

S Interview with Yoshiyasu Ono, fellow at Osaka University

Seeking True Driving Force to Achieve Sustainable Growth

Interviewer: *Japan SPOTLIGHT* Editorial Section

Growth strategy is today drawing much attention among governments, to avoid a global recession. We often assume that strategy is to be made by the national governments and also, under globalization, economic policy cooperation among the major economies is vital. However, in the following interview, Dr. Yoshiyasu Ono, fellow at Osaka University, highlights a totally new perspective of a growth strategy.

Judging from the latest QE of the GDP of Japan in the third quarter of 2011, which is nearly 6% on an annual basis, can we interpret this figure as a sign of recovery supported by the newly created demand for restoration of the area devastated by the earthquake and tsunami? It is often said that we would see recovery in the second half of 2011, though we had negative growth in the first half of 2011 in Japan. What do you think about the short-run outlook of the Japanese economy?

Ono: I am sure that the Japanese economy is definitely picking up, thanks to the need for restoration of the devastated area. Comparing the shock caused by the earthquake with the one caused by the financial crisis in 2008, the latter's impact is far greater than the former's, though the shock caused by the earthquake had an enormous impact upon the Tohoku region. Overall, the Japanese economy declined a little this time immediately after the earthquake and is today restored to the process of recovery from the Lehman shock. As long as we have a demand for restoration of the destroyed supply side of the economy, including production facilities, social capital, etc., we can enjoy positive growth. But this higher growth than usual in the short term cannot continue in the long run. After the restoration is completed, the Japanese economy, in my view, will enter a long-run recession.

Today, the US economy and the EU economy are both in a difficult situation, though both were in the process of recovery from the Lehman shock a while ago. Could this negative economic outlook of Japan's trading partners' economies discourage our export growth?



Yoshiyasu Ono, fellow at Osaka University

Ono: I would not take that view. Before explaining the reason why I do not agree with you on this point of export growth, I would like to clarify a distinction between the Lehman shock and the earthquake shock. The Lehman shock was on the demand side and thus people refrained from consuming as its result. However, this shock on March 11, 2011 was on the supply side. The supply-side shock can be resolved more rapidly, since it will be easier to restore what was destroyed then. Refraining from consumption due to an increasing concern about the financial crisis would have a more enormous negative impact on the economy.

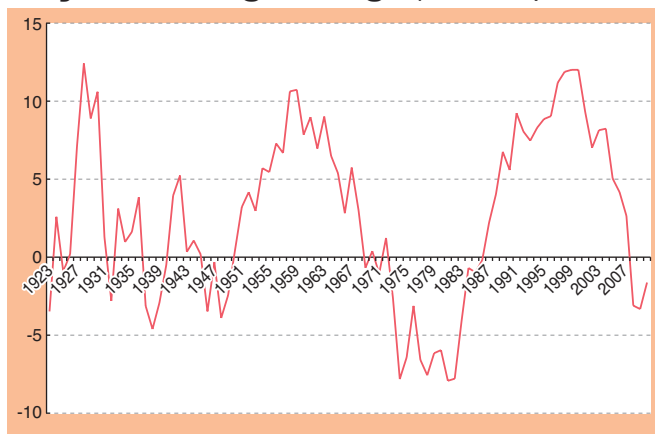
Many economists are now concerned about the world economy. I have been convinced that the recovery observed for a while is not in fact a genuine one. What is happening to the world economy now is exactly what happened in Japan in the 1990s. At the end of the 1980s the bubble economy of Japan burst and then at the beginning of the 1990s, the stock price started to decline and then continued to decline for two to three years. The financial crisis happened in 2008 and likewise, such a decline in the stock price has been continuing for a couple of years. Therefore, the world economy is now in as serious a situation as Japan in the 1990s.

However, it is completely wrong to say that stagnant growth in external demand will drag down Japan's economic growth. We should note that the Japanese economy was in a recession when the US economy was at the peak of the bubble economy. There is little, or rather a negative, correlation between external demand and business activity.

