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IN OUR TIME



The Japanization of the European Union

JESÚS HUERTA DE SOTO

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Illustrations by Álvaro Peral

Keynote lecture at the “3rd Annual Madrid Conference on Austrian Economics”, held at King Juan Carlos University, Madrid, November 7-8, 2019.

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Illustrations by Álvaro Peral.

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Introduction

According to Hayek, in his *Pure Theory of Capital*, the “best test of a good economist” is understanding the principle that “demand for commodities is not demand for labor.” This means that it is an error to think that an increase in the demand for consumer goods gives rise to an increase in employment. Whoever holds this belief fails to understand the most basic principles of capital theory: the demand for consumer goods is always at the expense of saving and the demand for investment goods, and since most workers are employed in the investment stages furthest from consumption, an increase in consumption always occurs at the expense of net employment.

I would add to this my own test of a good economist: the Professor Huerta de Soto test. According to my own criteria, the best test to determine whether we are dealing with a good economist or not is to check if he knows and understands why it is a grave error to believe that the injection and manipulation of money can bring about economic prosperity.

Neither Keynesians nor monetarists would pass my test, nor of Hayek’s test, and therefore, they would fail and would not pass my university course. For instance, Keynes never understood that it is possible to earn money even when sales of consumer goods do not rise. Because profit is always equal to income minus cost. And income may remain constant, but if you reduce costs, you can still make money. And one of the best ways to reduce costs at the margin is to replace relatively more expensive labor with capital equipment. And, of course, the capital equipment that is going to replace labor especially in the stages closest to consumption must be produced by someone, and it generates a huge number of jobs: Machines never harm employment; on the contrary, machines create employment on a massive scale.

The same could be said of one of the economists who, together with Keynes, has caused the most severe damage to economic science, mainly because in his book entitled, *A Monetary History of the United States*, he defends the wrong idea that the Great Depression of 1929 resulted from the Federal Reserve failure to manipulate and inject enough money. Obviously, I am referring to Milton Friedman, who is now so highly praised by all central bankers who favor *ultra-lax* monetary policies. And of course, Milton Friedman would also have failed my test for not understanding that monetary injections and manipulation are never the way to sustainable economic prosperity.

History illustrates again and again the soundness of the essential question Hayek and I ask to determine whether an economist really knows what he is talking about. For example, we can look at the massive influx of precious metals into Spain after the discovery of the Americas. Far from generating prosperity, this influx of gold made Spain a wasteland, an economic desert which did not recover the economic prosperity of its neighboring countries until many centuries later. In fact, the arrival of gold drove nominal prices up and it sank the purchasing power of the monetary unit in Spain. As a result, Spanish products ceased to be competitive, and it became much cheaper to buy abroad; as soon as the gold entered the country, it left our borders to pay for massive imports. The traditional products of the Iberian Peninsula were no longer competitive, and their producers went bankrupt and were forced to emigrate. And as a result basically there remained only three professional careers for any young Spaniard at that time: “the church, the sea, or the royal household.” In other words, one could become a clergyman or enter a convent and live on

ecclesiastical income, cross the Atlantic in search of one’s fortune in the Americas, or serve the king as a soldier in Flanders. And this accounts for the traditional economic poverty and underdevelopment of Spain for centuries, which was the final result of the ultra-lax increase in the monetary supply produced by the gold influx.

Another historical illustration is provided by the emergence of fractional-reserve banking. Another attempt – at first a private one, and later in cooperation with central banks and public authorities – to always inject more and more money, based on the idea that creating loans from nothing without the backing of real saving is always very good and favorable. As you know many economists have defended this wrong idea, for instance Joseph Alois Schumpeter, who, therefore, would not pass my test either and would fail my exam. But, we will not now discuss the Austrian Business Cycle Theory and the destabilizing effects fractional-reserve banking exerts on the economic system,

because you are already familiar with the content of my book, *Money, Bank Credit, and Economic Cycles* and the essential arguments developed in it.

Finally, another very clear illustration of the importance of our test can be found in the wild monetary manipulations and injections with which authorities around the world have reacted to the last Great Recession of 2008. This reaction culminates in what we will refer to as the “Japanese economic illness” or the “malady of economic Japanization.” What does this syndrome or disease, this “Japanese economic illness,” consist of? We will first take a look at its symptoms and analyze them from the perspective of the Austrian School. Then we will consider the extent to which this illness is contagious and exists a risk of transmission to other economic areas, specifically, to the European Union. But before we begin to analyze the symptoms of this sickness, let us briefly outline the historical background of the Japanese economy.



