



Abenomics and Takahashi Policy — Aiming to revitalize the Japanese economy

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It has been eight months since the Abe administration was inaugurated. Its catchphrase “Japan is back” is steadily being embodied, which is confirmed by the fact that the term “hollowing-out” has disappeared from media such as television and newspapers. I would like to discuss the current conditions and future challenges for Abenomics while attempting to present a retrospective assessment of Takahashi Korekiyo’s fiscal policies, which could be referred to as the Abenomics of the prewar period.



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As a first step to reviving Japan, the Abe administration aims to bail the nation out of a deflationary economy by undertaking drastic monetary easing by the Bank of Japan (BOJ). Before it was launched, Abenomics faced rising skepticism pointing out that monetary easing would not be effective in controlling the economy’s deflationary trends. Moreover, critics argued that no matter how sweeping the easing was, it would not lead to increased bank lending and circulation of money as long as capital needs remained minimal among businesses with money provided only being accumulated as *buta-zumi* (money uselessly amassed) in the current deposit account held by the BOJ, and serving no

positive function in controlling deflation. “Buta-zumi,” incidentally, is Japanese card-playing lingo for a worthless pile of cards. Against this prevailing criticism, Yale University Professor Emeritus Hamada Koichi, who asserts the effectiveness of this type of economic measure, strongly disagreed, and Prime Minister Abe took the decisive action to undertake a drastic monetary easing policy based on Hamada’s advice. With the bold easing policies put into practice embodying the Abe prescription, Japan has recovered motivation in its economy and is on track to steadily break free of deflationary trends.

Buta-zumi is, in fact, now happening in the United States as well. Following the Lehman Brothers collapse, the unconventional financial policy was launched by the U.S. government as a countermeasure to rescue the market from mounting bad debts totaling as much as U.S.\$600 billion for the United States alone arising from the subprime housing mortgage crisis. U.S. Federal Reserve Chairman Ben Bernanke introduced the unconventional policy amid worry that unless action was taken quickly the United States would also run the risk of falling into a deflationary spiral



similar to Japan, inviting a once-in-a-century economic recession the likes of the Great Depression. The Fed's balance sheet has resultantly swollen three times compared with the previous level, with useless money being accumulated like worthless playing cards (again, buta-zumi) in the current deposit account with housing-mortgage-backed securities listed on the asset side.

So why could such worthless playing cards ward off economic meltdown in the United States? To answer that question it might be helpful to provide an analogy using Japan, where massive purchases of financial instruments by land-rich billionaire financiers gave a boost to the economy during the period of the economic bubble. In the bubble era, massive capital gains were realized on the sale of land and equity shares each year; their total value was four times the country's GDP. With those massive capital gains earned, the billionaires and others purchased assorted assets, which boosted the economy. The Fed's massive purchases of financial instruments produced the same sort of effect.

Takahashi Korekiyo, the man who ended deflation caused by Inoue policy

Little is known, by the way, of the fact that the BOJ also practiced such a financial policy in the prewar years when Takahashi Korekiyo was the finance minister. Japan at the time was suffering from a post-World War I recession, similar to the post-Lehman environment experienced by the United States. Following World War I, Japan, as a "war profiteer" saw rapid expansion in its economy, which grew threefold. But the country plunged into serious recession as the European economies recovered following the war. To tackle this hardship, the BOJ implemented bold rescue lending, wherein on a large scale it discounted commercial bills issued by companies with financial difficulties, and this subsequently supported the Japanese economy. This is more or less the same as the Fed's massive purchase of housing-mortgage-backed securities after Lehman; a measure that subsequently reinforced the U.S. economy.

Rescue financing provided by the BOJ came to become structural in nature in the five-year period from the end of World War I until the Great Kanto Earthquake of 1923. The earthquake, which devastated nearly all of Tokyo and Yokohama, inflicted massive damage equivalent to one-third of the country's GNP at the time. The BOJ ended up growing even more deeply engaged in expanding its financing to rescue quake-devastated industries by discounting commercial bills, for which a moratorium was granted for upcoming payment. The Japanese economy, for the most part, was completely dependent on the benefits of the BOJ's rescue financing. Then Inoue Junnosuke entered the picture to lift a gold embargo in an attempt to return the country to normal status. Yet against his expectations, his attempt ultimately invited deep deflation and a serious recession since it was implemented through revaluing the currency back to the previous equivalent, well over the country's real economic strength – a hard-landing strategy. This was "Inoue deflation." Unemployed were seen along city streets, with impoverished farmers in Tohoku, which was damaged by cold weather, ultimately compelled to resort to sending their daughters into prostitution to earn money. Takahashi Korekiyo then emerged to turn around the situation. He adopted a drastic financial



policy to come off the gold standard and devalue the yen. He also chose to raise the maximum limit of guarantee-issue banknotes from 120 million yen to one billion yen, and succeeded in putting an end to the deep deflation. Public works spending was also raised with an aim of developing the country's agriculture. Metaphorically speaking, the first and second arrows of Abenomics were fired. With Takahashi's policy put into place, Inoue deflation came to be resolved as if falling victim to Takahashi's magic spell.