As shown in my [Chart 1](#) on the US Dow, a business cycle's length is around 35 years. I would say that the US economy was only at the peak of this cycle when the Americans started to talk about permanent growth, thanks to the IT revolution. Therefore, I think that the financial crisis in 2008 is the result of an extremely ordinary financial business cycle.

CHART 1

Annual real increasing rate of NY Dow 10-year moving average (1923-2010)



Sources: Dow Jones Japan, Dow Jones Indexes, The Federal Reserve Bank of Minneapolis

In that case, the growth strategy of Japan should have very little to do with external demand. How we can restore our domestic economy is all that matters. If that is the case, the next question is whether Keynesian policy can work effectively or not under a large fiscal deficit. This was examined in Rogoff and Reinhart's famous book, *This Time is Different*. What do you think about this question?

Ono: Let me explain the first point further, namely, why I think growth in external demand would have very little impact upon the economy. As exports from Japan increase thanks to an increase in external demand, the current surplus of Japan would increase, and then the value of the yen would appreciate.

Today, looking at Japan's current surplus, Japanese people accumulate foreign assets, which causes the surplus of income balance to increase and hence the yen to appreciate. The strong yen harms the international competitiveness of Japanese products. That is how the exchange rate would achieve the role of adjustment and the impact of an external demand growth would be cancelled out, though a long time ago when we had a fixed exchange rate, it was a different story.

I think we should understand that it is we ourselves, and no one else, who invited the strong yen by reducing consumption, making great efforts to export more and thus accumulating foreign assets. As the value of the yen rises, the competitiveness of US or Chinese industries must rise. However, in spite of the weak yuan, Japan's trade deficit with China continues to decrease. Therefore, I do not think the value of currency is vital in determining who wins the competition in trade. It is rather a result of current-account adjustment. I believe that the key to avoid a possible recession caused by yen appreciation is to stimulate domestic demand. We can increase imports by doing so and thus the yen will depreciate, which benefits Japanese firms in expanding their market share.

The next question is how we can increase domestic demand. I believe that job creation always leads to creating demand. Keynesians would advocate increasing government expenditure or tax cuts by issuing deficit bonds, whereas neoclassicists would advocate raising productivity to expand the economy. I would say neither of them is right or useful in encouraging business activity. It is far more important to create jobs than to implement these policies.

How can we increase job creation?

Ono: I would suggest trying to create jobs by a tax hike. With this, we can avoid an increase in government deficit bonds, since the money necessary to increase employment could be financed by a tax hike. We can keep the nation's purchasing power as it is, since the government will spend money for job creation to be financed by a tax increase.

With the increase in employment resulting from this policy, there would be two important effects. One is a decrease in the deflationary gap due to the unlikelihood of a wage and price fall in accordance with the rise in the employment rate. This would encourage private consumption. The other is the effect of alleviating the social concern possibly triggered by unstable employment. Today, young people in Japan in particular find it increasingly difficult to get jobs. Under such circumstances, people would not spend money, including their parents. Consumption would not increase in such a situation. Assuring job opportunities would be the best way to stimulate private consumption.

Corporate tax cuts or subsidies to a firm would not enable the firms to sell their products well, but creating jobs would make it possible for a firm to sell well, through the additional demand created by this policy. However, a subsidy for employment would not lead to an increase in final demand but result only in turning the unemployed into an extra labor force within a company, by distributing an alternative type of insurance for the unemployed. Creating domestic demand rather than only employment is the key to success of the current macropolicy in Japan. In other words, we need new industries and a new growth strategy.

Is the green industry one of those examples?

Ono: Yes. The green industry is certainly one. But even the green industry will require some government support. There seem to be very few new industries with growth potential unless there is government support. In the 1960s and '70s, there were many new products with great growth potential such as refrigerators, air conditioners, cars, etc., which encouraged private consumption. You can earn enough money only by working hard under such business circumstances. Today, we do not have such newly emerging goods, and so we are getting poorer.

When people talk about what we call a "growth strategy," they often refer to it as a government policy. However, I think it should be businesses themselves that think about their growth strategy and new areas with large growth potential, just like they did in the 1960s and '70s.

