

Neoliberal Cycles in Argentina and Japan

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要 旨

日本とアルゼンチンはいずれも、「新自由主義サイクル」と呼べる過程を経験した国々である。この景気循環は、経済の自由化・規制緩和・開放を含む新自由主義政策の導入と共に始まるが、そうした政策は経済を不安定化させ、最終的には危機的状況へと導く。危機の後には一定の補整政策がとられるが、その後にもまた経済の規制緩和・自由化・開放が実施され、かくして同じ事態が繰り返される。本論文の課題は、この新自由主義サイクルに関してアルゼンチンと日本の経験を比較分析し、そこにみられる異同ならびに同サイクルに対する両国の対応を考察することにある。

Keywords: Neoliberalism, cycle, Japan, Argentina, crisis.

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I. Introduction

The year 1976, starting with a military regime which introduced Argentina's first neoliberal program, marks the beginning of a neoliberal cycle (NLC) which brought 25 years of indebtedness, income transfer towards privileged sectors, liquidation of the State, and destruction of industry culminating in December 2001, in a popular uprising, social chaos, more than half of the population poor, children dying from hunger, and record unemployment.

In 1983, after the collapse of the military government, democracy was restored. Argentina, traumatized by the military repression, was starting to show the first effects of the economic and financial liberalism: a dwindling middle class, increasing poverty, and higher concentration of wealth. The return of democracy, despite its non-imposition of neoliberal practices, did not change the predominance of capital over labor. The new government was left with a huge debt burden for which it was increasingly difficult to repay wrecking public finances. Unable to control the economic situation and with increasing skepticism from the public, in 1989 a hyperinflationary process led to riots and looting, which brought down the government.

The next government, led by Carlos Menem, managed to rein down inflation and control public finances with an economic plan which included a currency board. The new plan, carried out within a neoliberal framework, started a massive program of privatization, liberalization, deregulation, and opening of the economy. Under Menem the economy grew on average 5% in 1991-98, with increasing productivity, but such benefits were captured only by a select few. Labor conditions worsened, the unemployment rate doubled to 14% in 1999 from 1991. At first poverty levels went down only to increase and surpass initial levels.

The change of government in 1999, full of hope that it would bring change, did nothing to improve the situation. As social conditions worsened, there was growing discontent among the populace leading once more in December 2001 to riots, looting, repression and death. The government resigned, marking the end of the NLC in Argentina.

What lessons can Argentina's NLC impart? And how can this apply to Japan? Argentina, after its collapse, steered away from neoliberal policies achieving high rates of economic growth, reduced unemployment by half, reactivated industry, and lowered the rate of poverty by 20 points. Japan too has experienced a NLC starting in the mid 1980s also going through a process of deregulation, liberalization, privatization, and opening of the economy. Consequently, social indicators in Japan worsened. This can be

seen in the rising unemployment rate, the increasing rate of non-regular work, the widening income gap, the appearance of homeless people in major cities, the rise in the number of suicides, etc.

The intention of this paper is to do a comparative analysis of Argentina and Japan within the framework of the NLC. The objective is to observe the similarities and differences of both countries in view of the neoliberal policies that were implemented in each and their reactions towards them. Where is Japan heading with its ongoing neoliberal policy? Despite the present economic expansion, social indicators in Japan do not seem to be improving as one would expect. Does Argentina have anything to suggest to Japan?

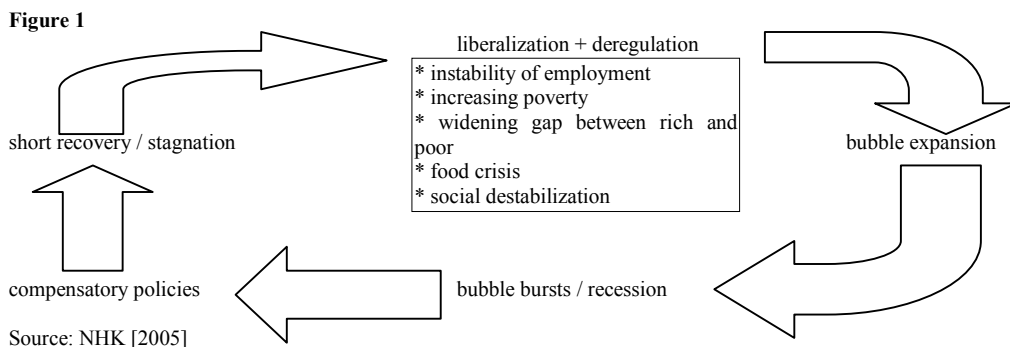
Modern industrial economies experience important swings in their economic activity. In times of economic expansion, typically called booms, most industries are booming and unemployment is low. In times of economic decline, called recessions or depressions, most industries are operating well below capacity and unemployment is high. The combination of booms and recessions, the ebb and flow of economic activity, is called the business cycle. Business cycles are divided according to when the direction of economic activity changes. The peak of the cycle refers to the last month before several key economic indicators, such as employment and output, begin to fall. The trough of the cycle refers to the last month before the same economic indicators begin to rise. Business cycles occur because there are disturbances to the economy of one sort or another. These disturbances are due to the multiple market operations that characterize capitalist economies which lead to discrepancies between supply and demand and their ongoing search for balance. Also, economies in the world are interconnected and are liable to receive external shocks, such as fluctuations in the exchange rate and in the price of oil and other raw materials, wars, crises, etc. Finally, cycles are often the result of changes in economic policy: they can be generated by surges in private or public spending, tax policy as well as monetary policy (Romer [1993] pp.173-177).

Joseph Clément Juglar, a French economist, is one of the first to discover the occurrence of periodic cycles in the fluctuations of economic activity. In 1862 Juglar identified a business cycle of approximately 10 years that has since been associated with his name. The Juglar cycle is usually associated with the demand for fixed capital goods that have an average economic life of 10 years. Fifty years later, Nikolai Dmitriyevich Kondratiev, a Russian economist, suggested that capitalist economies have long term business cycles of about fifty years. Kondratiev was not very clear on the specific causes of business cycles attributing them to the intrinsic nature of capitalist economies. It was Joseph Alois Schumpeter in 1939 who clarified onto the origins of these “super cycles” by stating that they were generated by waves of inventions and innovation. Between the Juglar cycle and the Kondratiev cycle is the Kuznets cycle by the economist

Simon Kuznets. This cycle which lasts around 20 years is associated with the demand for consumer durable goods and longer-lived capital goods, like houses, factories, warehouses, office buildings, train cars, airplanes, and ships that have average economic lives of 18-20 years. A relatively short cycle is described by Joseph Kitchin whose short-run inventory liquidation cycles last approximately 40 months and are associated to the adjustment of inventories caused by the changing demand for consumer durable goods that have average economic lives of 40 months (Yanbe 2005 pp.25-32). The last to be mentioned is the political business cycle presented by the polish economist Michal Kalecki in 1943. The theory of this cycle states that economic fluctuations are created by governments on behalf of capitalist interests in order to reduce the bargaining power of workers, strengthened during times of full employment, and bring them under control through induced recessions (Snowdon [1997] p.255).

Besides the above described theories, other factors also have to be considered. Business cycles take place in an institutional setting contained within a given historical framework. They occur in the context of existing institutional forms as well as in the context of changing institutional forms. In the first case, they are connected to minor crises, in the second case they happen with structural or major crises. The form such crises take are specific to the established institutional setting, explaining why the business cycles of today cannot repeat previous ones, like the 1929 crisis (Boyer & Saillard [2002] p.43).

The theory of the NLC¹ (shown below) serves to describe the economic cycles created under neoliberal reforms in Argentina in the period from 1976 to 2001.



The NLC differs from the common business cycle where imbalances between demand and supply are adjusted repeatedly through contractions and expansions of the economy. Under the policies of a neoliberal reform, in which there is deregulation, liberalization and a greater opening, the economy becomes

more vulnerable and more unstable. This increasing vulnerability and instability finally lead the economy to a crisis. After the crisis, certain compensatory policies are taken which lead to further deregulation, liberalization and opening, starting the process all over again. NLCs can be considered to be a type of political business cycle (PBC). The difference lies that in traditional PBCs, governments intervene in the economy through Keynesian policies, whereas in NLCs, the objective is for the government to pull away from it. Reforms are taken to reduce the role of the government and entrust the economy to market forces. Uchihashi [2006, p.24] goes on to develop the concept of the NLC. To him, the trigger of the business cycle is correlated to the huge amounts of capital flows that go in and out of an economy. This is applicable to a small economy like Argentina's, but it cannot quite explain the oscillations of an economy of the size of Japan.

