Japan: Failed Keynesian Experiment
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WOODS: Japan has been engaged in a Keynesian, I hate the word experiment, but they've engaged in Keynesian policy for a quarter century now, and just recently figures came out for GDP growth there, and they were expecting a couple of percentage points positive, and it turns out they keep sinking ever lower. Yet I don't see a lot of people saying on the Keynesian side: maybe this means that there's something wrong with our whole paradigm; we've got to rethink it. Unpack this for us. What exactly is going on in Japan, first of all?

MURPHY: The immediate news, as you say, is they had really terrible real GDP growth numbers. That's the thing that the financial press cares about and government officials. And so everyone is wringing their hands and saying, oh, gee, maybe we shouldn't have raised, you know, the retail sales taxes. Because that's what they did back in April. They raised them, and then they were supposed to raise them again. And the reason for that, though—it's not like it just came out of nowhere. The reason for that is Japan's government debt-to-GDP ratio is the highest in the world. It depends what figures you use, but they have more than double what the U.S. comparable figure would be. So well over 200% of Japan's GDP, the government has that much in its debt, and where did that come from? As you said, Tom, it's because Japan has been engaged in what the rest of the world has been doing since the crisis, but Japan has been doing it since the '90s.

People may remember that phrase "the lost decade." Or now the "lost decades," plural, of Japan. That's what people are referring to, that they had a huge stock market crash, real estate crash going from the late '80s into the '90s, and they have never recovered from that. The best thing I've seen in a while is if you Google Ben Powell Avoid Japan's Mistakes, he had an op-ed in the *Washington Times* where he just walked through the history of that, if people want to go and see the actual numbers. But the point is, Japan has just been mired in this rut for literally going on two decades now, and the irony is—I'm not even going to put the words in their mouth. Do you remember, Tom, when we were arguing about the Fed expanding its balance sheet and so on, and the government running up huge debt? One of the Keynesian standard arguments was to say that, hey, you guys worried about spiking interest rates and price inflation. You're wrong because Japan has been doing this for a decade now, and they didn't have that problem. But suddenly you would say, so why would we start doing something—the Keynesian solution—that Japan has been trying for more than a decade, and they're still stuck? So both sides are sort of agreeing that Japan has been doing this for a long time now, and gee, it's just not enough. It's never enough, is it?

WOODS: I'm hoping to get David Stockman back on the program sometime next month. He just wrote at least one really excellent column on Japan over at David Stockman's Contra Corner. And the thing that jumped out at me in that piece was, that when you look at the index of industrial production—and I'll be honest with you, I don't know how they measure that—but he's going back about 25 years, and he says it's at 96.8, and today it's at 96.8. So, in other words, they've had a quarter century of Keynesian policy, and they are exactly where they were at the beginning. That's pretty unimpressive, right?

MURPHY: Well, yeah, I don't know that particular number, but that certainly sounds plausible to me. Just to give you another sense of just how bad it is. The Nikkei 225, that's like the Japanese stock market index that everybody reports on, CNBC and *The Wall Street Journal*. That back in 1990 was about 38,500 or so, well, I'm looking at the graph here, and then it fell, and it has never gotten to more than half of that since. I'm talking nominal terms. So can you imagine you had money in the stock market in Japan, as of 1990 there was a big crash, and you're still waiting to get back to where you were in 1990 in nominal terms. That's really just to give you a sense of how bad things are over there in terms of the conventional way that pundits look at the health of an economy. Again, it's not that, oh, well, Japan must have been doing Calvin Coolidge-type policies. No. They were doing all sorts of ostensibly textbook Keynesian things of running up huge budget deficits and expanding their balance sheet.

And the other thing to is this latest round—Abe coming in and Kuroda, the central bank chairman. What their goal is is to promote price inflation. So it's not like that's an unfortunate side effect. Everybody is urging Japan, saying: you need to push up your prices so that you get at least 2%—they just say inflation, but it means price inflation. And that's the thing, and oh, man, they are just not inflating enough, and if only they could trick the Japanese public into thinking that there's going to be price inflation so they go out and spend the money. Really it just shows the logical conclusion of Keynesianism, where the way you fix an economy is to get everyone to realize the money is not a good asset to hold and to get rid of it.