We are now living in a period where the people's requirements have been more than filled, and therefore we cannot find any new goods that sell well. What is unfortunate about such a society is that we suffer from a shortage of demand, and thus unemployment and inequality among the people are born. To avoid such a situation and also possible ensuing social instability, we need to create demand.

There must be more new industries other than the green industry. For example, as aging progresses in Japan, we should have the health care and medicare industries.

Ono: Yes, these industries are important as well. What is important is that, although these industries cannot earn profits and may always have a deficit, we can employ people in these sectors. Instead of



providing the unemployed with social welfare payments, the government or the public sector would employ them as caregivers. Such projects cannot work on a market basis and we need government intervention. For example, the government can subsidize a private caregiving facility. It would pay for the fixed costs and let the facilities compete with each other in the market. New energy and nuclear power safety technology are other important areas where we need government support. METI's industrial policy would be needed to find industries that are necessary for social purposes but cannot earn profits and support them, whereas METI followed a so-called "picking up winners" policy in the past and thus supported only the most profitable industries. This is a completely new mission for industrial policy.

A growth strategy such as this kind of industrial policy must now be formulated by the private sector rather than the government.

Ono: Yes. Industrial policy should be implemented by the government in a country where commodity demand has not yet been saturated, such as India and China, but not in Japan. The people themselves should think about a growth strategy in Japan, where there is a saturation of goods and very few goods that everybody wants. For example, when you get older and retire, if you try to pursue as many hobbies as possible such as mountaineering, scuba diving, music, or painting, tourism and cultural industries will prosper. Then we can have more youth employment. We are not living in an era where the government always has to lead the economy and society. That was predominant in the Meiji era in Japan.

We should activate innovation to break through the saturation of goods and there is much potential for innovation in areas like environment-related technology and biotechnology, but in addition, we should have innovation in the social system to encourage technological innovation.

Ono: Yes, that is true. But you do not have to say so. Much more simply, you should just enjoy your life, and then that would be a source of economic growth. When we were poor, we were always pursuing many new goods such as automobiles, air conditioners, and so on. And such desires have brought us economic growth. However, today our material needs are almost fully satisfied and unless we create new goods that we come to want, we cannot have any desire, a locomotive for economic growth.

Somebody like Steve Jobs should appear and give us the dream of a new product.

Ono: Yes. But you do not have to think about something of high quality. Whatever you want just for your own enjoyment, a Japanese company could make to meet your request.

It does not seem that we have a culture that would create such an innovation originating from pleasure. How can we create it?

Ono: It is difficult. All we have to do is to simply enjoy our personal life, which we are not used to. The Japanese government has been working hard so far to provide people with infrastructure such as highways, the superexpress, etc. Now people ask the government to give them money and not any goods, which is causing a recession. Small government, small tax reduction, and further rationalization of the administration, which are all requested by the nation, are the true culprits behind the stagnant economy of Japan.

Would it be better to change our education system?

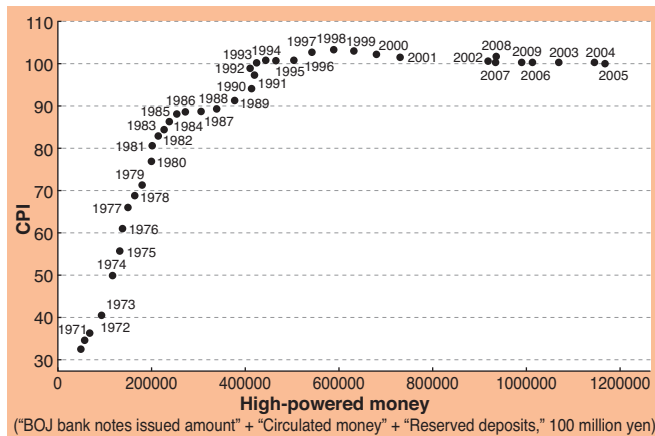
Ono: Yes, that might be a good idea. We have to learn how to enjoy life. We need efforts, intelligence and physical strength to do so. Our inability to enjoy life causes a recession through stagnant consumption.

We may need a think-tank to study how to enjoy life. That could create a wide range of new ideas about the joy of life and thus make an attractive society.

