Abstract

Since 1998, Japanese economy has experienced consistent deflation and the Japan’s government had responded to two economic shocks – first the global financial crisis of 2008-2009 then the devastating earthquake, tsunami, and nuclear crisis in March 2011 (henceforth 3/11). Somewhat surprising, though, it was not until early 2013 that the government took the most radical actions to reflate the economy with the inauguration of the new LDP cabinet led by Shinzo Abe. Informed by the role of Central Bank Independence literature and the impact of ideas on domestic politics, this paper analyzes the factors that drove the Bank of Japan responses to the country’s economic challenges of the last 15 years to explain how and why the BOJ failed to adopt an aggressive monetary policy during this period. Our analysis hinges on the important role of international norms in Japan’s economic policy making.
Introduction

In the last year, much has been made of the bold economic experiment of Prime Minister Abe Shinzo. Dubbed “Abenomics,” the government’s economic policy consists of three “arrows” – 1) expansionary monetary policy; 2) flexible fiscal policy; and 3) structural reforms. Since its launch, Japan’s central bank – the Bank of Japan (BOJ) - has pursued a policy of expanding its monetary base. The government also used fiscal policy to stimulate the economy while developing a longer-term fiscal consolidation plan. The third arrow – structural reform – includes a host of supply-side measures intended to boost productivity and the growth rate of the economy. In many ways, though, many of the reforms have not been particularly bold thus far, nor entirely novel. Throughout the 1990s, particularly the latter half, the government relied heavily on fiscal stimulus, and the government pursued various supply-side reforms under Prime Ministers Hashimoto and Koizumi. What does stand out, however, with Abenomics is the government’s firmer commitment to end decisively Japan’s bout of deflation. Japan’s more aggressive monetary easing, including a clear inflation target, appears to be working. The inflation rate has ticked up and is approaching 2%, asset prices have soared as the Nikkei composite index has skyrocketed 56.7 percent over the course of 2013, and economic growth is building steam. Consequently, Japan’s monetary policies have received widespread praise and media coverage.

If the aggressive monetary policy of inflation targeting would have done the trick, what took the Japanese government so long to take these aggressive measures to address its long battle with deflation? In fact, although Japan was an innovator in monetary policy experimenting with quantitative easing (QE) in early 2000s, the Japanese government has been slower than others to embrace a bold and activist monetary policy. There were many instances in the last five years where Japan could have benefited from such bold move. Indeed in the wake of the global financial crisis (GFC), Japan’s quantitative easing was surprisingly tepid, and no inflation targeting measures were pursued. Japan faced another compelling reason to experiment boldly with its monetary policy in March 2011 at the time of the economic free fall from the Great East Japan Earthquake, tsunami and nuclear crisis (henceforth “3/11”). Such cautious steps on the part of Japan’s monetary authority are even more curious given the fact that, unlike in other countries, Japan struggled with low inflation or deflation for a much longer period. Consequently, domestic political pressure increased on the government to take bolder monetary measures including reasserting government control over monetary policy by ending central bank independence (CBI), a sharp contrast to the US where a political backlash emerged against quantitative easing. Why was Japan so slow to break with the monetary orthodoxy to decisively address deflation when the economic and political context was conducive for bolder experimentation?

This paper argues that Japan’s delay in using bold and unconventional monetary policy to end deflation is rooted in the diffusion of the norm of CBI, which
created an entrenched mismatch between the monetary policy ideas and actual policy needs. With the transition to CBI and with desire to enhance credibility, the BOJ set out to establish its anti-inflation credentials and political independence, defying the pressure to shift its policy towards fighting deflation and accommodate demands for increased coordination with the executive. Throughout this period, the BOJ insisted that it was doing all it could to combat deflation in the face of dissatisfied critics. The Prime Minister Abe and the new BOJ governor Haruhiko Kuroda have demonstrated since early 2013, that the pre-Abe BOJ policy was clearly falling short. Instead of asking why the BOJ transformed its strategy in the post-Abe period, the paper asks why it was so insistent on its cautious policy prior to this transformation.

The economic case for CBI has largely rested on controlling inflation. A body of work has shown how the diffusion of this idea contributed to the spread of CBI. Less consideration has been given to how these ideas shape the behavior of central banks and the conduct of monetary policy, particularly in a deflationary context. The Japanese case between the late 1990s through 2012 illustrates how there can be a mismatch between economic ideas and economic circumstances, and how norms shape political actors' perceptions of the scope of their policy choices. Even more fundamentally, the experience suggests that the notion of independence may need rethinking when there is deflation since fighting it may require both coordinating with the executive and responding to political signals, such as widespread demands for reflation.

The paper develops the argument over five sections. The first section reviews the literature on CBI and monetary policy and presents the sociological approach to monetary policy upon which this study is based. The second section then establishes that Japan's monetary policy since the GFC was less aggressive compared to that of other central banks until the policy shifts associated with Abenomics. The third section explains the diffusion of the CBI norm and how it was then shaped and defined by actors in the Japanese context. Section four elaborates the high degree of pressure – economic and political – for bolder monetary policy, and then section five presents the evidence of how entrenched ideas created resistance to altering course despite these pressures; this section also briefly discusses how Abe and the BOJ finally overcame this inertia. A brief conclusion draws out the theoretical implications for the study of central bank independence, monetary policy, and norm diffusion.

**Central bank independence, monetary policy, and ideas**

A wide body of work has studied the issue of CBI explaining the rationale for independence as well as offering explanations for why governments grant independence to central banks. The case for granting independence to central banks hinges on the time-inconsistency problem (Kyland and Prescott 1977, Barro and Gordon 1983). While there may be a long-term desire to limit inflation, governments

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1 There is a vast body on CBI, and this literature review makes no attempt to be exhaustive.
may face shorter-term political incentives to use monetary policy to stimulate the economy. If private sector actors come to expect the government to behave this way, this can raise their inflationary expectations, thereby introducing an inflationary bias. Governments, therefore, may face a credibility problem even if they publicly commit to limiting inflation. To solve this dilemma, a government can ties its own hands by delegating monetary policy to an independent central bank (Alesina and Tabellini 1988; also see Quaglia p. 551; Rogoff 1985, Neumann 1991). The enhanced credibility from central bank independence can deliver lower inflation, bring interest rates down and encourage economic growth, so the argument goes.

Why would politicians cede control over monetary policy, which they can attempt to manipulate for their advantage? A related literature examines the conditions under which governments choose to delegate monetary policy to central banks. Bernhard (2002) usefully categorizes the key actors driving the decision to delegate into “policy demanders” and “policy suppliers.” Policy suppliers, such as politicians and parties, can deliver CBI. According to one early formulation, argues that left and right parties pursued different macroeconomic policies that reflect their different social bases of support (Hibbs 1977). Left parties rely on workers and those with lower incomes, groups that prefer higher employment and are less concerned with inflation. Conversely, groups that support right parties prefer lower inflation and have less concern about employment. The contention that left and right parties generated decades worth of scholarship to test this proposition with mixed results (Garret 1998, Boix 2000, Oatley 1999, Clark and Hallerberg 2000).

Elites may be motivated by the need to tame high inflation, incentives to tie the hands of future governments, or state capacity. Policy demanders are the plural interests – e.g., voters, economic interests – that have specific preferences towards inflation. For instance, retirees on fixed incomes and the financial sector may have a preference for low inflation, as will the export sector under a fixed exchange rate. Posen (1995) argues that the strength of these financial influences the degree of CBI, while Clark (1993) argues that stronger labor and heavy industry predict lower CBI. Beyond suppliers and demanders, others have emphasized the preferences and strategies of central banks in determining CBI (Elgie and Thompson 1998, Quaglia 2005).