One anecdote tells how much the Japanese economy recovered at the time with the help of Takahashi's policy. Ugaki Kazushige, a candidate for prime minister, almost gaining the post in vain in the prewar period, when seen in retrospect after the war, wrote: "Japan's rising industries at the time predominated in the overseas markets. ... Let alone the United Kingdom, we were even overwhelming the United States. ... If Japan succeeded in keeping its momentum for the next five to eight years, we would be the world's leading country. ... Japan should therefore not naively start a war now." (*Ugaki Kazushige's Diary 3*, Misuzu Shobo, Ltd.)

What should be noted in this anecdote is that Takahashi's policy fired the first arrow (monetary easing) and the second arrow (fiscal stimulus) of Abenomics, but not the third (growth-generating structural reform strategy). Regarding this point, Nishino Kiyosaku, a high-profile journalist at the time, noted, "Takahashi's policy was not primarily intended to boost the economy, which was, in fact, realized merely by accident. ... Fortunately, the BOJ operations went successfully. Takahashi chose to lower the interest rate. Despite being subject to all the criticism from orthodox fiscal theory advocates accusing him of applying a free spending policy, Takahashi firmly believed that lowering the interest rate would naturally lead to creating a better society, and that is what his economic policy was all about." This suggests that Takahashi believed that only the interest rate, if stabilized, would naturally encourage economic growth.

Japan's economy destabilized in the deflationary economy

If Takahashi's fiscal policy was in fact that way, why does Abenomics of our time prioritize the strategy for growth-generating structural reform as the third arrow? The answer to this question is that the Japanese economy has become weakened after long years of deflation, making it difficult to put the country on a track of self-sustaining recovery. Abe advocates that the key to the growth-generating structural reform strategy is the "explosion of private sector dynamism." This language is meant to emphasize the need to reboot the Japanese economy, which is currently like a core engine losing oil, from outside.

Incidentally, this explosion of private-sector dynamism is what has previously made Japan's high economic growth possible. The "Shimomura theory" is known well as having helped form a theoretical foundation for Japan's high-rate economic growth in the past. In his theory Dr. Shimomura advocated that the central bank should take decisive action to realize monetary easing needed for the country's economic growth, regardless of the level of savings, while the BOJ was reluctant to do so. It was like something that forms the theoretical basis for the first arrow of



Abenomics. He was convinced that the country's economy would grow on its own, helped by private sector dynamism. The private sector exploded, in fact, and the income-doubling plan was actually achieved.

Unfortunately, however, the explosion of private sector dynamism went too far in the bubble era of the late-1980s. Massive capital gains worth four times the GDP realized during the bubble era ended up turning out to be massive capital losses over the course of the 1990s. Despite some recovery being seen in the economy, Yamaichi Securities went bankrupt at the end of 1997, with the Long-Term Credit Bank of Japan, Nippon Credit Bank and Hokkaido Takushoku Bank following suit in 1998, ushering in a financial crisis. It was largely taken for granted at the time that large financial institutions would never go bankrupt, based on the "too big to fail" myth. Overwhelmed by the grave reality that brutally refutes the myth, corporate executives came to believe that they should take unprecedented measures in a new dimension. Early retirement for middle-aged or older workers was widely practiced, the social impact of which was seen in the number of suicide victims rising to the 30,000 mark in 1998 from the 20,000 average in preceding years. This 30,000 translates into one death just short of every twenty minutes, which is seven times the current annual number of traffic accident deaths (4,400). Amid the crisis, the business sector, which is supposed to have borrowings higher than the level of cash and deposits on hand for the purpose of business investment for future growth, in fact saw its cash and deposits surpassing the level of borrowings. In the bubble era under the golden rule of land collateral being the principal criterion for lending, banks competed to extend loans without comprehensive credit checks. And they resultantly were struck with the alarming amount of bad debt after the bubble burst. To cope with the situation, banks had no choice but to cut back lending or withdraw money in order to make their financial statements appear decent. Under these circumstances a tendency for under-borrowing became increasingly noticeable among businesses in Japan.

Even so, why is the under-borrowing trend still prevalent among companies today? The phenomenon is attributable to the fall in prices that began in 1999. This fall meant expanded debts for companies that already had them on a large scale. As the deflation progresses, unless they cut debts quickly, the excess borrowings will keep reproducing by themselves. Companies have gone all out to repay bank borrowings by undertaking cost restructuring. Capital investment is typically conducted within the framework of internal reserves. It is a restructuring-first business society these days.