Ono: That is a good idea, but first we need to think about how to change our custom of refraining from spending money for luxury or pleasure. If we keep this custom, even though we have new charming ideas on how to enjoy life, they will be considered a waste of energy or resources.

After having heard many economists' remarks on the Japanese economy, I found that all of their conclusions end up saying that any growth strategy can be ultimately determined by the so-called animal spirit or entrepreneurship, since

Money supply & CPI



Sources: Bank of Japan; Cabinet Office, Japan

no fiscal or monetary policy today is considered effective. Would you agree with this assessment?

Ono: Yes, I agree. Until the end of the 1980s, the money supply increase had been able to raise the nominal GDP and prices. However, in the 1990s monetary policy did not work well and it has not been successful since then in stimulating business activities. Any fiscal policy distributing money would not work well either. Instead, I advocate one to increase people's pleasure in life, as I mentioned earlier. The animal spirit you mentioned should emerge in consumer behavior and consumers' thoughts on how they could enjoy a better life rather than the producers' thoughts. A playful mind should be exploited more, just as Steve Jobs said. We could have a very large market to be created by new energy, the environment and aging. We now have in our current economy in the recession a 20-50 trillion yen GDP gap. Half of this gap will disappear with the total investment for development of new energy, which would change our business mind completely.

On the aging society, it is now said that we should prolong the age to qualify for getting a pension until 68 or 70, and also raise the retirement age. However, this could take job opportunities away from young people, who might have consumed more than older people. This has a negative impact on the economy, I guess.

Older people today are in good health and can still work hard, can't they?

Ono: That would increase the labor supply further. Our unemployment rate today is 4-5%. However, if we take into account older people who still have the ability to work, the current labor force population in Japan would increase by 10-15%. Our 4-5% unemployment rate would reach more than 10%, if the elderly continue to work even after their current retirement age, in many cases, 60-65. I would suggest directly giving them more free medical service and caregivers, of which the cost should be paid by consumption tax. If this were the case, since youth could get more job opportunities related to such medicare services, the tax on their consumption would come back to the young in the form of salaries for these new jobs, while the elderly could get the benefits of such services. Older people in good health could enjoy tourism free of charge instead of these services. The transportation and tourism sectors could increase their revenue, with the consumption tax revenue to be given to those sectors by the government.

It would be best to let older people enjoy the rest of their lives by giving them vouchers for free concerts or plays, as well as the previously mentioned free travel. Thus, the young have jobs and consume, while the elderly can enjoy life, their medicare being assured. We can create a new demand with this policy. Only when we have an insufficient workforce should older people work.

Let me ask you two more questions. First, how can we avoid a global recession?

Ono: If each country makes efforts to stimulate their domestic demand on their own, a global recession can be avoided. As I said, when the Japanese economy was in a bubble, neither the US economy nor the European economy was in an expanding state. The Japanese economy's dependency on trade to GDP is only around 10%. We exhaust the extra labor force and make a happy country.

Secondly, conventional economics does seem to have hit a stumbling block. How can economics make a contribution to global prosperity?

Ono: Conventional economics has been engaged in a study of the real economy without focusing on the role of money. A recession cannot be explained by the real economy and so the theory of conventional economics cannot explain the current economic situation. The price mechanism does not solve a recession, since a decade-long decline in prices in Japan did not result in amelioration of business. Conventional theory assumes that 100% of the supply would eventually be consumed in the long run, even if some short-run price adjustment process should occur. This means that in the long run we can always achieve full employment. However, in reality, a recession continues for one or two decades. This can only be explained by an assumption that people have an incentive to keep part of their income as money instead of spending all of it on material goods. We should use such extra money for expanding job opportunities such as caregivers or the green business; that would make everybody happy. And also, we should recognize that people can spend money not only on material goods but also for personal and spiritual pleasure. Raising productivity, which was assumed as a good policy, would lead to a worsened recession and serious deflation. We need a new economics to look at the economy from a different angle. A playful or artistic mind to encourage spending money to pursue personal pleasure is the key to resolving all the issues in our current recession. Policies such as building bicycle roads all over the nation and port facilities for scuba diving, etc. would lead to job creation, which is the most important policy goal today.

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