Other approaches have emphasized the role of international factors. One strain of this literature highlights the constraints imposed by the international economy. With greater economic financial deregulation and integration, governments must give up certain monetary policy instruments and face reduced policy autonomy. Financial globalization translates into a greater need for politicians to signal their creditworthiness, otherwise international markets will punish governments that deviate from these policies through effects on asset prices and interest rates (Dyson et al 1995, Maxfield 1997). Consequently, governments have an incentive to delegate decision-making to central banks to establish market credibility.

Another approach to understanding CBI focuses on the role of norms and ideas. Applying Haas’s (1992) concept of an epistemic community, scholars have shown how a group of international bankers and economic officials have contributed
to the diffusion of CBI (Verdun 1999, King 2005). Scholars have highlighted how ideational diffusion can occur through policy emulation (McNamara 1998) and through monetary regimes such as the European Monetary System (EMS) and Economic and Monetary Union (Elgie 1998).

CBI, deflation, and some conceptual issues

The economic case for CBI starts with the assumption that it can lower inflation and promote long-term economic growth. The economic case for CBI, however, is problematic on several levels. The empirical evidence regarding CBI is mixed. While there is some support for the claim that CBI lowers inflation, there is little support that CBI delivers higher economic growth for developed countries (see Maxfield 1997 and McNamara 2002 for a discussion of this work). Moreover, CBI itself is an idea that emerged under specific conditions very different from today. This idea, as well its diffusion, is one with specific historical roots, namely the inflation of the 1970s and the breakdown in the Phillips Curve, which suggests a stable tradeoff between inflation and unemployment. Since the GFC, however, many countries have faced very low inflation, and some have started experiencing deflation. Under deflation, there is no time inconsistency problem since the principal challenge is to stimulate inflation, which should converge with the shorter time horizons of politicians’ electoral incentives. With CBI there is conversely the risk that central banks may pursue a monetary policy that is excessively hawkish toward inflation thereby hindering reflation of the economy. Indeed, since the GFC, some prominent economists have leveled exactly this criticism against central banks (Krugman; Stiglitz). Furthermore, under conditions of deflation, greater coordination with the government’s fiscal policy may be required. CBI could impede such coordination. The literature has recognized some of these problems, including the challenge of coordination with the government (Haggard, Kaufman, and Webb, Clark 1994 – see Maxfield 155) and the potential for excessive emphasis on inflation (McNamara; also see Debelle and Fischer 1994 who make same point; Forder 1998). Under deflation, these problems may be particularly acute. Furthermore, fiscal outlays and under stringent fiscal conditions, the macroeconomic policy becomes the major instrument to combat economic downturn in the aftermath of the crisis.

Whether or not such problems emerge, however, depends on the behavior of central banks, and not statutory independence, raising an important conceptual separation regarding CBI. As Forder (2000, 174) notes, the two have often been conflated, noting: “...it is remarkable that so much credence has been given to the view that policy-making is determined by statutes.” Forder (1998) takes this critique one step further claiming that empirical studies that rely on statute reading are flawed because they fail to test independence. Other studies have attempted to circumvent this problem by devising ways to measure behavioral independence. For instance, Fry (1998) measures independence as the government’s willingness to respond to demands to provide credit, which he finds correlated to the level of government deficits. In this example, Fry implicitly assumes, however, that such behavioral independence is positive from a policy perspective. Thus, there is a conflation of
behavioral independence (not extending the government credit) with optimal policy. Indeed under deflation, there is a case to be made that central banks should take unorthodox monetary measures that in effect monetize debt, a step that central banks have in fact taken in the past. What then determines central bank policy choices in the context of statutory independence? Or in a normative vein, under what conditions is CBI likely to lead to suboptimal policy?

An ideational approach monetary policy

As discussed above, a body of literature has highlighted how norms have contributed to the diffusion of CBI. The sociological theory developed here builds on this work, as well as sociological institutionalism, to understand the conduct of monetary policy after the de jure establishment of central bank independence. First, the starting assumption, supported by a large body of empirical research, is that norms and ideas influence policy choices (See footnote).2 This should be particularly true for monetary policy, since it is carried out by policy elites who are often insulated from political pressure through central bank independence and often are part of tight-knit epistemic communities; as discussed above, these approaches have been applied productively to understand the diffusion of the CBI norm.

The second assumption is that independence in the abstract has little meaning, and there is a great deal of scope in terms of how actors can define it. While CBI has often been identified with statutory independence, independence can be conceptualized in other ways that give more specific meaning to the idea, and it is this specific meaning that influences policy choices. As McNamara (2002) has noted, central banks are embedded in a web of relationships and understandings that belie statutory independence. Credibility is one of the central theoretical justifications for CBI,3 but credibility too can take on different meanings. Establishing de jure independence is supposed to signal credibility, but as McCallum (1997) has pointed out, delegation alone does not necessarily ensure credibility. Central bankers may feel the need to establish credibility through policy choices that signal their inflation-fighting commitment. In other cases, central banks may feel more confident in the credibility of their institution and feel less need to resort to such signaling.

The scholarly literature has wrestled with the definition of independence, in some cases conflating or associating it with attitudes, optimal policies, or credibility, none of which necessarily stem from statutory independence. There are at least three dimensions along which we can expect variation in the idea of independence: 1) relative degree of hawkishness toward inflation; and 2) the degree of cooperation with the government. Regarding the first dimension, keeping inflation low has been one of the central justifications of statutory independence, but that says little about how policymakers will behave. While statutory CBI may allow authorities to appoint central bankers that prioritize inflation stability, in practice central bankers may have

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3 Forder (2000), however, argues that there is little support that credibility matters.
differing preferences regarding inflation and employment stability. There is also a prescriptive strain in the literature that has contributed to this confusion. Rogoff (1985) suggests that governments should appoint agents that should prioritize anti-inflation, a powerful normative idea that can shape the practice of monetary policy. Germany is often cited as an example, whose historical experience has shaped the Bundesbank’s inflation preferences. Because of Germany’s experience with hyperinflation during the Weimar Republic, the Bundesbank has a long history of taking a hawkish position toward inflation (Henning 1994), a preference that was later reflected in the European Central Bank (ECB).

Regarding the second dimension, despite statutory independence, central bankers may have different norms about the degree to which they cooperate with the executive. The Bundesbank, for instance, had a shared understanding with various actors, which facilitated and economic policy that promoted growth and stability (McNamara and Jones 1998). Conversely, a central bank may view independence as maintaining distance from the executive and therefore be less cooperative in coordinating with fiscal policy. Some studies have attempted to measure this degree of behavioral independence (e.g., Fry 1998). While some of this work has assumed that behavioral independence is positive, other work has stressed that there is a need for policy coordination that statutory independence may in fact inhibit. Practice may be shaped by the norm of cooperation.

The third assumption is that these behavioral dimensions of independence are as much social ideas as they are economic ideas backed by theory and empirical support. Indeed, as social ideas, there is in fact the possibility of a mismatch between these ideas and the optimal policies that economic circumstances may require. In some cases, ideas that emerged under specific circumstances may be diffused into very different environments. As McNamara (2002) states, “…actors borrow those models collectively sanctioned as successful even though they may be decoupled from or incongruent with functional needs” (McNamara 2002, 62). Ideas are also sticky and may create path. Given uncertainty stemming from a shock such as the GFC, policymakers often resort to existing ideas to guide policy choices (Goldstein and Keohane 1993, Blythe 2001, Berman 2001). This path dependency may slow the response to changing conditions.