The background of the current Japanese economy

We must go back to the 1960s, and particularly the 1970s and early 80s. While it may come as a surprise now, during those years the Japanese economy was one of the most admired in the world. Almost in every business school, the so called “Japanese economic miracle” was studied with detail. Many people praised and even worshiped the Japanese economic and entrepreneurial culture, which somehow seemed to be a model of success. Japanese workers were strongly protected in every company, in a quasi-family atmosphere, in exchange for the absolute reciprocal loyalty of each employee. This took place in a context of constant innovation and economic growth in exports. It is true that the model largely rested on copying prior innovations and discoveries from the United States and Europe, and launching them in the market at much lower prices, and at a level of quality that was initially quite acceptable and later, even very high. However,

this idealized model, concealed the fact that both the Japanese culture and (especially) the Japanese economy were (and still are) extremely rigid and interventionist, and that what appeared during those years to be a highly prosperous and stable economy actually rested on a huge bubble of artificial growth, monetary manipulation, and credit expansion. The bubble took shape mainly around the real estate market, and in that euphoric and speculative environment, the large Japanese industrial conglomerates (or zaibatsus) became de facto speculative financial institutions which, as a secondary activity, relatively speaking, also manufactured vehicles, electronic devices, and so on. As was predicted by our Austrian Business Cycle Theory at beginning of the 1990s, the Japanese bubble burst. Just to give you an idea, the Nikkei index fell from 30,000 yen at the start of the 90s to 12,000 yen ten years later. And still today, nearly thirty years later, the Japanese stock market has not yet recovered. Not only there was



a catastrophic collapse of the stock market but also very important banks and financial institutions failed one after the other.

Now we must focus our analysis on the reaction of the Japanese authorities to the bursting

of the bubble and the arrival of the financial crisis. But before we do that, we must remember the four possible scenarios that can follow the bursting of an irrational “exuberant” economy like this one of Japan.

The four possible scenarios that can unfold after a financial crisis

In the first scenario the economic and monetary authorities might insist on continuing to inject money in a never-ending flight forward which tries to prevent the arrival of the recession. Eventually, in this first scenario a hyperinflation results, as we have seen at certain times in the past: for instance, following World War I, hyperinflation in Germany nearly destroyed the German monetary system and of course helped bring Hitler to power. Although this first scenario is possible, and it has happened on various historical cases it did not happen in the last cycle nor in the case of Japan.

The second scenario is exactly the opposite. It consists of a total collapse of the banking system and the monetary supply. And if the monetary system disappears, it must evolve again from scratch and new money must be chosen to replace the previously destroyed fiduciary money. This is another possible catastrophic scenario which did not happen either in the last cycle, nor in previous cycles, since central banks were precisely created to support private banks as much as necessary to keep them from suspending payments one after the other, in a chain reaction.

The third scenario is usually the most common. With great difficulty, and in spite of more or less timid or isolated monetary manipulations, the real economy ends up being restructured and adjusting to the new situation. In other words, productive factors are removed on a massive scale from unsustainable lines of investment and, in an environment of relative free enterprise, entrepreneurs eventually recover their confidence and start to detect new, sustainable lines of business and investment projects. In this way, the recovery gradually begins. It is true that human beings do not learn, and once a sustained recovery has occurred, political and institutional incentives will sooner or later lead to new artificial credit expansions which will plant the seeds for the next cycle, and so on and so on.

For instance, this third scenario has played out in the United States following the most recent US economic cycle. We must remember that the bubble originated in the US economy, and after the crisis, the Federal Reserve injected a large quantity of money. However, the American economy is one of the most flexible in the world. If something characterizes the American economy is its remarkable capacity to quickly

remove productive factors and reallocate them to other, sustainable investments discovered by an entrepreneurship that is quite free, restless, and creative. Therefore, despite all of the monetary aggression and growing interventionism in the American economy, again and again it ends up restructuring and starting a path toward sustainable recovery. It is true that sometimes recovery is not complete, and even today, the American economy has not yet been fully restructured, nor has monetary policy been entirely normalized. As we know, central bankers find it extremely hard to raise interest rates,

rigidity, heavy taxes, highly regulated labor markets, together with growing state intervention in the economy at all levels, intense manipulation, and unbridled injections of money, is precisely what characterizes the economy of Japan and threatens to spread to other economic areas in the world, starting with the European Union.

Indeed, Japanese central bank responded to the bursting of the bubble with an *overly lax* monetary policy, in which it was decided that there would be a continual rollover of loans to offer zombie companies unable to repay their loans new loans with which to pay off the old

In an environment as rigid as Japan's, massive currency manipulation and uncontrolled spending block any incentive for spontaneous economic restructuring.

and they are constantly looking for the smallest excuse to lower them. In this context, although long-term interest rates were raised to 3 percent more recently, in response to political pressures not only has monetary normalization been paralyzed, but a step backward has been taken, and interest rates again have been lowered twice a quarter of a point... But in any case, the American economy is highly flexible, and for that reason provides the typical example of a recovery that sooner or later becomes a reality.

