

The Japan Times Online

Sunday, August 5, 2001

[Main page](#)

[News](#)

[Business](#)

[Opinion](#)

[- Letters](#)

[Time Out](#)

[- Arts & Culture](#)

[- Life in Japan](#)

[TechnoTimes](#)

[Sports](#)

[Cabinet profiles](#)

[** Search **](#)

[Subscribe](#)

[Advertising](#)

[About us](#)

[Contact us](#)



SUPPLY-SIDE REFORM

Ignite Japan's service sector

By LEONARD SCHOPPA and HERMAN SCHWARTS
Special to The Japan Times

For several years, Princeton economist Paul Krugman has been preaching that what Japan needs to fix its economy is a good dose of inflation to cure its demand-side problems. Japanese policymakers -- along with most mainstream economic experts -- dismissed his initial 1998 proposals as unnecessary, difficult to pull off and potentially dangerous. This July, however, Krugman was welcomed as a far-sighted prophet on a visit to Tokyo, and Prime Minister Junichiro Koizumi, strengthened by an Upper House electoral victory, is likely to consider his inflation solution seriously.

Krugman is certainly right that Japan needs to boost demand. But his prescription is incomplete. Without a coordinated dose of true supply-side reform, his inflationary medicine will only prolong Japan's decade of economic stagnation. Japan needs supply-side reform to shift its economy away from its current reliance on deflation-prone manufacturing sectors toward increased emphasis on services. Absent this, additional purchasing power in the Japanese economy will only prop up inefficient industries, while shifting some of Japan's domestic macro-economic imbalances onto its global trade partners.

Why has Krugman suggested inflation as a fix for Japan's economic problems? Other potential solutions -- most notably bank recapitalization and fiscal pump-priming -- have been tried and failed. These fixes have not reduced the volume of bad loans at Japan's near-insolvent banks, but they have pushed Japan's public debt to 130 percent of GDP by wasting trillions of yen on useless public works. Krugman argues that a little inflation, about 4 percent a year, would reduce the burden of all of these debts, making them easier to service. Inflationary expectations would also push Japanese consumers and firms to begin spending and investing their money, rather than hoarding their cash in anticipation of continued deflation.

But Japanese consumers are not hoarding cash merely because they anticipate falling prices, but also because they have nothing to spend on. Fear of rising TV and automobile prices

[- Weekly News Roundup](#)

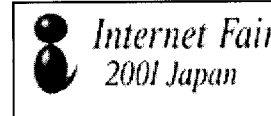
[- Festivals in Japan](#)

Cartoons !



お薦め派遣会社情報
株式会社インテリジェンス
英語 スタッフ時給2,000円以上
業界成長率 No.1 の会社で!

Japan Times Affiliations:



won't make them rush out to buy more when their houses are already full of electronic equipment and there's no room to park a second car.

This is why Japan needs a supply-side solution that complements efforts to generate inflation. An "unorthodox" supply-side reform would couple Krugman's inflationary stimulus to policies designed to spur the expansion of new service firms. Instead of purchasing government bonds from banks and relying on them to channel new money into the economy, as Krugman proposes, the government should print vouchers for a variety of under-provided services like day care, elder care, and education and training for mature workers. These would be distributed to needy citizens and would be redeemable for the specified services only. Service providers would trade in the vouchers they received for newly printed yen from the BOJ.

This kind of program would stimulate the economy, like Krugman's proposal, but would shift it in the direction of less deflation-prone service sectors that need to grow if Japan is to overcome its long-term demographic problems. The program would address the "demand problem" by pulling unemployed manufacturing workers and full-time housewives into the workforce to staff voucher-funded services. It would also alleviate the long-term labor shortage expected as baby boomers retire in large numbers by providing women with the care services they need to participate in the full-time workforce.

Education and training vouchers for mature workers -- a "G.I. Bill" for demobilized corporate warriors, if you will -- would also assist this service sector initiative by providing unemployed workers with skills they need for work in new sectors of the economy. This program would also force educational institutions to reinvent themselves to provide the kind of training workers actually need to survive in today's world.

Krugman recommends starting the inflation process by having the Bank of Japan purchase massive amounts of dollars, without sterilization, on international currency markets. Flooding the world economy with yen would create inflationary pressures at home as the value of the yen fell. This program is designed to create inflationary expectations, driving real interest rates down to a level where banks and borrowers might actually have an incentive to begin lending and spending again.

The flaw in Krugman's approach lies in a feature that makes it

appealing to most economists: its apparent "neutrality" with regard to the question of credit allocation. Krugman doesn't care where the money goes, as long as it goes somewhere and starts stimulating the economy. Once real interest rates fall low enough, it would be up to "the market" (banks and individual borrowers) to decide which goods and services are actually produced and purchased.

In fact, however, the Japanese financial system is far from being the "neutral" intermediary assumed by Krugman. The most likely recipients of new loans are the same old-economy firms privileged under the system that got Japan into trouble in the first place. Shaky construction firms and over-expanded manufacturers will get a new lease on life, validating their low- (or negative-) return investments.

Simple inflation won't fix the structural problems that generated deflationary pressures in the first place, so Japan may end up eating up pensioners' savings without fixing its fundamental problems or providing the services Japanese citizens want and need. Internationally, a falling yen would generate more exports and stimulate the Japanese economy. But this would hurt competing exporters in Asia and also lead to a larger trade deficit for the U.S. Japan would import fewer goods from those economies while flooding them with cheaper Japanese goods. It might knock shaky Asian economies into a new debt crisis and slow U.S. recovery from its own recession.

In contrast, a service sector-led reflation program would divert Japan's economic resources into its own domestic economy. It would provide Japanese consumers with something to buy and, by creating new uses for existing properties, it would revalue them, allowing banks to recover some of the money they lost when the property bubble burst.

A retrained, feminized, better-cared-for workforce might pull the economy up by its own bootstraps.

Leonard Schoppa and Herman Schwartz are professors in the Department of Government and Foreign Affairs at the University of Virginia.

The Japan Times: Aug. 5, 2001

(C) All rights reserved

[NEWS](#) / [BUSINESS](#) / [OPINION](#) / [ARTS & CULTURE](#) / [LIFE IN JAPAN](#) / [TECHNOTIMES](#) / [SPORTS](#) / [FESTIVALS](#) / [CARTOONS](#) / [SUBSCRIBE](#)