Bringing these pieces together, several conditions should increase the likelihood that monetary authorities will be slow to respond to changing circumstances. A mismatch between monetary policy ideas of CBI and policy needs is most likely to occur when: there is low inflation or deflation; there is a strong anti-inflationary norm; and independence is defined as in opposition to the government. While international factors such as international epistemic communities can drive diffusion of ideas, domestic actors give meaning to the abstract idea of independence, thereby shaping actual policy preferences and choices. This paper applies this theory to the Japanese case to explain the BOJ’s slow reaction to embracing more aggressive monetary policy.

Japan’s monetary policy
Japan was in fact an early innovator in the arena of monetary policy as the BOJ experimented with unorthodox monetary policy to combat prolonged recession since Japan’s economic bubble burst in the early 1990s. After the devastating year of 1997 when Japan faced with an external economic crisis (Asian Financial Crisis) and an internal one (the rise of consumption tax and collapse of major financial institutions), Japan adopted a zero interest rate policy (ZIRP) from February 1999 to August 2000. After a brief period of lifting ZIRP, the BOJ was forced to adopt the policy again in March 2001 after Japanese economy fell into deflation. At that time, the BOJ experimented with QE - policies that increase the monetary base by large amounts. With interests at zero, central banks are unable to lower interest rates further through the purchase of securities and can become stuck in a liquidity trap when there is deflation.

During March 2001 to March 2006, the BOJ shifted its focus from the uncollateralized overnight call rate to a quantitative target for bank reserves, which was expected to drive the overnight call rate to zero; the BOJ also purchased public and private debt (Fawley and Neely 2013). In addition to this shift of monetary control from the short-term interest rate to monetary base provided through BOJ’s current account balance, the BOJ introduced money supply through QE with an explicit time frame noting that “the procedures for money market operations continue to be in place until the consumer price index registers stably a zero percent or an increase year on year” (BOJ 2001). Since March 2001, the BOJ expanded the goals of QE gradually including the expansion of BOJ monthly purchase of JGBs from ¥400 billion (March 2001) to ¥1.2 trillion (October 2002) and raising the BOJ account balance target from ¥5 trillion (March 2001) to ¥30 to 35 trillion (January 2006).4 As discussed more below, however, the BOJ was deeply resistant to introducing an inflation target, which some have argued to be one of the most effective monetary policy instruments against deflation (Ito 2004).

[Table 1: Japan’s Quantitative Easing 2001-2006]

Despite these early experiments with unconventional monetary policy, the BOJ was reluctant to embrace aggressive monetary policy with the onset of the GFC (Katada 2013, Hoshi 2013). As housing prices in the United States and UK began to drop and then with the collapse of Lehman Brothers, other central banks lowed their respective policy rates (Figure 1) and expanded their monetary base (Figure 2) through asset purchases more aggressively than Japan. Finally, having managed to lift the ZIRP two years earlier, the BOJ was reluctant and slow to pursue aggressive monetary easing. It took the BOJ until October 2010, two years after the onset to the GFC, to start another round of the ZIRP and QE. This pattern of slow and

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4 Takuji Koike (2006) Zero kinri jidai no kinyuseisaku; seisaku suii to sono ronten (Issue brief #550; National Diet Library; Chosa to Joho), Table 2 on page 4. Also see Ito and Mishkin (2006; 147).
reluctant monetary expansion largely persisted until Abenomics was introduced in late 2012.

[Figure 1: Main Policy Rates of Fed, ECB, JOB and BOE]

[Figure 2: Monetary Base Expansion in the US, UK, Europe and Japan]

Meanwhile, the Federal Reserve deployed a large QE program (referred to as QE1) by more than doubling the monetary base at the end of 2008, purchasing government-sponsored enterprise (GSE) debt (e.g., Fannie Mae and Freddie Mac), mortgage-backed securities (MBS), and long-term Treasuries. After the Fed wound down QE at the end of 2009, inflation dipped below 1%, and the Fed announced in February 2010 another monetary stimulus – QE2 – to lower long-term interest rates. Then the Fed announced a third round of quantitative easing – QE3 – in September 2012 committing to a set amount of monthly asset purchases, which it then ratcheted up in subsequent months.

The Bank of England (BOE) in cooperation with Her Majesty’s Treasury was initially more reluctant to use QE, but once it did in March 2008, the BOE acted boldly, more than quadrupling the monetary base through purchases that focused on medium- and long-term gilts to achieve its inflation target of 2%. Subsequently, the BOE continued to expand its QE program in 2009 by £125 billion in asset purchases, and then expanded asset purchases further in 2011, and then by an even larger magnitude in 2012.

The European Central Bank (ECB) reacted at first both more slowly and with less gusto after the collapse of Lehman brothers, increasing its monetary base less than 50 percentage points. After a brief hiatus as economic conditions improved, the ECB turned once again to QE, this time more aggressively, as the European sovereign debt crisis grew more severe. In October 2011, the ECB resumed QE, and then again in September 2012, this time allowing the ECB to purchase sovereign debt of Eurozone countries. The figure above shows the effects of these actions on the monetary base of the Eurozone.

As Figures 1 and 2 clearly demonstrate, Japan was more cautious in its monetary response by comparison to the other three central banks. After the Lehman bankruptcy, the BOJ announced a program of QE but its monetary base expansion was very modest in relative terms. As economic conditions worsened in the fall of 2010 in the face of the US economic slowdown, the BOJ announced new QE policies, but Japan’s monetary base expansion remained modest. Japan’s monetary base expanded only slightly after the devastating events of 3/11. As the economy went into a tailspin, the BOJ announced large-scale, unsterilized asset purchases several days after the earthquake. The BOJ also increased the scale of QE once again at the end of 2012, as a general election approached, in which the leading

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This overview is based on work by Fawley and Neely (2013) and supplemented by the authors as needed.
candidate and eventual prime minister, Abe Shinzo, advocated much more aggressive monetary stimulus and threatened to abolish central bank independence. Even with these shifts in monetary policy, though, as Figure 2 above clearly shows the magnitude of the expansion of Japan’s monetary base from 2007 was comparatively small.

[Figure 3: GDP growth for Eurozone, UK, US, Japan from 1995]

To some extent, the aggressive QE of the Fed, BOE, and ECB reflects their circumstances. The UK and US were more exposed to the GFC initially, and there was a pressing need to restore credit, especially to the housing market. In the Eurozone, the sovereign debt crisis precipitated a crisis for the ECB. It is not all clear, though, that Japan’s circumstances did not call for similarly bold monetary action. Japan actually suffered both a more severe drop in the economic growth and experienced the deepest deflation. Japan’s economic growth plunged from 2.2 percent in 2007 to -1.0% in 2008 and then -5.4% in 2009, much more dramatic than for the US or Eurozone – see below. Similarly, by 2009, Japan’s rate of inflation rate was -1.3%, much lower than that of the US which had a rate of -0.4%, and Japan’s inflation rate stayed below the Eurozone, UK, and US through 2013. Japan also experienced a large economic shock with the devastating Great East Japan Earthquake and ensuing tsunami and nuclear crisis. Furthermore, throughout this period, currency markets drove the yen upward against other currencies (check against Euro and add chart), both after start of the GFC and then again with the events of 3/11. Arguably then, Japan had as great as, if not greater, need for active monetary policy.

