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A JAPANESE LESSON

The Japanese economy, the world's second largest, apparently is unable to recover from a lingering recession that descended on the country in 1991. Industrial output has been erratic and lackluster ever since, meandering between expansion and contraction. Unemployment has been rising steadily and now exceeds 5 percent of workforce.

All along, the Japanese yen has fluctuated wildly between 124 yen to the U.S. dollar in 1991, 99 in 1994, and 132 today. In the face of so much instability and adversity, Japanese authorities have sought guidance from the universal full-employment prescript which is Keynesian economics. They have wholeheartedly embraced the most influential formulation of the economic thought of the twentieth century and have deliberately pursued a policy of spectacular deficit spending in order to revive the economy.

In 1992, facing a stagnating economy and plummeting stock prices, the government adopted a comprehensive package of measures totaling 10.7 trillion yen, the equivalent of 2.3 percent of GDP. One year later, to offset the worsening economic slump, it unveiled another stimulus package, the largest in history. In 1994 a new administration added its own huge pump-priming package. When the Japanese yen nevertheless rose sharply in world money markets, distressing and depressing important export industries, the government launched new public works projects and adopted the largest stimulus package ever.

At the same time, the Bank of Japan lowered its discount rate to a record low of 0.5 percent. For a moment the economy seemed to recover, but unemployment continued to rise steadily. A few months later, the Japanese economy suffered the biggest drop in 23 years, shrinking at an 11.2-percent rate. It caused Japan to be buffeted by a stream of investigations, indictments, arrests, and resignations, involving many politicians and the most prestigious financial houses.

When hope changes to despair, politicians are tempted to accelerate public spending. In 1998 the Japanese government adopted another comprehensive stimulus package – the largest ever – increasing public expenditures for social infrastructure. After months of political wrangling, the Diet appropriated some $ 500 billion to rescue the nation's top 19 banks. With unemployment at 5.4 percent, another supplementary stimulus package of some $ 195 billion was to create 700 000 jobs. The Bank of Japan revealed that it had spent some $ 580 billion to clean up bad loans and vowed to keep its discount rate «near zero».

When in 2000 the economy contracted anyway, the government once again mapped out record budget expenditures. Instead of marketing its obligations in the capital market, it borrowed massive funds directly from commercial banks, thereby saving some interest costs. In 2001 the Japanese economy is estimated to have contracted 1 percent; it is expected to continue to stagnate in the foreseeable future.

It is difficult to imagine how the Japanese can ever return to a market-adjusted economic order, that is, to one shaped by the people's choices and preferences. With a government debt of more than 135 percent of GDP and still rising, and with government bonds presently yielding 1.08 percent, the debt consumes some 23 percent of government expenditures. If interest rates were allowed to rise to market rates of 5 to 6 percent, the interest costs would soon exceed total present revenue. Taxes would have to be raised significantly, which would prevent any recovery. Or, government expenditures other than debt service would have to be slashed drastically, which would cause unforeseeable social and political problems. Of course, there always is the proven method of drastic debt reduction: rampant inflation which depreciates all debt and defrauds all creditors.

Economic considerations point in the same direction. Even if we assume that the blunders of the past will be corrected eventually, the present monetary policy of extreme ease with the discount rate near zero and the prime rate at 1.375 percent undoubtedly is leading the Japanese economy into a new state of horrendous maladjustment. Countless businesses will face new difficulties if and when interest rates are allowed to return to market levels. Of course, inflation flushes all monetary debt away, but it also tends to raise the market rates of interest by the anticipated rate of money depreciation.

Victims of Ideology

As the history of the Great Depression is one long regret of political follies and blunders that aggravated the suffering, so is the story of the Japanese recession from the 1990s to the present. The Japanese government tried to spend its way out of the recession, but instead merely prolonged it and created a mountain of debt. It probably improved the Japanese infrastructure but simultaneously propped up a badly misguided economy; sustained insolvent banks and insurance companies, always preventing the needed readjustment and thereby prolonging and aggravating the recession; and, last but not least, consumed the people's savings of a decade. It is a hard world of politics, where every mistake must be paid for in full by the people.