This trend continued to be seen among companies even after their repaying activities let up, thus devitalizing Japan's economy. Restructuring widely practiced by companies invited deflationary spirals caused by the "fallacy of composition." Labor unions accepted wage cuts in exchange for securing jobs under Japanese labor practices. But consumer spending is not vitalized unless wages increase. Departure from a deflationary economy cannot be realized unless consumer spending is vitalized. As deflation continues, companies will tend to intensify restructuring activities further in order to secure profitability, which results in prolonging the deflationary spiral.

Moreover, young workers in particular have been strongly influenced by companies' efforts at



reducing labor costs, resulting in looming worries about the quality of human resources, a major resource for economic growth. In 1998 when suicides numbered over 30,000, the average wage of workers began to fall, though this was not the case for permanent employees. The average wage began declining partly because the share of relatively low-paid service jobs expanded in the statistics. But more importantly, this is due to the increasing prevalence of workers hired under indefinite contracts. Realizing the enormous cost benefit of employing indefinite contract workers, companies have no choice but to utilize them to survive global competition. They chose to cut the number of young new staff employed as permanent staff, which severely affects young workers.

The share of indefinite-contract workers in the country's total workforce currently stands at as high as 38.2%, a large part of which is represented by women. This raises an important issue for debate, and I wish to focus attention on the high ratio of young male indefinite-contract workers. The percentage of indefinite-contract workers among male workers in their late-twenties was 5% in 1989, but now nears 20%, which means one in five young male workers works under an indefinite contract. On-the-job training is rarely provided to such workers to develop their skills and abilities, which means they never receive pay raises, making marriage a difficult option. The lifetime non-marriage rate for males is currently as high as 20%. With other factors being equal, a further rise in the non-marriage rate is inevitable. This reflects the current situation in the country where human resources necessary for future growth are not being produced.

Gross national product is merely the sum of added value produced by each citizen. With a further decline already anticipated in the birthrate, successful economic growth will never be achieved by a country in which one in five males aged twenty-five, valuable human resources, works as a non-permanent employee not participating in activities producing added value and has no opportunities to develop skills and abilities. The future looks extremely bleak with no future generations being produced. Restructuring activities undertaken by individual companies are based on economically rational business decisions to cut labor costs for each of them, but each of those business decisions, when combined, ultimately compromises Japan's future. The phenomenon will gradually devitalize the country's economy, like slowly boiling a frog. It is no exaggeration to say that revitalization of the Japanese economy depends solely on the success of Abenomics in bailing the nation out of its deflationary spiral.

Japanese citizens are a main player in revitalizing Japan

There are two ways for a company to become more profitable: restructuring and innovation. The third arrow (growth-generating structural reform strategy) of Abenomics is designed to change the prevailing condition in Japan where restructuring is prioritized as a means of securing profitability in the deflationary economy. It is also intended to revitalize the country by creating a society in which innovation is prioritized to achieve profitability. To achieve the goal, it is expected that Japan's potential growth rate will be raised with the help of scientific technology and deregulation, and a positive growth cycle around demand and supply will be realized by creating demand through



projects dealing with new problems arising in, for instance, the health and medical fields. The scheme is also looking to provide assistance to companies aiming to boost profitability through the use of innovation, and is targeting realization of a positive cycle of higher wages and growth. Motani Kosuke, who notes that Japan will continue to see development of a low growth rate with fewer children, writes: “In Germany, where companies do not compete in lowering product prices with lowering labor costs, a low growth rate is not foreseen as materializing even with a low birthrate” (*Kinyu-kannwa-no-wana*, coauthored, Shueisha). Departure from deflation without higher income would essentially mean only a 2% rise in consumer prices, which would in no way represent revitalization for Japan. Revitalization can only be realized through a range of positive cycle combinations.

In February 2013, Abe directly encouraged three major business organization leaders to support wage hikes for Japanese workers, based on the basic strategy mentioned above. Also based on the strategy was establishment of the Forum for Promoting Active Participation by Young People and Women, which drew up proposals in May. In October, Diet sessions will start deliberating the growth strategy. Bills that will be submitted to the Diet form a part of the strategies mentioned above.

Lastly, I would like to stress that the Japanese citizens should serve as a main player in revitalizing Japan. The comprehensive policy put together in June by the government thanks to the efforts of Amari Akira, Minister of State for Economic and Fiscal Policy, stipulates that the Japanese people will move forward believing in a bright future, corporate executives will show strong initiative in implementing reforms and the government will encourage and support that move. Japanese citizens will play a pivotal role in meeting challenges, realizing openness and promoting innovation. The government will create an environment in which hard workers, mainly comprised of younger people and women, will be rewarded through responding to the diverse means of employment. Theoretically, Japan’s GDP could be raised substantially with more women joining the workforce, making it comparable to other leading nations. When asked what was necessary for economic growth, John Maynard Keynes answered “animal spirits.” This suggests we should step forward with the belief that a bright future awaits us. Each of us must have animal spirits.

Note: All opinions expressed herein are solely those of the author.

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