Placing Top Priority on Ending Deflation and Actions to Solve the Issue Directly

Interview with Mitsuhiro Fukao, Professor, Keio University

FUKAO Mitsuhiro
Professor, Faculty of Business and Commerce, Keio University, and Senior Economist, Japan Center for Economic Research. Joined the Bank of Japan upon graduation from the Kyoto University Faculty of Engineering in 1974. Obtained his Ph.D. from the University of Michigan in 1981. Previous positions have included the following: a post at the Research Bureau of the Economic Planning Agency; Economist at the Monetary and Fiscal Policies Section of the Organisation for Economic Co-operation and Development (OECD) Economic and Statistics Division; Deputy Director of the Bank of Japan Institute for Monetary and Economic Studies; Head of the Strategic Research Division of the Bank of Japan Research and Statistics Department; and Counselor for the above Division. Major publications include *Kawase Reeto to Kinyu Shijo* ("The Exchange Rate and the Financial Markets"), Toyo Keizai recipient of the Nikkei Prize for Excellent Books in Economic Science; and *Nippon Hatan* ("The Breakdown of Japan"), Kodansha Gendai Shinsho.

Problems with the Japanese Economy

Iio: Would you name some of the issues you consider to be problematic regarding the overall Japanese economy as it is today?

Fukao: What we would like is for the economy to be in a normal state - that is to say, prices up slightly and interest rates positive - but what we have is zero short-term interest rates and deflation. We have had virtually no experience of what to do in this kind of situation, or of the effects our actions might have. That means we have no choice but to work from logic when making decisions - you know, this is the way the economy works, so such and such an action should do the trick, that sort of thing. At that level of logic, it gets difficult to form a consensus, because everyone has a different take on the way policies exert their effect. Another issue has to do with making policy recommendations: things would be simple and clear-cut if the discussion were based purely on economic logic, but once you start making recommendations that take political constraints into consideration, this situation emerges where you are not sure what to say anymore. And another thing, there are actually a great many people who feel there is nothing they can do because they have no ideas. These three problems are what we are dealing with.

Iio: Professor Fukao, I understand that you consider deflation to be the most important problem facing the Japanese economy. Roughly how many major factors related to deflation - for instance, the state of the economy, the fiscal deficit, etc - do you feel we should take into consideration?

Fukao: There are so many problems that I could go on and on listing them, but in terms of what becomes possible when we stop deflation, one is financial recovery. Naturally, as the opposite side of the same coin, the corporate sector can also recover. That is to say, sales will go up, and debts can be paid off. And what is more, we will be able to step on the fiscal brakes. In other words, relaxed monetary policy will make for fiscal tightening, and then we can start rebuilding our balance sheet. Stopping deflation, in my mind, is at the very least a necessary condition for financial recovery and fiscal reconstruction. Structural reform is a case in point: we are talking about a process of phasing out the weaker sectors and closing down institutions that fail, allowing the good segments to grow. But, deflation makes it very difficult to start up new businesses, which means we are not moving ahead with structural reform. So when we consider the overall picture, I believe that breaking out of deflation is a precondition, or rather, a necessary condition, for the recovery of our economy.

Iio: So you are saying they are interrelated, and it is usually not the case that one thing fluctuates independently?

Fukao: What I am saying is that while yes, it is possible to do just one thing, doing so will make the other things worse.

Deflation

Iio: Well then, could you first of all define the kind of phenomenon the present deflation is, at a level that even an economics layperson like myself can understand?

Fukao: Deflation, in a nutshell, is a state whereby prices fall continuously. The situation is particularly dangerous when wages and prices are both going down.

Iio: Wages and prices are treated separately in terms of statistics. Do they fluctuate in tandem?

Fukao: They fluctuate differently. Wages tend to fluctuate at a slightly higher level. This means that, due to the improvement of productivity, rising wages do not result in rising prices. That is why the situation is not that dangerous when wages are up and prices are slightly down. It is my understanding that the current situation in China is like that.

Iio: I see. So the difference between what is called deflation in China and the Japanese deflation is whether or not wages are going up.

Fukao: Since China is a very poor country, food carries a lot of weight in the consumer prices. If I remember correctly, food was about 70%, which means food prices are coming down. In the context of gradually rising wages, it is likely that the high productivity gain is carrying over into better productivity in agriculture as well.

Iio: By contrast, what is the situation in Japan?

