Meiji Restoration shows how Japan can judo its debt problem

by Kathy Wolfe

It's time for Japanese patriots, who are tired of lectures from Washington about economics, to make a command decision. Tokyo's top banks are legally bankrupt, with more than $1 trillion in bad loans. This debt is the blackmail now held over Japan's head by British-directed speculator George Soros, the City of London, and its Wall Street clones such as J.P. Morgan. Since the credit-rating agency Moody's downgraded Japan's national credit in March, blaming bad bank debt, global speculators are now threatening to "sell Japan," to dump Japan's government bonds, stocks, and yen. They aim to bring Japan's economy lower than they have already dragged South Korea.

There will be no chance for Japan to export its way out of this crisis, to earn profits to cover up the bad debt. Tokyo's only advantage is that Western banks are also legally bankrupt, with some $80 trillion in bad derivatives assets held by European banks, and another $40 trillion held on Wall Street, as compared to $15 trillion in derivatives held by Japanese banks.

Japan must now use the debt as a weapon, as patriots did during Japan's 19th-century Meiji Restoration. Those nations with the courage to reorganize the debt first, will have the critical strategic advantage.

Tokyo bureaucrats today protest that "bank debt is sacred," like some solemn promise to one's ancestors, but such nonsense is to be found nowhere in Confucius. Rather, it was probably learned at Harvard Business School in the 1960s, along with Adam Smith and other Opium War-era free-trade fairy tales.

"Debt is only paper," to be used as a servant for national development, as Meiji Finance Minister Ōkuma Shigenobu put it. In 1868, Ōkuma, Ōkubo Toshimichi, and their allies made a command decision to industrialize Japan, by overthrowing warlord feudalism and restoring central government under the Emperor Meiji. Travelling to the United States during 1870-73, Meiji leaders studied the writings of America's first Treasury Secretary, Alexander Hamilton, and of his followers, Mathew and Henry Carey. Hamilton's method had just won the Civil War for the Lincoln Republicans, who issued greenbacks to fund the war, and the development of the American West.

Ōkuma modelled the Meiji's 1872 National Bank Regulations on Hamilton's Bank of the United States, transforming Japan from a backwater into a world power.

Debt: liability or capital?

Hamilton viewed debt not as a liability, but as the basis for expanded capital formation. After the American Revolution, the colonists' "Continental debt" was about $80 million, equivalent to several trillion dollars today. Hamilton proposed to turn the debt into *capital* by circulating it as America's currency. "In countries in which the national debt is properly funded [i.e., converted into interest-bearing bonds], it answers most of the purposes of money," he wrote in his January 1790 *Report on Public Credit*. "Transfers of public debt are there equivalent to payments in specie [currency] . . . or in other words, [debt] stock passes current as specie. . . . The benefits of this are various and obvious. Trade is extended; agriculture and manufactures are promoted."

Hamilton did insist that the debt must be "funded," i.e., paid. "These good effects of a public debt are only to be looked for when, by being well funded, it has acquired an adequate and stable value," he wrote, and thus is generally acceptable as "a substitute for money."

The key was the use of the debt to expand credit for industry, rather than to contract the economy.

Hamilton used the debt as part of the capital to found the Bank of the United States in 1791, America's first national bank. A national bank is "a political machine of the greatest importance to the state," he wrote in his December 1790 *Report on a National Bank*. "The combination of a portion of the public debt in the formation of the capital, is the principal thing, of which an explanation is requisite. The chief object is, to enable the creation of a capital sufficiently large to be the basis of an extensive circulation. But to collect such a sum in this country, in gold and silver, may be pronounced impracticable. . . . This part of the [debt] fund will be always ready to come in aid of the specie. It will more and more command a ready sale and can therefore expeditiously be turned into coin."

Hamilton's purpose was to industrialize the United States, then a developing country. With "vast tracts of waste land, and a little advanced state of manufactures . . . it is immaterial what serves the purpose of money, whether paper, or gold and silver," he wrote. "The effect of both upon industry is the same; and that the intrinsic wealth of a nation is to be measured, not by the precious metals contained in it, but by the quantity of the productions of its labor and industry."

The Meiji 'debt revolution'

At the time of the restoration of the Emperor Meiji in 1868, Japan was an agrarian society, whose population was 85% peasant serfs and 8% merchants and craftsmen, ruled, as the Shogun's power withered, by a few dozen *daimyo* warlords, leaving the country fractured. Taxes and most other exchanges were paid in rice, while warlords printed their own paper money. During 1868-69, the new Tokyo central government had to borrow over 20 million yen from Osaka and Tokyo merchants for the war for unification.

