Japan: The Fall of a Miracle System

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Japan, a nation that has seen much economic growth over the last century, has often been studied by many economist and historians alike. Many countries of similar status have even chosen to pattern themselves after Japan. The reason for this interest in Japan is that they like none other were able to rise out of the ranks of a third-world or developing countries and find their place with the elite. The observers of this Japanese system began to call it the “Japanese Miracle” because of its rate of growth in the post-war era. Developing countries all across the world were looking at the system as a way to solve their own problems in their respective countries. Admirers of the Japanese system even marveled that it would not be long until the Japanese were economically on par with the US. Until recently, all of the lessons that the Japanese system was able to teach were those with positive implications.

After some unfortunate international events and policy decisions, Japan and its economic miracle were in the midst of a free fall from the heights of prosperity to the depths of recession. Now, Japan was the object of a whole new lesson. This lesson centers around the fact that Japan has found itself trapped in a recession for over two decades despite the numerous policies that its government has enacted. The government has taken a part Keynesian and Monetarist approach in its policies to lead the way to economic recovery. These policies have only succeeded at driving Japan so far into debt that it appears impossible for them to emerge. In closing, the Japanese economy is a very unique one in that it grew to become the world’s third largest economy, but as a result of the interventionist attitude Japan has depended on throughout its history, they are finally reaping the consequences. Therefore, they must reform and fix over six decades of economic damaging policies.
Before looking at the economic down turn, it is important to first overview the post-war period during which Japan grew at astronomical levels. This period begins at a time when Japan was faced with the destruction war can bring on a country. For instance, many of the cities which were the population centers were destroy due to air attacks. Also, large portions of the industrial and commercial facilities were either destroyed or during the war were used for military production.\footnote{1} In that, Japan was a country with a depleted source of capital which was needed for recovery after the war.

Also, after the war the Allied Powers were seeking to punish and to reform the Japanese rather than providing for economic recovery. These policies showed through the production statistics immediately following the war. For instance, in 1946 production was 30 percent of its pre-war level, and by the next year there was not much improvement (37 percent the pre-war level). Consumption too was only 50 percent of the pre-war level. There was no exportation of goods which meant Japan was cut off from the rest of the world market. The currency had been greatly devalued during the war and was worth practically nothing.\footnote{2} In short, Japan was part of an economic crisis which was deepened by the American’s stringent policies.

In 1947, the American agenda began to change from reform to recovery.\footnote{3} As a result of the change, Japan began to see a spike in its production output which only served as the start of its economic successes. The US involvement in the Japanese economy allowed for reemergence into the international economy. This especially became evident with the breakout of the Korean

\footnotetext{1}{G. C. Allen, Japan’s Economic Expansion (London: Oxford University Press, 1965), 15.}
\footnotetext{2}{Ibid, 16-17.}
\footnotetext{3}{Ibid, 17-18.}
War in 1950. War as it often does created demand for the manufactured goods of Japan leading to booming conditions in the production sector. A year later, the Allied Forces signed a treaty with Japan which returned complete sovereignty back to Japan. This set of events proved to be the best possible thing that could have happened to Japan’s economy.

In the years that followed the Korean War, Japan continued to see its economic conditions improve. This period directly after the war is referred to as “the era of high-speed growth,” an era that lasted until 1973. In 1955, the recovery from the war was believed to be completed, for Japan had seen an increase in gross national product at around 44 percent higher than in the pre-war years. Japan had also seen its major industries return to greater than pre-war productivity levels. In fact, industrial production was advancing at such a high level that it was forced into balance of payment difficulties.

