

Japan and the World's Economic Problem.

The World's Liquidity Trap.

The World's private sector is seeking to save more than it wishes to invest - the same problem caused the slump in the 1930s. Then the whole world suffered, though Japan less than most because Finance Minister Korekiyo Takahashi increased fiscal spending.¹ He was right and, as Keynes showed, in times he called 'liquidity traps', large fiscal deficits are needed, despite ultra-low interest rates, to avoid large scale unemployment.² The 1930s were one such period and the 21st Century is another.

We now have a new problem. The national debts of several important countries, including France, Japan, the UK and the US, appear to be on track to grow faster than their economies' ability to pay the interest on them. Conventional economic theory has no policy to answer this, so a new policy based on a different theory is needed.³ The Stock Market Model (SMM) recommends tax restructuring to prevent the current crisis being followed by a 1930s' style disaster.

The SMM shows that corporation tax (CT) is not a tax on profits but on investment. Shifting government revenue from CT to income and value added taxes, boosts demand even when the fiscal deficit is unchanged, because the rise in investment that results is greater than the decline in consumption. This policy of tax restructuring solves the current problem in two ways. It lowers the interest governments must pay by reducing the deficit needed to prevent unemployment and accelerates countries' ability to pay by speeding the growth rate of national income.

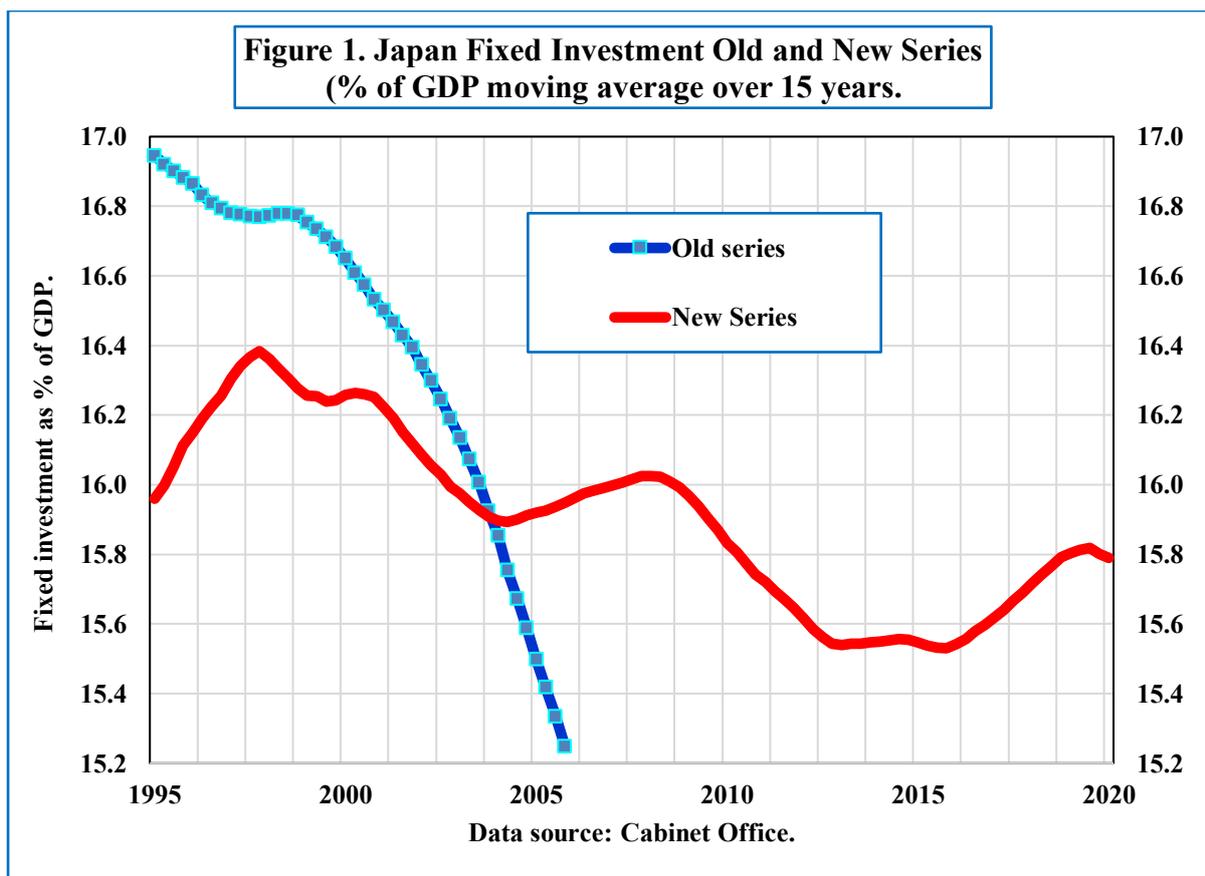
Japan is a bit different.