Finally, a fourth scenario is also possible and arises when in sharp contrast with the United States the economic environment is very rigid with high taxes, interventionism, and regulations. In this highly rigid context, when monetary authorities insist on injecting a large quantity of money, the syndrome I have called the "Japanese economic illness" or "economic Japanization" inevitably occurs. And this cocktail of great institutional

ones. In Japan, it is culturally unacceptable for a company to fail; it is culturally unacceptable for workers to be let go. Each company is like the mother of a large family, and she must keep all the members safe and employed. Though officially, the unemployment figures may be very low, and everyone may seem to have a job, we must remember the photographs of those big departments in many Japanese companies, where employees were seen sleeping or doing nothing. Officially, they are working, but obviously, the hidden unemployment is massive, and the drop in productivity and the ongoing loss of competitive advantage are very high (especially with respect to China, South Korea, and the other emerging Asian economies). Moreover, interest rates were reduced almost to zero, and on top of that, the government added an aggressive fiscal policy which greatly pushed public spending.

And of course, in an environment of great institutional and economic rigidity, massive monetary manipulation and the large increase of public spending block the necessary incentives to restructure the economy. As a result, productive factors are not transferred from the projects where they were erroneously invested during the bubble toward alternative,

sustainable lines of investment, which entrepreneurs could discover only in an environment of liberty, economic flexibility, and confidence. And this is how Japan entered an indefinite period of recession and economic lethargy that has already lasted several decades and from which it has not yet managed to emerge.

So-called Abenomics and the current main symptoms of the syndrome of economic Japanization

Let us now recall the most recent attempt to stimulate the Japanese economy through an economic policy called Abenomics. It takes its name from its sponsor, the Prime Minister of Japan, Shinzo Abe, who was helped by the Governor of Japan's central bank, Haruhiko Kuroda.

What does Abenomics consist of? It consists of doing more, much more, of the same. Japan has used and applied – and with great enthusiasm – the entire arsenal of monetary and fiscal interventionist prescriptions contained in the textbooks both of monetarists and Keynesians, but without achieving anything. In the last chapter of Abenomics, the Bank of Japan adopted an even more aggressive (if possible) and completely *ultra-lax* monetary policy. In fact, "unconventional monetary policies" originated not with the Federal Reserve, but, beginning in March of 2011, precisely with the pioneering implementation of quantitative easing by the Japanese central bank. All of this was combined with an additional, even larger and more disproportionate dose of public spending,

which caused the fiscal deficit to skyrocket. And this prescription of much more of the same is what the Japanese authorities depended on to pull Japan out of its lethargy. Well, except for a short-lived economic "improvement" which resulted from the depreciation of the yen and initially boosted exports somewhat, the lethargy again promptly returned. In short, nothing was achieved, except to make Japan's economy the most indebted in the world.

Japan's public debt is equal to 250 percent of its GDP. Remember that here in Europe, we are criticizing Portugal and Italy, whose indebtedness is between 120 and 135 percent, and Greece, with a figure of 180 percent. That is, these highly indebted European countries are roughly half as indebted as Japan is. As for the annual deficit in the Japanese public accounts, it is not, for instance, the 3 percent established as a limit in the Eurozone, nor even 4 or 5 percent. The annual deficit in the Japanese public accounts is 6 percent, while economic growth has nearly flatlined. In other words, this is a case of clear economic lethargy and very low infla-

tion: interest rates around zero or even negative rates, inflation of 1 percent, and seemingly “full” employment, with a very high volume of hidden unemployment and ongoing losses in productivity and competitiveness.

To use a military term, Japan has already used up all its available interventionist ammunition, and not only has it not achieved anything, but the result has been highly counterproductive and disappointing. Everything that could be tried has been tried, and no goal has been reached. And now the key question is: Why has nothing been achieved? And the answer is clear: because in all these decades, in Japan there have been no structural reforms to liberalize the economy, to liberalize the labor market, to introduce deregulation in the midst of suffocating interventionism at all levels, to lower taxes across the board, to reorganize and balance the public accounts, nor even to reduce public spending.

And although this is a very pitiful result, the main message of my lecture today is that this

Japanese economic illness or syndrome, could easily be transmitted to other economies and cease to be exclusive to Japan. In other words, this Japanization scenario could unfold in any other economy in which the same conditions exist and are responded to in the same way: namely any highly rigid environment with no economic flexibility, in which entrepreneurs are unable to recover the necessary confidence because they are overwhelmed with the regulations, taxes, intervention, and harassment of the state, along with serious monetary and fiscal manipulation. But before we analyze whether or not a risk exists of this happening in the European Union, let us first make some analytical reflections which will enable us to better understand what could happen, if it is not already happening to us. Specifically, what does Austrian economic theory have to say about this phenomena related to the Japanese economic illness, or the syndrome of economic Japanization?