[Figure 4: CPI rate]

[Figure 5: Yen-Dollar and Yen-Euro exchange rate from 1995]

CBI and norm diffusion in Japan

The government established de facto central bank independence with the passage of the 1998 Bank of Japan Law. One interesting aspect of the BOJ’s transition to independence is that it is not attributable to either high inflation or monetary policy failures. Indeed, Japanese economic policymakers had an exemplary record in keeping inflation in check. Cargill et al (2000) point out that of nineteen industrialized countries, Japan had the lowest average inflation rate between 1975 and 1996 despite having one of the most dependent central banks, a puzzle that has drawn the attention of scholars (see Cargill et al 1997); moreover, during the deliberation and then passage of the bill, Japan was in fact experiencing very low inflation which then turned to deflation by the latter half of 1998. The BOJ’s monetary policy track-record did come under criticism during the 1990s with some arguing that the BOJ’s excessively loose monetary policy during the later half of the 1980s after the Plaza
Accord fed the asset bubble, and that the BOJ was too slow to lower rates as the bursting of the bubble gave way to recession (Posen 1998, Ueda 2000). These critiques, however, were far from driving the reform process, and as Cargill et al (2000, 112) note: “The 1998 revision had little to do with dissatisfaction over past monetary policy.”

The electoral political calculation of politicians explains the timing of the new BOJ law in the second half of the 1990s as government set out to demonstrate its willingness to “embrace international standards in its efforts to restore financial economic vitality” and “regain the confidence of domestic and international market participants” (Dwyer 2004, 246). From this motivation, the best way to gain credibility was to model the new BOJ as closely conforming to international best practice (Dwyer 2004, Suzuki 1997 and Posen 2000). Here we see the agency in the norm diffusion as domestic actors drove the policy process. By the 1990s, central bank independence had become an international norm (McNamara 2002, Quaglia 2005). Academic studies dating back to the 1980s established an empirical relationship between inflation and statutory CBI, and scholars provided further empirical support during the 1990s such that the value of CBI became a conventional wisdom and ‘the global standard.’ Governments increasingly embraced CBI during the 1990s. The IMF also supported this move by the start of new century economic textbooks cited the empirical relationship between statutory independence and lower inflation.6 The international norm shaped the discourse in Japan as well. As one former BOJ official explained that the moves towards CBI among various countries including those in the European Union compelled the Japanese government to move towards the new law that secured independence and transparency for the BOJ (Shikano 2006, 327).

While the changing norm of CBI provided the impetus for change, domestic actors translated these ideas into policy. In the case of Japan, however, the key actors were not economic interest groups; rather, the “demanders” of CBI were policy elites and the Liberal Democratic Party (LDP). While the norm of CBI provided an economic justification (despite the fact that Japan had no problem with inflation), CBI succeeded because the idea found supporters in the ruling LDP. Pro-CBI reformers found a receptive supporter in the LDP in part because of the declining reputation of MOF, which had authority over the BOJ. Over the course of the 1990s, MOF was blamed for economic stagnation, faced growing criticism for its handling of the financial system (including non-performing loans and the bailout of housing loan companies), and faced a number of corruption scandals. This all made the MOF, usually a formidable political force, an easy target for politicians wanting to score political points for delivering “reform.”7 Indeed, the political attacks on MOF

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6 See Cargill and Dwyer 2013 for an overview of the conventional wisdom. They critique this view.
7 Cargill et al (2013) argue that the MOF accepted BOJ reform as they tried to avoid even worse damage to its ministry as the politicians were trying to divide the Ministry’s fiscal function and financial responsibilities. The same point noted by Dwyer (2004, 255).
went well beyond granting the BOJ independence and even included the consideration of taking budgeting functions from the Ministry (Park 2011). It did not help MOF that leaders in the LDP viewed MOF as having been too cooperative with the previous government, which had excluded the LDP (Cargill et al 2000; Mabuchi 1997). In short, the politics of CBI ultimately had little to do with the objective of CBI – achieving greater inflation control.

The 1998 BOJ Law established de facto independence and set two primary responsibilities for the BOJ: price stability and maintaining the credit and payment system. Notably, neither economic growth nor employment was included in the law, although Article 4 states the sharing of views with the government, so that, “monetary policy be compatible with other economic goals of government policy.”

Post Reform BOJ Policy: Guarding Independence in a Deflationary Environment

The new BOJ law was adopted at the time the Japanese economy was in the state of deflation. The period of no to very little economic growth for Japan extended from the early 1990s for two decades, when the Japanese economy grew more than 2 percent only five years of these years. Particularly in the aftermath of the Global Financial Crisis, the Japanese GDP contracted 5.4 percent in 2009. The Consumer Price Index (CPI) during the five years after the GFC stayed visibly flat, and continued to be almost constantly below zero until early 2013 indicating the prices were actually falling (Figure 4). The Japanese government, during this period and particularly in the aftermath of 3/11 in 2011, has continued to stimulate the economy with various fiscal and quasi-fiscal measures as illustrated by the past fiscal stimulus packages (Table 2) contributing to worsening of fiscal deficit and accumulating public debt (Katada 2013; Katada and Park forthcoming). With the government fiscal position extremely weak, the alternative to cope with the persistent deflation should have been the active monetary policy. The BOJ was, however, reluctant to implement measures demanded by the government and the experts as discussed below.

[Table 2: Main Economic Stimulus Programs since 1998]

Meanwhile and prompted by the massive economic downturn after the Lehman Shock of September 2008 and sustained by the following Eurozone crisis into 2009 and 2010, other major industrial country governments went into overdrive in implementing both fiscal stimulus packages and extremely loose monetary policies. The US and ECB expanded their monetary base much larger and faster than that by the BOJ during this period (Figure 2) with use of various measures of quantitative easing. There was also support from prominent economists for these aggressive monetary policies on the part of the central banks of the countries hit hard by the economic downturn. Two Nobel Prize laureates in Economics, Krugman (2010) and Stiglitz (2009), both came out vocally to warn the threat of deflation and in support
of active stimulus packages. Subsequently, the gap between Japan’s cautious monetary expansion during this period and the aggressive monetary easing actions by other central banks contributed to the appreciation of the Japanese yen, which placed even more pressure on the Japanese economy both in terms of imported deflation (i.e. imported goods became cheaper) and export challenges in the already difficult global market. Needless to say, under these conditions, there was increased pressure on the BOJ to further loosen its monetary policy.

This deflationary environment was incompatible with the CBI norm that took root in Japan with BOJ independence. The mismatch between the norm and the Japan’s policy needs was exacerbated by the Bank’s perceived need to establish credibility in two ways. First, the BOJ remained insistent on vigilance toward inflation, and second, the BOJ resolved to stand firm against political pressure toward expansionary monetary policy.

**Anti-Inflation Norm**

At the time when the major actors of the Japanese government were discussing the revision of BOJ law between 1996 and 1997, the main motivation common to the ministries and politicians was to regain credibility in the face of market actors both domestically and internationally after the burst of economic bubble and the series of financial scandals (Grimes 2001; Dwyer 2004). The ongoing efforts towards the “Big Bang” financial reform during this period, where the Japanese government engaged in further liberalization of Tokyo financial market to make it “free, fair, and global,” no doubt heightened the country’s need to earn the confidence among the global financial players, and following the CBI norm, particularly anti-inflation became important for the BOJ.

