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Japanese Economy Should Set out to "Regain the Lead over China"

By TAMURA Hideo

Year 2013 started in full swing. The stock market is so roaring that it is hard to believe it has chronically been in a slump. Prime Minister ABE Shinzo has only to give voice to "defeating the deflation and reversing the value of the yen" to make them happen. While Prime Minister hardly spent a penny, the foreign exchange market, hitherto utterly unresponsive to a series of 10-trillion-yen monetary easing steps introduced by the Bank of Japan, suddenly shifted to depreciation of the yen and the stock market began to absorb huge amounts of money. Tailwinds also blow from abroad. The United States, for now, avoided falling off the "fiscal cliff," and in Europe, Greece, EU's troubled child, narrowly escaped the abyss of severe debt crisis. It seems that Japan has the rare opportunity to revitalize its economy. Problem is what lies ahead.

What should be done? Naturally, the Bank of Japan should first set an inflation target. The inflation target of 2%, for example, would convey a clear message that the Bank of Japan will keep printing more money to pump ultra-low interest funds into the financial market until the price levels goes up by 2%. Then, the yen appreciation would tend to be stemmed and prospects of corporate earnings would dramatically be improved. The stock price would also start its upward journey. The Abe administration should keep watchful eyes on Bank of Japan Governor SHIRAKAWA Masaaki, who wants to remain evasive on the inflation target, and should work out a joint accord between the government and the Bank of Japan. However, that is not enough to give Japan more punch. For, Japan has disastrously spoiled itself with the "two lost decades" since the burst of the bubble economy. The media repeatedly tries to fuel imaginary fear of a virulent inflation, saying that price rise would be a disaster.

The common sense of economics of the world that an inflation target means to increase income and employment more than the rate of price rise is routinely disparaged as fantasy in this country. In short, today's Japan is riddled with shriveled mode of thought which has been fostered as its nominal gross domestic product (GDP) has been contracted by 10% in fourteen years. Officials in the Ministry of Finance, without any reflection on their past failure that the tax raise accelerated the deflation and ended up in decline in tax revenue, are still enamored

with a plot to raise the consumption tax. Majority of the online public opinion turned completely inward-looking and abusively criticize proponents of joining the Trans-Pacific Strategic Economic Partnership (TPP), insisting that TPP would destroy Japan's agriculture and medical care system. In order to realize full-fledged revival, Japan must undermine the conventional wisdom and policies thereby turning to an aggressive strategy under bold political leadership. In this regard, Bank of Japan's inflation target would only be one chapter of Japan's overall rollback scheme. Substantial large-scale public spending together with monetary easing would kick fiscal operations and financial activities into high gear toward a path out of a deflationary spiral.

What should Japan's rollback scheme be aimed at? Adding 3-4% to nominal GDP growth rate sounds good. But it is just a means to an end. Let me suggest that Japan should set its goal of regaining the lead over China in terms of nominal GDP. China surpassed Japan in nominal GDP as stated in U.S. dollars in 2010. The biggest factor other than growth rate is China's accelerated inflation as contrasted to Japan's long-running deflation. Actually, Japan, as of year 2011, far exceeded China by 42% in real GDP reflecting price changes based on year 2000 prices. If Japan could return to a proper growth track enjoying a healthy inflation rate, its economy would for sure regain the lead over that of China both in name and in reality. Then, the Japanese public would gain much self-confidence from the recovered national strength, earn trust from the United States and a sense of reverence from other Asian nations.

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