The problem with the balance of trade was that as Japan’s industrial sector produced more to export there was a resulting increase in imports of raw materials. This then produces a phenomenon where imports increase to levels high enough that Japan could not finance the increases. This is a problem for Japan because it is a significantly small nation without an abundance of natural resources and raw materials. Therefore, its growth is considerably dependent on imports unlike other countries that do not have to import nearly as much. Throughout its years of extensive growth Japan experiences this setback from time to time creating a sort of boom-bust pattern. This result can be attributed to the fact that every time Japan

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5 Allen, Japan’s Economic Expansion, 20.
6 Ibid, 20.
runs into a balance of payments dilemma the Bank of Japan has to implement a tighter restriction on credit. The bank then follows the previous action with an easy credit policy to stimulate the economy and resume the high rates of economic expansion.\(^8\)

After this continual cycle throughout the late 1950s and early 1960s, Japan’s government sought a system by which they could eliminate the balance of trade problem while maintaining massive economic growth in the production sector. The Japanese government developed the Income Doubling Plan to eliminate this problem and to bring about the desired results. The plan was designed to first double the gross domestic product of Japan in ten years which appeared to be impossible given the current trade situation. So the Japanese devises a plan that would boost its exports by 3 percent, and it would then eliminate the balance of trade problem. The cornerstone to this plan was the highly praised industrial plan which was first created in the 1950s then revised under the plan in 1960.\(^9\)

The industrial plan primary focus was to systematically select industries where growth would be the result. The government would then employ policies that would lead these industries in the direction of the specific economic objective of the government.\(^10\) Much of the selections stemmed from the fact that Japan felt like it needed to change the mix of products that they were exporting. Therefore, the industries that were chosen had to fit the specific exports that their main importers demanded. The industries that Japan selected to fulfill its industrial plan were those that were more capital and knowledge concentrated rather than labor concentrated. The

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8 Allen, Japan’s Economic Expansion, 21.  
industries that fell under these categories were steel, automobiles, machinery, and shipbuilding. They saw these industries as the ones which would produce the most demand in the future.\textsuperscript{11}

The plan also through the Ministry of International Trade and Industry sought to promote economies of scale in order to decrease both the production cost and the price of goods. The idea is based on the idea that there is a specific size of a production facility where it produces the optimal amount at the lowest possible cost. The idea here was to promote mergers of the existing firms in a market, and to provide barriers from more firms entering the market. The MITI also provided these industries that were selected with protection from outside imports, subsidies, cheap capital investment and special tax breaks.\textsuperscript{12}

Many of these benefits were the results of a method referred to administrative guidance. This guidance was the product of several government bureaucracies which advised private sector organizations. These bureaucracies had control over policies both in terms of banking activity and the fiscal policies enacted. In other words, if a business wanted to operate in a favorable business environment they had to comply with the guidance provided by the government bureaucracies.\textsuperscript{13} Much of the guidance was focused in the area of investment of private banks to industrial production. They were persuaded to invest in the protected industries or risk losing the credit allotted by the Bank of Japan.\textsuperscript{14} The result of such a system is the close relationship between the government and businesses. The government essentially elicited control over the entrepreneurial decisions of the businesses in the name of promoting growth.

\textsuperscript{11} Katz, The System That Soured, 118-119.
\textsuperscript{12} Alam, Governments and Markets, 98.
\textsuperscript{13} Hsu, Encyclopedia of the Japanese Economy, 1-2.
As a result of these policies, Japan was able to end the problem of balance of payment
which allowed for them to maintain continual growth. The income doubling plan easily met its
growth rate of 7 percent by exceeding that rate by 2 percent annually.\(^{15}\) In addition to the 10
year period, Japan experienced growth nearly two and a half times the average growth rate for
most developing nations during the period from 1950 to 1970.\(^{16}\) From this information, it is
possible to understand that Japan’s miracle has been like none other in that they have grown at
historical rate for a developing nation.

Even though Japan has experienced such a high level of economic development many
economist have discredited the actual effectiveness of the model. Economists have noted that
the growth in the Japanese economy is a result of the government created boom, and the massive
amount of subsidies received from the United States. Theses economist also believe that the
market forces would have promoted production in the very same industries that brought the most
productive growth. The point can also be made that the industrial policy itself created some of
the balance of payment setbacks. Such a bold statement points to the idea that because of the
acceleration of market functions by the industrial policies there was created a demand for more
imports. The demand for more imports to cope with the rise in production then led to the
balance of payments problems for Japan again and again until 1964. During this period of
frequent boom-bust activity, Japan did manage to maintain 9.3 percent growth.

