

# How to Revitalize Japan: An Economist's Manifesto

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Mr. Laurence Summers, US Deputy Treasury General, is quoted as saying that Japan should stimulate domestic demand by tax cuts. In a similar context an eminent Japanese economics professor emeritus proposes to provide every household vouchers worth JPY 50,000 (or \$350). I do feel that Mr. Summers' suggestion makes a better sense, but if domestic demand needs to be effectively stimulated, I think I have a better idea.

I would propose a grand subsidy policy to scrap urban rabbit hutches to be replaced by a little larger doggy houses (hopefully of Texan size) with complete central air-conditioning a la American homes. The multiplier effect of such subsidized investment would be profound. The Japanese can surely afford, and perhaps also deserve that.

The US has, or once had, a housing investment subsidy policy of this sort in either the Federal or the State or both levels. I would think that an ad valorem subsidy (or negative tax) on quality housing should be quite effective. For example, if \$10 billion is injected for a 10% subsidy per application, then up to \$100 billion increases in housing investment can be expected. The higher the price elasticity of demand for housing investment, the higher the net increase in investment (up to \$100 billion). And since a rabbit hutch condo, being referred to as a 'mansion' in Japan is a super luxury for the public, the elasticity of demand I suspect is quite high, and the net increase in investment quite high accordingly. Combined with what economists call multiplier effects, this autonomous increase in investment will create a substantial increase in effective demand (up to \$500 even if the so-called marginal propensity to consume is only 50%), if that is what really is needed.

Such a policy may sound like subsidizing the rich, rather than the poor. But it is at least friendly to the poor elderly whose population is expected to explode soon in Japan. They deserve a lot more comfortable centrally-airconditioned housing hopefully with ecol-friendly (not e-coli friendly) and energy saving technology.

Robert J. Samuelson apparently agrees with me when he proposes (June 27, '98, *The Japan Times*) that the obvious way to make the economy's driving force permanent is "to reform the housing market." He correctly observes that most Japanese live in homes and apartments that are "unnecessarily cramped," or what I call *condominima*, which the proud Japanese themselves would call "mansions". Mr. Samuelson also observes "a maze of zoning, environmental and tax regulations" which hamper not only new building, but also new business in other areas such as communications, distribution, and transportation. These hampered businesses all require "opportunities to invest profitably," which nevertheless are frustrated "mainly by laws and regulations --- not weak banks." I fully agree with him in diagnosing that the things that "Japan ought to be doing now" are really the things that "it ought to have done then", i.e., in the mid-1980s after the so-called Plaza Agreement. If we had, he concludes, it might well be today what almost everybody thought it was: an economic power house that would overtake the United States.

Ryutaro Komiya seems to disagree to my proposed policy, however. In his opinion "it only aggravates waste of resources" despite a lot of observations relevant to the Japanese economy and his prognosis that I share with him. Komiya is one of elite retirees from top-flight national universities now teaching at a private university. Typical of these ex-government employees are their stoic mentality in both work and leisure or consumption. To them (economists included) seeking comfort seems to be a sin, and luxury a waste (as it was an enemy during the last War). Komiya's comment reminds me of a wealthy distinguished member of my university's Board of Trustees who would regularly dine at a humble campus cafeteria. It was decades ago when that late gentleman saw me order a shrimp dinner (with a couple of tiny fried shrimps THICKLY battered to make them appear large enough) and teasingly commented, "how can a junior professor like you afford or even deserve that?" Japan's contemporary enemy is perhaps such an imprinted idea of elite bureaucrats and economists that a comfortable luxury home is a waste or wasteful consumption, which is not. Instead it is a "productive" investment, rather than consumption or what Komiya calls "unproductive" investment. What I call 'high-definition' housing investment yields a constant flow of services over time to help recreate human capital of the public and protect not only their off-springs, i.e., children, but also their elderlies .

Professor Komiya also seems to oppose the so-called "permanent income tax cut" despite his call for a smaller government (expressed in his recent paper, "Declining Population, the Size of Government and the Burden of Public Debt: Some Economic Policy Issues in Recent Japan" to be presented at a conference in Sydney, August 20 - 21, 1998). I, for one, find it dubious and elusive in substance, but find it better than nothing. If they (politicians) mean it, then it sure is a good news as it calls for a smaller government, which Komiya also drums up in his paper on grounds that government expenditures are doomed to creating a grand waste. In this context he specifically denounces such "unproductive" government investment as on gigantic "seaports" used in effect as a fishing pier, "airports" seldom used, etc., etc. (Komiya cites a best-selling (?) book written by an ex-high-ranking official who is presumably responsible for those projects, but now repents, seeking for redemption, rather than royalty perhaps?)