II. The Neoliberal Cycle in Argentina

Figure 2

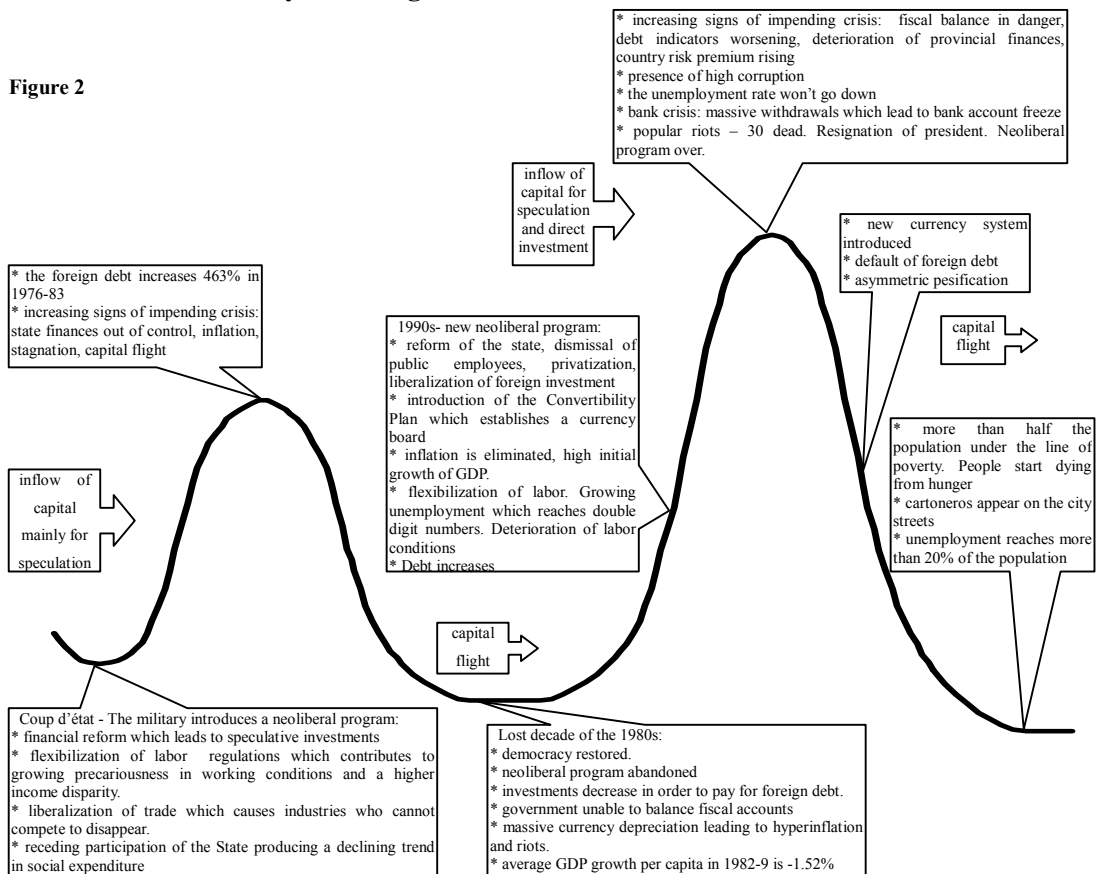


Table 1: the neoliberal cycle in Argentina and Japan

ARGENTINA												
5/1976 →	8/1977 →	3/1978 →	9/1980 →	6/1982 →	6/1984 →	6/1985 →	6/1987 →	3/1990 →	12/1994 →	8/1995 →	6/1998 →	6/2002 →
Expansion	Recession	Expansion	Recession	Expansion	Recession	Expansion	Recession	Expansion	Recession	Expansion	Recession	Expansion
Coup d'état, flexibilization in labor and investments, opening of economy.	Financial reform. Growing financial speculation	Adoption of the <i>tablita</i> , a system of gradual programmed devaluations of the currency. Lowering of import tariffs.	Financial crisis. Massive capital flight (20,000 million dollars in 1980-82). Foreign debt increases 460% in 1976-83. (on average 30.8% a year from 1976 to 1980).	Exchange rate liberated. Freezing of prices of public services and state salaries. Interest rate left without controls. Reintroduction of export levies and modification of tariff structure.	Democracy restored. Alfonsín elected president. Initial populist monetary policy. Later, a loan is secured from IMF. Conditions: tighter monetary policy, controls on wage increases, reduction of subsidies, and phasing out of price controls.	Launching of heterodox <i>Plan Austral</i> : stabilize the economy with growth, rather than with recession, by means of wages and price freezes and readjustment of relative prices.	1987 - New freezing of prices: the <i>australito</i> . 1988 - New heterodox plan: the <i>Plan Primavera</i> . 1989 - Hyperinflation and Riots. Menem elected president. Promulgation of the Law of State Reform and the Law of Economic Emergency	Reorganization of public finances, privatization of public enterprises, liberalization of exchange market, renegotiation of external debt, restructuring of domestic public debt, introduction of Convertibility Plan, labor market flexibilization. The unemployment rate increases from 6.9% to 10.7% in 1991-94 despite strong economic growth.	Tequila Crisis. Run on banks. Capital flight of US\$4,600 million. Central Bank loses 25% of reserves. Country risk index rises from 8% to 55%. The number of people out of work reaches 18.4% in May 1995.	Growth of GDP 15% in 1994-8. Russian currency crisis. People out of work reach 12.4% in October 1998. Tighter supervision and better accounting in banks. Minimum capital requirements raised and enforced. Mergers and rationalization of banks. Many banks bought by foreign banks.	De la Rúa elected for president. Fiscal austerity program. Adjustment of Convertibility Law. Massive outflow of reserves in April-July 2001 (almost US\$10,000 million). The <i>corralito</i> is implemented. Riots, 30 people dead. The president resigns. Default of foreign debt <i>Cartoneros</i> appear on city streets.	More than half the population poor in 2002. Jobless rate at 21.5%. Duhalde ends Convertibility. Capital controls reintroduced. Managed exchange rate by Central Bank. Regulation of labor market. Restructuring of foreign debt. Jobless rate halved. Poverty at 31.4% in 2006. Strong GDP growth in 2003-6.
liberalization & deregulation			crisis	compensatory policies & stagnation				liberalization & deregulation	crisis	Compensatory policies	crisis	breakaway from cycle?
JAPAN												
6/1985 →	11/1986 →	2/1991 →	10/1993 →	5/1997 →	1/1999 →	11/2000 →	1/2002 →					
Recession	Expansion	Recession	Expansion	Recession	Expansion	Recession	Expansion					
Plaza Accord signed in September. Easing of monetary policy. Financial liberalization continues apace. Yen appreciates from 260 per dollar in February to 200 in December of 1985.	Start of Bubble Economy. Financial institutions give credit loosely fomenting speculative investments in stocks and real estate. Yen at 150 per dollar in last quarter of 1986.	Official discount rate raised 5 times in 1989-90 to 6%. 1990 - bubble bursts: value of stocks slump followed later by land prices. Stocks lose 63.1% in 33 months, until August 1992. Homeless people appear on the streets of Japan's cities.	Interest rate lowered to 1.7% in 1993 and 0.5% in 1995. Economic recovery is slow. 1992: capital loss over GDP equal to 86.9%. Banks left with huge amounts of non performing loans (NPL). 1993: First non-LDP government since 1955. Electoral law changed. Non-regular employment grows at an increasing rate. Economy grows 3.4% in 1996.	Hashimoto's 'Six Major Reforms'. Further labor flexibilization 'Small government' pro-supply side fiscal reform: consumption and other taxes raised with government expenditure cuts. 1997-98: many banks collapse.	Credit crunch in 1998-99. In a 180 degree turn from the previous government, the Obuchi Cabinet interrupts fiscal reform, with a fiscal stimulus. Nonetheless, the tax system is reformed making it more regressive	Exports and investments fall. Mori implements a policy of budget deficit reduction, public investment goes down. The Mori Cabinet enacts the Social Welfare Service Law. In 1992-2003, GDP growth averaged 1.2%. In 1990-2002 the unemployment rate rose from 2.1% to 5.4%.	Koizumi advocates a 'Structural Reform with no Sacred Cows': restructuring bank's NPL, restructuring regional finances and relaunching fiscal and tax reforms. Longest period of postwar expansion, longer than <i>Izanagi</i> boom. Jobless rate around 4% in 2006. One third of workers in non regular employment.					
liberalization & deregulation		crisis	compensatory policies	liberalization, deregulation & crisis	compensatory policies	stagnation	liberalization & deregulation					

Source: Yanbe [2005], Gotō [2002], Gerchunoff & Llach [2005], OECD [1997], INDEC, Ministry of Economy and Production (Argentina).

2.1 The *Proceso* and its consequences

After twenty-six tumultuous months, sparked by the death of president Juan Domingo Perón, with an economy out of control, a paralysis of production caused by strikes and scarcities, growing societal tensions, and an escalation of guerrilla violence, bombings and kidnappings, in March 24 1976 the government was overthrown in a coup d'état².

Many sectors of society greeted the new military government and its Process of National Reorganization (*Proceso de Reorganización Nacional* or '*Proceso*') with relief. Exhaustion and a sense that things could not get worse, only better, triggered acquiescence in some quarters and applause in others. The program of the *Proceso* announced the next day of the coup had two primary objectives: one economic, to restore 'discipline' to the monetary and banking system and to 'clean' public accounts; the other political, to 'clean' and 'discipline' society (Lewis [2002] pp.148-9)³. Contained in this program was Argentina's first neoliberal reform initiated by the new Minister of the Economy, José Alfredo Martínez de Hoz. There was a general idea that the prevailing economic model had to give way to a model where there would be more market and less state in the regulation of the economy. According to the advocates of neoliberalism, the reasons for the economic difficulties of Argentina could be attributed to two causes: domestic price distortions introduced by the policy of industrialization and the excessive size of the State apparatus. To these could be added the existence of monopolistic practices on the part of a unitary and vertical labor unionism which permanently pushed wages above the levels of worker productivity.

The government initially implemented a stabilization plan consisting of the removal of price controls, an adjustment of the exchange rate to inflation, and a freezing of nominal wages. Labor movements were suppressed, the General Workers Confederation was dissolved, and the right to strike was abolished, resulting in the imposition of a harsh flexibilization of labor. The institutional framework in which wages were negotiated changed: for the first time since the 1940s, wage negotiations were done between workers and employers of each company, without the participation of sector unions. The atomization and dispersion of wage negotiations was one of the main objectives of the structural reform of the military government, based on the increase in efficiency which would come as a result of a labor market operating closer to how it is described in traditional microeconomics textbooks. Many labor union leaders were detained or 'disappeared'⁴. Never before had the labor movement been so fiercely persecuted. The consequence was a drop of almost one third in the value of real wages in just a couple of months. The participation of wages and salaries on national

income fell from 45% in 1974 to 26% in 1983.

In 1977, a financial reform was carried out which deregulated the financial market, decentralized deposits, and simplified the types of financial institutions. This was a much needed reform without which the financial system could have collapsed. Due to high inflation rates from the end of WWII to 1977, real interest rates were constantly negative⁵. With the new system, positive real interest rates would stimulate savings and discourage unproductive activities, focusing on investments with a high real productivity. The number of banks climbed from 119 to 219 between May 1977 and May 1980. From the government this was seen as a sign of growing competition in the sector. In fact, the number of banks was less related to the state of the economy and more to the speculation caused by the massive influx of foreign capitals and the new legislation.