Of course in the late 1990s, the Japanese economy was not facing any threat of run-away inflation, but the anti-inflation norm rooted in the experience of the 1970 or at least fear of possibly triggering inflationary consequences guided the BOJ monetary policies during this period and led directly to the BOJ’s reluctance to take aggressive steps to overcome deflation. According to some critics, the BOJ appeared to be haunted by the “ghost of inflation” fearing that the excess liquidity in the market would trigger sudden inflation (Nihon Keizai Shimbun June 30, 1999). Three major debates surrounding the BOJ’s policy choice are illuminating on this point.

First, the BOJ’s anti-inflation norm in the early years after its reform was represented by the way in which the BOJ interpreted the on-going deflation in the late 1990s and in the way in which the BOJ implemented and lifted the Zero Interest

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8 Big Bang reform included full capital account liberalization and liberalization of foreign exchange transactions as well as the compliance with the international accounting standards (Toya, 2006: 144-154)

9 The article notes that the BOJ experiences of the bubbles in the 1970s and 1980s have also informed the BOJ’s fear of inflation (Nihon Keizai Shimbun June 30, 1999).
Rate Policy (ZIRP). By the time the first post-reform BOJ Governor, Masaru Hayami, was sworn in March 1998, Japan was in the midst of Japan’s financial crisis, and there was intensifying calls to address falling prices (Asahi Shimbun May 15, 1998; October 15, 1998). Governor Hayami and his policy board members were repeatedly criticized for taking a relatively optimistic view of the sources and severity of the deflation; they believed that “deflation that resulted from technological innovation and cheaper imports could be desirable (Ito 2004; 222).” This optimistic view of “good deflation” slowed the BOJ’s response to the challenge.

While the LDP-led government introduced three fiscal stimulus packages from April through November of 1998 to counteract the economic downturn, the BOJ was slow in lowering its call rate. Following the series of domestic and international financial challenges in late 1998, the BOJ finally reduced its uncollateralized overnight call rate to zero in March 1999, ushering in the era of the ZIRP, which was announced in April and would last until “deflationary concerns are over.” The issue of when to lift the ZIRP then became a major political tug-of-war between the BOJ and the LDP-led government. As the signs of economic recovery became visible in the spring of 2000, the BOJ began to pave the way towards lifting the ZIRP by repeatedly pointing out the country’s economic recovery and alluding to drawbacks of continuing the ZIRP (Nikkei Kinyu Shimbun, April 4, 2000). Despite vigorous political opposition expressed by the government, the BOJ lifted its discount rate in August 2000 to 0.25 percent. While the goal of asserting independence from the government (discussed further below) motivated the BOJ, it is clear that concerns about inflation informed the policymakers at the BOJ.

The second debate centered on the BOJ’s implementation of the Quantitative Easing (QE), which the Bank introduced in March 2001 within seven months after the end of the ZIRP. Although it was a virtual ZIRP policy because the long-term interest rate stayed at zero, the call rate was maintained at 0.15 percent until the phasing out of the QE (and the ZIRP) in summer of 2006. The media seems not to have caught much in the way of BOJ resistance against implementing this phase of QE, but the BOJ opted to maintain positive interest rate to manage its monetary

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10 As an important asset of the new and transparent BOJ, the new governor Mr. Hayami, a former BOJ board member, was brought back from private sector partly because “he was considered to be incorruptible” (Ito and Mishikin 2006; 142)
11 Ito (2004; 225) also notes Governor Hayami’s speeches made as late as 2000 to substantiate this effect.
12 Hashimoto government (April 1998) announced ¥16 trillion Comprehensive Economic Measures, and Obuchi government (twice in November 1998) committed total of ¥42 trillion in emergency economic measures to stabilize the financial system and support medium and small size businesses (See Table 2)
13 The potential problems of the ZIRP includes (a) the loss of short term market function, (b) the sacrifice of private savers, and (c) delay of structural reform of firms (Koike 2006; 6).
14 Arita (2007) argues that due to the massive failure of the BOJ policy to abandon the ZIRP in August of 2000 amid of massive opposition by the diet members, the BOJ had no choice
policy more effectively. Moreover, the BOJ was quite slow and reluctant to reintroduce the QE in the aftermath of the Global Financial Crisis in September 2008. It was not until the Comprehensive Monetary Easing was introduced in October 2010 two years after the Lehman Shock that the BOJ took active stance against the GFC-triggered recession. Although the QE policy has been in place, the concern about the liquidity trap and the fear of excessive liquidity kept the BOJ reluctant to massively expand the amount of asset purchase.

The third and most prolonged debate that represents the BOJ’s anti-inflationary stance has been its long rejection of adopting inflation targeting. Learning from the experiences of Sweden and New Zealand, inflation targeting was adopted as an effective policy tool to maintain price stability in countries like Canada, the UK and Germany (Mishkin and Posen 1997). Krugman (1998) first proposed the forceful inflation targeting of 4 percent over the next 15 years for Japan (Nihon Keizai Shimbun November 8, 1999), which was followed up by continuous debate by prominent economists in Japan in promotion of the BOJ’s use of inflation targeting (Ito 2002; Iwata 2003). Ito (2004; 242-243) argued that adopting inflation targeting would be highly beneficial for the BOJ because it would (a) increase accountability and transparency, (b) provide instrument independence to the BOJ, and (c) impact inflation expectations. By committing to a certain level of “good inflation,” the monetary authority can establish expectations for sound economic growth through investment and consumption. Facing pressure from the government and the LDP (Nihon Keizai Shimbun August 21, 2001), the BOJ policy board intensely discussed this measure from 1998 through 2003. The Board at the end of the day decided against adopting the policy; one fundamental reason given was “inflation is most likely uncontrollable once triggered (Hayami 2000).”

Resistance to adopting an inflation target as a BOJ policy instrument under the ZIRP continued into the 2010s as the Japanese economy was hit hard by the GFC and 3/11. Nonetheless, as the US Federal Reserve announced its commitment to its goal of price increases of 2 percent on January 25, 2012, the pressure mounted for the BOJ to provide a clear goal of its monetary policy (Nihon Keizai Shimbun, but succumb to the political pressure to implement the QE to sustain fiscal health of the Japanese government.

15 Inflation targeting is defined (Mishkin and Posen 1997; 1) as a policy “which involves the public announcement of medium-term numerical targets for inflation with a commitment by the monetary authorities to achieve these targets.”
16 Ito (2004; 244) documented the frequency of its debate from the Policy Board minutes.
17 Also cited in Ito (2004; 248). Other reasons given are; no good price indicator, no optimal inflation rate can be identified, inflation targeting in deflation is unprecedented, announcement alone will not be credible, the long-term interest rate will go up, and no additional instruments available at the zero interest rate (Ito 2004; 247-251). It is also illuminating that the Institute for Monetary and Economic Studies, the research wing of the BOJ, published a report noting political consequence of inflation targeting. The BOJ would worry about intense pressure to achieve a committed inflation target, which might obligate it to purchase more JGBs (Okina et. al. 2000; 13).
February 11, 2012). In response the BOJ took up the issue in February 2012 at the following Policy Board meeting and decided on the medium and long term price stability “goal” of 1 percent CPI inflation.\(^{18}\) Despite the announcement, there was no obligation on the part of the BOJ to achieve this 1 percent goal, and it was reported that Governor Shirakawa himself did not seem to believe in the positive effect of inflation targeting (Miwa and Maruyama 2012; 5).

**Shielding against Political Pressure**

The revision of the BOJ law establishes de jure policy independence regarding its mandate of price stability, including its autonomy to manage currency and monetary control (Article 3). Furthermore, the new law granted the BOJ political and personnel autonomy by prohibiting the government from firing the governor or the members of the Policy Board (Article 25).\(^{19}\) Cargill et. al. (2000; 172-173) argue that the introduction of the new law during a time of deflation led the BOJ to be unnecessarily ‘conservative’ (inflation-conscious) and timid fighting deflation, falling into what they call an “independence trap.”