The Japanese people are the latest victims of a spurious economic ideology. Their political leaders who shape economic policies are possessed by the notions and theories of Keynesianism, which is akin to basic statist philosophy. Unfortunately, Keynesian thought misinterprets the very nature of the business cycle. Contrary to its contentions, a recession does not signal a failure of the market order that government needs to correct; rather,

Sakaki Hyakusen (1698–1753) Himmelsbrücke (ame no hashidate), Edo-Zeit, erste Hälfte 18. Jahrhundert. Hängerolle, Tusche auf Papier (ehemals Sammlung Heinz Brasch)

Die Himmelsbrücke (ame no hashidate) ist eine etwa zehn Kilometer lange und durchschnittlich 60 Meter breite, mit Kiefern bewachsene Landzunge in der Bucht von Miyazu im japanischen Meer. Sie gehört zu den drei berühmten Landschaften Japans, in denen nach dem konfuzianischen Gelehrten Hayashi Razan (1583–1657) die Harmonie zwischen Land und Meer am vollkommensten erlebt werden kann.

In dieser Version der Himmelsbrücke von Sakaki Hyakusen (1697–1725) setzt der Maler die künstlerischen Mittel mit grösster Sparsamkeit ein, um das Wesen dieser Landschaft in atmosphärischer Weise wiederzugeben. Der Betrachter blickt aus der Vogelperspektive auf die Landzunge, die in unscharfen Konturen in einem sanften Bogen die ganze Bildbreite einnimmt. Sie wird in der Art chinesischer Darstellungen von Winterlandschaften durch ein weiches Tuschlavis weiss ausgespart. Unterschiedlich lange vertikale, rhythmisch über das weiss ausgesparte Papier verteilte helle Tuschlinien und horizontale, teilweise ineinander fliessende dunklere Tuschflecken deuten die Kiefern an. Den sanften Bogen der Landschaft übernehmend, sind die 17 Silben des Gedichtes sowie sein Titel und die Signatur des Malers über die ganze Breite der Bildfläche verteilt. Für den Kenner und Sammler japanischer Kunst, Heinz Brasch, evoziiert diese Anordnung der Schrift die Formation der Wildgänse. Ihr Schrei bewog den Künstler, während einer Übernachtung im Herbst in der Bucht von Miyazu dieses Haiku zu dichten und das Bild von der Himmelsbrücke zu malen.

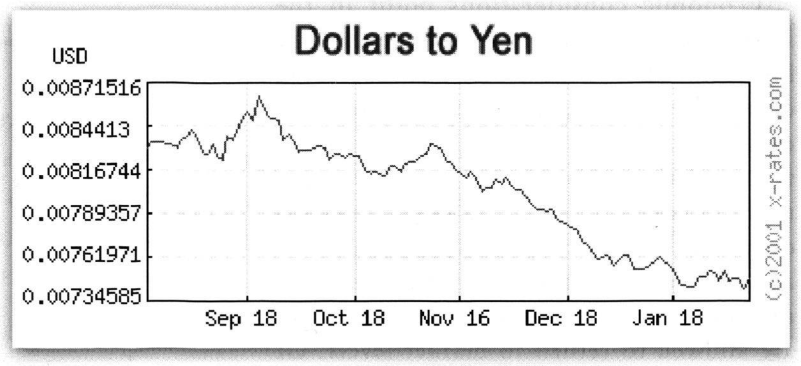
it is the inevitable consequence of a misguided economy. False interest rates tend to cause maladjustments by misleading businessmen in their investment decisions.

The primary function of the market rate of interest is to guide entrepreneurial activity. It leads businessmen to satisfy the most urgent needs of consumers in the best possible way and shows them what they may invest in the production of present goods and what they may allocate to future production. When a central bank substitutes its rates for that of the market, it falsifies economic calculation and accounting. It misguides the process of production and causes costly maladjustments which sooner or later necessitate readjustments, that is, recessions. Recessions last until the mistakes are corrected. In an effort to shorten the recession, central banks usually falsify the rates again, which may prevent the corrections and create new imbalances.