Japan is different from France, the UK and the US as it has a large current account surplus, which makes its problem less acute; its interest rates are much lower, which makes it likely to get worse and to which its huge national debt makes it sensitive. So long as China runs a large current account surplus, the rest of the world must run a deficit, and this shows no sign of ending. President Trump is trying to end the US deficit, but the problem won't go away even if he succeeds, it will simply shift to other countries. Countries borrow from foreigners when they run current account deficits. This boosts their economies' growth if they spend the money on investment and ends in disaster, as the Greek euro crisis showed, when spent on consumption. The solution to the world's problem is not to cut fiscal deficits, it is to spend the inflow of foreign savings on tangible investment rather than consumption.

¹ Cambridge History of Japan Vol 6 p468 quoting *Kinshuku seisaku*.

² The General Theory of *Employment Interest and Money* by John Maynard Keynes (1964) Macmillan

³ *Coming to Terms with Fiscal and Trade Deficits* by Andrew Smithers (2025) American Affairs (Vol. 9 No.3).



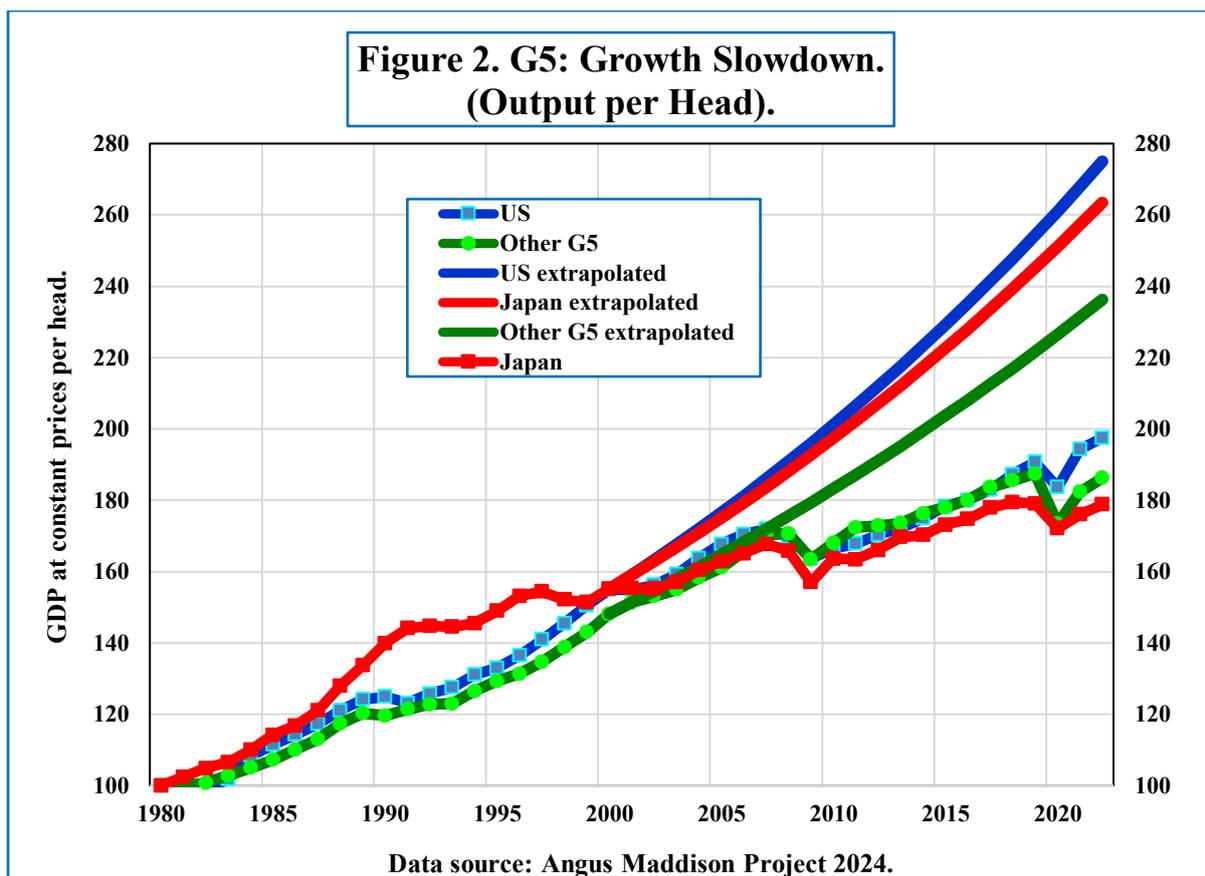
Some years ago, I received an unofficial question from friends in the Bank of Japan. “Why” they asked, “had Japan’s growth slowed so much when investment had remained so strong?” My answer was simple. “Real investment has fallen sharply, but the data don’t show this because the way national accounts, including GDP, is calculated has been changed.”⁴ The result is dramatic, as shown in Figure 1.