As we have argued above, the impetus for the “conservative” (i.e., anti-inflation) stance also supported the pre-GFC anti-inflation norm in the world and it was clearly reflected on the BOJ reluctance viz-a-viz the ZIRP, QE and inflation targeting. We argue, furthermore, the BOJ has suffered from another type of “independence trap,” where the BOJ leadership desired to demonstrate their policy independence from the government by resisting political pressure and by refusing to coordinate with the ministries or the government.\(^{20}\) The period following the BOJ “independence” was a very difficult time for the Japan’s economy. Although establishing an appropriate monetary policy for the economy was the BOJ’s mandate, it was also critical for its leadership to establish credibility by distancing itself as much as possible from the government using CBI as its normative underpinning.

These formative years of the new BOJ’s drive for credibility coincided with the sharp politicization of monetary policy in Japan. Dwyer (2012) explains that, in

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\(^{18}\) The wording for this policy decision was peculiar. A very uncommon term “mokuto” was used to mean the BOJ’s goal (but not target) of its monetary policy. This posture has placed the BOJ between “showing understanding” of the inflation targeting of the pre-February 2012 and the announcement of its commitment (“target”) to inflation targeting that came in January 2013 under the Price Stability Target (Miwa and Maruyama 2012; Hoshi 2013; 5).

\(^{19}\) The document of the new Bank of Japan law can be found at [http://law.e-gov.go.jp/htmldata/H09/H09HO089.html](http://law.e-gov.go.jp/htmldata/H09/H09HO089.html). Further discussion on the new Bank of Japan law, see Dwyer (2004; 247-248) and Cargill, Hutchison and Ito (2000; 96-106). Cargill et. al. measured the BOJ independence based on the new law using Cukierman, Web and Neyapti (1992) ranking methodology and conclude that the index from very low among the industrial economies to the top one third.

\(^{20}\) This does not seem to be a particularly Japanese phenomenon, for the first ECB President Wim Duisenberg called the Bundesbank that “[it] is like whipped cream. The harder you beat it, the stiffer it gets.” (van Overtveldt 2011: 37)
addition to hard economic times, there are two broad developments in Japan in the 1990s that heightened the politicization of monetary policy. One is the loss of fiscal and regulatory options available to the government due to deteriorating fiscal conditions and reforms. The other is the growing importance of macroeconomic tools in affecting the electoral outcome. For a long time into the early 1990s under the LDP rule and under the parliamentary system where the electoral cycle is endogenous, the relationship between Japan's monetary policy and political business cycle was ambivalent. Since the late 1990s, however, there has been increasing stake among both the LDP and DPJ to usher in the favorable macroeconomic conditions either to hold onto the majority position or to win elections.

Effective coordination between a central bank, the government and the ruling party on macroeconomic management is expected even under the CBI framework. Such coordination is particularly important under deflationary conditions. Even in the new BOJ law, the coordination between the BOJ and the Japanese government is clearly stated in Article 4. Nonetheless, the combination of the stubbornly “independent” and “apolitical” BOJ on the one hand, and the parties and the government vehemently interested in swaying positive growth through active monetary policy delivered suboptimal policy outcomes in several ways listed below. The BOJ’s desire to not bend to the will of the government and the fear of the politicization of monetary policy slowed the reflation of the economy throughout the late 1990s into 2012 since this is precisely what the leading parties demanded. (LDP in the late 1990s into 2009, and DPJ from August 2009 through December 2012).

The first aspect of the BOJ’s political sensitivities and its desire to distance itself from the politics emerged as its response to the challenges imposed by the government and leading parties to its autonomous policymaking as well as its management matters. The BOJ leadership has been very concerned about the adverse effect of politics on economic policy. There have been many incidents of such political wrangling, but one major illustrative case was the process of filling a vacant BOJ governor’s chair from March 20 through April 9, 2008, which concluded with the appointment of Governor Shirakawa. Under the divided government that started in summer of 2007 (where the LDP was the majority in lower house, and DPJ in the upper house), the opposition party DPJ used its veto power in the upper house to oppose the LDP favored BOJ governor candidate, Toshiro Muto a former MOF

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21 For a good analysis of the studies on the topic, see Cargill, Hutchinson and Ito (1997, Chapter 7).
22 In addition, due to the 1994 electoral reform, the weakening of the particularistic electoral politics in Japan made it more important to cater to large electorate by improvement of general economic conditions rather than bringing in specific “pork” to constituents (Noble 2010).
23 The new BOJ law Article 4 states “The Bank of Japan shall, taking into account the fact that currency and monetary control is a component of overall economic policy, always maintain close contact with the government and exchange views sufficiently, so that its currency and monetary control and the basic stance of the government’s economic policy shall be mutually compatible.” (emphasis by the authors).
official, arguing that the appointment violates “separation of fiscal policy and monetary policy.” 24 This move led to a delay, in which the top position at the BOJ was unfilled for three weeks. This episode led to a major loss of credibility at the time when the global economy faced the subprime mortgage crisis and the near collapse of the Bear Stearns Companies (Nihon Keizai Shimbun March 24, 2008).

There were also repeated “threats” from the leading parties, the LDP and DPJ, to revise the 1998 BOJ law so that the government would be able to control the BOJ more effectively especially by giving the government the right to fire the BOJ governor. As Japanese deflation worsened in early 2001 after the lifting of the ZIRP (August 2000), the LDP formed a study group with the aim to revise the BOJ law and used this position to pressure the BOJ (Nihon Keizai Shimbun August 15, 2001). Such posture continued into the 2012 lower house election where the LDP won decisively with its leader Shinzo Abe vocally promoting the possibility of revising the BOJ law. It is also striking that the incumbent party (irrespective of the ideological spectrum) came to promote the idea of revising the BOJ law. Even the DPJ, which was quite supportive of BOJ independence as the opposition party since the late 1990s, had many members join the 150-member ‘Anti-Deflation League’ after their 2009 electoral victory, which announced in October 2010 a proposal to revise the 1998 BOJ law including inflation targeting, reduction of BOJ autonomy and increasing its policy accountability (Dwyer 2012; 188-189; Nihon Keizai Shimbun April 19, 2012).

It is quite likely that the BOJ had to respond to these immense political pressures. But its concerns about credibility led them to insist on (at least) the appearance of its policy independence and often either delay or dampen its actions. In contrast to reflationary policy demands of the leading parties, the BOJ tended to insist on policies that took a more hawkish stance toward the threat of inflation. The discussion from the BOJ Policy Board meeting on August 11, 2000 at the time when the Board lifted the ZIRP is quite illuminating on this account.25 During the meeting, the Japanese government requested to delay the BOJ board decision (of ending the ZIRP) by invoking the Article 19 (section 2) of the new BOJ law. But the Board members including the Governor Hayami flatly rejected this motion. The discussion on this issue clearly indicated how the BOJ board members objected to the government’s challenge to the BOJ policy independence and the appearance of the BOJ succumbing to the government’s pressure (BOJ 2000; especially pages 102 through 104). The media also intensively covered this story, and there was a strong sense that if the BOJ postponed lifting ZIRP this time around, it would look like the BOJ buckled under political pressures (Nihon Keizai Shimbun, August 12, 2000).