Yes, Japan did experience soaring growth rates, but the policies utilized to do so violate
some economic truths. From the definition, it appears that Japan is a mixed economy. In that, its

\(^{15}\) Katz, The System That Soured, 122.
\(^{16}\) Alam, Governments and Markets, 93.
system is no socialism because it still promotes private ownership, yet it is not a totally free market system because it uses some intervention to purge the so called “deficiencies” of the free market. Japan, to counter these deficiencies, sought a system with a Keynesian background filled with government planning and providing. This system was an illusion of real economic, and the frequent downturns are testament to this proclamation. True economic growth requires savings and investment that produces capital accumulation. This type of growth is only found on the market where consumers’ preferences drive the economy not government preferences.17

Despite these fundamental problems with the system, it was able to maintain high growth rates for nearly 20 years. The actual growth throughout this 20 year period is recorded at 8.6 percent annually.18 The question then must be asked, how did Japan with all of the interventionist policies manage to grow at such a significant rate? This is a valid question because in most circumstances where production and other aspects of the economy are being planned by the government much inefficiency and malinvestment will result. In the Japanese case, there were some factors in terms of the economic environment that allowed for the persistence of the system.

First, the fact that Japan created economies of scale which were able to keep productivity high, and cost low allowed for the continual success of the system. As a result of this economic change, the total factor of productivity grew at an astronomical level during most of the economic miracle recording 6.2 percent growth in the 1950s, and 7.5 percent in the 1960s.19 In relation to both the rise in productivity and sustained growth of the miracle era there are cultural

18 Alam, Governments and Markets, 93.
aspects that must be examined. It is often speculated that the economic system Japan chose would not have lasted nearly as long without the strong cultural influences.

These cultural influences fall into three categories: the attitude of national identity, the work ethos, and the implementation of the “vertical principle” of organization. Chalmers Johnson writes about the attitude of the Japanese people saying, “from 1941 to 1961 the Japanese remained on war footing. The goal changed from military to economic victory, but the Japanese people could not have worked harder, saved more, innovated more ruthlessly if they had actually engaged in a war for national survival, as in fact they were.” The presence of these factors allowed for the productivity that enabled Japan to succeed with its economic system.

Another vital occurrence that allowed the system to last as long as it did was the benefit of having the backing of the United States economy. The reason for this is that without the massive United States economy Japan would not have had the ability to export as many of its manufactured goods. The relation between the two countries grew during this period. In fact by the 1960s America accounted for nearly 30 percent of all Japanese exports. The relationship is not subject to only Japanese exports to the United States, but it was also the case that during this same period one-third of all Japanese imports were supplied by the United States. There was even a special relation between firms within the two countries which allowed for an abundance of American products to reach Japan in the form of industrial machinery. It was also the case that the Japanese received hundreds of millions of dollars in the form of “special procurements”

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20 Alam, Governments and Markets, 122-125.
21 Ibid, 116.
from the United States.\textsuperscript{22} The plan of the United States was to insure that Japan succeeded both economically and politically in order keep stability in the region through a powerful ally.\textsuperscript{23}

Furthermore, Japan was dependant on the US economy under the Bretton Woods system as was the rest of the world. The Bretton Woods system was an international monetary order created in the mid-1940s which used the US dollar as the key currency of the entire system. Since the system was no longer hampered by being checked by a gold standard the result was an inflationary attitude among most nations in the system especially the United States. The system was setup so that as US dollar inflated countries backed by this currency also had to inflate their own currency and credit. As a result of dependence on the heavily inflated dollars, the system was moving quickly toward an inevitable crisis, and had to be disbanded in August 1971. The world currencies were then forced into a fiat system similar to the system of the 1930s. The future was grim as Rothbard noted in his book, \textit{What Has Government Done to Our Money?} by saying, “Ahead loomed the dread spectre of currency blocs, competing devaluations, economic warfare, and the breakdown of the international trade and investment, with the worldwide depression that would ensue.”\textsuperscript{24}

In terms of Japan’s involvement in the system, it is important to note that Japan was largely dependent on international trade, and with the ending of the Bretton Wood system Japan was most likely going to feel the effects. In terms of Japan’s economic growth after the fall of the system, it was already experiencing steady decline throughout the late 1960s, but in the years