According to the Austrian School the only way to recover sustainable economic prosperity is to promote economic liberalization and free enterprise at all levels. There is no other way.

This means that in very rigid economies, a number of fundamental structural reforms must be carried out. Basically, these are all microeconomic in nature, and none has to do with the macroeconomic manipulation of the money supply or of fiscal spending. Politicians and monetary authorities inevitably fall to the temptation to engage in such macroeconomic manipulation in contexts of great institutional rigidity, financial crisis, and economic recession. Precisely what do the necessary microeconomic reforms consist of? Basically, they consist of systematically deregulating the economy; liberalizing markets, particularly the labor market (key in the case of Japan and of the European Union); also reducing the public sector and public spending; minimizing subsidies and reforming the “welfare state” to return its responsibility to the private citizens; and finally lowering the taxes that overburden economic agents, especially taxes on entrepreneurial profits and capital accumulation.

We must remember that profits are the signals which guide entrepreneurs in their constant search for sustainable investments. And a tax system that falls on profits systematically distorts the traffic signals that guide us in the market, and this inevitably makes economic calculation chaotic and gives rise to a misallocation of scarce resources. Also, taxes on capital have a particularly adverse effect on workers, and especially on the most vulnerable, since their pay depends on their productivity, which in turn depends on the accumulated amount of well-invested capital goods per worker. Therefore, to stimulate economic deve-

lopment and push up wages, what is needed is the per capita accumulation of an ever-increasing volume of well-invested capital goods. If capitalists are harassed and capital is taxed, the accumulation of capital is blocked at the expense of labor productivity and wages.

All of these necessary reforms encourage the dynamic efficiency of our economies and promote an environment in which entrepreneurial confidence is quickly recovered. In this business friendly environment entrepreneurs can detect the investment errors committed in the bubble years and massively transfer the productive factors from projects in which they were mistakenly invested to sustainable investment projects. Certainly, these new, sustainable investment projects are not going to be discovered by the state, nor government ministries, nor public officials or experts, but only by an army of fully motivated entrepreneurs in a context in which they have recovered their confidence.

What happens if, instead of encouraging these structural reforms, none of them is implemented, the economy remains very rigid, and the only actions taken, as happened in the case of Japan, are the massive injection of money supply, the lowering of interest rates to zero, and the increase in public spending? In this case, two very important effects are brought about. First, an *ultra-lax* monetary policy is always self-defeating; in other words, it prevents itself from fulfilling its intended goal, and thus, it cannot possibly produce any of its expected results. Second, an *ultra-lax* monetary policy acts as a true drug which blocks any political and institutional incentives to launch, support, and complete the necessary structural reforms. And, as we can now easily realize this is directly applicable to us in Europe, especially if we remember the monetary policy of the European Central Bank during the last years.

There are different reasons why an ultra-lax monetary policy is always self-defeating. To begin with, if the interest rate is forced down to almost zero, the opportunity cost of holding cash balances is practically eliminated. Ultra-lax monetary policies rises the demand for money. Furthermore, when in a rigid economic environment, structural reforms are not carried out, considerable uncertainty about the future spreads. And we must remember that a desire to be able to cope with future uncertainties is one of the main reasons why we demand money. Under such circumstances

tand that the great temptation entrepreneurs face is to throw in the towel and avoid any trouble. (“*Que invierta su puta madre!*” [Let some other damn fool invest!] as this widespread sentiment is so graphically expressed on t-shirts my students designed and are so successfully distributing around the university campus.)

However, for central banks the main solution lies in injecting massive amounts of money and lowering interest rates to zero so that the banking system will grant loans and people will decide to request them. But at the same time

Monetary injection is self-defeating, fails to achieve any of its objectives, blocks and paralyzes recovery, and never increases prosperity.

of great uncertainty and a rigid, highly controlled economy flooded with new injected money, where the opportunity cost of holding cash balances is zero, without a doubt the most sensible thing to do is to significantly increase our cash balances.

To this, we must add that many entrepreneurs are still fearful, due to what they lost and suffered in the last financial and economic crisis. And they see that the economy is still highly controlled, that it is practically impossible to take a single step without asking permission from the authorities, that there are many bureaucratic and labor-related difficulties, and so on. Moreover, entrepreneurs are fully aware that if, in spite of all the difficulties they are finally successful, the state, through corporate tax, income tax, and wealth tax, is going to take more than half of the profits they earn. Under such conditions, we can unders-

they want bankers avoid mistakes and lend wisely establishing all kind of regulations and higher and higher capital requirements. And in the end, what happens? Well, banks are not able to lend the money it is practically given them for free, and ordinary entrepreneurs as a group remain keep returning their old loans at a faster pace than they request new ones. And this causes an additional monetary contraction which largely blocks and sterilizes the expected effects of the injection of money. For all these reasons monetary injections are self-defeating; they do not achieve any of their objectives; they block and paralyze the recovery; and they never increase prosperity.