Fukao: Wages are going down gradually on a total compensation basis. In addition, employment is currently falling at a pace of around 700,000 jobs per year in terms of the entire employed population, which includes the self-employed and those working for other companies. This translates to an extremely accelerated decline in the total income base, which means the economy is shrinking rapidly.

Iio: Why do you think this is occurring?

Fukao: Basically, there is a major supply and demand gap. The supply and demand gap, plainly speaking, is the utilization rate in a broad sense, and a large gap means a low utilization rate in terms of people and production capacity. You then get a surplus of both production facilities and people. When this happens, there is an incentive to slash prices to somehow attract customers, which may be fine for a company that manages to lure customers, but when you look at the economy as a whole, it starts to shrink. Companies are forced to cut wages and reduce employment. And this is the situation that is going round and round.

Iio: If the supply and demand gap that you just mentioned is a temporary one, we should be seeing a business cycle fluctuation. Why is it that the economy is moving in only one direction, without being cyclical?

Fukao: It is usually the case that even when the economy is in a downturn, prices are up and wages are up slightly too. In such cases, if you cut interest rates enough, it becomes advantageous for people to procure funds and make investments. If the feeling is that prices are at a temporary low now, but will probably continue rising for some time in the future, people will gradually start investing when the economy is weak and interest rates are low, which will prompt a recovery. But once prices start to fall continuously, and people lose the sense that things are bottoming out, these worsened conditions do not cease.

Iio: If that is the case, and since the business cycle fluctuation I mentioned assumes a mild inflationary nature, are you saying that, without mild inflation, business cycles do not occur and things just go on progressing toward deflation?

Fukao: If the deflation has established itself to a certain degree and the cyclic bottom is deep, that could be a possibility.

Iio: What about the situation in Japan today? Is this what is happening?

Fukao: Yes. I consider the present supply and demand levels to be about 6% in terms of the gross domestic product (GDP) gap. This is the figure estimated by the Forecasting Team of the Japan Center for Economic Research (JCER) and other financial groups. Estimates by the Cabinet Office and the U.S. Federal Reserve Bank committee were around the 5% level as of 2001, so given that 2002 was by no means a stellar year, we believe that a figure of around 6% is not off the mark at all.

Iio: In addressing the supply and demand gap, a layperson might think that in addition to increasing demand, we can also consider decreasing the supply. I understand you do not believe that decreasing supply would be a good idea.

Fukao: The supply and demand gap refers to a situation where demand is small in relation to production capacity. Therefore, it is true that reducing production capacity will result in a smaller gap. However, there are two sides to production capacity -

facilities and people. You can reduce facilities, but you cannot reduce people. That means we only end up with too many people, which may further accelerate the fall of wages. This is why reducing supply would be the height of stupidity. People who advocate it do not understand how the economy works.

Iio: Why has this kind of deflation not occurred very much up until now?

Fukao: It occurred repeatedly before World War II. After the war, our nation had growth potential, and a slightly inflationary economy continued for a long time. So in days past, we actually knew very well about the risk of having the economy go into deflation - American economists right after the Great Depression knew about it, and so did the Japanese economists who studied it. The fact that we do not have the same recognition now may be because not too many people these days have a solid grasp of economic history.

In the United States during the Great Depression, it is true that prices fell 23% peak to trough measured by the GDP deflator, but actually, more than half of the decline consisted of agricultural produce. Farm produce had a weight of about 20% in terms of added value, and this fell by about 65%, that is, two-thirds, and became a third of what it was before. This means that if we remove this factor, we find the drop in other prices was slightly over 10%. In Japan, we are already seeing a decline of about 10% compared to 1994, falling at an annual rate of around 2%, so I think we can say we are in a very grave position.

Iio: Are you saying that we are already in a situation that is comparable to the Great Depression?

Fukao: In terms of the fall in prices other than for agricultural produce, that is indeed the case. It is simply a matter of the symptoms not surfacing, because the government is protecting all the banks with deposit insurance and propping up spending by running a fiscal deficit.

Measures to Resolve Deflation

Iio: Then what should we be doing to eradicate deflation to begin with?