Concerning the liberalization of trade, in order to eliminate any uncertainties about the evolution of the exchange rate and bring down the expected rate of inflation, a policy of preannounced adjustments of the exchange rate, the so-called *Tablita*, was announced in 1978, whose objective would be to bring domestic prices closer to their international values. From January 1979 to March 1981, there would be periodic adjustments of the rate of exchange, at below the level of price increases in the private sector, which were designed to make business more cost-aware. Peso appreciation due to the inflow of foreign capital and the exchange policy, which made imports cheaper, was intended to compel firms to become more competitive. Cheaper capital imports would enable businesses to become more efficient: the general removal of restrictions on imports would make local producers competitive.

The government's anti-inflationary plan failed in its purpose. The persistence of a high inflation rate was of course intrinsically bad, but coupled with the *Tablita* scheme, it proved to be additionally worse. The stipulated increase in the dollar was much less than the increase in prices, creating an exchange lag which, by reducing the value of imports and making exports less profitable, tended to deteriorate the trade balance. In addition, external indebtedness was getting out of control just as interest rates were on the rise in the early 1980s. Everything pointed out to a possible structural crisis. There were increasing signs of distress in the banking sector, bankruptcies were rising, a default on the domestic and external debt seemed imminent, international reserves were contracting, and the exchange rate was unsustainable. In March of 1980, the collapse of one of the most important financial houses triggered a run on the banks which brought down three more banks. Between 1978 and the first semester of 1982, 102 financial institutions disappeared from the market. A massive capital flight ensued which, between the first quarter of 1980 and the first quarter of 1982, totaled \$20,000 million. In July 1980, new measures of stabilization were announced by the government

which included steps towards the reduction of the public deficit and a further easing for taking credit abroad. But the credibility of the government seemed to be irreversibly undermined. The abandonment of the *Tablita* scheme was a foregone conclusion. The mistrust towards the government turned into panic and by the end of March 1981, the accumulated loss of reserves since October (US\$5,000 million) was more than 50% of the total. The financial crisis marks the end of the economic program initiated by Martínez de Hoz.

The legacy of the 1976-81 neoliberal reform was increased indebtedness in both public and private sectors, state finances out of control, inflation, stagnation, the closing of an uncompetitive economy, and capital flight. When the military seized power, the external debt totaled around US\$8,000 million, by 1983 the figure was US\$45,000 million, corresponding 70% of the total to the state. This would severely condition the management of the economy in the coming decade due to the necessity of repaying this debt, allocating fewer resources for other purposes such as investments. This is one of the underlying causes of the Lost Decade of the 1980s. The sudden opening of the economy was a complete disaster for the manufacturing sector producing massive bankruptcies. During the second half of the 1970s industrial output shrank and the share of manufacturing in GDP decreased from 32% in 1975 to 27% in 1983⁶. Comparing the national economic censuses of 1974 and 1985, there is a 14% decrease in the number of industrial establishments along with a reduction of 13% in employment. This translates into the closing of 18,000 businesses and the loss of 250,000 jobs. The industrial structure became heavily modified, depending increasingly on advantages in terms of natural resources and in the use of unskilled labor force at the expense of a more qualified work force and a higher technological potential. This shock opening occurred precisely at the point in which some branches of industry were ready to make an export breakthrough, eliminating the previously acquired gains. The economy specialized in a new way as reflected in the changing composition of exports: the increase of commodities and the decrease of high value-added products (Miotti [1991] pp.454-5).

The implementation of the economic program of Martínez de Hoz immediately led to a redistribution of income from labor to management. The freezing and control of nominal wages decreased real wages and reduced, as a consequence, the proportion of wages and salaries on national income. The distribution of income acquired a regressive turn. Even though the distribution of income had tended to worsen in the 1960s and 1970s, it reached unprecedented levels at the start of the 1980s. The increase in poverty rates is another aspect consistent with the fall of real wages and the decrease in consumption of workers. An additional factor contributing to the rise in poverty is the declining trend of social expenditure (education, health and housing) by the government not only with respect to GNP and but also within the total

national budget, a trend that started in the 1960s and which subsequently got worse in 1976-1983. Social expenditure per capita shrank by 14% between 1977 and 1982, affecting more education than health and housing. Consequently, the deterioration of social public services, in relation to the emerging needs, affected mostly those sectors with the lowest income (Rapoport [2000] p.836).

While the military regime claimed to have stabilized society by eliminating armed terrorist and subversive groups, in the process 'disappearing' around 30.000 people in what came to be known as the 'dirty war', it clearly failed to stabilize the economy. Thus ends the first neoliberal program in Argentina.

The decade of the 1980s in Argentina is characterized as a period of economic stagnation marked by very volatile economic cycles with production and investment below historic average levels, including an accelerated process of capital destruction, increasing unemployment and growing inflation which ultimately led to hyperinflation. In 1982, with rising popular discontent against the regime and with a system in crisis, the military government decided to divert the focus of attention of civil society away from current problems by occupying the Malvinas Islands, long claimed by Argentina, from Great Britain. Military defeat further disgraced the government and brought about the return of democracy. The main task of the newly elected president Raúl Alfonsín (UCR party⁷) centered on the reconstruction of democracy and civil society after years of brutal repression. Economic reactivation was considered dependent on the political process, though it was assumed that economic growth would contribute to re-democratization and social stability.

The main economic issue concerned the foreign debt which from 1976 to 1982 increased more than 400%. Furthermore, the impact of the 1982 Mexican debt crisis was quite severe. First, from being a capital importer, Argentina became a net exporter of capital. The transfer abroad of debt service payments and earnings over GDP grew from 2.2% to 9.4% from 1980 to 1983 (Gerchunoff & Llach [2005] p.391). Adjusting to this new restriction made it necessary, to obtain trade surpluses by contracting imports, at the cost of an acute drop in gross domestic investment. The internal mobilization of funds necessary for the transfer abroad implied, not only a decrease in public spending, but also an accentuation of fiscal pressure, an inflationary levy imposed on the private sector, and by the public sector resorting to debt vis-à-vis the private sector. Other than the contractive effects on demand, this type of situation had negative effects on supply, and therefore, led to a weakening of the productive capabilities of the country. In the government of the *Proceso*, since the productive capacity of the economy had not been expanded (because the debt financed the acquisition of financial, not physical assets), in order to service debt interests the capacity to earn hard currency was increased by decreasing other components of GDP (Fanelli & Frenkel [1989] p.4). In 1983,

imports as well as investments were at half the level they had been in 1980.

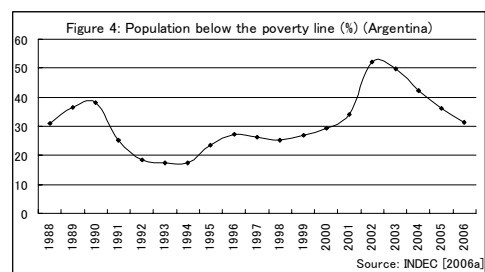
The political economy of the new government can be divided into three stages. At first, the Alfonsín administration ran a loose, populist monetary policy in an attempt to buy support from voters, organized labor and business. But this policy, combined with the monetary expansion of the last year of the military regime, triggered a further surge in inflation and a flight from the peso. In September of 1984, a standby loan of US\$1.5 million was secured from the International Monetary Fund, whose conditions were: tighter monetary policy, controls on wage increases, reduction of subsidies, and the phasing out of price controls. To that effect the government devalued the currency, increased public utility fees and tightened monetary policy. Together with certain measures of public expenditure cuts, the fiscal deficit and the rise in prices were moderated to some degree.

In June 1985, the heterodox Plan Austral was launched designed to stabilize the economy with growth, rather than through recession, by means of a wage and price freeze and readjustment of relative prices. It was assumed that in historically inflationary economies like Argentina, inflation perpetuated itself through inertial factors like indexation and adjustment strategies devised by all economic agents based on expectations of continuing inflation. The ultimate causes of inflation (fiscal deficit and monetary emission) had to be deactivated in order to reinforce the new situation and the expectation that it would be prolonged in time. The government would have to raise income by increasing public utility prices, taxing imports, and making the revenue service more efficient. A new currency unit, the *austral* valuing 1.000 pesos, was introduced at the initial rate of 0.80 austral = US\$1, at the same time all prices in the economy (as of June 12, 1985) were frozen and indexation was made illegal. The plan was accepted with success and brought an initial period of stabilization which saw real wages pick up and consumer credit lines back on the market⁸. The recessive trend of the first semester was reversing its course, turning into a full recovery by the beginning of 1986. The initial freezing of prices had had an important role in producing a truce in the distributional conflicts between economic sectors, and so the announcement of a flexibilization of the plan in April rekindled the race of every sector for their share of the cake. The Austral Plan started to unravel. By the end of 1986 the need to finance public deficits with monetary emission resurfaced, braking one of the promises of the Plan Austral. The structural causes of the fiscal deficit were practically intact. After the defeat in the elections for Congress in 1987, the government never recaptured control of the economy.

During the first half of 1988 the rate of inflation kept on growing at a continuous pace. In response, a new heterodox plan was launched, the Plan Primavera. But growing skepticism among the

populace undermined it from the start. Between February and May 1989, the consumer price index doubled each month, starting from 9.6% and arriving at 78.4%. The increase in prices was the result first of a variation in relative prices (reflected in the struggle among sectors to maintain or increase their income) and second because of a generalized rise in prices accompanied by an explosive speculation in the exchange market (where the national currency was rejected and lost all its functions). When the currency loses all its functions, the inflationary process becomes hyperinflationary.

2.2 Menem and possible break from the cycle



In the presidential elections in May, the candidate of the opposition Peronist party⁹, Carlos Saúl Menem was elected. Alfonsín unable to control the situation resigned, transferring power ahead of schedule to Menem in July. That month, the rate of inflation reached 196.6%. The priority of Menem's economic team was the stabilization of prices by reducing external and fiscal imbalances. Two very important laws were promulgated: the Law of State Reform and the Law of Economic Emergency which covered, among other things, the administrative reform of the state, the authorization to privatize state enterprises, the elimination of subsidies towards national enterprises, the reform of the charter of the Central Bank, the liberalization of foreign investment, and the dismissal of public employees.