And we come now to the maximum stupidity of negative interest rates. In a natural, uncontrolled market economy, interest rates can never be negative. If the interest rate is negative – for instance, if I lend you one thousand

euros, and at the end of one year, you have to return only 990 – obviously, this is an encouragement for people to do nothing and avoid investing. It motivates people to leave the money in their pockets and a year later, to pay back exactly 990 euros, and make ten euros without doing anything and without having to take on any entrepreneurial risks. If, as an entrepreneur, I invest, and things go badly, I may not be able to return even the 990 euros. In contrast, with negative interest rates, the best thing to do is to request new loans without any limits, sit on them and do nothing, and then pay back less than the borrowed amount, keep the difference, and make a sure profit without taking on any risk. Therefore, in conceptual terms, a negative interest rate leads directly to increasing ad infinitum the demand for money, to doing nothing, to lethargy, and to economic Japanization.

Furthermore, the aberrant monetary policy of negative interest rates has another very har-

mful side effect: The negative interest is used to automatically finance the public deficit at no cost and without limit, thus blocking the few incentives that might remain for governments to implement any structural reforms. Negative interest rates encourage politicians to increase subsidies and vote buying, which inevitably sink our societies into populism. Indeed, we have a crystal clear illustration of what I am talking about in our own country, Spain, as well as in the rest of Europe: practically the same day the European Central Bank introduced quantitative easing in 2015, all reforms were paralyzed. Therefore, ultra-lax monetary policies of quantitative easing and negative interest rates do not achieve any of their objectives; they are self-defeating; and they block the necessary structural reforms of economic liberalization.

And now, the final blow. Entirely disconcerted, central bankers see that they are achieving none of their objectives and are simply turning



their economies into drug addicts, since at the slightest mention of withdrawing the stimuli, the economies sink into recession. And as central bankers see no way out of this vicious circle they themselves have created, all that occurs to them is to recommend the adoption of fiscal policies of high increases in public spending. This is even worse, because it distorts the real economy even further by placing a growing number of productive factors in projects which

depend on the government and have no more sustainability than short term political decisions. Employment depending on government spending is not sustainable if it is not backed by consumers and only depends on the future decisions of politicians. And again, such fiscal policies prepare the ground even more, if that is possible, for the complete Japanization of our economies.

Stunned and bewildered, central banks realize that they are failing to achieve any of their objectives, except to turn their economies into drug addicts.

The chances of the Japanese illness spreading to other economic areas: the case of the European Union

Let us now elaborate the influence of the Japanese illness on other economic areas.

I am not going to expand too much on the United States. I have already mentioned that the fundamental difference between the Japanese and the American economies is that the latter is far more flexible. That is why, despite all of the errors and monetary aggressions, the American economy has been significantly restructured. However, there are still very large companies and sectors in the American economy that remain heavily dependent on cheap money. In any case, the Americans have dared to raise interest rates, though they have done

so very hesitantly and later lowered them again, which could mean they are in the typical starting phase of a new expansion of credit, which would, in turn, indicate the beginning of a new cycle within a few years. And the added uncertainty of new protectionist policies and the Brexit has been used by the Federal Reserve precisely as an excuse to temporarily suspend or even reverse its policy of monetary normalization. Again, on the slightest pretext, central bankers are always ready to justify lowering interest rates, but they find it extremely difficult to start raising them. But we will not comment anymore on the US economy and instead

we will focus on our own economic area because the case of the European Union is far more interesting.

To begin with, the policy of the European Central Bank has gone through two very different stages. During the first stage, which lasted until the year 2015 the ECB did not launch yet the aggressive quantitative easing and the euro served to discipline the most spendthrift European governments, above all those of the periphery countries. A crisis of sovereign debt (not of the euro) emerged in certain countries, including Spain, and the European Central Bank used this crisis to force the implementation of the necessary reforms in various countries, including Spain. The European Union even intervened Ireland, Greece, and Portugal. In the countries where reforms were put into effect, economies were restructured and eventually overcame the crisis. This is the case of our own country, Spain, in which the government, with great difficulty, in a very lukewarm manner, and committing the grave error of emphasizing tax increases over reductions in public spending, took several steps in the right

direction undertaking certain structural reforms.

