

# Introduction

**Kunio Okina and Shigenori Shiratsuka**

The 11th International Conference of the Institute for Monetary and Economic Studies (IMES) of the Bank of Japan (BOJ) was held on July 5 and 6, 2004, on the theme of “Challenges for Sustained Economic Growth under Changing Economic, Social, and International Environments.” (See Appendix 1 for a list of the round-table participants.)

The conference focused on how to achieve and promote sustained economic growth in the world economy, amid the considerable changes taking place in the economic, social, and international environments. Specifically, the conference accommodated an exchange of views based on theoretical and empirical analyses as well as the practical standpoints of central bank economists and policymakers. Our primary focuses included (1) the sources of sustainable growth, (2) the long-term consequences of uneven economic growth in different regions of the world on the international allocation of resources, and (3) the roles that should be played by central banks and other policy authorities.

The conference began with an opening speech by BOJ Governor Toshihiko Fukui, followed by keynote speeches from the two honorary advisors of IMES, Bennett T. McCallum and Maurice Obstfeld. The subsequent five sessions dealt with presentations and discussions of papers on various aspects of sustained economic growth. The conference ended with a panel discussion session on price stability and sustainable economic growth. (See Appendix 2 for the program.)

Session 1, entitled “Globalization, Inequality, and Development: The Big Picture,” focused on the mechanism of economic growth in increasingly globalized environments, such as the role of international trade and production factor flows, as well as the problems of international economic disparities.

Session 2, entitled “Sustained Economic Growth and the Financial System,” addressed the role of the financial system in achieving sustained economic growth from wide-ranging perspectives, such as the implications of large-scale asset price fluctuations and financial system crises on economic growth.

Session 3, entitled “Privatizing Social Security: A Political-Economy Approach,” examined the effects of the aging population on social security systems, focusing on the political-economy aspects of pension systems.

Session 4, entitled “Asset Price Fluctuations, Structural Adjustments, and Sustained Economic Growth: Lessons from Japan’s Experience since the Late 1980s,” took up issues related to structural factors and sustainable growth, highlighting the Japanese experience subsequent to the collapse of the bubble economy.

Session 5, entitled “Securing the Peace after a Truce in the War on Inflation,” considered the relationship between price development and economic growth, including the role of monetary policy in achieving sustainable economic growth in

a low-inflationary environment, with emphasis on the non-negativity constraint of nominal interest rates.

The concluding panel discussion session, entitled "Sustained Economic Growth and Central Banking," focused on the proper role of central banks in promoting sustainable growth, with the five panelists consisting of one each from the European Central Bank, the U.S. Federal Reserve Board, and the BOJ plus the two honorary advisors of IMES.

The discussions at the conference covered a very broad spectrum of issues. Our summary of the main points is shown below.

- (1) An analytical framework for understanding the economic growth mechanism and the international and domestic economic disparities in the increasingly integrated global economy was proposed. This framework was based on two perspectives: endowment and accumulation of production factors, and differentials in productivity. The framework was generally accepted by many participants as providing an appropriate starting point for discussions. Further extensions of the framework were suggested by participants, for example, incorporation of alternative formulations of technological progress, new types of international integration (such as greater intra-industry trading), and the dynamic interaction between accumulation of production factors and improvements in productivity.
- (2) Some emerging market nations were thought to have reached a stage of integration with international financial markets. These nations were marked by high per capita income, favorable long-term economic performance, and low output and consumption volatility. Their integration was the result of their solid economic performance.

The emerging market nations were still enjoying a very limited portion of benefits from integration of domestic and international financial markets, compared with industrial nations. This was because emerging market nations generally had difficulty resolving the open-economy trilemma, despite their achievement of good macroeconomic performance. Given that many emerging market nations faced their own structural and institutional problems, they seemed to experience difficulty surviving under either a fixed exchange rate regime or a completely floating exchange rate regime. They thus were unlikely to improve their economic performance under either of the two extreme exchange rate regimes.

- (3) Financial systems were judged to play an important role in achieving sustained economic growth, by promoting efficient resource allocation as well as maintaining financial system stability.

