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September 12, 2014

Bank of Japan

**Commencement Speech at the Graduation Ceremony of  
the National Graduate Institute for Policy Studies**

**Haruhiko Kuroda**

*Governor of the Bank of Japan*

## **Introduction**

Congratulations to all of you who are about to graduate from the National Graduate Institute for Policy Studies (GRIPS). I also extend my congratulations to your families. I am wholeheartedly delighted to be with you today -- a very special day that marks the start of a new life for the graduates.

I myself graduated from a university in Japan in 1967 and completed a master's program in the United Kingdom in 1971. In both cases, what I studied and experienced in my student life became irreplaceable assets for me, and when I attended my graduation ceremonies, I was quite excited thinking about the future that lay ahead of me. Looking at the bright smiles on your faces brings back good memories of that time.

When I joined the master's program, I majored in economics after having majored in law in my undergraduate studies. This means that my experience was a bit different from that of most students in that I took different majors in different languages for my bachelor's and master's degrees. During my subsequent career, I also gained experience at the Ministry of Finance and in a variety of work assignments, including as Advisor to the Executive Director of the International Monetary Fund (IMF), Special Advisor to the Cabinet, Professor at Hitotsubashi University, President of the Asian Development Bank, and now Governor of the Bank of Japan. Today I would like to tell you three lessons that I have learnt from this experience, and that, I think, will provide useful guidance when you become involved in policy planning and implementation.

### **I. Reconciling Theory and Practice**

The first lesson is about the importance of reconciling theory and practice. In the near future, many of you will find yourself in a position where you are expected to consider how to respond to various policy challenges. In that case, you will first need to assess the situation as accurately as possible and consider realistic and specific policy responses. As a policy practitioner, it is critical to get used to such a pragmatic approach. At the same time, however, you should be aware that relying solely on a pragmatic approach could entail risks. Policy responses may become rather idiosyncratic and piecemeal, with little consistency across policies, or may be insufficiently strong. That is why you need theory.

Theory will provide an important cornerstone when, taking a longer-term perspective, you think about the consistency of policy responses or about drastic policies with far-reaching implications. Of course, there may not be that many cases in which theory provides policy recommendations that are effective in practice. Nevertheless, being mindful of a theoretical approach, in addition to a pragmatic approach, will allow you to take a step back and consider issues from a broader and more three-dimensional perspective. That will widen your policy planning capability.

Let me give you a practical example from my experience. I was involved in the introduction of a general consumption tax as Deputy Director of the Tax Bureau in the second half of the 1970s, and then a reduction of income taxes as Director from the late 1980s to early 1990s. On both occasions, the fact that I had studied the optimal tax theory at graduate school meant quite a lot to me. Put simply, optimal tax theory assumes that a tax system should be designed to minimize the deadweight losses stemming from taxation while maximizing the welfare of society as a whole. This notion may sound quite obvious to you. However, back in the 1970s, optimal tax theory had a large impact on taxation authorities by providing a perspective that could lead to rather innovative policy recommendations. They were completely different from policy recommendations based on then existing tax theories, which had strongly focused on fairness in income distribution when assessing a tax system. For example, a highly progressive income tax can be considered desirable from the viewpoint of fairness. However, if this progressive tax acts as a disincentive to work for those who earn a higher income because of their higher productivity, that may result in a decline in the welfare of society as a whole. Thus, from the perspective of optimal tax theory, such a tax system is not ideal. Another example of the different implications derived from optimal tax theory concerns taxes on daily necessities. Heavy taxes on daily necessities would be undesirable from the view point of fairness, since they would impose a disproportionate burden on those with relatively low income. However, they would be desirable from the perspective of optimal tax theory, since such goods and services have a low price elasticity, so that the deadweight loss produced by taxing them would be small. As these examples illustrate, theories cannot be applied straight "out of the box." Yet, having studied them helped significantly to broaden my horizon and showed me what aspects to take into account when considering policy

measures. While the introduction of the consumption tax and the reduction of income taxes ended up being considerably delayed, the knowledge accumulated in the process of examining these policies became a great asset both for taxation authorities and myself.

Quantitative and qualitative monetary easing, or QQE, which was introduced immediately after I became Governor of the Bank of Japan last year, is a good example of an attempt to reconcile theory and practice. Since the late 1990s, the Bank of Japan had implemented a variety of unconventional monetary policies ahead of other central banks in its battle against the deflationary pressure that Japan's economy had been facing. These unconventional policies include a zero interest rate, quantitative easing, and forward guidance. Nevertheless, Japan's economy was unable to escape from deflation for 15 years. When I became Governor of the Bank, I discussed policy measures to overcome deflation with members of the policy board and the staff of the Bank of Japan, and I was fully aware of the various views on why Japan was unable to escape from deflation. However, based on theories on unconventional monetary policies developed since the late 1990s by Professors Paul Krugman, Michael Woodford, Gauti Eggertsson, Tsutomu Watanabe, and others, it appeared that the Bank of Japan's commitment to overcoming deflation had not been sufficiently strong. The Bank of Japan's monetary policies seemed have been insufficient in terms of affecting people's expectations because of the Bank's weak commitment. This reminded me of my days at graduate school in the 1970s. In one seminar, Sir John Hicks stressed the importance of commitment and the role of expectations in monetary policy. He said that the reason why the Bank of England (BOE) could affect the economy by raising the Bank rate by merely 0.5 percentage points was that the BOE had shown its strong commitment to raising the policy rate as much as was necessary to ensure the stability of the economy. Thus, QQE was born as a result of an examination of both past experience and theoretical developments. There is no pre-determined formula as to how to strike the right balance between theory and practice. But I would like you to remember that if you are too obsessed with what is happening in front of you, this will narrow your thinking and might prevent you from taking necessary policy responses. In this case, returning to theory may help you to take a step back and restore flexibility to your thinking.