Fukao: Methods to stop serious deflation are extremely tricky. There are several ways to do it, depending on the severity of the symptoms. If the supply and demand gap is small, you can effectively use methods like increasing public sector investment and cutting taxes. The idea is simply to increase demand. But as long as the supply and demand gap remains significant, deflation will not stop. Rather, the tendency will be for its gradual acceleration. Since we are already in a state of negative inflation and zero interest rates, it is extremely difficult to exert any effects through monetary policy. Since we cannot lower interest rates any further, it is ineffective to buy short-term government bonds and supply cash. Short-term bonds and cash are both like government debts at zero-rate. Therefore, the government operations to buy short-term bonds will have no effect. I do not believe long-term government bonds are effective either, now that interest rates are so low. Interest rates are now so low, it is inconceivable that they could go any lower.
On the fiscal side, the effect may not be zero, but say we increase public works spending: the Keynesian multiplier is 1.4 or 1.5 at most. When you subtract the cost of land acquisition and multiply that by the multiplier, this is about what you get. Which means that assuming a gap of 6%, you could take the current government spending of ¥30 trillion and increase it by ¥20 trillion, which would make things at least level off. And then there is a need to maintain that level. This is impossible, and increases the risk of breaking the nation's finances. On the tax-cut side, the Keynesian multiplier is almost 1, meaning that if we are to tax cut our way out of the ¥30 trillion gap, we would have to cut ¥30 trillion worth of taxes. Even if we completely eliminated income and corporate taxes, it still would not be enough. In short, neither tax cuts nor public spending will do the trick. This fact must first of all be recognized.

Iio: So cuts may have an effect, but they do not have enough sheer physical bulk to exert a strong enough influence, and it is physically impossible. Well then, in a situation where traditional methods are all out of the question, are there any nontraditional methods that can be considered?

Fukao: Yes, I believe there are. But to do so, we must first reconsider how we view our present situation. My recognition is that present-day Japan is in a negative bubble.
By bubble, I mean a kind of bubble where real assets, such as real estate and stocks, are sold, and assets shift to cash, deposits and government bonds. The reason why I say bubble is because people hold government bonds, deposits and cash under the illusion that the government can back the credit. But in fact, the government's credit is getting

worse and worse. Therefore, this is a bubble, because it is not sustainable.
The thing is, even though the government is losing credit, people are still full of trust, going about buying large amounts. The government's debt is ballooning, but all of it is being absorbed within our borders. This is nothing less than a bubble.

Iio: Then is it possible that the bubble may burst?

Fukao: It may do if the opposite thing happens; in other words, if assets were to shift from assets guaranteed by the Japanese government to things that are not - for example, foreign currency, real estate, what have you.

Iio: This would mean a massive loss of confidence in the currency.

Fukao: Exactly. Failing to address the current deflation is tantamount to sitting on our hands while the Japanese government's credit takes a nosedive.

Iio: Loss of confidence - is that the reason why people say hyperinflation will set in again when things eventually swing the other way?

Fukao: I do believe we might possibly see a considerably high level of inflation.

Iio: Are you saying that may happen the instant the bubble collapses?

Fukao: I do not think it will occur instantaneously. The reason is because prices do not go up that easily. Asset prices and exchange rates fluctuate, but prices in general, and wages, do not fluctuate so soon. However, after about two years, we may have inflation in the range of several tens of percent. And we will be unable to stop it, because the government will be suffering a cash flow crisis. If inflation sets in when debt as a percentage of GDP is skyrocketing and there are high short-term debts, then there will be a need to raise interest rates above the rate of inflation in order to stop it. When you do that, the burden of interest payments shoots up.
I have run some simulations too. Let us say prices go up and we are forced to raise interest rates to 5%. At that stage, supposing that the government's gross debt as a percentage of GDP is over 200%, the burden of interest payments does not go up immediately, but it is possible that within about two years, the burden will have increased to about 10% as a percentage of GDP. This includes the deficit of postal

savings. Postal savings deposits are invested for an average of about four years, but since deposits can be transferred very easily, there will be a massive rollover if interest rates go up 3-4%. If that happens, count all the deficit, and we may find that the addition to interest payments, or the increment compared to right now, increases by nearly ¥50 trillion in today's GDP.
Even if we threw in the entire national tax pool, we would still be unable to handle the extra payments - our nation would be drowning in debt. And such a scenario would lead to major downgrading and a further rise in interest rates. In fact, in countries like Brazil, the real interest rates for government debt are close to 10%. When this happens, the government's primary balance would have to be something like 5% or thereabouts in order to keep going.

Iio: In that case, there is no choice but to make the government a lot smaller, very fast.

Fukao: Well, we would not have to shrink the government; we could just raise taxes. There is no way you can shrink the government in one or two years, so if you quadrupled the consumption tax, that would result in a ¥12.5 trillion tax increase for every 5%, so we would be able to stabilize the situation, more or less. That is, provided the economy somehow improved to a certain degree. But without stabilization measures through drastic tax hikes, we may invite credit uneasiness about the Japanese government.

