where constructivism fits perfectly into the analysis of the Japanese Asset Price Bubble. The changing of norms being the key principle of the Japanese Asset Price Bubble. Where changing ideas rather than states, gave way to the crisis.

Conclusion and Future Implications for Japan

Financial liberalism is without a doubt the main culprit of this case. Although the changing of norms and interactions among various political actors could help explain the argument for constructivism, it is without a doubt not the most central notion in explaining the crisis. Even before the crisis came to fruition, the ideas of financial liberalism had already become prevelant in Japanese society. Although norms had not changed, political decisions that mirrored the notions presented by financial liberalism had already been put in place, erasing the notion that norms had come first before said policies. With this, it's apparent that financial liberalism is the best way of explaining the Japanese bubble of the 1980s. From the massive deregulation to the little government interference provided by the BOJ, it's apparent that all these actions were conducted following the core beliefs of liberalism across the financial sector. More so, following the course material and lectures, the case of Japan is almost the picture one comes to imagine when thinking of what it is to become less interwoven with state interference. From deregulation, to free trade without the burden of state involvement, Japan followed the principles that enshrine the fundamental beliefs that is financial liberalism. Although Japan suffered from the formation of a massive bubble forming inside its economy, the key takeaways that one may come to realize is that the formation was caused mainly due to the beliefs that were put in practice in Japan that closely echoed that of financial liberalism.

In the case of Japan, recovery has not been fast. Many scholars argue that Japan may never truly recover due to the damages it sustained during this financial crisis (Hossain & Rafiq, 2011). It should be of no surprise to see Japan exit the belief of economic liberalism and instead shift its focus to a far more Keynesian approach. Almost immediately—a crash seemed unavoidable—Japan began enforcing extreme financial regulations and made accessing loans quite difficult for anyone. In addition, the BOJ started interfering far more in domestic affairs as far as completely overhauling the monetary policy domestically. Japan may never truly reach a point again in its time where the attitudes of financial liberalism are considered to be the best outcome for the state. Ironically, the crash—which was fueled by thoughts of economic freedom—only cemented the belief that a strong state with heavy regulations would be the best entity to safeguard the Japanese markets. More so, it would not be surprising whatsoever to see Japan never embrace the ideas of financial liberalism to the extent they did in the early 1980's (Wolf 2000).

Financial liberalism explains the event in a much compelling light due to the fact that almost every policy leading up the crisis is greatly influenced by such ideas. Deregulation combined with less state intervention is core to almost every policy. But where it comes short—explaining where these beliefs came from—constructivism can aid its approach in explaining how such beliefs came to fruition in the first place. Rapidly changing norms alongside beliefs helped usher in a new approach to Japanese society. The truth is, no single perspective can clearly encompass an event like this as a whole.

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