To maintain financial stability, large-scale asset price fluctuations inconsistent with underlying economic fundamentals, on the one hand, should be staved off with maximum effort. They were most likely to affect economic growth seriously. Asset price fluctuations consistent with economic fundamentals, on the other hand, seemed to have positive effects on economic growth. Some cautions were posed, however, that judging whether or not large-scale asset price fluctuations were actually consistent with underlying economic

fundamentals and making appropriate policy responses in real time were extremely difficult.

- (4) Japan's experience after the bursting of the asset price bubble was viewed as a case in which the large-scale asset price fluctuations led to a major loss of economic welfare. As for the influence of asset price fluctuations on trend growth rates, it was emphasized that more research would be needed to uncover the mechanism behind the dynamic amplification of cross-sectional misallocation across industries. In this respect, the lack of supply-side analyses concerning deflation in Japan was pointed out.

At the same time, considering that the weak price development in Japan during the 1990s was characterized as mild deflation under output stagnation, one of the root causes should be insufficient aggregate demand. In particular, the bursting of the asset price bubble was regarded as creating a major demand shock, as excessively bullish expectations for the future were revised downward. It was also pointed out that Japan's insufficient aggregate demand was a somewhat persistent phenomenon, and that it should differ fundamentally in nature from short-term and temporary demand shortages.

- (5) Concerning the negative correlation between inflation and economic growth, it was emphasized that such a relationship should not be regarded as indicating causality whereby a low inflation rate itself raised the economic growth rate. Rather, it was stressed that the macroeconomic policies and stable social and economic environments which were desirable for achieving low inflation should also be recognized as a basis for sustained economic growth.

Moreover, even though empirical evidence generally supported long-run monetary neutrality, such evidence should not be understood as an indication of the automatic guarantee of long-run monetary neutrality. Rather, it signified the importance of maintaining and promoting a stable economic environment that did not distort the decision making of economic agents. This in turn was expected to ensure long-run monetary neutrality.

- (6) Based on the understanding above on the relationship between price stability and sustained economic growth, it was stressed that monetary policy could best contribute to promoting sustained economic growth by securing price stability. As for definitions of price stability in an operational manner, it was generally pointed out that the particular conditions in each nation must be considered. It was deemed difficult to set "one-size-fits-all" standards in terms of a desirable rate of inflation, targeted price index, and appropriate time frames.

- (7) The risk of falling into deflation should be contained at a minimum after achieving price stability. Deflation was judged as a more serious threat than inflation in achieving price stability, considering the non-negativity constraint of nominal interest rates. To this end, it was generally pointed out that the desirable target of inflation should be small but positive.

Meanwhile, the importance of influencing public expectations was emphasized as a policy response in the event of a fall into deflation. However, the discussions did not converge on any consensus on practical measures to combat

deflation. Views diverged on the effectiveness of unconventional policy measures beyond a central bank's commitment.

- (8) The great influence of aging societies on the sustainability of public pension systems was widely recognized. In particular, analyses incorporating political-economy aspects were considered as an effective approach to balance conflicting interests between pension recipients and contributors, and for the transition toward a sustainable system.