Iio: What would happen if there were credit insecurity? Would defaulting be a possibility?

Fukao: Yes, I believe it would be.

Iio: But if the government were to default - we are talking about mostly domestic creditors. Would it be like in the feudal ages, when the government would periodically cancel samurai's debts to merchants?

Fukao: I have no idea what it would be like, but if the government were to get the Bank of Japan (BOJ) to take over the bonds and issue cash, that would not be defaulting. It would just be inflation.

Iio: Let us go back to what we were talking about. Is there a way to stop the current deflation?

Fukao: The reason why I said we have to recognize the current state of deflation is because our take on the present situation has a bearing on how we explain government policy. All we need to do is to stop the bubble and there are two ways. One way is to supply large quantities of what people are buying in large quantities, and to buy up what everyone is selling.

Iio: That would mean issuing currency.

Fukao: That is right. The BOJ would supply huge quantities of high-powered money, and buy up huge quantities of high-quality stock and real estate.

Iio: Why would that have to be high-quality stock and real estate, and not government bonds?

Fukao: If the BOJ were to accept huge quantities of bonds, and the government were to throw down cash in helicopter money, we would have inflation. There are some who argue that doing so would not burden the people, but that is a mistake. For instance, say the BOJ were to go ahead and print bank notes and hand everyone ¥1 million. Some would say this is not a burden, and that we should just forget about the bank notes. But this is an obvious misconception. The reason is because not all that cash would go into circulation; a lot of it would go into savings. Some of the money may be used before it is deposited, and some of it may go directly into savings. Savings would increase by ¥130 trillion, and the BOJ's current account would balloon by several hundred and ten trillion in yen.
So the government issues ¥130 trillion in bonds, which the BOJ buys. The BOJ hands over ¥130 trillion in cash to the government, which then strews that money around. When this happens, initially, you have more cash. But after a while, the BOJ current account deposit increases, and the bonds stay on the BOJ balance sheet. So now the government has ¥130 trillion more debt. Helicopter money, in the end, is the same thing as a tax cut. Massive tax cuts are somewhat effective in expanding the economy, but they bring on financial ruin.
Carrying out quantitative easing or using helicopter money to inject massive amounts into the BOJ current account will not be a burden as long as the deflation continues.

But if you try to raise interest rates at the stage when prices start to go up, the BOJ needs to recover all excessive deposits and BOJ current account deposits. There would be a need to reduce the BOJ current account balance to ¥4 trillion or ¥5 trillion. In order to do that, the BOJ would have to sell off massive chunks of the government bonds it bought. The BOJ will sell at a loss, but it will need to sell off several hundred trillion in yen.
Let us say the government does not issue bonds, but merely has the Ministry of Finance print government notes. What would happen then is this: as long as these notes exist, the BOJ's base money remains high, thus making it impossible to raise interest rates. Therefore, were the BOJ itself to recover cash, it would have to issue IOUs; there would be a need to issue bills drawn for sale by the BOJ and recover all of the cash. But if the BOJ did that, it would be forced to recover the cash through interest-bearing means, and in addition, the BOJ would have a massive excess of debt. In any case, if we were to consolidate the BOJ and the government, the government/BOJ balance sheet could worsen by ¥130 trillion. The burden of interest payments would also set in when interest rates start to rise. That is why the argument that issuing bank notes would not be a burden is total hogwash. I want to emphasize this.

Iio: So what you are saying is that, contrary to what is often said, hyperinflation is not the reason for discouraging this method. Rather, the method is ineffective to start with, and comes at an extremely high cost to boot.

Fukao: I am not saying it is ineffective. Helicopter money has an effect that is comparable to a tax cut. However, it costs the government dearly. Therefore, what I am suggesting is to supply the cash deposits, which is where the bubble is forming, and to supply the BOJ current account deposits, and at the same time buy up the stocks and real estate that everyone is selling. The idea is to change people's expectations by doing this. We need to hammer the idea into people's heads that there is no value in cash. Cash is merely paper with pretty printing. So since the problem is that the value of this paper keeps going up, the idea is, if everyone wants so much of it, to supply as much of it as is necessary until the value starts coming down.

Iio: So the point where this differs from helicopter money is that, because we are buying high-quality land and stocks, we can expect the BOJ balance sheet not to be compromised.