We can look at historical events, and we can do all kinds of sophisticated analysis, but just to try to grab the public at the gut level and say are you sure this is a good idea? That's what their avowed policy is. They want to convince the public that the yen is a bad thing is to hold and to get rid of it, to turn it into a hot potato. I'm hoping some people just recognize that doesn't really make sense, that the government's goal is to go out and convince people that the money they use is a bad thing to hold.

WOODS: What about the excuse that we need to engage in this expansionary monetary policy to avoid deflation—deflation and Japan have been mentioned in the same sentence so many times that we assume there was some terrible crisis where deflation was threatened. Now, leave aside whether or not deflation is a real threat. We've addressed that on the show before, not that it would hurt to mention it again. But was that really a problem? Was there a specter of deflation to begin with?

MURPHY: Well, when you use specter, that's kind of loaded term. It is true. Let me make sure that your listeners understand that the CPI, the conventional measurements in Japan, that has been roughly flat. People can go to the St. Louis Fed's website if they want to see these things, but for example, from about the early 1990s, if you call that at 100 for their consumer price index. Until fairly recently, it was back to 100 again. So it would go up a little bit. Then it would go down a little bit. So over long stretches they did have a roughly stable consumer price index, and so that is the case, but I am not sure what that's supposed to prove. It's certainly not the Keynesian story, which is to say, well, gee, when you get stuck in one of these ruts, you're stuck forever, and no matter what the central bank does, it's pushing on a string. That's certainly not true, because what happened is if you look at a chart of Japan's monetary base, the total amount of assets that the Bank of Japan holds, that was rising pretty rapidly, and then in the mid-2000s, they dropped it rapidly. They sold off a bunch of assets. Okay, they sucked a bunch of money out of the system, if you want to think of it that way, and why did they do that? Well, because consumer prices in Japan had actually started going positive, and they didn't want that.

So the people running the Bank of Japan are much more committed to stable consumer prices than their counterparts at other central banks. So that's true, but from that you shouldn't conclude that, oh, man, those poor people, they're just stuck. They can't get prices to rise. No, as a matter of policy, they were pumping in all kinds of money, and then when consumer prices started ticking up, they sucked a bunch of it out, and that's how they reassured the public that we're not going to let consumer prices get out of hand. So the thing, again, to repeat myself, it's different in the last couple of years, is now the leadership is telling everybody, well, we're doing an about-face. You know how we've maintained the strength of the yen in terms of consumer goods for all this time? We're not doing that anymore. Our active plan now is to make the yen become weaker. So that's what the new twist is, and everybody was praising them, and it looked good for a while. The yen fell against other currencies, and both Keynesians and market monetarists were lauding these new efforts. Then all of a sudden the economy is back into a bad recession—it seems to be—and so everyone is like, oh, well, it's something else. It's not the fault of printing a bunch of money.

WOODS: Stockman seemed to suggest there's a subtext beneath all of this—that when the inflationary policy is being recommended, that it's not just that they're saying we need to do this to avoid deflation. We also need to do this to devalue the tremendous debt that Japan has taken on. It's something like a 230% debt-to-GDP ratio, and they are thinking that inflation helps to erode that, and maybe inflation can jump start the economy, give it some kind of push. Do you think there's something to that?

MURPHY: Well, yeah, I definitely agree with Stockman's analysis that those things all go together. It's sort of like the Gruber approach to health reform—you could talk about a policy that's going to do a bunch of stuff, but then if you're going to sell it to the public, you maybe want to stress one element of it and kind of sweep under the rug the other stuff that doesn't make it sound so appealing. So I think that's what going on here. Clearly, if you pump in a bunch more yen compared to what the status quo would have been, then the yen is going to be weaker against foreign currencies. And so if you're an exporter, that might give you a short-term boost. Certainly, consumers in businesses are going to be less likely to sit on yen-denominated assets. They might go and spend more if they think that the currency is going to weaken in the near future. So that's certainly true. So if you're a Keynesian economist, and you think the reason economies are bad is the people just aren't spending enough and they are saving too much, well, that might be a feather in your cap. And certainly, given an outstanding amount of nominal government debt, if the yen weakens, it's easier to service that debt. So those things are all true. But again, I don't think you'd see finance ministers or something getting up and saying, oh, the reason we're going to do this is because we want to weaken the purchasing power of our currency so that it's easier for us to pay for our past profligacy. They are probably not going to come out and say that, even though that's what the economists behind the scenes know is maybe one of the main reasons.