## **APPENDIX 1: LIST OF ROUND-TABLE PARTICIPANTS**

**Franklin Allen**  
University of Pennsylvania

**Palle Andersen**  
Bank for International Settlements

**Milagros S. Atraje**  
Bangko Sentral ng Pilipinas

**Agathe Côté**  
Bank of Canada

**Jean-Philippe Cotis**  
Organisation for Economic  
Co-operation and Development

**William R. Easterly**  
New York University

**Charles L. Evans**  
Federal Reserve Bank of Chicago

**Hiroshi Fujiki**  
Bank of Japan

**Toshihiko Fukui**  
Bank of Japan

**Stefan Gerlach**  
Hong Kong Monetary Authority

**Pietro Ginefra**  
Banca d'Italia

**Jeong-Ho Hahm**  
The Bank of Korea

**Gregory D. Hess**  
Claremont McKenna College

**Hiroyuki Hino**  
International Monetary Fund

**Eiji Hirano**  
Bank of Japan

**Nobuo Inaba**  
Bank of Japan

**Otmar Issing**  
European Central Bank

**Yasushi Iwamoto**  
Hitotsubashi University

**Kazumasa Iwata**  
Bank of Japan

**Jiao Jinpu**  
The People's Bank of China

**George A. Kahn**  
Federal Reserve Bank of Kansas City

**Keimei Kaizuka**  
Chuo University

**Philip W. Lowe**  
Reserve Bank of Australia

**Yasuhiro Maehara**  
Bank of Japan

**Bennett T. McCallum**  
Carnegie Mellon University

**Toshiro Muto**  
Bank of Japan

**Hiroshi Nakaso**  
Bank of Japan

**Ng Bok Eng**  
Monetary Authority of Singapore

**Maurice Obstfeld**  
University of California at Berkeley

**Kunio Okina**  
Bank of Japan

**Akira Otani**  
Bank of Japan

**Richard W. Peach**  
Federal Reserve Bank of New York

**Simon Price**  
Bank of England

**Robert H. Rasche**  
Federal Reserve Bank of St. Louis

**Assaf Razin**  
Tel Aviv University and Cornell  
University

**Vincent R. Reinhart**  
Board of Governors of the Federal  
Reserve System

**Hermann Remsperger**  
Deutsche Bundesbank

**Rozainita Shamsudin**  
Bank Negara Malaysia

**Etsuro Shioji**  
Yokohama National University

**Masaaki Shirakawa**  
Bank of Japan

**Shigenori Shiratsuka**  
Bank of Japan

**Peter Stalder**  
Schweizerische Nationalbank

**Miyako Suda**  
Bank of Japan

**F. X. Sugiyono**  
Bank Indonesia

**Kazuo Ueda**  
Bank of Japan

**Atchana Waiquamdee**  
Bank of Thailand

**Kenichiro Watanabe**  
Bank of Japan

## APPENDIX 2: PROGRAM

Date/Time	Session	Chairperson/Moderator	Paper Presenter/Panelist	Designated Discussant	
Monday, July 5	9:00–12:00	Opening Speech	Toshihiko Fukui (Bank of Japan)		
		Keynote Speeches	Bennett T. McCallum (Carnegie Mellon University), Maurice Obstfeld (University of California at Berkeley)		
		1 Globalization, Inequality, and Development: The Big Picture	Masaaki Shirakawa (Bank of Japan)	William R. Easterly (New York University)	Etsuro Shioji (Yokohama National University), Stefan Gerlach (Hong Kong Monetary Authority)
	13:30–16:45	2 Sustained Economic Growth and the Financial System	Jean-Philippe Cotis (Organisation for Economic Co-operation and Development)	Franklin Allen (University of Pennsylvania)	Palle Andersen (Bank for International Settlements), Richard W. Peach (Federal Reserve Bank of New York)
		3 Privatizing Social Security: A Political-Economy Approach	Nobuo Inaba (Bank of Japan)	Assaf Razin (Tel Aviv University and Cornell University)	Gregory D. Hess (Claremont McKenna College), Yasushi Iwamoto (Hitotsubashi University)
Tuesday, July 6	9:00–12:15	4 Asset Price Fluctuations, Structural Adjustments, and Sustained Economic Growth: Lessons from Japan's Experience since the Late 1980s	Robert H. Rasche (Federal Reserve Bank of St. Louis)	Kunio Okina (Bank of Japan), Shigenori Shiratsuka (Bank of Japan)	Charles L. Evans (Federal Reserve Bank of Chicago), Philip W. Lowe (Reserve Bank of Australia)
		5 Securing the Peace after a Truce in the War on Inflation	Eiji Hirano (Bank of Japan)	Vincent R. Reinhart (Board of Governors of the Federal Reserve System)	Simon Price (Bank of England), Masaaki Shirakawa
	13:30–17:00	Concluding Panel Discussion: Sustained Economic Growth and Central Banking	Kazumasa Iwata (Bank of Japan)	<b>Introductory Remarks:</b> Kunio Okina <b>Panelists' Remarks:</b> Kazuo Ueda (Bank of Japan), Vincent R. Reinhart, Otmar Issing (European Central Bank), Maurice Obstfeld, Bennett T. McCallum	