\textsuperscript{22} Allen, Japan’s Economic Expansion, 236-237.
\textsuperscript{23} Alam, Governments and Markets, 117
\textsuperscript{24} Murray Rothbard, What Has Government Done to our Money (Auburn: Ludwig von Mises Institute, 2005), 95-101.
following the collapse Japan’s growth seemed to fall exceedingly. Also, during this period, Japan saw its first dip into negative growth rates in over twenty years.\textsuperscript{25}

Next, it is important to give some perspective on why the 1970s proved to be a difficult era for the Japanese economy. First of all, during the Bretton Woods era the yen/dollar rate was determined and set at 360 yen/dollar in 1949 and stayed there until the collapse of the system in 1971.\textsuperscript{26} It was the case that the Bank of Japan was restricted from adjusting this rate under the Dodge Plan in order to keep the price of exports from Japan low. So when the system collapsed, the Bank of Japan was given freedom to conduct its monetary policy in any manner in which they could freely control the prices of imports and exports. After Japan receive its monetary freedom, there were some trade disputes with the United States because Japan began to appreciate its currency from 360 yen/dollar to 315 yen/dollar. The fact that the currency was continually appreciating brought about a controversial agreement between the two countries to set a fixed rate at 308 yen/dollar.\textsuperscript{27} Therefore during this period in the 1970s, it is possible to see that Japan kept a close economic relationship with the United States especially in terms of trade.

By looking at the historical occurrences, the idea that the Japanese economic system is connected to the United States system can be perceived. The Japanese economy not only followed the US economy in down-turns but also in growth. For instance, during the era of high-

speed growth the United States saw a steady growth rate at around 3.6 percent.\textsuperscript{28} The dependence that the Japanese economy had on the US economy is most likely the explanation for the connection of the two systems. Another example is during the Middle East Oil Crisis 1973, when both the Japanese and US economy entered into a recession. In terms of growth rates, both economies experienced negative rates soon after the crisis.\textsuperscript{29} The economies of both nations entered into a period of stagflation where inflation skyrocketed and growth rates were negative.\textsuperscript{30}

In the time after the oil crisis, Japan began to change its inflationary ways, and a year after raising inflation to nearly 25 percent the Bank of Japan decreased the rate to fewer than 10 percent.\textsuperscript{31} It appeared that the move by the bank was an attempt to change its inflationary ways of the early 1970s because the increased inflation is precisely what aggravated the situation of this period. The Japanese also began to separate themselves from US economic policy, for in the years that followed the set yen/dollar exchange rate the Japanese adopted a floating exchange rate system.\textsuperscript{32} When the second oil crisis arrived in 1978, Japan was in a totally different position then it had been in the first. In that, its economy reacted differently because by the late 1970s Japan had allowed the inflation rate to reach 5 percent, and was actually showing signs of a

\textsuperscript{30} Ito, “Great Inflation and Central Bank Independence in Japan,” 11.
boom by 1979. Meanwhile, the US dollar was having its own crisis while the yen was appreciating.\textsuperscript{33}

After the end of the second crisis in 1980, the appreciation of the yen began to widen the trade imbalance between Japan and other advanced industrial countries.\textsuperscript{34} As a result of the trade imbalance, Japan was experiencing growth at a high rate. In fact, “nearly half of all GDP growth came from a growing trade surplus.” Then there was the Plaza Accord in 1985, an agreement between the G-5 nations to force the US to devalue the dollar, and bring balance back into the international trade arena. The Plaza Accord affected Japan by causing the yen to appreciate by 50 percent.\textsuperscript{35} The idea was to bring the trade surplus down and allow greater involvement in the trade market. More specifically, this agreement caused the Japanese exports to price themselves out of the market. The trade surplus that Japan had experienced to this point began to shrink, and eventually it resulted in decreasing growth.\textsuperscript{36}