In December 1989 there was a change of the Minister of the Economy. The new minister, who lasted until February 1991, went through five successive economic plans in order to bring the economy under control. The main objectives of these plans consisted in trying to reorganize public finances in order to achieve a fiscal surplus, controlling monetary emission, maintaining the trade balance surplus, recomposing foreign currency reserves, privatizing some of the most important public enterprises, liberalizing the exchange market and domestic prices, renegotiating the external debt and, above all, restructuring the domestic public debt. In this way, the path was set for the next phase, which consisted of monetary

stabilization and a deepening of structural transformations.

The Convertibility Plan, introduced by the new Minister of the Economy Domingo Cavallo on April 1 1991, was much more radical and encompassing than previous plans had been. The plan was based on a new monetary system, further opening of the economy, and thorough reform of the state. Through the Convertibility Law, the domestic currency was to be backed by dollar reserves held by the Central Bank which would function as a Currency Board. The Central bank became an autonomous entity, free from political control and was prohibited from financing the fiscal deficit. The main objective of the Convertibility Plan was to increase the predictability of the workings of the state. A major part of the instability of the past was attributed to the periodic and sudden changes in the rules of the game which impaired the initial objectives of economic plans. People stopped believing in these rules speculating on when a new sudden change would take place. This is why regaining the trust of citizens required curtailing governmental functions. With this plan, the government would be prevented from carrying out any monetary or exchange policy and its margin of action for the implementation of fiscal and sector policies was severely reduced.

The Convertibility Plan was successful in its immediate purposes. The stability of prices was achieved towards the end of 1991, with monthly inflation rates of less than 1%. Measures to this effect also included limiting the increase of wages to within the increases of productivity and weakening labor movements (Sano [2005] p.50). The stability of prices was initially accompanied by high rates of economic growth. From 1991 to 1994, output grew at an annual rate of almost 8% a year. Unemployment also rose, but remained below double digits until 1994, even with the accelerating pace of privatization, while the investment rate picked up. The virtual elimination of the inflationary tax had a progressive effect since its consequences fell mostly on the most vulnerable strata of society, revealing that not only the stabilization but also the effects of the economic boom had reached the lower levels of the social structure. The unemployment caused by the opening of the economy, the reorganization of the public sector and, to a smaller degree, the privatization of state enterprises was compensated, initially, by the impact that the increase of GDP had on employment. Growth during the initial four years of the plan was based on domestic consumption with domestic savings remaining low and the trade balance deficit growing. Consumption and economic growth were financed to a big degree by foreign savings, but the situation reversed itself in 1995 with the Tequila Crisis. The initial success of the Convertibility Plan is associated with a favorable evolution of world economic trends as a consequence of the lowering of interest rates, the increase in the availability of liquid funds and a better environment for the renegotiation of the external debt (Lewis [2002] p.164 & Gerchunoff

& Llach [2005] p.433)¹⁰.

The policies adopted by the government with respect to the labor market included further flexibilization, which meant making the use of working time more flexible, reducing hiring and layoff costs, lowering social security contributions by firms, and reducing costs related to labor accidents. Under this system, unemployment tended to increase and wages fall. The labor situation was further aggravated by the sudden change in relative prices which favored imports against national production. The deterioration of the labor market conditions did not take place only in times of recession: even in the years of economic expansion the unemployment and underemployment rates increased. Judging by the evolution of work in the informal sector and by the length of probationary periods, working conditions became increasingly precarious under Menem (Sano [2001], Frenkel [2003]).

As privatization receipts dried up after 1995, the fiscal balance started to be in danger. The authorities continued to cut down on several items, such as wages and salaries, operating expenses, and public investment, but despite this, total expenses continued to increase due to at least three factors. First, with the privatization of social security – a switch from state agencies to private pension funds – the public social security system started to get divested, as an increasing part of contributions were diverted towards the AFJPs and because the phasing out of pension payments given by the government would only happen in the long term. At the same time, the big surge in unemployment increased the transfer of subsidies towards the unemployed. Second, a bad allocation of resources coupled with the widespread use of ‘secret expenses’ prevented the reduction of expenses of other areas from having any effect on total expenses. Third, the weight of the debt service expanded manifold, climbing more than 130% between 1993 and 1998. Already in 1994, the public deficit started growing directly as a function of the debt service.

On December 20 1994 a run on the Mexican peso originated the Tequila Crisis which triggered a currency crisis affecting many emerging market economies, not least Argentina which had similar economic fundamentals as Mexico. The stability of the currency board was put into doubt prompting an attack on the Argentinean peso and a run on the banks. The Central Bank lost a quarter of its reserves and the country risk index rose from 8% to 55%. GDP decreased in 1995 by 4.5%. The social impact was tremendous: unemployment reached 18.6% in May of that year. The system was starting to show its negative points: an economic expansion could be abruptly turned into an acute recession in a matter of weeks. To ensure the continuity of the system, the economy had to constantly receive foreign capital flows. Since the system generated current account deficits, these inflows became indispensable. In their absence, given the monetary

constraints, the economy had no choice but to go through recessionary adjustments. The government, in order to restore confidence tightened supervision of banks and improved accounting and disclosure practices, forcing banks to face up to their bad loans. The worst-hit banks were closed while minimum capital requirements were raised and more thoroughly enforced. Subsequently, there was a string of mergers and rationalization of banks. Since 1994, more than a quarter of Argentina's banks were swallowed by rivals, many of them bought by foreign banks.

The Tequila Crisis prevented an important part of society from fully integrating socially. Between 1992 and 1994, employment rose a scanty 0.5% per annum while growth for the same period had been 6.5% yearly. After 1995, a quick return to the lower unemployment rates that had characterized Argentina was highly in doubt. With privatization and investment, capital displaced labor as firms were producing more with fewer workers. It could no longer be argued that growth alone would deliver 'real jobs', i.e. in the formal sector, and thus reduce poverty. Society was becoming less equal.

Growth continued until mid 1998, GDP had expanded by 15% since 1994, and unemployment fell to 12.4% in October 1998. Nevertheless, the sustainability of the system was in need of a growth rate in exports for which the economy could not effectively generate. The growth of exports between 1992 and 1998 was not enough for the repayment of the debt. Indicators of debt sustainability started to deteriorate well before the worsening of the international financial situation. While most emerging countries reduced their foreign debt/exports ratio after the Tequila Crisis, Argentina's ratio increased by 20% in 1994-1998. Additionally, the average debt maturity went from 35 to 7 years between 1994 and 1998 (Gerchunoff & Llach [2005] pp.446-7 & Panigo & Torija-Zane [2004] pp.49-50). Also, there was a progressive deterioration of provincial finances. Although the federal budget was brought into balance, uncontrolled provincial expenditure destabilized the national accounts. The federal government was unable to enforce fiscal discipline on the provinces. The problems for Argentina started unfolding in August 1998 with the Russian currency crisis. It seemed that the optimism of capital market indicators towards emerging markets would not recover as fast as they did with the Tequila Crisis. By the third trimester of 1998, Argentina was entering a recession.

In December 1999, Fernando De la Rúa of the Alliance for Work, Justice and Education (a coalition of the UCR, Frepaso¹¹ and other smaller political parties) became the new president of Argentina. The first objective of the new government was to instill trust in markets so as to revert the outflow of capital reflected in an increasing country risk premium, which hindered the way to economic recovery. For this purpose, the emphasis of the Minister of the Economy lay on fiscal austerity. Even though a policy of belt

tightening during a recession is usually considered to be counterproductive, the thinking of the government was that budgetary prudence would lead to a lowering of the country risk and that the expansionary effects of a drop in interest rates would largely surpass any recessive influences that might be caused by the fiscal tightening. Nonetheless, the fiscal austerity measures were not able to attract capital or reactivate the economy. Gradually, the Argentinean economy was becoming the focus of attention of international investors as a possible candidate for defaulting on its financial obligations.

But, why were interest rates not going down? There are several factors which can be mentioned: first, markets were starting to be in doubt about the technicalities of sustaining the Convertibility plan, especially after 1999, as debt service and the fiscal gap were in need of additional borrowing; second, the growing demands of the government for credit kept rates high; third, the presence of corruption which increasingly permeated the political system. These factors raised the cost of doing business in Argentina undermining confidence in the political sustainability of the system. From 1991 to 2001, the fiscal deficit averaged 2% of GDP. Under a currency board arrangement, a fiscal deficit of this magnitude can be sustained for one or two years, but not for a whole decade (Lewis [2002] p.171).

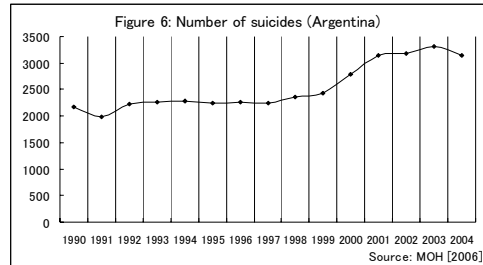
In March of 2001, the banking system was witness to the largest ever monthly withdrawal of deposits – US\$5,500 million. In the last quarter of 2000, some US\$2,000 million had already been withdrawn. At the height of the Tequila Crisis the peak had been US\$4,600 million. In comes Domingo Cavallo, Menem's former Minister of the Economy to save the day. Cavallo made a decision to adjust the Convertibility Law and modify the Central Bank Charter. The consequences of such an announcement were not positive since it was perceived as a debilitation of the commitment of Argentina with Convertibility. Between April and mid July there was a massive outflow of reserves of almost US\$10,000 million. This caused a remarkable shrinkage of the domestic money supply, which in turn led to a further credit crunch. Cavallo insisted on his policies and so, through the implementation of the *Plan Cero Déficit* new taxes were introduced and public sector salaries and pensions were reduced in order to bring the federal budget into balance. But raising taxes and cutting expenditure during a recession was likely to worsen the state of the economy, further aggravating the recession, reducing tax receipts, creating a necessity of further tax hikes or reducing expenditure to close the fiscal gap, and so on. Finally, by the end of the year, in order to prevent a bank run, Cavallo implemented the *corralito*, a partial freeze of bank accounts for 90 days, which permitted depositors to withdraw only 250 pesos per week.