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24 The new BOJ law (Article 23) requires the approval from both the upper house and lower house to appoint the BOJ governor.
25 As one of the requirements under the 1998 BOJ law, the BOJ is now required to publish the entire minutes from the BOJ Policy Board discussion ten years after the meeting. The one for the late 1990s and the early 2000s are now available at http://www.boj.or.jp/mopo/mpmsche_minu/record_1998/index.htm/
The second aspect that makes the BOJ adamant against collaborating with the government arises from its position of “separation between fiscal and monetary policy.” The origin of this push to separate fiscal policy and monetary (and financial) policy in Japan goes back to the time of the post-oil shock recession of the 1970s where the Ministry of Finance pressured Japanese banks to buy up the Japanese Government Bonds (JGBs) to fill the gap in the primary balance. This led to the expansion of the public debt during this period (Mabuchi 1997; 24-28). It took the political turmoil and major failure (and public outcry) of the 1990s for this separation to become a reality with the division of banking and financial supervisory function from the MOF in 1998 (Amyx 2004; Grimes 2001). Contemporaneously, the increased independence of the BOJ was granted (Mabuchi 1997; 258-293). The rising public debt and ballooning JGB issues has been a major concern of the BOJ when it speaks of “separation” and independence. Throughout this period, the BOJ was constantly critical of the shortage of fiscal and structural reform (Nihon Keizai Shimbun, May 2, 2001, featuring Governor Hayami’s interview). When the BOJ agreed to adopt the first QE policy in March 2001, it also inserted the “banknote rule” to self-impose the ceiling of the JGB purchase to the amount of banknotes in circulation. The BOJ credibility was at stake here, too, to keep itself away from “zaisei fainansu (monetization of debt),” which is a common concern of all the central banks.

Finally, the BOJ’s credibility consciousness has prevented it from taking any firm commitment on goal-oriented monetary policy, particularly when the goal appeared to have been imposed by the government. In relation to the discussion of the inflation targeting, the major reason behind the BOJ’s reluctance to engage in such goal-oriented policy comes from the fear of the BOJ will come under political pressure to achieve the goal by any means necessary including unrestrained purchase of the JGBs (Nihon Keizai Shimbun, September 11, 2001).26

In sum, the desire on the part of the BOJ to establish credibility led the post-1998 BOJ to insist on its political independence from the government and leading parties. As demonstrated above, the politicization of monetary policy during this period was intense, and the lack of coordination between the government and the BOJ, which could not quite buy into the anti-deflationary commitment, slowed its responses to Japan’s economic challenges until the emergence of the Abenomics.

Abenomics

The BOJ finally broke with the status quo with the LDP’s electoral landslide at the end of 2012. Shinzo Abe became prime minister for a second time, and he appointed a clear advocate of bolder monetary policy, Haruhiko Kuroda, as the new governor of the BOJ, after pre-scheduled retirement of BOJ Governor Shirakawa in

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26 The same concern was also noted by the report published by the then-the head of BOJ Institute for Monetary and Economic Studies (Okina et. al. 2000; 13-14)
March 2013. The BOJ’s policy – referred to as Qualitative and Quantitative Easing (QQE) – has several features that distinguish it from previous policy. First, the BOJ is now committed to a larger QE. The BOJ announced in April 2013 that it would double the monetary base in two years, a much larger expansion than with earlier QE – see figure below. Second, the BOJ has announced an explicit inflation target of 2 percent, as well as a time frame for achieving that target in two years. Third, the government has targeted assets with longer-term maturities to target long-term interest rates, extending the average maturity from four to six years (Iwata and Fueda-Samikawa 7); this is the “qualitative” part of QQE. In addition to these significant policy shifts, the BOJ has also taken on other sacred cows, including abolishing the “purchase rule,” allowing it now to buy new JGB issues (Iwata and Fueda-Samikawa 7).

While Abenomics represents a break with the past, it is important to bear in mind that the monetary base expansion since 2007 will put it on par with that of the QE of the Fed and BOE (Hoshi 2013). Thus, in comparative terms, Abenomics is neither radical nor novel. As Lipsy et al (2013) note, the US and others benefitted from learning from the experience of Japan prior to the GFC. The Japanese case helped others understand the need for quick resolution of financial crises, some of the dangers of deflation, and how QE might be used to combat it. It is not the goal of this paper to elaborate the reasons behind the current success of PM Abe to turn the BOJ around to follow his aggressively reflationary policy. As the Japanese economy began to show vibrancy sustained by declining yen and the booming stock market, one wonders how and why the BOJ resisted this policy option. The change in the CBI norm in the aftermath of the GFC where many central banks engaged in unconventional reflationary policies is obviously constitutes an important backdrop of this shift. Neither the anti-inflationary posture nor the adamant political independence is now called for in order for a central bank to be an effective and credible agent of monetary policy.

CONCLUSION

This paper develops a social theory of central bank independence. The paper then applies this theory to explain Japan’s delayed embrace of a more aggressive monetary policy to combat deflation. The foregoing shows how Japan’s importation of the CBI norm was embraced by domestic actors, who zealously sought to establish central bank credibility through the assertion of independence. Central bankers equated CBI with establishing inflation-fighting credentials and freedom from political influence. These norms, however, were imported as Japan was grappling with low inflation or deflation and ultimately hindered the BOJ’s effectiveness in addressing this problem.

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27 Although Governor Shirakawa had already agreed to implement many of the monetary policies of the Abenomics’ “Bold Monetary Policy,” active implementation of these policies did not start until the new Governor Kuroda came into the office in April 2013.
The theory and case of Japan presented here has two larger implications – one conceptual and one normative. First, there is a need to be careful in distinguishing between de facto and de jure independence, something the literature has addressed but not always satisfactorily. Statutory independence says little about de facto independence, i.e., the behavior of central banks. De facto independence, however, is a problematic concept. Policy decisions are made in a larger context of social meaning and practice – such as sharing information, exchanging views, and coordinating policy – and in a sense, de facto independence is a concept that in and of itself has no meaning. Actors can, however, interpret what independence should mean – e.g., fighting inflation or not cooperating with the executive – but this reflects social norms and practices. These interpretations of independence, this paper shows, can be detrimental to monetary policy decisions. Second, given that policy ideas are sticky and emerge under particular historical circumstances, there is the potential for a mismatch between ideas and policy needs. We see this clearly in the Japanese case. Thus, in a normative vein, there is a need to avoid reifying the notion of independence. Cooperation is sometimes needed, and it is potentially counterproductive to view cooperation as somehow opposed to central bank independence.

Moving forward, there is a need to build on the ideational literature on CBI to better explore how the social dimension influences the conduct of monetary policy. This paper has done so by analyzing the Japanese case, but future research should look at how the social embeddedness of other central banks - BOE, ECB, and Federal – might explain the nature of their monetary policy responses to financial crisis and declining inflation.
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### Table 1: Japan’s Quantitative Easing 2001-2006