A quarter billion (?) dollar fish pond may certainly be a waste of resources, but maybe it can be used as a naval port in case of emergency. Frankly I wonder what particular investment by either private or public is more productive than unproductive? In a related vein, is eating potatoes to be classified as either consumption or investment? Who are to make such judgment? This sort of question may be of greater importance than is what specific expenditure is more meaningful or productive in advance or in hind-sight. These questions get us back to one single answer: Let an economic, rather than political, power house decide insofar as what economists call private goods are concerned. (A difficult question arises, however, regarding the provision of public goods as they can be either underproduced or overproduced depending on how they are provided. Cf. Hiroshi Ohta and Jacques Thisse, eds., *Does Economic Space Matter?:* Macmillan, St. Martin's Press, 1993.)

In any case, what is unfortunate in terms of resources wasted is the fact that a political, rather than economic, power house reins in Japan, as would in any other rent-seeking society. The amount of rent at stake is huge, but no matter how huge it is the existence of rent itself matters not inasmuch as it is a mere transfer of income or wealth already created. What matters is the time, money and related resources, above all, workforces

(often elite bureaucrats) that are wasted in the process of rent seeking. (The elite bureaucrats are not to blame in this context as they, too, are a victim, in a sense.) Resources wasted are a forgone wealth, not a mere transfer thereof.

To see a glimpse of resources wasted consider the following statistics. The number of firms in the construction industry: 564,900 (Source: Tetsuji Maeda, *Kensetsu, Jitsumu Kyouiku Shuppan*, in Japanese, 1998). Out of this staggering number (565 thousand) of firms almost half (267,000 firms) are alleged as the so-called "paper companies." Total employment therein amounts to 6,700,000. Thus, almost seven million people are somehow engaged in this industry, get paid by more than half million companies with or without actual work. Moreover to "guide" these firms and secure "orderly conduct" by them a grand scheme of bureaucracy is called for, even if not needed. The statistics of employment in the Ministries of Construction, Transportation, Health and Welfare, Industry and Trade, etc. is presumably not included in the employment in the private sector industry. These Ministries and their elite instructors supposedly give minute guidance on orderly conduct and proper ways, ranging from a proverbial way of "picking chopsticks up and down" to the proper numbers and sizes of golden(?) nails to be driven into the edifice of a million dollar rabbit hutch -- for safety and quality regulations. The underlying waste persists as a flow magnitude, i.e., every year, rather than a stock magnitude as in the case of a gigantic fish pond.

Getting back to my own proposal, the recommended subsidy is for private investment, neither public nor unproductive investment. And in light of the amount proposed I do not fear much about inflation even if it is financed by deficit financing. But if opposed, then how about selling the US TBs that the MOF is alleged to have accumulated in the amount of \$200 billion for purposes of the foreign exchange market intervention via BOJ? Insofar as the average purchase price is less than 135Y/\$, selling \$ for Y140 or above would easily generate the subsidy fund needed. Moreover, the Yen may shoot up at least in the short run through the unsterilized intervention provided that the BOJ sells the special government bond FB (not circulating in the market) to the MOF. This is tantamount to the BOJ withdrawing the Yen currency up to the amount of 27 trillion yen while the MOF is left with one trillion yen of profit from foreign exchange transactions. A possible adverse impact sometimes alleged upon the NSE or the US bond market should be minimal insofar as the BOJ keeps selling (with MOF's approval, if needed) the US\$ until its value comes down to the 135Y/\$ level. If the market overreacted, and the dollar went sufficiently below that level, then the BOJ should be allowed to repurchase the bills.

According to Daniel Slesnick (1993, *Journal of Political Economy*) the consumption-based poverty rates in the United States are much lower than those based on income, i.e., the American poor are not so poor as their official measures of poverty may make us believe to be. In a converse context I believe that the seemingly rich Japanese are in fact poor despite an opposite appearance that such figures as their per capita GNP may give. As a symbolic example, consider how people in Japan react to a typical summer heat wave. A TV weatherman there would say, "we are going to have a tropical night tonight, and a sleepless one, hard to sleep." As the shivering winter approaches, he would then say, "we are going to have a Siberian night tonight, and a sleepless one." I suspect that the rich people hardly understand what is meant by the underlined phrase in the quote. Only the poor does, having to spend a series of sleepless winter as well as summer nights because he can hardly afford reasonably comfortable airconditioning, though perhaps

even knowing not how poor he is. Whether or not the weatherman's such remark makes sense to the public TV viewers may thus make a more realistic piece of evidence about the standard-of-living differences among them than would more comprehensive statistical data on income distribution differentials.

As Richard Feynman, the late Nobel laureate physicist, observes there is a fine distinction between knowing the name of something and knowing something. It is important to know the true standard of living and housing condition of the 'wealthy' Japanese. Forget the name of a half million or even one million-dollar mansion we live in. We deserve a better housing. We can afford a better standard of living. A little subsidy may go a long way towards achieving such an objective.