What Went Wrong.

The alteration in data involved a new definition and a new way of measuring investment. Those who supported the change claimed that the value of intangible investment could be measured and had not previously been included in the national accounts data. Both assumptions were, I think, wrong.⁵ The value of capital equipment depends on the technology which it uses; even if this requires no new physical investment – the type termed “putty-putty” - and we cannot tell how much of the value of capital stock depends on its intangible (IP) element and how much on its tangible one. It’s not a matter of cost, as equipment which has not benefitted from a putty-putty advance in technology does not cost less than stuff that does, it’s just worth more.

⁴ The change was internationally agreed under the United Nations’ System of National Accounts (SNA) and implemented in most countries e.g. in 2012 by the US Bureau of Economic Analysis (BEA) in its 14th amendment.

⁵ As I explain in *Tangible and Intangible Capital* by Andrew Smithers (2025) World Economics (Vol. 26 No.2).



In all countries included in the G5 group (France, Germany, Japan, the UK and the US) living standards have slowed sharply this century, in line with a marked deceleration in the growth rate of the value of capital stock. As Figure 2 illustrates, had the trend rates of growth continued this century, G5 countries would have been between 25% and 50% better off by 2022. This slowdown could be due to less money being invested or to the technology used advancing less rapidly than before. It would be helpful to know, but we can't tell and, as others have also remarked, it is dangerous to pretend to know things we don't.⁶

The Technology Bias.

Confused by bad data, the consensus view is that growth depends on the rate at which technology advances. In fact, it depends much more on how much we invest. There have been huge advances in technology not yet exploited because they need new tangible investment. The big stock market successes this century have been the companies with new technology, and this has misled public opinions and policymakers into thinking that technology is the sole key to growth.

Spending on research (R&D) is subsidised heavily in both the UK and the US, and investment on it has risen as it has fallen on equipment. We can't tell whether

⁶ *Macroeconomics after the Crisis: Time to Deal with the Pretense-of-Knowledge Syndrome* by Ricardo Caballero (2010) *Journal of Economic Perspectives* Vol. 24 No. 4.

tangible investment would have been even lower if less had been spent on R&D, but we do know that the policy of subsidising it has not produced growth.

Persevering with a policy that has failed and expecting the results to differ in the future is a form of insanity.

If Japan's current account surplus falls as the US becomes protectionist, it will need to boost domestic demand to avoid unemployment. Tax cuts will make its debt problem worse, so Japan should, as it wisely did in the 1930s, ignore consensus theory, which today means subsidising tangible investment. I hope that this will be followed by other countries, preferably before the next financial crisis.