In January of 1986, Japan decided to offset the increasing yen by changing the monetary policy to one of easy money. The bank of Japan brought about this policy by decreasing the interest rate from 5 percent to 2.5 percent.\textsuperscript{37} This set of policies then reestablished investment, asset prices in real estate market and stocks sky-rocketed.\textsuperscript{38} In fact, Japan significantly raised asset prices, the over abundance of economic activity, and the sizable increase in money supply

\begin{itemize}
\item \textsuperscript{33} Ito, “Great Inflation and Central Bank Independence in Japan,” 19-20.
\item \textsuperscript{34} Statistical Bureau of Japan
\item \textsuperscript{36} Katz, The System That Soured, 213
\item \textsuperscript{38} Katz, The System That Soured, 216
\end{itemize}
and credit which led to the idea that they had created a “bubble” of sorts.\(^{39}\) Once again, Japan had created an environment for growth in its economy for extremely high growth through intervention in the market, and they were proud of their accomplishments.\(^{40}\)

It was during this bubble that began to boast of that in theory it could purchase the United States which at the time was twenty-five times its size. The Banks in Japan were allowing companies to hold loans up to 80 percent their value, and the companies would then use the loans for leverage to invest wildly. The situation was one of high confidence in its economy even though the high times were created artificially. The rest of the world too began to get caught up in the success of the Japanese system. The people of both Japan and the rest of the world did not realize that they were caught in a bubble for much of this period until they were forced to tighten the monetary policy. The Japanese failed to see this bubble even though many economists have shown that the intervention of the government in to the money market often creates such a boom or bubble. As a matter of fact, Japan displayed a high level of self-confidence which developed in the Japanese an attitude that they had long transcended the rules of capitalism. Many people in America began to talk of Japan as a super nation that would overtake America by the year 2000. These people believed that this system of strategic economic management was the economic plan of the future and that laissez-faire economics were a thing of the past.\(^{41}\)

The truth is that even though Japan felt that its economy was invincible it was only involved in the upswing of business cycle, and the other aspect of the cycle was looming in the


\(^{41}\) Ibid, 2-3.
near future. The theory behind this cycle begin with the bank supplying more credit which then results in a lowering of the interest rate below the market rate. The lower rate then brings economic stimulus in that it increases investment into the means of production. Prices will then continue to rise in both sectors of the economy as long as the credit expansion is continued. When the bank decides to discontinue the credit expansion the people will see that the increased profitability were false. Many of the business ventures of the period are no longer seen as successful investments, but rather as malinvestments. As a result, companies either liquidate these bad investments or fail. The price level then collapses at an alarming rate and crisis or depression will be the result of the artificial credit expansion.\textsuperscript{42} The period that follows the bust is one of massive credit tightening and business failings which result in a recession.

The Japanese government acted with the attitude of intervention that it had been employing ever since the recovery period. The result of these actions created a dramatic boom-bust cycle, and the events of this interventionist behavior paralleled the events of the previously explained business cycle. For instance, the government eventually recognized the bubble and sought to tighten the monetary policy by increasing the interest rate to 6 percent. Next, the economy did collapse soon after, and the prices levels appeared to fall off of a cliff. In that the Nikkei stock market index plummeted more than 60 percent from a high of 40,000 to fewer than 15,000. Real estate prices also fell drastically decreasing 80 percent as a result of the recession. As a result of the cut backs by businesses, unemployment rates more than doubled from 2.1 percent to 4.7 percent.\textsuperscript{43} Corporate bankruptcies also increased with the bust from 11,463 to

\textsuperscript{43} Powell, “Explaining Japan’s Recession,” 36.
77, 738 bankruptcies from the bad-debt expenses.\textsuperscript{44} Just as the business cycle suggested events would take place if credit expansion was adopted it was carried out.

The concern then shifted to how could Japan recovery from the recession and return to the growth rates it was familiar with in past history. An interesting question arose as the 5 Ds known as deflation, debt, declining demand, de-industrialization, and default became a reality.\textsuperscript{45} Would Japan apply more intervention as was the trend of the country throughout its post-war history or would they seek a new identity with laissez-faire policies? The answer is found by studying the 1990s where Japan takes a primarily Keynesian approach toward its quest for economic recovery.