Fukao: If we can break out of deflation, stock and land prices will rebound. The current stock and land price levels have been determined by incorporating the expectation that future rent and profits will continue to decrease. If this decrease goes up to zero, or becomes positive, prices will rebound to a level that reflects the current value, and the BOJ would make a profit. So the BOJ's argument that government bonds are safe but stocks are dangerous is untrue under the current circumstances.
The argument holds water if we have no prospects of breaking out of deflation, but if the intention is to get out of deflation, bond-buying operations are extremely dangerous.

The Second Method for Solving Deflation

Iio: Well then, what is the second method of getting out of deflation?

Fukao: The other method is one usually employed when dealing with a bubble: taxing the targets of the bubble. At present, the bubble is in cash, deposits and bonds, so taxing all government-guaranteed financial assets will stop the bubble. When you do this, the funds will shift to other things.

Iio: So the targets are basically cash and deposits.

Fukao: What I am suggesting is for the government to tax the balances and/or current value of all financial assets for which the government has guaranteed future cash flow, at a rate of deflation plus a little extra as of the date of taxation, repeatedly for as long as the deflation continues. If the taxation were to occur under the current circumstances, I believe 2-3% would be about right.

Iio: I see, so we start out with 2-3%. But how can we make this a reality? For instance, when we talk about government guarantees, we include postal savings and other ordinary deposits, don't we?

Fukao: A complete list would look something like this: government bonds, municipal bonds, government-guaranteed bonds, all deposits in yen, and all yen-denominated bank debt, including derivatives. The list would also include the future yen cash flow of swaps and options. These would be targeted first and foremost. Then we would target postal savings, postal life insurance and cash. We would also include postal checking accounts. In terms of taxing cash, a reprinting is slated for 2004, so if the BOJ imposes a 2% exchange fee, the banks would naturally pass that cost on to the citizens.

Iio: But would we not have to do that frequently? Would it be enough to exchange money just once?

Fukao: It would probably not be a good idea to do this every year, so we would do it once every two or three years, at most. So say deflation is continuing; we would impose a tax that is equivalent to the rate of deflation plus 1% or so. The effect of doing this is that funds will shift from taxable assets to nontaxable assets. Those would be stocks, real estate, durable consumer goods - general consumer goods, I guess - and foreign currency. There would also be an increase in things like corporate bonds and loans. And this would occur not on the day of taxation, but before the taxation takes place.

Iio: The instant the announcement is made?

Fukao: It would occur at the point the announcement was believed. When this happens, government bonds will lose their premium to nontaxable corporate bonds issued by, say, Toyota. Foreign exchange will probably fall about 10% when the announcement is made, but there will not be any more capital flight. The reason why I say this is because, once the yen loses value, the yen will already be weak on the day of the announcement, so the situation would be one in which it is too late to move.

Iio: But we would have to make preparations in secret, and make all this materialize at once.

Fukao: No, discussing the issue has an effect in itself. Doing so incorporates expectations at that stage.

Iio: Discussion is desirable, then. It becomes a self-fulfilling prophecy.

Fukao: I believe it is very desirable. When the discussions reach the point where we are saying, "why not tax at a rate of 5%," that is the stage where we will be able to get out of deflation. When we reach such a stage, we can actually get away without imposing the tax. But I believe we should do this at least once, because without actual experience, the point will not actually hit home. Now, if we do this, tax revenue would exceed ¥20 trillion. The taxable assets would be ¥1.5 quadrillion, so we could rebuild our balance sheet as well.

It would also help us deal with the credit crunch. If banks pile up their deposits in the BOJ current account, they will of course be taxed. If they loan out that money, it will not be taxed. The idea is that financial assets which are government-guaranteed cash flow will be taxed, but financial assets that are not guaranteed by the government will not be, so if I borrow money from you, Professor Iio, there is no tax on that. On the other hand, if I borrow money and hold on to the cash, I will be taxed, so I will try to pay back the money as quickly as I can. People who can pay back their debts will try to do so as soon as they can, but the ones who are loaning out the money do not want it returned. So what will take place is an expansion of inter-firm credit. Everyone will want to be paid later. Buy this car now, pay us after the taxation date. No way, says the customer, I want to pay cash. People will try to force cash on one another. In a nutshell, funds will flow from cash to things, so the economy will improve. Just what we want.

Iio: But supposing we made such a decision; would it be possible to implement?