The seeds to the Japanese economic predicament were sown between 1985 and 1990 when, in response to both economic sluggishness and a rising exchange value of the yen, the government conducted a deliberate policy of expanding domestic demand. It adopted several packages of incentives, including lower interest on government loans, and added a supplementary budget for public works, housing, and assistance to small business. And in order to make the economy less dependent on exports and more amenable to domestic spending, the Bank of Japan did its part by cutting its base rate from 5 percent to 3.5 percent.

Economic Bubbles and Deficit Spending

When the yen nevertheless appreciated some 30 percent toward the U.S. dollar, the bank lowered its rate to 2.5 percent while the government announced emergency measures in order to stimulate domestic demand. And while the Japanese gross national product continued to expand at some 5 percent annually, government outlays for public works increased by some 20 percent. Japanese stock prices soared to unprecedented levels.



False interest rates tend to cause maladjustments by misleading businessmen in their investment decisions.

In 1990, the Japanese government and the Bank of Japan finally parted ways. With the economy expanding at record rates and stock prices at wondrous levels, and with consumer prices rising at an annual rate of 3.5 percent, the highest in eight years, the Bank of Japan raised its basic rate, first to 5.25 percent and finally to 6 percent. The boosts were meant especially to «dampen volatility» at the Tokyo Stock Exchange. The government, however, preferred to continue in its spendthrift ways. It adopted a supplementary budget with an additional 4.4-percent increase over the 1991 budget. The sharp increase was to help finance additional public works of some 430 trillion yen ($ 2.9 trillion) over a ten-year period. The government was determined to sustain the bubble, the biggest in modern times.

All economic bubbles must burst sooner or later because they consist of countless business errors that finally yield painful losses. As financial institutions and capital goods industries are most prone to fall prey to false interest rates, they are the primary victims of the inevitable readjustment. The Japanese bubble finally burst when the Bank of Japan raised its rates. The Nikkei 225-stock average soon plunged to a 15-month low, below the 30000-point level and down some 26 percent from the peak reached in December 1989. And once the bubble had burst, it was well-nigh impossible to restore it despite prompt discount rate deductions to 3.25 percent and massive deficit spending. This merely propped up the ill-fated system and encouraged banks and businessmen to hold on to their poor investments. Even consumers became rather defensive, saving their cash and bracing for uncertain times ahead. In terms of popular econometrics, the velocity of money fell, which tended to depress prices and aggravate the plight of business. The Japanese people have been in this predicament for over a decade.

The Japanese economic malaise provides ample material for serious reflection about popular economic thought. No one can deny that both the boom and the bust are characterized by feverish deficit spending and active government intervention that visibly are unable to facilitate a recovery. Mainstream economists may want to reconsider the Keynesian notion that capitalistic economic systems are plagued by equilibria short of full employment and that they lack forces that automatically lead to recovery. They may even heed the advice of a few economists who, ever mindful of numerous money and banking reforms throughout history, point at the monetary policies of the Bank of Japan as the ultimate cause of the malaise and the pivotal object of reform. They would immediately inactivate the bank and allow all interest rates to find their market levels. And lest the government obstruct the readjustment, it would have to balance its budgets forthwith.

No one can deny that both the boom and the bust are characterized by feverish deficit spending.

To inactivate a central bank is to stabilize a given volume of its currency and credit on the day of reform. Henceforth the bank would be barred from expanding or contracting its stock of money and from setting rates. Bank of Japan inactivity undoubtedly would trigger a financial crisis that would reveal the full magnitude of the maladjustment. The crisis probably would be rather severe, but the readjustment would be swift and efficient in today's vast global capital market, which is swamped with U.S. dollars. Japanese financial institutions have ready access to the world capital markets which stand ever ready to serve and support a return to the market order.

A stabilization through Bank of Japan inactivity undoubtedly would draw a furious censure and condemnation, not only from mainstream economists but also from all agents of government and their beneficiaries. And it would be rejected summarily by many individuals who would have to bear the pains of readjustment. Of all the evils, they probably will choose the worst: inflation, which defrauds all creditors and rewards the debtors caught in the net. ✦

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