Free market and Austrian economists believe that prices equilibrate according to supply and demand. Therefore, in a recession when prices deflate the Austrian economists believe that the best solution is to allow the price to come to the equilibrium of supply and demand, and then allow the market to work from this point. Keynesians on the other hand believe that prices are sticky downward and that they do not adjust to equilibrium in a timely fashion. Therefore, Keynesianism’s core belief when it comes to economic recovery is to increase the aggregate demand to counter the decrease in investment. This task is completed by the government lowering the tax rate while increasing government spending.\textsuperscript{46}

After the bubble burst in 1991, the Japanese implemented six different stimulus packages totaling 65 trillion yen which annually equaled around three percent of the total Japanese

\textsuperscript{44} Asher, “What Became of the Japanese “Miracle,”” 5.
\textsuperscript{45} Ibid, 4-6.
\textsuperscript{46} Powell, “Explaining Japan’s Recession,” 39.
In addition to the stimulus packages, Japan followed its Keynesian platform when it introduced the fiscal budget for 1993 which totaled 72.35 trillion yen. Of the more 72 trillion budget, it was split between several government projects to stimulate growth. The government also eventually added a 2.25 trillion tax cut that was initiated in 1994. This set of government spending which took place in 1993 was the largest in history. Over the remainder of the decade, Japan tried four more stimulus packages accumulating to over 100 trillion yen. The government then added in 2008 another 16.7 trillion dollar public works stimulus package. Even after all of these stimulus packages which were designed to lead the economy out of the recession, the economy was still stagnant pointing to the fact that stimulus has not worked. These stimulus plans have only succeeded at increasing the public debt to 100 percent the GDP of Japan. The Keynesian system does not work to create recovery as the history of the system has shown.

The Keynesian explanation is that the economy is suffering a liquidity trap. A liquidity trap is a case where Keynesians maintain that demand for money may be so high that that the interest rate remains so high that investment could not be stimulate by the Keynesian means. In other words, the interest rate is so high that the banks do not want to lend money for investment. In the case of Japan Keynesians would push for the government to lend directly to businesses. To bypass the problem of liquidity trap, Japan has the Federal Investment and Loan Program which is an agency that collects money they then lend directly to businesses. Also, it is

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worth noting that with the expenditures of FILP added the public debt exceeds 200 percent GDP.

Paul Krugman an economist from the Keynesian school of thought began to emphasize that the problem with Japan’s economy was not supply it was inadequate demand. He furthered proposed a set of economic policy solutions for the problem of inadequate demand. He stated this solution in an article entitled “Purging the Rottenness” when he pushed for an, “unconventional monetary expansion, with the Bank of Japan buying dollars, Euros, and long-term government bonds; it also involves accepting and indeed promoting mild inflation and a weak yen. I could explain why this would probably work, but what’s the point? It’s not about to happen” The fact is that Japan took his advise in 1997 and 1998 when they attempted to increase its commercial paper from zero to $117 billion dollars. The Bank of Japan and the ministry of finance began to purchase government bonds increasing the stock owned to $2.22 trillion. Still, this Keynesian plan formulated by Krugman could not usher Japan out of the recession, and by this time Japan had lost an entire decade to these failed policies.

The monetarist too entered the discussion of Japan’s recession with an easy solution. The blamed the continued recession on the fact that Japan contracted credit too quickly when the Bank of Japan raised the interest rate to 6 percent in 1989. To the contrary, Ludwig Von Mises in his essay “The Austrian Theory of the Trade Cycle” stated, “As soon as public opinion becomes aware that there is no reason to expect an end to the inflation, and that prices will

54 Ibid, 40.
55 Ibid, 41.
56 Ibid.
continue to rise, panic sets in. No one wants to keep his money; because its possession implies 
greater and greater losses from one day to the next; everyone rushes to exchange money for 
goods, people buy things they have no considerable use for without even considering the price, 
just in order to get rid of the money.”

In addition, the monetarists believe that in terms a solution to a recession is to re-inflate 
the monetary system to avoid falling deeper into a recession. The monetarists are strong 
believers in the saving power of the money supply. The Japanese have implemented this 
monetarist policy in its economy by decreasing the interest rate from 6 percent to 0.5 percent in 
the period from 1995 to 2000. The Monetarist also stress direct control of the monetary supply 
and have called for an annual increase of the monetary supply by 3 to 4 percent. Throughout the 
1990s, Japans money supply grew at a rate of 2.5 percent annually, but many of the monetary 
rule oriented monetarist would emphasize the need to have maintained a set money supply 
growth rate before the collapse. Although monetarists do not believe in government 
intervention to the extent of the Keynesians, their policies of controlling the money supply have 
not been successful either.