The situation got out of hand by the end of December with public demonstrations against the

government which were violently suppressed, looting of shops and riots which left around 30 people dead. This led to the resignation of Cavallo followed by De la Rúa. The opposition Peronist Party took charge of the government. In the last week of 2001, President Adolfo Rodríguez Saá – who did not even last a week in power – declared a moratorium of Argentina's public debt, marking this as the biggest default in history, amounting to almost US\$200,000 million¹². In the first week of 2002, President Eduardo Duhalde announced the end of Convertibility. This marks the end of the second neoliberal reform program which brought a second Lost Decade to Argentina.

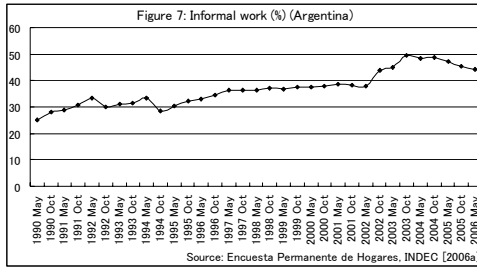
At that time, Argentina was going through its worst crisis ever. Between the second half of 1998 and the start of 2002, GDP had fallen 20% and the rate of unemployment stood at 21.5%. In 2001-2, the public debt climbed from 74% to 193% of GDP (mainly due to the devaluation of the peso, the fall of GDP, 'pesification' of debts and issue of various compensatory bonds). In the abandoning of the Convertibility system the peso was devalued, the debt moratorium was ratified, and private dollar denominated debts (including loans in the *corralito*) were pesified (converted to pesos) at the rate of 1.40 pesos to the dollar while loans in dollars were pesified at a rate of one to one. The difference of this asymmetric pesification was assumed by the Central Bank which was obligated to issue a compensatory bond estimated at around 14,600 million pesos. The State reappeared as a central agent concerning the redistribution of wealth. These forced conversions originated an avalanche of lawsuits which sought to have the deposited dollars returned as dollars and not as pesos. The Minister of the Economy, unable to contain the continuing draining of deposits from banks caused by the lawsuits, not having succeeded in obtaining fresh funds from the IMF and without political support in the Senate, resigned on April 23. By that time, the exchange rate in the open market was hovering around 3.45 pesos to the dollar, sparking inflation which reached 41% in 2002. The new Minister of the Economy Roberto Lavagna modified monetary policy in order to further regulate the liquidity of the system, the draining of banks was reduced by the promulgation of a law and the exchange rate was brought under control by a managed floating system. Capital controls were also reintroduced. On the fiscal side, in order to finance itself, the State introduced levies on exports. In February an agreement was reached between the central government and the provinces to restructure their debts and reduce their fiscal deficits by 60%.

The social impacts of the crisis were devastating: in October 2002 the poverty rate reached 57.5% of the population. The number of suicides increased by one third between 1999 and 2001. Children started dying from malnutrition. This is very paradoxical for a country, once considered the breadbasket of the world, which is able to produce food for its population many times over. This will severely limit the capabilities, as



defined by Sen [1999]¹³, of future generations of Argentines. Another phenomenon of this crisis is the appearance of *cartoneros*, whose lives depend on the garbage they collect daily from the street. They are unemployed workers who earn a living by collecting carton or cardboard and selling them to recyclers. Around 4500 tons of garbage are generated in Buenos Aires each day. The *cartoneros* collect approximately from 9 to 17% of it (L'Estrange [2006])¹⁴.

In the 2003 presidential elections, Néstor Kirchner was elected. In the formation of his cabinet, he decided to keep Lavagna as Minister of the Economy, who continued with his policies towards the stability of prices and the exchange rate. He is credited with much of the recovery that Argentina is going through now. Argentina's new pattern of growth is characterized by a de facto protection of domestic production by the new exchange rate, technological imports unbiased towards labor saving technologies, and new fiscal instruments (such as export levies) which have led to a fiscal surplus creating a buffer stock that has allowed the implementation of policies of income distribution (such as the PHHJ program¹⁵). The new political context includes a redefinition of the state by which monetary sovereignty was recovered, capital controls established, the foreign debt reprogrammed, and social programs implemented (in employment, labor relations, social dialogue, etc) (Kostzer [2005]). The economic recovery was due initially to the substitution of imports by domestic production, high prices of commodity exports, devaluation and the existence of much idle capacity, but was soon taken over by the components of domestic demand, in particular investments and private consumption. The 'wealth effect' created by assets held by Argentines outside of Argentina, estimated at US\$ 125 billion, greatly contributed to the recovery of investments and private consumption (Damill & Frenkel [2006] p.117). The economy grew by 8.8%, 9% and 9.2% in 2003, 2004 and 2005 respectively. The economy is estimated to grow no less than 7.5% in 2006. Argentina successfully restructured its foreign debt, reducing it from US\$ 208.2 billion in December 2004 to US\$123.6 billion in early 2005. As a result of this, the reduced foreign capital outflows necessary for debt repayment also contributed to the economic recovery. In this new context, the unemployment rate was cut in half from May 2002 to May 2006 (with and without



including the PJJH subsidy). Although there is still a high proportion of informal jobs, most of the new employment being created is in the formal sector. Poverty levels although still high, have decreased to 31.4% in the second semester of 2006.

III. The Neoliberal Cycle in Japan

3.1 The bubble economy and Hashimoto's reforms

The 1990s are considered as a 'Lost Decade' in Japan. In that decade, Japan entered a long-term economic stagnation that became structural, with continuous financial and fiscal crises, deflation, worsening of employment indicators, and a widening income gap. The causes of the Lost Decade emanate from the rise and fall of Japan's 'bubble economy' as a direct result of various policies of financial liberalization that began to be implemented in the middle of the 1980s. These policies include a series of liberalization, deregulation and supply-side policies, i.e., policies contained within the framework of a neoliberal reform.

Japan's liberalization and deregulation process has been going on for a longer time than Argentina. In 1955, by joining GATT, Japan gradually liberalized trade. In 1964, it joined the IMF and OECD, starting to deregulate foreign currency transactions and to liberate direct investment, respectively. In the 1970s, a process of financial liberalization was initiated, picking up speed in the 1980s. Also in the 1980s, the privatization of state enterprises was promoted leading in the 1990s to an easing of regulations where no sector was left untouched. The financial liberalization created the setting for the appearance of a speculative boom, the bubble economy, which collapsed, and together with further liberalization and deregulation of the economy, contributed to Japan's Lost Decade.

The bubble economy is usually attributed to the Plaza Accord which highly increased the value of the yen, prompting the government to apply ultra-easy measures of credit expansion to forestall a loss in competitiveness in foreign markets. In this context, the previous institutional background of the financial liberalization must also be considered (Itō [1987, 1988], [2000] chapter 3, Miyazaki [1992], Haga [1993] & Yoshitomi [1998] chapter 2).

At the end of the high growth era, the increase in internal reserves that went along with the

movement away from reliance on banks by big companies for corporate capitalization accelerated the process of the liberalization and deregulation of capital markets. This, together with the liberalization of interest rates and the deregulation of intra-industry regulations, intensified the lending race by financial institutions. Also, before the financial liberalization, under the so-called 'convoy fleet approach', restrictions to competition and bankruptcy rules constituted some relatively mild prudential regulations. In this way, after the liberalization, this continued institutional inertia promoted an unhealthy competitive environment for the operations of financial institutions. Finally, with the abolition of the 'principle of real demand for currency trading' and of regulations of conversion into yen, it became possible, through the use of equity finance in euro markets, to procure huge amounts of funds with negative interests rates, which were later used for speculative purposes (Itō [1987,1988], [1999] pp.22-3, [2000] pp.77-79, Kaneko [1999] pp.25-6).

With the above mentioned reasons coupled with the ultra-easy monetary measures, in 1987 financial institutions started to give credit loosely to real estate companies for land financing and for speculative investments by big companies. Asset prices (stock, land, golf club memberships, art objects) experienced an enormous rise in value, which was not reflected in real economic activity, leading to what became known as the bubble economy (Yanbe [2005] p.94).

The bursting of the bubble came about after a change in monetary policy. Stock prices reached a maximum in December 1989 and the price of land did so in January 1991. With the change of monetary policy and the fall in asset prices, the economy went into recession in February 1991 until November 1993. The fall in asset prices and the associated recession had an adverse impact on bank's balance sheets. Financial institutions were saddled with a massive nonperforming loan problem. For many years in the post-bubble period, the government tried to compensate by preventing the economy from worsening and in this way contributed to the economic expansion of 1994-96. The government started on a course of successive decreases of the interest rate to boost activity, but the effects were not very perceptible at first. From 1991 to 1993, the interest rate was lowered from 6% to 1.7%. Finally, at the end of 1993, the economy started growing again. The interest rate was further lowered to 0.5% in 1995. The economy grew a healthy 3.4% in 1996, it was believed that Japan had recovered and got back on track. However, in 1997 Japan entered another recession, caused by the implementation of a 'small government' oriented pro-supply side fiscal structural reform, marking the start of a new NLC. This change in policy was done in the context of Ryutaro Hashimoto's 'Six Major Reforms' in government administration, economic structure, financial system, fiscal structure, social security, and education. In particular, the reforms in the financial system and social security

had the most impact in economic activity. The main factors in the economic downturn consisted in expenditure cuts, a hike in the consumption tax, and a repeal of special taxes. In addition, as a part of the reform of the social security system, an overhaul of the medical system was carried out where people were made to pay for 20% of their medical bills (up from 10%). This is the first time in the postwar years that an economic slump was caused 'unintentionally' by government policy (Yanbe [2005] pp.99-100 & 109-11).