## **II. Putting Together Your Own Thoughts and Exposing Them to External Assessment**

I have taken up some time on the first lesson. Let me now move on to the second lesson, which concerns the importance of exposing your own views to external assessment.

Whatever policy challenges you may face in your future career, there will probably be multiple possible responses. In the process of putting together specific policy responses, you will most likely have to choose from a range of policy options. In addition, you will have to discuss your choices with people with different views and identify points where you should convince them, where you should incorporate their ideas, and where you should concede to them. To make such a process truly productive, it is critical to present a clear overall picture of your own views, possibly in written form, and to expose it to external assessments. When discussing a policy response, some tend to focus only on part of it, without paying much attention to the overall picture. Unless you clarify what kind of economic model and assumptions you have in mind when discussing your views, it is unlikely that such discussions will produce better policy responses.

For these reasons, ever since I was a young official, I have tried to expose my own views to the views of others, for example by contributing articles to journals and newspapers or by writing books under my name rather than that of the organization I was working for. Of course, on quite a few occasions, my views were shown to have some shortcomings and I felt rather embarrassed having them pointed out to me, but I also felt that, as a result, my views became more balanced, leading to better policy responses. This process has also resulted in some unanticipated relations of trust and even long-term friendships. One of such friendships, with Professor Joseph Stiglitz, developed from an exchange of views at a conference held in New York when I was Special Advisor to the Cabinet of Prime Minister Koizumi. Since then, Professor Stiglitz and I have held discussions on numerous occasions, visiting each other's offices whenever the opportunity arises. Similarly, the tie with President Shiraishi of this Institute goes back to when I was examining policy responses after the Asian currency crisis in 1997. I had not met him before, but decided to meet and asked him to exchange views on the economic and social situation in Indonesia, on which Professor Shiraishi was the leading expert. At the time, better policy responses

were taken thanks to his advice, for which I am still grateful. I also very much appreciate subsequent exchanges of views with him on various occasions.

Many of you will work as a member of a certain organization after graduation. I hope you will not hide behind the name of the organization, but will create as many opportunities as you can to present your views under your name and receive feedback from different perspectives.

### **III. Appreciating Diversity**

The third lesson that I would like to tell you is about the importance of appreciating diversity.

In policy planning, a diversity of views among those involved may not always be viewed positively. It often takes time to iron out different views, and the person in charge of bridging such differences needs to have great persistence and flexibility. However, policies reflecting diverse views tend to be more robust to subsequent changes in circumstances. In addition, they are also bound to be more effective, since they are likely to gain support from many people with different views. I mentioned as the second lesson that it is important to expose your views to external assessment. If such assessment takes place from a wide range of perspectives, this will help you to further develop your thinking. This means that it is crucial to have access to people with diverse views.

I would like you to remember that you cannot expect to have access to diverse views only when you need them. To be able to hear diverse views, you need to constantly appreciate ties with those who have a different background from you and respect views different from your own.

As I mentioned earlier, after graduating with a bachelor's degree in law, I had the opportunity to study abroad at graduate school majoring in economics. That was partly the product of chance. However, since my undergraduate days, I was interested in a wide range of subjects, including economics and the philosophy of law, and acquired a basic understanding of these subjects. This may have allowed me to grasp the opportunities that

suddenly presented themselves to me. Thus, having a wide range of interests as well as appreciating and seeking out diverse views resulted in enhancing my policy planning skills and enriching my career.

### **Concluding Remarks**

Based on my experiences, I have told you three lessons that are, I believe, important for you as potential future policymakers. Namely, that it is important to reconcile theory and practice, to expose your own views to external assessment, and to appreciate diversity. In this respect, I am quite sure your alma mater, GRIPS, has already provided you with a good head start. First, the Institute focuses on policy studies underpinned by theory, while strongly recognizing the importance of practice and of applied policy studies. Second, the Institute encourages students to interact with each other and with teachers in various situations. Thus, the Institute offers numerous opportunities to expose one's views to others. Third, as epitomized by the fact that two-thirds of the students here are from abroad, hailing from more than 65 different countries, this Institute is highly international and full of diversity. As students here, you have already acquired skills and qualifications that will serve you in your future lives. I would like to express once again my respect for President Shiraishi and the staff of the Institute, who provide such excellent programs. To the graduates: I hope that you will continue to foster the network you have established at GRIPS, further enhance the skills and knowledge you have acquired here, and venture decisively into addressing policy challenges around the world. I sincerely hope that today will be the first step toward a successful future for each one of you.

Congratulations again!