To the contrary of both of these schools of economic thought, there is the Austrian policy 
which believes that government is not the answer. Analysis of the Austrian theory begins with 
the initial boom. The Austrians believe that the boom is an unsustainable measure that has no 
choice but to collapse. The basis of this theory originates from the idea Mises explained in the 
quote that was mention previously in this paper. In this quote, he states that because of the

58 Powell “Explaining Japan’s Recession,” 42.
59 Ibid.
banking crisis continual credit expansion creates this method is not a viable option. The bank
will not want to risk the collapse of the currency due to people getting rid of the devalued
money. 60 People will recognize that the easy credit is artificially created and that it is not based
upon the actual time preferences. 61 Therefore, the only choice the bank has is to remove the
expansionary policy which then will allow credit to tighten. The result of the tightening credit
then brings about the bust and the eventual recession. This chain of events therefore renders the
boom as an unsustainable process within the business cycle.
In terms of the post recession activity, Austrians believe that it is necessary for the economy to
hit the bottom and restore balance to the economy. 62 They understand that at the bottom
liquidation of all of the bad-debt and malinvestments takes place. For example, the liquidation
process is like a gardener that cuts off the dead growth in order to allow the plant to grow even
more without the dead weight. Murray Rothbard affirms the idea of liquidation by explaining
that it is essential for the government to allow the market to adjust to the correct allocation of
market resources. He says, “If government wishes to alleviate, rather than aggravate, a
depression, its only valid course is laissez-faire—to leave the economy alone. Only if there is no
interference, direct or threatened, with prices, wage rates, and business liquidation will the
necessary adjustment proceed with smooth dispatch. Any propping up of shaky positions
postpones liquidation and aggravates unsound conditions.” 63
The Japanese have adopted policies that are directly opposite of this laissez-faire policy
Rothbard alludes to in his book America’s Great Depression. The Japanese system has followed

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60 Ebeling, Trade Cycle, 30.
61 Powell “Explaining Japan’s Recession,” 43.
62 Ibid.
63 Rothbard, Great Depression, 185.
Keynesian structure with all of its stimulus packages, and the government as it has operated throughout the miracle year has shifted the production structure to fit the government demands at the expense of the market. As a result, these stimulus packages have allowed many undeserving and inefficient companies that would fail on the market to survive. In his essay, Benjamin Powell said, “the government has hindered the market process of adjustment by maintaining a capital structure that does not reflect the consumers’ desires.”

In conclusion, the Japanese system should serve as an example to all governments how intervention does not work. More specifically, Japan must examine its own system and use it as a deterrent from the policies that fail to perform for the good of the economy in the past. Instead, the government continues to try and fix the economy with quantitative easing, stimulus packages and other government intervention. Albert Einstein, one of the most regarded scientist and intellectuals of all time once defined insanity as “doing the same thing over and over again and expecting different results.” By no means do I mean to spite people who continue with this type of system, but I do see a need to try a different approach. The approach I am referring to is laissez-faire economics where the economy works hands-free.

The United States could have also learned from the Japanese failure in our current recession. Instead, with the same intentions as Japan the United States has adopted several stimulus packages, performed bank bailouts, and nationalized industries. The US has also decreased the interest rate to near zero levels. We seem not to understand that we are embarking on a path that has been tried, and proven to lead to longer economic stagnation. In fact, the

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64 Powell “Explaining Japan’s Recession,” 44.
government has totally ignored the Japanese example.\textsuperscript{65} To me this seems like the exact chain of events that Mr. Einstein was referring to in his quote. In other words, it is ludicrous for governments to seek government spending as a means to bring an economy out of recession with failed fiscal solutions over and over again. In closing, the overall lesson for the future of all governments is as Johnsson explained, “Preventing a free-market adjustment to changing circumstances, can prevent or prolong a recovery. Similar policy measures are most likely to fail in the future as well, despite the advice of some famous mainstream economists.”\textsuperscript{66}

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