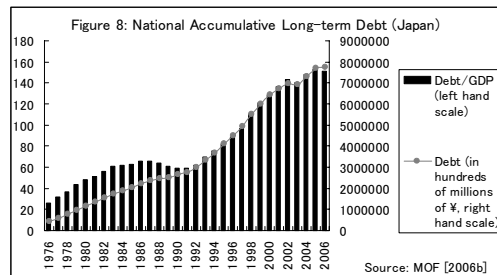
Even though Hashimoto's 'Six Major Reforms' did not completely bring about the recession, it did make it more severe. This happened through a 'big bang' reform of the financial system. This reform, which changed the foundation of the financial system and the whole concept of management of financial institutions, made the system even more permissive than heretofore. The task of surveillance of the system by the Ministry of Finance was minimized and left increasingly to market forces (Yanbe [2005] p112). The progressive liberalization brought about a squeezing of profits and together with increasing speculation by foreign corporate investors, led to a crisis of the financial system which spread to the economy, marking the next stage of the NLC (Yoshitomi [1998] p.145, Yanbe [2001] pp.34-6).

By the end of 1998, the government under Keizo Obuchi was forced to introduce certain compensatory policies by making changes in the fiscal policy through the implementation of huge tax reductions and large scale public works. The enforcement of the Fiscal Structural Reform Law was suspended, but not completely since a tax reform was carried out which favored the wealthy classes and enterprises and elevated the burden borne by the middle and lower classes (Gotō [2002] p.106). There was also a reversal in the direction of the monetary policy. Huge public funds were used for the stabilization of banks. The government did a 180 degree turn from previous policies fully involving itself with the economy. Special credit guarantees were given in support of small and medium enterprises. The Bank of Japan lowered the interest rate to zero to ease credit expansion and reverse the recession. The economy started recovering on January 1999 led by exports and corporate investments (Yanbe [2005] pp.115-7). The expansion was short-lived, lasting only 22 months, ending on November 2000. One of the reasons for this was a slowdown of the US economy which hurt Japanese exports causing companies to reduce their investments, sinking the whole economy into recession. Japanese companies could not expect the sluggish increase in domestic consumption to take the place of falling exports. Another reason is the change of government to Yoshiro Mori and his subsequent change of policy from a fiscal policy of economic boosting to one of reduction of the budget deficit, which suppressed public investment. In addition, the decision to raise the interest rate was another factor in causing the new recession which lasted 14 months. This process of stagnation marks the end

of the NLC which began with Hashimoto’s reforms setting the stage for the next one under Koizumi. In the end, these tug of war interventions and retractions from the economy by successive governments in the 1990s created a political business cycle (Sano [2005] p.57) which in the end eliminated any chance of a ‘normal’ business environment leading to Japan’s Lost Decade.

3.2 Koizumi’s reforms

A second wave of structural reforms by the government of Junichiro Koizumi, inaugurated on April 2001, has sought to promote an acceleration in reforms and bring about more radical social changes than the ones envisaged by the first wave of reforms under Hashimoto thus starting a third NLC. Koizumi called



for painful change through “reforms with no sacred cows” warning of “no growth without reforms” and attacked his own party urging to “change the LDP, change Japan”. This included disposing of bank’s non-performing loans (which led to the bankruptcy of many companies elevating the unemployment rate), restructuring regional finances, relaunching the fiscal reform, tax reform, etc.

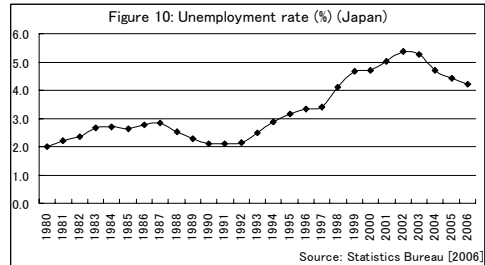
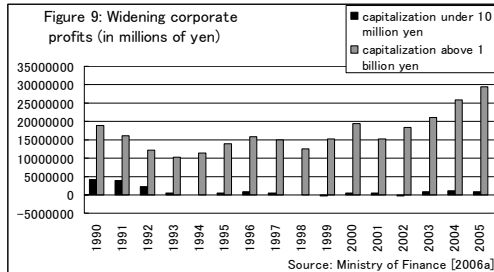
In connection with this is the dismantling of the so-called ‘developmentalist state’ in Japan. Starting in the 1960s, the developmentalist state, through the Comprehensive National Development Plan, helped develop Japan’s regions through the use of public funds in huge public works, decreasing income differences between rural and urban areas. The developmentalist state is a state-led market system guided by an economic bureaucratic apparatus aiming, through the management of the economy, to foster industry and protect agriculture (Gotō [2002] pp.13 & 134-7). This state, built up mainly by the LDP, is tightly connected to ‘money politics’ in Japan. Money politics concerns the circulation of funds – legally and illegally – through the LDP factions and onto party members and their districts. It was Kakuei Tanaka who, in the 1970s, turned money politics from a cancer into the system itself. After the period of high economic growth ended, public works which used vast amounts of state funds continued to be a hotbed for corruption well into the 1990s. After the collapse of the bubble, this situation worsened. The 1993 electoral reform tried to change the system in order to bring political corruption under control. Although somewhat reduced, corruption lingers on. Through a drive for ‘small government’, Koizumi has felt that the dismantlement of the developmentalist

state would be a right step in combating money politics. One step in this direction is the privatization of Japan's postal savings system whose funds, which finance Japan's "off-budget" expenditures known as FILP (fiscal investment and loan program), have been used by bureaucrats to advance their vested interests in useless public works (Gotō [2002] p.13) and in zombie companies (i.e., companies deemed to be too politically sensitive to be allowed to go bankrupt). The main objective in achieving a 'small government' has to do with improving public finances since at present the indebtedness of the government stands above 150% of GDP.

In 2002, the US was headed towards an economic recovery and China intensified its growth, boosting the demand for Japanese exports. From 2002 through 2003, public works were still being reduced, as a result of the reforms implemented by Koizumi, hindering any possible additional boost to the economic expansion. This explains in part the weakness of the recovery which started on January 2002. Another factor is that only demand by enterprises was recovering, demand by households remained sluggish. The reason for this is mostly due to lower household income which had been steadily decreasing since 1998. Nonetheless, it was thought that through the reforms in place, if companies did well, this would spread to labor through an increase in wages and in employment thus favoring household economies. This had been the case in postwar Japan up to the mid 1990s. Since then, an improvement in the corporate sector has not necessarily spread to the household sector. Quite the opposite has happened: companies are doing well to the detriment of households. This is what characterizes the present economic expansion in the context of the neoliberal structural reform (Yanbe [2005] p.128).

According to pro-reformists, until the 1980s, the structure of Japan's supply side of the economy corresponded well with the external sector, hence its high growth rate. But things changed quickly in the 1990s. In order to overcome the long term depression, the structure of Japan's economy should adapt to the new changes in the world arena. But what should be done? The most important points concerned removing obstacles to the operations of corporations and letting market principles work. For these purposes regulations should be eased. The main point in the reforms had to do with the strengthening of the supply side of the economy by lowering entry costs, decreasing taxes and reducing personnel costs (through deregulation of the Labor Standards Law). Also, by reducing taxes and social insurance contributions, the government hoped to achieve a 'small government'.

Koizumi's government continued with this policy of strengthening the supply side of the economy but divided it in two: a growth sector and a stagnant sector. Resources should be used to stimulate the growth



sector away from the stagnant sector. Resources from the stagnant sector (industries with nonperforming loans, with inefficient low profit structures, real estate, construction and distribution industries) should be transferred to the growth sector (life sciences, information and communication, environment, and nanotechnology industries). Everything should be done to stimulate the growth sector (such as lower taxes for investment) while eliminating as much as possible the stagnant sector (in particular, the problem of nonperforming loans should be solved as quickly as possible¹⁶). But according to Yanbe [2005], Japan has a surplus of resources (labor and capital), there being few cases where resources are piling up in the stagnant sector to the detriment of the growth sector. In the 1980s, the process of transfer of resources from non-profitable to profitable sectors contributed to the high growth in the economy. But why, despite deregulation in the 1990s, has that transfer of resources not continued? Koizumi by promoting a boosting of the economy through reforms promoted an intense flow of resources into the growth sector. Despite this, the growth sector failed to achieve the expected growth, bringing to light some of the errors of Koizumi's reform.

With the emphasis on market principles and competition, the gap between companies has widened. Business indicators show that big companies are doing very well whereas small and medium companies are not. Most noticeable is their growing gap in profits which has multiplied manifold. In 1990, the combined current profits of big companies (capitalized above 1 billion yen) was 4.36 times the amount earned by small and medium companies (capitalized under 10 million yen), whereas in 2005 this proportion had increased to 31. The decline of profits in small and medium companies, which represented around 62.4% of all companies in 1990-2005, is more perceptible than the rise in profits of big companies, whose numbers corresponded to 0.2% of total companies (data from the Ministry of Finance).

In the drive for a 'small government', a process of decentralization has been promoted. Because of this, regional differences have widened due to the reduction of public investments and local allocation tax grants to local governments. Visible differences have sprung up among regions in Japan. Tokyo and Nagoya are doing well, but not the Kinki, Hokkaido, Tohoku and Kyushu regions. The differences in the regions

reflect the conditions of their main industries and are also related to their dependence on public works projects, which have been reduced by the central government. A contributing factor in regional decline is the repeal of the Large-Scale Retail Stores Law in 2000 which permitted general merchandising stores, such as Kmart and Home Depot, to spread into the inner regions of Japan, saturating the market and squeezing out local shops, which until then had fulfilled a very important role in the support of their communities (Yahagi [2005] pp.2-10). Regional differences can also be seen in the conditions of employment. Most of the new jobs offered (regular and non-regular) can be found in the central part of Honshu, from Tokyo, through to Osaka to beyond Kobe where the ratio of job offerings to applicants is above 1. It is in the extremities of Japan (Hokkaido, Okinawa, northern Honshu and parts of Kyushu and Shikoku) where the ratio is below 1 and people have a harder time finding employment¹⁷.