WOODS: Let's shift gears and talk about Paul Krugman. Although we're not really shifting gears, because Krugman has been commenting on Japan, and it would be interesting to hear your comments on Krugman's comments on Japan.

MURPHY: (laughs) The guy is funny. It was on November 13, I believe, he came out and posted a picture from the CBO, Congressional Budget Office, showing what had happened to tax rates for various income groups under Barack Obama as part of the legislation going from 2012 to 2013. And the chart from the CBO showed that income tax rates went up on every single income group across the board. They went up more on the upper 1% compared to the other groups. But nonetheless, everybody's income tax rates went up, according to the CBO chart, and Krugman just completely ignored the fact that income tax rates went up on everybody else, and just was telling his progressive readers, hey, let's give Obama some credit. He really has been trying to address inequality. Look at how much he raised taxes on the upper 1%. Let's give him some credit. That was his sole commentary. He didn't even mention the fact that income tax went up.

Four days later, when the news of Japan came out, and their GDP contraction, Krugman is lamenting on his blog, saying: I can't believe they went ahead with that sales tax increase back in April. Contractionary policy is contractionary. I could have told them that. In fact, I have been telling them that over and over, but some people just don't listen. These deficit hawks just need to address the debt problem now, now, now instead of just going out and lamenting like how could these idiots have possibly thought it would be a good idea to raise taxes when the economy was so weak to deal with the debt crisis that surely could have been—we could have let that slide for a few years to make sure the economy had its feet.

So, again, it's just the standard thing with Paul Krugman that to him addressing inequality—that's fine to raise taxes on everybody so long as you raise them more on rich people, even in the midst of what he still thinks is the U.S. and the liquidity trap. That's fine, but oh, my gosh, raising sales taxes in order to deal with the debt-to-GDP ratio that's the highest in the world, well, no, that's just crazy. We just can't believe these people would ignore the sound recommendation coming from Krugman that you never raise taxes in the midst of a weak economy. What are you thinking?

WOODS: Explain to everybody what a—this is your term—what a Krugman Kontradiction is?

MURPHY: I had to come up with some term because Krugman—he's a very smart guy. Some people are like, Bob, why do you keep even reading that guy? Let's just ignore him. Well, he's a Nobel laureate in economics, and he's hands down, literally planet Earth's leading Keynesian apologist. But other than that, he's also very smart, and so he'll come up with sort of logically consistent defenses of his position. Because he's clever, and he knows a bunch of economics, and the thing is, with mainstream economics, you can say whatever the heck you want. You can just spit out any output you need. So even though there is certainly some tension, and I label that a classic Krugman kontradiction, with the analysis that I just gave, that he went from one day congratulating President Obama for raising taxes on the upper 1% and just ignoring the fact that his own chart showed he raised them on everybody else as well in the midst of a weak economy, and then four days later he's lamenting: I can't believe the people in Japan raised taxes—don't know they know that that's the wrong thing to do in the midst of a weak economy.

So you could say, now, did he technically contradict himself in the sense of saying A is not A? Well, no he didn't do that, and I know his partisans would defend him because they do in the comments of my blog. And they come in and say, well, no, see the difference is, blah blah blah. So it's not a formal contradiction as a matter of pure logic. But clearly, he knows what he wants the policy conclusions to be or he knows, oh, geez, if there's a recession, even though Japan has been doing exactly what I recommended in terms of its monetary policy, I need to come up with some reason that they didn't listen to my advice. He's not just going to say, yeah, they followed my advice, and it blew up in their face. So he's got to come up with something, but he's very clever, and so will often be able to thread the needle and make it look like I'm technically not contradicting myself even though he's completely switched the whole tone of his analysis, and a regular reader of Krugman's would surely utter outright contradictions if he tried to paraphrase what the master's position was because it's so tortured and careful to avoid those landmines that he set for himself.