<table>
<thead>
<tr>
<th>Announcement Date</th>
<th>BOJ Account Balance Target (Trillion ¥)</th>
<th>JGB Purchase Target (10 billion ¥/month)</th>
<th>Main Components</th>
</tr>
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<tbody>
<tr>
<td>March 19, 2001</td>
<td>5</td>
<td>4,000</td>
<td>Introduction of QE</td>
</tr>
<tr>
<td>August 14, 2001</td>
<td>6</td>
<td>6,000</td>
<td>In support of the government’s initiative on structural reform</td>
</tr>
<tr>
<td>September 18, 2001</td>
<td>Above 6</td>
<td>6,000</td>
<td>In response to 9/11 terrorist attack. Call rate at 0.10%</td>
</tr>
<tr>
<td>December 19, 2001</td>
<td>10-15</td>
<td>8,000</td>
<td>Amplify measures for monetary expansion</td>
</tr>
<tr>
<td>February 28, 2002</td>
<td>Ample supply</td>
<td>10,000</td>
<td>Secure liquidity at the end of fiscal year</td>
</tr>
<tr>
<td>September 18, 2002</td>
<td>Ample supply</td>
<td>10,000</td>
<td>Purchase of stocks held by private financial institutions</td>
</tr>
<tr>
<td>October 30, 2002</td>
<td>15-20</td>
<td>12,000</td>
<td>Term Extension of purchase of bills</td>
</tr>
<tr>
<td>March 25, 2003</td>
<td>17-22</td>
<td>12,000</td>
<td>Establishment of Japan Post. Iraq War started</td>
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<tr>
<td>April 30, 2003</td>
<td>22-27</td>
<td>12,000</td>
<td>SARS impact Asian economies</td>
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<td>May 20, 2003</td>
<td>27-30</td>
<td>12,000</td>
<td>Nationalization of Risona Bank. Appreciation of the yen</td>
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<tr>
<td>June 11, 2003</td>
<td>27-30</td>
<td>12,000</td>
<td>Start BOJ purchase of Asset back securities</td>
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<tr>
<td>October 10, 2003</td>
<td>27-32</td>
<td>12,000</td>
<td>Three conditions for lifting QE announced</td>
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<tr>
<td>January 20, 2004</td>
<td>30-35</td>
<td>12,000</td>
<td>Monetary loosening under acknowledgement of economic recovery</td>
</tr>
<tr>
<td>May 20, 2005</td>
<td>30-35</td>
<td>12,000</td>
<td>Acknowledged that the economy underperformed from the expectation</td>
</tr>
<tr>
<td>March 9, 2006</td>
<td>Lifted</td>
<td>Maintain the same level</td>
<td>Moved to the ZIRP (the ZIRP lifted in July 2006)</td>
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Source: Koike 2006, p. 4, from Bank of Japan Home page
<table>
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<tr>
<th>Announcement Date</th>
<th>Cabinet</th>
<th>Name of Stimulus Program</th>
<th>Project Budget (Trillion ¥)</th>
<th>Fiscal Expenditure (Trillion ¥)</th>
<th>Main Components</th>
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<tr>
<td>April 1998</td>
<td>Hashimoto</td>
<td>Comprehensive Economic Measures</td>
<td>16</td>
<td>4.6</td>
<td>Public works, Employment, Special tax reduction</td>
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<td>November 1998</td>
<td>Obuchi</td>
<td>Emergency Economic Measures</td>
<td>24</td>
<td>7.6</td>
<td>Stabilization of Financial system, permanent tax reduction</td>
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<td>November 1999</td>
<td>Obuchi</td>
<td>Policy Measures for Economic Rebirth</td>
<td>18</td>
<td>6.5</td>
<td>Financial measures for mid and small size business, Senior care measures</td>
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<td>October 2000</td>
<td>Mori</td>
<td>New Development Policy for the Rebirth of Japan</td>
<td>11</td>
<td>3.9</td>
<td>Public works, Employment measures</td>
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<td>October 2001</td>
<td>Koizumi</td>
<td>Front-loaded Reform Program</td>
<td>5.8</td>
<td>1.0</td>
<td>Employment, Mid and small size business measures</td>
</tr>
<tr>
<td>December 2001</td>
<td>Koizumi</td>
<td>Emergency Response Program</td>
<td>4.1</td>
<td>2.6</td>
<td>Public works, IT promotion</td>
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<tr>
<td>December 2002</td>
<td>Koizumi</td>
<td>Program to accelerate reforms</td>
<td>14.8</td>
<td>3.0</td>
<td>Employment, Mid and small size business measures</td>
</tr>
<tr>
<td>August 2008</td>
<td>Fukuda</td>
<td>Comprehensive Measures for the realization of peace of mind emergency</td>
<td>11.7</td>
<td>1.8</td>
<td>Disaster Measures, Financial measures for mid and small size business</td>
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<td>October 2008</td>
<td>Aso</td>
<td>Life measures</td>
<td>26.9</td>
<td>4.8</td>
<td>Supplementary Income Payment, Reduction of highway toll fee</td>
</tr>
<tr>
<td>December 2008</td>
<td>Aso</td>
<td>Emergency Measures to protect livelihood</td>
<td>37</td>
<td>4.3</td>
<td>Expand unemployment payment and insurance.</td>
</tr>
<tr>
<td>April 2009</td>
<td>Aso</td>
<td>Economic Crisis Measures</td>
<td>56.8</td>
<td>15.4</td>
<td>Subsidy for purchasing low-emission cars and energy-saving consumer electronics</td>
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<tr>
<td>December 2009</td>
<td>Hatoyama</td>
<td>Emergency Economic Measures for Growth and Peace of Mind Tomorrow</td>
<td>24.4</td>
<td>7.2</td>
<td>Housing Eco-point, Supplement for reduction of tax allocations for local government</td>
</tr>
<tr>
<td>September 2010</td>
<td>Kan</td>
<td>Emergency Response to Strong Yen and Deflation</td>
<td>9.8</td>
<td>0.915</td>
<td>Extension of Eco-points for housing and consumer electronics, Job creation for targeted areas</td>
</tr>
<tr>
<td>October 2010</td>
<td>Kan</td>
<td>Emergency Economic Stimulus Package of support for the Yen-deflation</td>
<td>21.1</td>
<td>5.1</td>
<td>New Developmental Programs such as measure for rare metals, Public works, including creation of Community revitalization grant</td>
</tr>
</tbody>
</table>
Source: Cabinet Office, Japan (http://www2.ttcn.ne.jp/~honkawa/5090.html) and Takayama (2009)
Figure 1: Main Policy Rates of Fed, ECB, BOJ, and BOE

NOTE: The main policy rates for the Fed, ECB, BOJ, and BOE are, respectively, the federal funds target rate, the main refinancing operations fixed/minimum bid rate, the uncollateralized overnight call rate, and the official Bank rate.

SOURCE:

(2) After September 2013:
FED: http://www.federalreserve.gov/newsevents/default.htm
BOE: http://www.bankofengland.co.uk/monetarypolicy/Pages/default.aspx
Figure 2: Monetary Base Expansion in the US, UK, Europe and Japan

Reference Year: 2007 Q1

Source:

(2) BOE, retrieved from: http://www.bankofengland.co.uk/boeapps/iadb/index.asp?Travel=NlxSTxTAX&levels=1&XNotes=Y&B7989XNode7989.x=4&B7989XNode7989.y=10&C=2GS&XNotes2=Y&Nodes=X39867X39927X7989X8020X8042X8045X39928X39931&SectionRequired=A&HideNums=-1&ExtralInfo=false#BM
(3) ECB, retrieved from: http://sdw.ecb.europa.eu/home.do
Figure 3: Growth from 1995 for Eurozone, UK, US, Japan from 1995

Reference Year: 1995 Q1

Source: OECD Stats Extracts
Figure 4: Consumer Prices Index of Europe, UK, US, Japan from 2006

Reference Year: 2010

Source: OECD Stats Extracts, retrieved from http://stats.oecd.org/Index.aspx#
Figure 5: US. Dollar / Yen Exchange Rate

Note: at 17:00 in JST, Average in the Month, Tokyo Market
Source: BOJ, retrieved from:
http://www.stat-search.boj.or.jp/cgi-bin/famecgi2.cgi=$graphwnd_en