Add to that the warlords' debt of 50 million yen, and by 1871, Japanese government domestic debt was 74 million yen, against government revenues of 50 million yen. Since one yen was worth one U.S. silver dollar, this was a disaster of roughly the same magnitude that Hamilton had faced.

Warlords and other nobles working with British consul Sir Harry Parkes called for a "private bankers' central bank," modelled on the Bank of England, to cut central government operations, slash credit to the economy, and cut spending for defense, to repay the debt.

Ōkubo and Ōkuma, however, agreed with Prince Ito Hirobumi, who had just returned from a study of banking in America, to mobilize the debt: to centralize it, and turn it into specie (currency), as Hamilton had done. In 1871, they unilaterally dissolved the feudal *daimyo* system, transferring the 70% of Japan's land owned by *daimyo* to the ownership of the peasants who farmed it and to the Emperor. In return, the central government agreed to assume the *daimyo* debt, as Hamilton had insisted the United States assume the $25 million in debts of the 13 colonies. They argued, as had Hamilton, that national credibility was at stake. Many *daimyo* were also paid for lands in new central government bonds.

Ōkuma's Finance Ministry reorganized the 74 million yen debt into government bonds, cancelling debts incurred before 1844 and reducing interest rates. In a 1871 currency reform, the warlords' paper currency was recalled, and replaced with central government bonds.

Ōkuma's National Bank Regulations of 1872 then *capitalized* much of the government bonds in national banks "upon the basis of the American National Bank Act," as Ōkuma wrote in his later book, *Fifty Years of the New Japan*. Starting with the First National Bank, founded in 1873, Ōkuma "persuaded, nay, ordered" large government bondholders to form private-public banks. Government bonds had to be deposited back with the government as capital, Ōkuma wrote, which "enabled the government more quickly to redeem" and reduce the government debt.

The national banks, in return, were granted the privilege of issuing paper bank notes. These far outstripped the sums of government debt being reduced, greatly multiplying the amount of productive credit available for Japan's industrial development. By 1880, there were over 150 national banks with 34 million yen in national bank notes in circulation.

Turning debts into assets

There were other ways in which Meiji leaders turned debt into an asset for national development. Japan's large *samurai* noble military caste, which lived on annual stipends paid in rice, payments that ate up one-third of the central government's tax revenue, was compelled in 1876 to accept a lump sum payoff of government bonds.

"Useful state enterprises must be established and encouraged by making full use of economic measures in accordance with the national ability to do so. This is the basic principle of national economy," wrote Ōkuma in his March 1876 *Proposal Concerning the Abolition of the Fief System by the Issuance of Government Securities*. "The first thing to be done is to regard all the fiefs and stipends of nobles, *samurai,* and even commoners, as debts of the government. To redeem these within thirty years, government securities should be issued. . . .

"Upon receiving all at once an enormous amount of money . . . those who wish to pursue their own livelihood can go into the appropriate enterprise. . . . Even those who cannot make up their minds will in the end plan some way to support themselves. The accumulated customs of several hundred years will all at once be changed . . . making a useless group occupy itself in useful occupations."

From 1876 to 1882, over 310,000 *samurai* received public bonds amounting to 113 million yen. Nearly 200 individual *samurai* businesses were established as a direct result, creating Japan's shipbuilding, construction, cement, fertilizer, and other industries.

The lessons for today are obvious. Proposals to "globalize" the problem away with more deregulation, will only result in Japan's best assets being sold off to foreign financiers, just like Britain's Sir Harry Parkes proposed in 1871, leaving Tokyo more, not less vulnerable to bank runs. Japan's banks, like the warlords and *samurai,* must accept their losses for foolish loans, such as the 1980s real estate speculation. Japan's taxpayers must not bail this bad debt out, or Japan will face hyperinflation. Useless debt must be written off.

Japan's banks also hold huge loans for productive purposes to the rest of Asia and to Japanese industry, and cross-share stocks in industry, all of which are now grossly undervalued because of foreign speculation. These loans can be saved. Useful debt can be capitalized in a government development bank, and the banks provided with fresh government bonds as capital—provided globalization policies are dumped, so that the money doesn't leave the country. The banks' ledgers must be cleared of bad debt, and made to issue fresh credits for productive purposes.

Japan should propose to Washington a joint project, to include a similar cleanup of Wall Street's derivatives mess. It would then be possible to fix reasonable currency exchange rates, and found a New Bretton Woods monetary system. Yet, if Washington lacks courage, Tokyo must act alone, or the strategic window of opportunity will close.