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COPING WITH THE ECONOMIC IMPACT OF THE EARTHQUAKE

Takao Komine

Dealt successive blows by the massive earthquake, the tsunami and the damage to the nuclear power plant, the Japanese economy is still reeling from its greatest shock since the end of World War II. In considering the impact of this great shock on the economy and the measures required to cope with it, we need to take into account two phases.

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Phase I is the stage where the short-term impact of the disaster emerges. This includes, first of all, the loss of a large amount of stocks. According to estimates by the Cabinet Office, 16 trillion to 25 trillion yen in stocks has been lost due to the earthquake and the tsunami, which is more than 10 trillion yen in damage Japan suffered at the time of the Great Hanshin-Awaji Earthquake.

Economic activities will stall drastically. This is because economic activities, including production and consumption, have shut down in the affected areas and, even outside these areas, production has been suspended due to the disruption of distribution networks. Furthermore, depressed consumer confidence has slowed down spending. Japan had been enjoying continued economic recovery from March 2009, but the earthquake will no doubt cause the country to enter into a recession. We will see negative growth rates in the first and second quarters of 2011.

Next comes Phase II, which begins roughly six months after the earthquake. Economic activities should be gradually returning to normal levels by then. Lost production bases will have been replaced by new sites, and the damaged distribution networks will have been restored. The public's mindset should be improving as well. Added to all this will be reconstruction demand. There will be increasing investment flowing in to recover stocks in lost housing, factories, office buildings, roads, railways, bridges, ports, harbors and so on. Commensurable with the scale of the damage, investment for reconstruction is expected to reach a considerable amount. This will work as a *de facto* large-scale fiscal stimulus and improve growth rates.

Our response to the disaster should differ according to the phase. The utmost priority during Phase I is lifesaving and victim assistance. We also need to restore stability at the nuclear power plant and stave off radioactive emissions. These are emergency measures with fairly clear-cut goals, and we should dedicate all our strength to achieving these goals.


The real challenge will lie in Phase II. The reconstruction efforts we pursue must be based on a new vision for the Japanese economy. In this respect, the following are of particular importance.

The first is the reconstruction budget. In order to secure a large budget

for reconstruction, the government will need to review existing expenditures and then consider tax increases. At the same time, the government may be tempted to increase the issuance of bonds, for this will keep anyone from having to bear the costs for the time being. Given the already serious financial condition of this country, however, the government should avoid further inflating the budget deficit.

The second is the rehabilitation of local communities. Given the extent of the destruction those communities have suffered, it would be inappropriate to restore them to their original states. Rather we should draw up new land use plans and prepare social infrastructure, although the residents of afflicted areas may wish to see their towns and villages return to their original states.

The third is the role of social capital. In the immediate aftermath of the earthquake, or during Phase I, the Japanese people have made the best use of their discipline and their spirit of mutual cooperation. These are indeed elements of social capital of which the Japanese people can be proud. During the reconstruction stage of Phase II, however, a spirit of mutual cooperation alone will not suffice. What are needed are a long-term vision and rational policies to realize it.

The way Japan copes with this Phase II will determine its future. 

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