The most serious problem has arisen during the second stage, from 2015 up to now. During this last stage the ECB introduced without any need (since M3 growth was already close to 4 percent at the beginning of 2015) its ultra-lax monetary policy of lowering interest rates to zero (and even less than zero), and especially it implemented its own, very aggressive quantitative easing. In fact, the ECB actually purchased sovereign and corporate debt at a pace of eighty billion euros a month, which meant almost one trillion euros of newly created money per year. This was roughly equal to 10 percent of the GDP of the Eurozone for almost all of four long years – from 2015 through 2018, when the program was temporarily suspended and then reintroduced again amid strong controversy and with the express opposition of Germany, France, Holland, Austria and other countries in November of 2019 (at a pace of twenty billion a month).

This second stage of the ECB has been a disaster. At the very moment this ultra-lax



monetary policy was initiated, as the case of Spain illustrates, all of the policies of structural reform, reductions in spending, and liberalization that the very rigid European economy needed were suddenly suspended. Clearly, compared with Japan, Europe is composed of a heterogeneous set of economies. Some of Europe's economies were already on a relatively sound footing, for several historical and political reasons, as in the case of the German economy. Other economies are very rigid, and in a certain sense more Japanized, despite their wealth, and these are the truly "diseased economies of Europe": France and, particularly, Italy. These economies have a very long list of pending structural reforms, and they have implemented practically none of them, especially since the ECB started purchasing their public debt. Finally, another group of countries had launched structural reforms in the right direction; some of these countries – like Ireland and Portugal, and even Greece – have already nearly completed them; while others – like Spain – are only halfway there. The countries that have managed to complete their reforms are very

fortunate. But in Spain, all subsequent reforms – those which had been planned but were still pending – were suspended. If we are not careful, this will have a very high social and economic cost, especially if populism is strengthened, based on the increases in taxes, subsidies, and public spending the socialist administration has announced.

In many ways, the German economy is paradigmatic. To begin with, it is an export power. But how has Germany come to export so much? It exports so much, because it produces very high-quality products. And why does it produce products of outstanding quality? Because traditionally, the German entrepreneurial culture has developed in a very difficult trade environment; that is, with a currency, the old German mark, that was steadily appreciating, thus making it harder and harder to export anything. And in this context, the only way to export products is to produce the best ones in the world. In other words, under such circumstances, the Germans had no choice but to discover, innovate, produce, and introduce the very best products in the world – whether

vehicles, precision instruments, machinery, and so on. So, in spite of all the false logic around competitive monetary depreciations advocated by Keynesians and monetarists, Germany became one of the strongest export powers in the world. Against Monetarists and Keynesians it is a strong currency, and not a weak one, which in the long run fuels entrepreneurial success and triumph as an exporter. Most analysts are conceptually impaired by their mathematical models, in which competitive depreciations appear to be the ideal recipe, since they immediately lead to an apparent,

vements in quality. The depreciated euro has acted like a drug. It has generated fat instead of muscle on the German economy and, to a certain extent, has allowed it to rest on its laurels. As a result, Germany is now obliged to at least recover its lost muscle, if the country does not actually go into a recession.

France and Italy are horses of a different color. Their economies are extremely rigid, and it is practically impossible to carry through a single reform in them. Take, for instance, Macron, with all of his promised reforms, practically none of which he has accomplished.

Central banks always take advantage of the slightest excuse to justify lowering interest rates, but they find it extremely difficult to start raising them.

short-term prosperity which derives from the increase in exports that every depreciation facilitates. But, this prosperity is "bread for today, hunger for tomorrow." It is fundamentally deceptive and short-lived, and it involves the unavoidable cost of dampening the creative and innovative entrepreneurial spirit, the drive to make things better and better. Why should we make an effort, if, with a weak currency, our products sell themselves so easily? Remember my "best test of a good economist": Monetary and fiscal manipulation will never produce sustainable economic prosperity, but the opposite. Without a doubt, the ultra-lax monetary policy depreciated the euro, and this has permitted Germany, in the short term, to export products much more easily, and consequently, it has allowed Germany to neglect, relatively speaking, its traditional competitive advantage based on perpetual impro-

Adopt reforms in France? Never! It is practically impossible, and so France, which is a very wealthy country, is rapidly approaching Japanization and the illness of indefinite lethargy.

Italy's situation, though more picturesque, is even worse than that of France. And as for the rest of the periphery countries, we have already discussed them, especially our own country, Spain. All signs point to a slowing down of the economic growth Spain has enjoyed due to the timid reforms in the right direction adopted in the past and to a number of tailwinds that are tending to disappear. This situation certainly does not bode well, especially if, as the socialist administration is announcing, taxes and public spending are raised and regulations are tightened (like minimum-wage increases, the regulation of the rental market, and the obligation for all workers to clock in at work).