Fukao: I had some people at the National Tax Administration Agency check this idea out. They told me it is legally possible. This was when I was teaching a training session at the National Personnel Authority. I was giving a lecture on deflation to about 50 participants, and was asked to set some homework. I told my class to identify all the problems with the tax on cash and deposits that I just talked about. Two of my students were from the Tax Agency, and they went over all the Notifications and such, as well as the taxation treaties, and said yes, it was doable.

Iio: Then that means this is legally feasible. The remaining problem is probably that of manpower.

Fukao: It would probably not require all that much manpower. Although exchanging the cash would probably be the biggest problem. For actual government bonds, all you need to do is slap on the tax when they are brought in, which is not so difficult. And since government bonds are already registered, for the most part, so all we need to do is tax the balance of transferred or registered bonds at the time of taxation. The tax is deducted from the source, so whack, you cut it off, and the whole thing is over in one instant. Easy. The same goes for deposits, like the way interest on deposits is currently deducted at the source. A tax is imposed on the balance at a specific point. In the same way, you impose a 2% tax on the balance. Now cash - this is the trickiest. Some of the problems include ¥500 and ¥100 coins. They will probably disappear. Since it is extremely difficult to tax coins, we will have to re-denominate or something, and replace the coins as well. Maybe we should print ¥100 and ¥500 bills temporarily.

Iio: Are you sure doing this would not result in funds fleeing overseas?

Fukao: As I said before, the yen will be weak by the time the announcement is made, so no further funds will go out of the country. What is more, a weak yen is desirable. And since this is not a mere cheap-yen policy, but an extremely expansionist one, it will minimize criticism from other countries.

Iio: Do you mean Japan will be off the hook since we are buying things? In terms of criticism from other countries, I mean.

Fukao: The idea I talked about will strongly stimulate demand for durable consumer goods and the like, so despite the weak yen, imports will rise, too.

Iio: Well then, are these more or less the two methods for stopping deflation?

Fukao: I will organize my points. First, we set the inflation target. Target inflation levels will be 1.5% annually, plus or minus 1%, three years from now. That means we start from where we are now, and we take an annual rate of 1.5%, plus or minus 1% three years from now, which means in terms of the price levels three years from now - we are talking about a compound interest formula - it brings our target to a range of slightly over 4.5%, give or take 3% or so. To that end, the BOJ buys massive quantities of stock, particularly exchange-traded funds (ETFs), that track the TOPIX index, and high-quality real estate investment trusts (REITs). You do this for about a year, and if you are still getting nowhere, you slap the tax on assets. If we take this two-stage approach, I am pretty certain we can break out of deflation.

Iio: So basically the BOJ starts the buying process first, while we go on with the discussions, and then we do the tax.

Fukao: I believe we can get out of deflation just by taxing financial assets, but politically speaking, it is extraordinarily difficult. That is why I think the BOJ should make a show of doing all it can, calling on the government to do the tax thing without fail if the BOJ attempt falls short. It would be good if we could emerge from deflation without having negative interest rates.

The Deflation Debate

Iio: What, then, are your views on the other debates taking place over deflation? For instance, there are some who argue that the present deflation is a completely new phenomenon, that we have no choice but to take it lying down because it cannot be stopped, as evidenced by its international spread, for instance in China, which is also into deflation, and that an economic science should be built around this premise.

Fukao: Those people do not understand that bank notes are merely pretty pieces of paper that human beings print and distribute, that is all. Deflation is when the value of these pieces of paper has gone up. There is no reason why deflation cannot be stopped. I do not believe China is truly in a deflation, because as I mentioned before, wages are going up over there.

Iio: Another argument is one that says deflation can be stopped by the government continuing to spend and building up a budget deficit; and that doing so would improve the economy, bringing deflation to an end. Do you feel this argument is also mistaken, in physical terms, as you mentioned earlier?

Fukao: I do not think the proponents of such arguments have fully analyzed the GDP gap and the fiscal deficit figures.

Iio: Do you feel the reason your approach is said to be nontraditional is because it is different from what is usually stated by economic theory?

Fukao: I do not believe so. Conducting buying operations on real assets or the idea of negative interest rates are well-known concepts among central-bank economists. For instance, in the age of the gold standard, what did the central banks do when deflation set in? They bought up gold. They did a buying operation on real assets. They avoided deflation that way. Also, taxation on cash is mentioned in Chapter 23 of Keynes'

General Theory, where he describes Silvio Gesell's stamp-duty on currency. Most central-bank economists are familiar with this.

* Interviewed on January 21, 2003