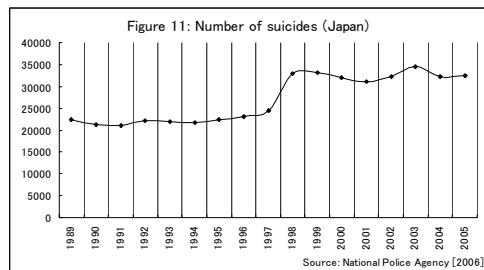
Starting in the early 1990s, the unemployment rate has risen to unprecedented levels in the post-war years. The composition of the workforce also changed with non-regular employment increasing its proportion on total employment. Likewise, the number of poor receiving welfare as well as the number of homeless people rose significantly. Moreover, since the 1980s with a tax system advantageous to the richest strata of society, the distribution of income has continued to become more unequal. With the 1999 tax reform, enterprises and high income groups got their tax burden reduced while middle and low income groups had theirs increased. This is good-old supply-side Reaganomics called “trickle-down theory”, which claims that rich people should be helped so they will contribute to the economy. As a result, the Gini index has steadily increased from 0.31 in 1981 to 0.38 in 2002. The increase in inequality can also be seen across and within social classes. If society is divided into four classes, a capitalist class, new middle class, working class, and old middle class, the first two classes, which comprise around 25% of members in society, are gradually receiving more income than the other two classes. The difference is even more striking between the capitalist class and the working class. Also, within classes, the poverty ratio has been increasing in the working and old middle classes and decreasing in the capitalist and new middle classes (Hashimoto [2006] pp.39, 96 & 98). During his government, Koizumi stated that social disparities were not bad per se if they are the product of fair competition. That would be true if everybody started from the same base (Shirahase [2006] pp.208-9).

Connected with this is the flexibilization of labor. With the economic recession still dragging on, certain work related social restrictions were eased, in other words, the long term employment agreement between labor and management so characteristic of Japan began to falter. According to a survey by OECD [2006], “Income inequality and relative poverty among the working-age population in Japan have risen to

levels above the OECD average. This trend is partially explained by labor market dualism – the increasing proportion of non-regular workers¹⁸, who are paid significantly less than regular workers¹⁹ – as well as by other factors, such as the ageing of the workforce²⁰. ... The impact of social spending on inequality and poverty is weak ... and inadequate to offset the deterioration in market income. The scope for increasing social spending is constrained by the fiscal situation. Instead, reversing the upward trend in inequality and poverty requires reforms to reduce labor market dualism²¹ and better target social spending on low-income households,”²².

Working conditions are worsening, control is weak, regulations are seldom applied, and the political restrictions of an originally lax labor market are becoming even more flexible. For example, the minimum wage level has fallen since the 1980s to below welfare provisions, also reducing itself by international standards. In 1997, 10% of workers received less than minimum wage. From 1995 to 2002, the number of people classified as poor receiving welfare increased by 50% (Tachibanaki [2004] pp.121-9).

Serious consequences of the ever-growing income gap are the rise in the number of suicides and a decline in the fertility rate. For eight consecutive years (1998-2005), the number of suicides has stood above 30,000, jumping from the average 22,000 of previous years. Likewise, the steady increase in low-wage, part-time workers and those in temporary jobs is



contributing to an already low birthrate as people become reluctant to marry because of financial insecurity, according to a report by MHLW [2006]. Also, although it seems incredible, 14.3% of Japanese children lived in poverty in 2000, compared with an OECD average of 12.2%. Given the high cost of schooling and private tutoring institutes, children in poor families are at risk of receiving an inadequate education, thus reducing their growth potential and perpetuating poverty across generations (OECD [2006] pp.115-6). One has to think why there are no protests or riots against these growing disparities, sharpest among Japanese in their 20's and 30's. The reason may be that most of these young people live with their parents. With free housing and food, those with temporary jobs, NEETs (not in employment, education, or training) and other ‘parasite singles’ can still afford to pursue a certain degree of personal interests (Onishi [2006]). This includes young people under 35 who are content with their present situation and who have no will or interest to succeed or better themselves in life (Miura [2005] p.6).

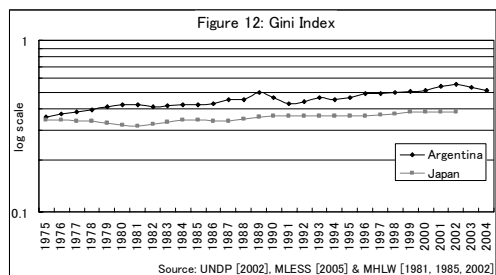
Given the results of the neoliberal structural reforms in Japan, on what legitimacy are they being

carried out? Some of these reforms might be necessary, but they may be going too far, favoring the rich and those with connections at the expense of the average Japanese. When Koizumi assumed as prime minister, he asked the Japanese people to endure today's pains so as to create a better tomorrow by pursuing much needed reforms. But people are disappointed and angry because through these reforms, certain government officials have advanced their own particular interests, such as Bank of Japan Governor Toshihiko Fukui who profited in shady dealings by investing in a fund set up by Yoshiaki Murakami, a financier and former government bureaucrat, arrested for insider trading. This is but one of the scandals which put into doubt the neutrality into which reforms are being implemented, showing the darker side of Koizumi's reforms. Fukui and Murakami are but the tip of the iceberg in relation to people connected to the government who profited personally from reforms under some sort of 'crony capitalism' in Japan (Tokumoto [2006] p.113).

Now that Shinzo Abe is at the helm of the government, it remains to be seen how far he intends to go with reforms and what remedies he offers to offset the growing social problems associated with them. Abe has said he will follow and expand on Koizumi's reform policies. But he will make certain adjustments in face of the growing criticism that gaps between haves and have-nots widened in Japanese society during Koizumi's more than five years in office. Abe has launched a "rechallenge society" initiative aimed at helping the unemployed or failed entrepreneurs make another try.

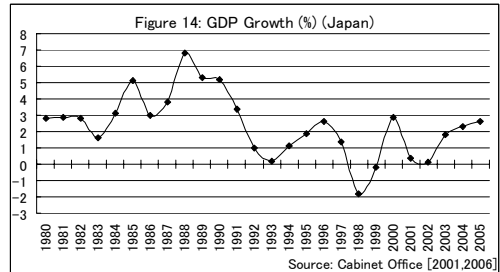
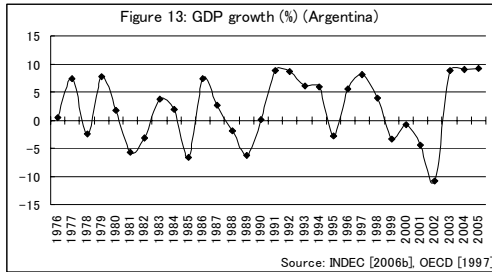
IV. Conclusion

Why are the Japanese accepting docilely the widening gaps in Japanese society brought about by deregulation, the flattening of tax rates and liberalization of capital movements? Reasons for this include the deluded claim that deregulation will magically eliminate the postwar bureaucracy whose corruption and other scandals, along with the feeling that they constitute an elite or chosen people, have aroused public anger. It's true that some changes are necessary in how the bureaucracy operates in the government, but must these changes be generalized over all aspects? Must the public nature of labor, welfare, medical care, and education be put under examination? This is what constitutes the "reform with no sacred cows". Also, respected and supposedly neutral economists are backing the reforms pushed in by Koizumi



who with his own personal consultative group fooled the public with attractive catch phrases splashed all over the media. The last to be mentioned is the change, by former Prime Minister Morihiro Hosokawa in 1993, of the electoral system in order to eliminate money politics, from multiple-seat constituency system to single-seat constituency and proportional representation system (Gotō [2002] p.95). Koizumi took full advantage of the new system and so on September 11, 2005 he called for elections on account of the refusal of the House of Representatives to pass a bill for the privatization of Japan Post. As president of the LDP, he handpicked candidates, branded as “assassins”, to defeat rebel LDP legislators in their own constituencies. This strategy was largely successful, with the majority of the “assassins” elected within the rebels’ former constituencies (Uchihashi [2006] pp.64-72).

In this way, Japanese democracy under Koizumi may have regressed, to some degree, to being a delegative democracy²³. According to O’Donnell [1997, pp.293-295 & 299], delegative democracies are grounded on one basic premise: a leader who wins an election is enabled to govern the country as he sees fit, and to the extent that existing power relations allow, for the term to which he has been elected. What he does in government does not need to bear any resemblance to what he said or promised during the electoral campaign – he has been authorized to govern as he sees fit. Since this paternal figure has to take care of the whole nation, it is almost obvious that his support cannot come from a party; his political basis has to be a movement²⁴, the supposedly vibrant overcoming of the factionalism and conflicts that parties bring about. Delegation includes the right – actually, the obligation – of applying to the nation the tough medicines that, even though many of its members cannot recognize it now, will heal it. A deep social and economic crisis is the ideal terrain for unleashing the delegative propensities that may be present in a given country. Such a crisis generates a strong sense of urgency. Leaders get elected promising that they, being strong and courageous, having the capacity as well as the foresight to lead, and being above parties and interests, will save the country. This leads to a magical style of policymaking: the delegative “mandate” to rule supposedly emanated from the majority. A strong political will and adequate technical knowledge should suffice to fulfill the savior’s mission and, in this way, “packages”, economic programs, or “reforms” follow as a corollary. Delegative democracies refer more to Latin American democracies such as Argentina under Menem. But maybe, by thrusting reforms top down like Koizumi did, through the Council on Economic and Fiscal Policy whose members he could personally choose without scrutiny, instead of negotiating and securing agreements as Hashimoto did, democracy in Japan may have become delegative. It seems that Koizumi wouldn’t take ‘no’ for an answer with respect to his policies and so whenever he found himself to be in a disadvantageous



position against his opponents within the LDP or in the opposition, he turned the tables by taking his case to the people to win their overwhelming support, hence the 2005 election.