Several unsustainable economic myths

Finally I would like to conclude with a critical look at several economic myths we constantly read and hear not only in the media but also in professional Journals.

The first myth is that the increase in the minimum wage in Spain (from 600 to 900 euros, and eventually to 1,000 or 1,200 euros) is not having a negative effect on employment. All of economic theory shows that rises in the minimum wage do boost unemployment, the underground economy, and the misallocation of the labor factor. Theoretically, the only way such a rise could possibly not have these negative effects would be if the government set the new wage lower than the already freely existing market wage. But in that case, why set one at all? As a general principle, if in the constellation of different jobs and wages, there is even one worker whose discounted value of his marginal productivity is less than the legal minimum, that will be sufficient to keep that worker from being hired or, if already working, to cause that worker to be let go. Without a doubt, this measure will cause – and is already causing – unemployment and a misallocation of resources (though in economics, changes always take place gradually and at the margin). The very Bank of Spain has published a study in which it predicts that at least 150 thousand jobs will be destroyed, and these are jobs done by the most vulnerable people (young people just entering the workforce, women, immigrants, etc.). For instance, it is obvious that an immigrant who has, with great difficulty, managed to get his papers in order, is going to have a very hard time finding a job if the minimum cost to the entrepreneur of hiring him is going to be, including social security, over sixteen thousand euros a year (nine hundred euros a month, in fourteen paychecks, plus 30 percent in social security costs). Nobody is going to hire him!

(And clearly, very few families are going to be able to afford to pay sixteen thousand euros a year to the people who care for their elderly members, or to their domestic workers, a sector which, up to now, has employed hundreds of thousands of people.) So, our immigrant will most likely be forced to wander from place to place in the underground economy. The government hypocrisy in this matter is staggering. We welcome everyone (“Refugees welcome!”), but mind you, no one is going to find a job here in the formal economy, because now the minimum wage is 900 euros, and the government plans to raise it to 1,000 euros and even to 1,200 euros per month. (And why not raise it to two thousand or even more, if employment will not be affected?)

The second myth is that central banks saved our economies during the Great Recession. This is the myth of the arsonist-fireman, for it was precisely central bankers themselves who orchestrated the credit expansion and generated the bubble that later led inexorably to the crisis and the recession. And now they look like the ones responsible for saving the day, because they kept banks from failing at least in theory because they saved, for instance, Bankia, but they allowed the Banco Popular to go under, because it was smaller. They even made greater mistakes, like when they let Lehman Brothers collapse and everything else nearly collapsed with it. Clearly, central bankers have intervened in an irresponsible, ad hoc manner that generates great uncertainty and constant financial instability.

The third myth is that quantitative easing was necessary to avoid a deflationary crisis. This is untrue. For instance, the European quantitative easing was unnecessary. When it was initiated in January of 2015, the European M3 was already growing on its own at a rate

of 4 percent; that is, at a rate very close to the reference target of 4.5 percent. Quantitative easing was totally unnecessary, it has had a very damaging and self-defeating effect that has completely blocked the reforms the Eurozone needed. Even Mario Draghi’s old rhetoric that monetary policy does not replace the necessary structural reforms the different countries must make to meet their Maastricht obligations was, after the quantitative easing, almost totally forgotten and replaced with a desperate request for more fiscal spending. By now, it is so obvious that no one is making structural reforms because the European Central Bank is financing governments for free that it would be hypocritical to keep mentioning such reforms. It is obvious that the ECB has betrayed its founding principles. Ultimately, it is financing the public deficit of all the countries. (Remember that it already owns 30 percent of the outstanding European public debt, including Spain’s.) Furthermore, it attempts to stimulate economic growth (like the Fed), when it has authority only to keep monetary stability. Consequently, the ECB has become a hostage

to its own errors, its ultra-lax monetary policy. The moment it announces it is withdrawing this policy, a recession will hit, and no one is willing to deal with it. And if the ECB continues to inject money, it will fully Japanize the Eurozone and sentence it to indefinite lethargy, and all this with a growing and constant discord between the members of the ECB governing council, which has been already almost completely politicized.

The fourth myth (or rather, dogma of faith) is that inflation must be less than 2 percent but close to 2 percent. But why? Where did that magical figure come from? It came from mathematical models. All the “experts” locked themselves into a meeting room – the governors of the ECB, the Bank of Japan, the Federal Reserve, the Bank of England, etc. And bingo! They determined the rate should be 2 percent. But why 2 percent? It is a bizarre, totally arbitrary target and one that is very difficult to reach in an environment in which productivity has risen as much as it has at the beginning of this century, as a result of the technological revolution and the introduction of numerous innovations.