Among the reforms implemented in Japan up to now, the most damaging ones concern the liberalization and deregulation of financial markets and its corollary in the labor market. In this last one, in order to reverse the rising social inequality and create a pro-growth environment for the economy, many steps can be taken, such as lowering the unemployment rate, stabilizing employment, reducing non-regular employment, offering more training, allowing workers in temporary employment to become permanent ones, reducing long working hours, and helping the poorest segment of the population by giving greater social coverage. For this, the Labor Standards Law could be strengthened. In overcoming relative poverty, certain steps include targeting social spending on vulnerable groups and reforming the tax system by making it more progressive. But how can employment be increased? Some institutional changes might be necessary. One idea is to reduce working hours in a way that has been done in France and Germany thereby creating the need to employ new workers (approximately 8,000,000, effectively lowering the unemployment rate to zero). In previous times, whenever there was an economic expansion, wages would grow, but since 1999 that has not been the case. Other measures can also be taken, such as paying wages in accordance to the amount of time actually worked, including overtime²⁵. If unpaid overtime were actually paid, it would amount to 10 trillion yen, amounting to 3.8% of total wages (for the year 2003), representing a considerable increase in income (Yanbe [2005] p.198).

The culprit of Japan's woes can be found in the financial liberalization which led to the formation of a speculative bubble and its collapse. The 1997-98 financial crisis further worsened the situation. Does Japan have enough prudential regulations against the onset of another crisis or is it still too exposed? For example, it was feared that Japan's economic recovery might be undermined by the first ever early closure of the Tokyo Stock Exchange on January 19 2006 due to a selling frenzy caused by an investigation into Livedoor Co. Perhaps Argentina's example in the reinstatement of certain regulations can show Japan against

the disastrous consequences of leaving financial systems blindly to market forces. Thanks to the establishment of capital controls, Argentina may have acquired a certain degree of stability in its growth pattern. Argentina in the 20th century has had a very unstable pattern of growth, due in part to the absence of mechanisms of countermeasures against external shocks. This unstable pattern of growth was named the 'Argentine economic cycle' by the economist Raúl Prebisch. At first, the oscillations in GDP growth were caused mainly by instability in exports and capital movements and not by investments (O'Connell [2001] p.58). In the first decades of the 20th century, Argentina's economy was very open, its trade to GDP ratio was around 50%. Gradually, as the country started to close itself to the world, external price shocks to its commodities started losing weight as capital flows gained importance in originating external shocks (particularly in the 1970s, after the oil shocks) (Arriazu [2003] pp.113-9). This coincides with the establishment of the first neoliberal reforms in Argentina and the subsequent financial liberalization which brought increasing amounts of foreign capital and vulnerability to the economy, marking the beginning of the NLC. If figures 13 and 14 are compared, Japan's pattern of growth is starting to resemble Argentina's. This is a result of the "neoliberal policies → crisis → compensation policies → neoliberal policies" sequence applicable to both countries, but with capital movements having a special importance in Argentina.

Perhaps Argentina's present economic expansion can in some way give hints to Japan as to the possibility of growth and expansion away from neoliberalism, whose results appear to be abating social disparities to some degree. Argentina has its own problems, characteristic of a developing nation, quite different from Japan, a world economic power. Argentina used to be among the richest nations at the start of the 20th century, but because of political and economic mismanagement due to the lack of a good institutional development, it devolved into what it is today. The last 30 years in which neoliberal policies were enforced have been the hardest. Without a doubt, Argentina's NLC proved to be far more disastrous than what Japan is experiencing now. In particular, the Convertibility system had nefarious consequences on the economy, which together with the opening of foreign trade aggravated the loss of competitiveness of existing industries and prevented other activities in the export and import substitution sectors from developing, intensifying the adverse effects on employment. The overvalued exchange rate exaggerated the incentives to reduce labor per unit of production within companies, since it additionally lowered the relative price of inputs and imported machinery relative to the cost of labor (Damill & Frenkel [2006] p.119). Argentines, it seems, have learned their lessons and broken free from the vicious NLC (unless one considers the present recovery and economic expansion to be just compensatory policies leading to the next bout of neoliberal reforms). It's true that

Kirchner has a certain tinge of populism and has been accused of being “more interested in bashing creditors and the IMF than in devising social policy” (Castañeda [2006] p.39), but his policies appear to be paying off lowering poverty and increasing employment. Abe with his ‘rechallenge’ initiative has recognized that the problems associated with reforms have to be addressed, just as much as Menem did in the latter half of the 1990s, but it has to be done within the frame of the neoliberal program. Are Japanese ever going to wake up and see the reality of the neoliberal policies thrust upon them? With this, where is Japan heading with its huge public debt, low birth rate, aging population, and growing social disparities? Will Japan depend solely on its huge reserves of wealth created during the fifty years of high-speed growth? Can Japan’s present expansion (economic growth with no tangible benefits in the daily lives of most people) be considered optimum? Or, does it represent the calm before the storm?

Endnotes

- 1 An idea first proposed by Professor Makoto Sano of Niigata University.
- 2 According to the newspaper *La Opinión*, in that month of March there was a political assassination every 5 hours and a bomb went off every 3 hours. In December there had been 62 deaths originating from political violence. In January they climbed to 82 and in February they reached 105. Novaro, Marcos & Vicente Palermo [2003], *La dictadura militar 1976-1983: del golpe de Estado a la restauración democrática*, Buenos Aires: Paidós, pp.17-8.
- 3 The immediate motive of the *Proceso* was the elimination of armed groups and subversives, in particular the ERP (*Ejército Revolucionario del Pueblo* – People’s Revolutionary Army) and the peronist *Montoneros*. Gerchunoff & Llach [2005] p.350.
- 4 Workers account for 30.2% of those disappeared, employees 17.9% and professionals 10.7%. CONADEP [1984], *Nunca Más – Informe de la Comisión Nacional sobre la Desaparición de Personas*, Buenos Aires: Eudeba, p.296.
- 5 Exceptions are 1954, 1960, 1968 and 1969. For example, in 1976 the real interest rate was -57%. This implied for the lender losing more than half of his capital in one year. Gerchunoff & Llach [2005] pp. 359-60.
- 6 The share of manufacturing over GDP shrank even further to 26.1% by 1989. OECD [1997].
- 7 The Radical Civic Union (*Unión Cívica Radical, UCR*) is a major centre-left political party in Argentina. Founded in 1890, it is Argentina’s oldest political party.
- 8 During the first two years of the Alfonsín government, real wages increased by 21% despite any advances in productivity. Distribution struggles were intense and strikes became common practice. However, they were not very effective, and they could not prevent a steep fall of real wages in the following years. Panigo & Torija-Zane [2004] p.42.
- 9 The Peronist Party (*Partido Peronista*) was founded by Juan Domingo Perón in the 1940s. It is a traditionally nationalist and pro-labour party (but during the 1990s, it departed from its roots and was supportive of neoliberal economic policies).
- 10 On April 7 1992, Argentina entered the Brady Plan which permitted the restructuring of its debt with private banks to 15 years for debt service (approximately US\$8,300 million) and to 30 years for capital (approximately US\$20,000 million). Rapoport [2000] p.984.
- 11 The Front for a Country in Solidarity (*Frente por un País Solidario; Frepaso*) is a moderate leftist grouping of dissident Peronists who split from the Peronist Party in the 1990s.
- 12 Payment to multilateral organizations was continued, only the remainder, which was in the hands of private holders, was considered to be in default. Parodi Trece, Carlos [2003], *La crisis argentina: lecciones para América Latina*, Lima: Universidad del Pacífico, p.158.
- 13 Capability, according to Amartya Sen, is “the substantive freedoms [a person] enjoys to lead the kind of life he or she has reason to value”. In this sense, “poverty must be seen as the deprivation of basic capabilities rather than merely as lowness of incomes, which is the standard criterion of identification of poverty”. Sen [1999] p.87.
- 14 The collecting and recycling activities that *cartoneros* do is not a recent phenomenon, but their explosive growth at the end of the 1990s is. L’Estrange [2006].
- 15 The Unemployed Men and Women Heads of Household Program (PJH) is a subsidy of 150 pesos given to unemployed heads of households in exchange for a minimum of four hours of daily work. MLESS (Ministry of Labor, Employment

- and Social Security) [n.d.], *Plan Jefas y Jefes de Hogar Desocupados*, Buenos Aires: MLESS.
- 16 At their peak in March 2002, the ratio of nonperforming loans over loans outstanding stood at 8.7%. By March 2006, they had dropped to 1.8%. Data obtained from the Financial Services Agency.
- 17 Although lately, the ratio of job offerings to applicants has gone up countrywide (Chiiki no Keizai 2006).
- 18 From 19% of employees in 1994 to 29% in 2004. OECD [2006] p.100.
- 19 On average only 40% as much per hour as full-time workers. OECD [2006] p.100.
- 20 The Cabinet Office acknowledges today's growing inequality but insists that it is mainly due to the aging of the population. The argument is that elderly people tend to have the widest income disparity, and the proportion of their age group on the general population is growing. Thus, the problem would be structural, related to the changes in the composition of the population, and not to the ongoing reforms. But in other age groups, in particular among young people, a growing income disparity can also be perceived. Also, the income disparity among the elderly is partly assuaged by the social security system, which raises their minimum standard of living. Moreover, they have generally accumulated significant wealth, in part to finance their retirement. Shirahase [2006] pp.211-212.
- 21 Halting this growing dualism may prove difficult given the limited mobility between the regular and non-regular segments of the labor market. OECD [2006] p.118.
- 22 The lower wages and non-wage costs of non-regular workers makes them attractive to firms. Another important motivation for hiring non-regular workers is to enhance employment flexibility. The flexibility afforded by using non-regular workers is needed to compensate for the high level of employment protection provided to regular workers. OECD [2006] p.97 & pp.101-3.
- 23 An idea suggested by Professor Makoto Sano of Niigata University.
- 24 In Koizumi's case it would be the need for structural reforms.
- 25 According to the 12th Questionnaire Survey on Work and Life of Workers, 37.4% of workers were not paid for their overtime work, although this is an improvement from the previous year which was 43.2%. Rengō Sōken [2006], *Dai 12 Kai Kinrōsha Tankan*, Tokyo: Rengō Sōgō Seikatsu Kaihatsu Kenkyūsho, p.24.

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