In this context, 2 percent is an unrealistic goal, and attaining it requires a super-lax monetary policy which causes all of these negative effects we have discussed. These effects destabilize the economy and the financial world and, as we have seen, they lead to the process of Japanization in rigid economies like ours. A few years ago, I was invited to a meeting at the Kiel Institute for the World Economy. The meeting was also attended by, among other experts, a former head economist at the ECB. Well, we eventually arrived at the conclusion that, under the current circumstances, the inflation target

interest. All that can be observed is the gross interest rate in the credit market. In the absence of coercive intervention, this rate includes the natural rate of interest, premiums for expected inflation or deflation, and risk premiums. It is so obvious that no one can observe the natural rate of interest that some people say: "Well, a proxy might be provided by the interest rate on 'risk-free' public bonds." But one moment! It is precisely risk-free sovereign bonds that central banks are compulsively buying, generating in their markets a bubble without any historical precedents! Again what hypocrisy!

In Japan, there has been a tremendous increase in monetary demand, which is largely placed in public debt that is considered as if it were cash.

should not be 2 percent, but 0 percent, and the reference target for M3 growth should be between 2 and 2.5 percent (instead of 4.5 percent). If this had been the target, we would have been spared the ultra-lax monetary policy and the Japanization process. And –paradox of paradoxes– very recently, there has been talk of making the target more flexible, but not to suspend the ultra-lax policy (an unnecessary policy if the inflation target is lowered to 0 or 1 percent), but to justify higher inflation rates throughout the cycle (which "compensate for" the prior downward disparities). What a kind of spurious logic!

The fifth myth you will have heard is that the natural rate of interest is falling. What hypocrisy! Central banks artificially lower the interest rate to zero (or even make it negative), and then they argue that the natural rate is dropping! Nobody can observe the natural rate of

The sixth and last myth we are going to discuss is the mantra that interest rates are very low because people are saving a lot and the population is getting old. It is said that Japanization is due to the fact that the Japanese population is aging more and more and is saving a great deal. This argument is false and confuses saving with inflation (inflation in the traditional Austrian sense of monetary growth). Benjamin Anderson used to say that according to this argument, the bigger the injection of money, the greater the saving! Of course, money is injected, and people all hold it in their pockets, as we have seen, and then it is argued that people are doing a lot of saving. But no. What is happening is that there is an increase in the demand for cash balances (a stock), which should not be confused with an increase in saving (which is a flow). And as for the aging of the population, that argument is also weak.

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When people retire, they consume what they had saved before. We must realize that in Japan, the demand for money has increased dramatically, and this increased demand is lar-

gely being channeled into government bonds, which are treated as cash. What a time bomb for Japan should the bond markets collapse!

Conclusion

I will now conclude where I began when I presented my alternative test to complement Hayek's, and my conclusion is that monetary and fiscal stimuli fail because they do not attack the underlying problem. The underlying problem is the rigidity of the economy; that is, excessive regulation, high taxes, unbridled public spending, and the resulting demoralization of entrepreneurs. An economy can emerge from a crisis and a recession only if the entrepreneurial class is motivated. I am not talking about Keynes's "animal spirits," which make us manic depressive. We entrepreneurs have been harassed and demoralized by force. As long as the authorities continue making regulations, raising taxes, and giving money away, the easiest thing to do is to hold onto our money and let others do the investing, if they want to (and of course, there are very few of them, if any). Furthermore, easy money blocks the implementation of any free-market reforms and makes them politically impossible. So, the only way our economies can escape Japanization is blocked. And what is our only escape from this problem, toward which we are dangerously sliding in the Eurozone? Our escape is our great challenge for the coming years: the challenge facing France (which seems to have no escape), the challenge facing Italy, and the great challenge facing Spain

as well. It is true that France has a very wealthy economy and a large amount of accumulated capital, as Japan does, but this tends to conceal the problems. The stubborn facts and results are clear: lethargy and the failure of any reform-oriented policy. What is the only way out of this vicious circle we are dangerously entering? Well, that is clear: We must normalize monetary policy as soon as possible and create a framework that forces governments to implement the painful structural-reform measures our economies need. The current ultra-lax monetary policy benefits only a few: spendthrift governments and holders of fixed-income securities, hedge funds, and speculators, to the great detriment of most citizens, particularly millions and millions of small savers that are trying to build their future pensions. Also, this Keynesian euthanasia of the saver policy has created a bubble in fixed-income markets that even dwarfs the real-estate bubble generated before the last Great Recession.

Once we normalize monetary policy, governments will be obliged to control their spending, introduce austerity policies, and encourage the necessary liberalizing reforms, which were suspended or postponed at the wrong time and which we desperately need today in order to recover our former sustainable prosperity.

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