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Memo to the U.S.A. on Japan's Infrastructure Success

by Daisuke Kotegawa

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Feb. 10—In the United States, there is currently an intense debate underway on the issue of infrastructure. Having learned about the Hamiltonian approach to national banking from the American Occupation Army after the Second World War, Japan established the Fiscal Investment and Loan Program, which played a major role in the rebuilding of the war-ravaged Japanese economy.

Since Japan did not benefit from a Marshall Plan, we mobilized Post Bank savings and government pension funds as a major source of financing. While the ministries in charge of these funds preferred independent management, the Ministry of Finance, with the support of the powerful General Headquarters (GHQ) of the American Occupation Force under General Douglas MacArthur, established the "integrated management" of the Fiscal Investment and Loan Program by the Ministry of Finance. In addition, the Ministry of Finance oversaw the national budget, and established tax policies. This system of comprehensive management of the three major sources of credit for economic recovery was critical. It enabled a maximum utilization of the limited credit sources towards the objective of restoring the national economy.

Over the period of 50 years, from 1951 to 2001, the Fiscal Investment and Loan Program (FILP) accumulated extensive experience and understanding of the most effective use of funds for the reconstruction and

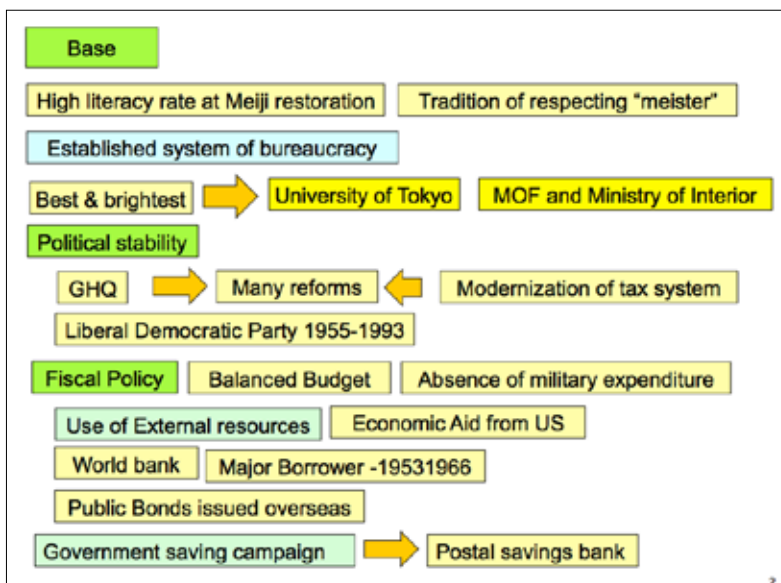
maintenance of different elements of the national infrastructure grid. This included a differentiated understanding of how to recover costs of construction, based on user charges and other revenue sources.

I was in charge of the program at its peak in the late 1980s and early 1990s, and learned a great deal from that experience. I offer the following observations and recommendations for my American friends, as they proceed to design and implement an urgently needed infrastructure program.

Economic vs. Financial Returns

The first critical point in designing an efficient program for government-assisted infrastructure investment is the need to differentiate between *financial returns* and *economic returns*.

A commercially viable project has sufficient positive financial returns to warrant private investment and



FILP's Role in the Growth

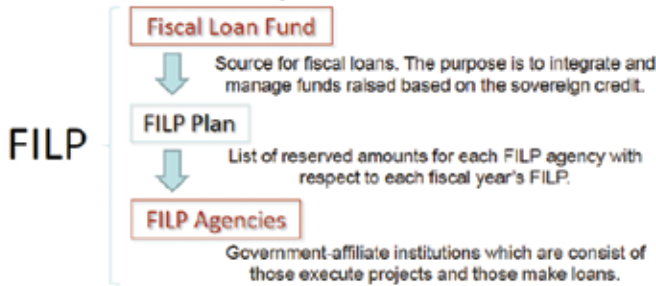
Early years of post-war recovery (until mid-1950s)

- Focused on fund provision to industrial plant and equipment investment
 - Helped reconstruct four prioritized industries
 - Shipbuilding
 - Coal
 - Steel
 - Maritime
 - Utilized post-war financial aid from the United States
- Established FILP agencies amid the recovery (next slide)
- With World Bank loans, 31 projects of infrastructure development were implemented (1953 – 1966).
 - Bullet Train ("Shinkansen") - Steel works
 - Highways ("Tomei" and "Meishin") - Hydroelectric dam ("Kurobe" dam)

What is FILP?

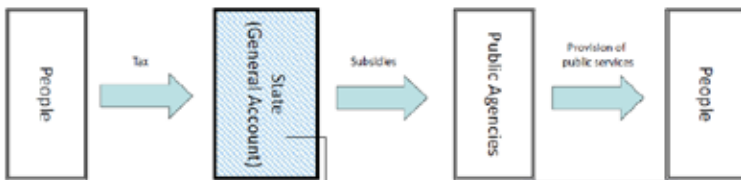
"Fiscal Investment and Loan Program"

- FILP utilizes financial techniques to bring together interest-bearing funds and the FILP agencies in the most effective and efficient way.

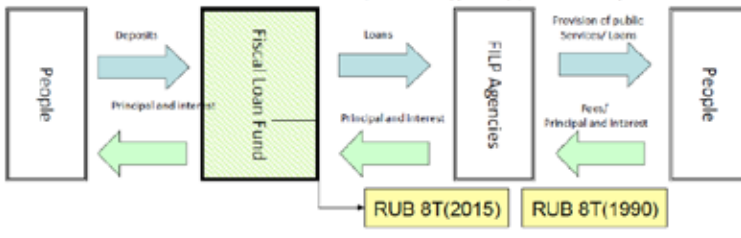


Grant Funds (Tax) and Loan Funds (FILP)

[Scheme of Flow of Funds in General Account Subsidies] (Grant funds) (i.e. Toll-free roads)



[Scheme of Flow of Funds in FILP]

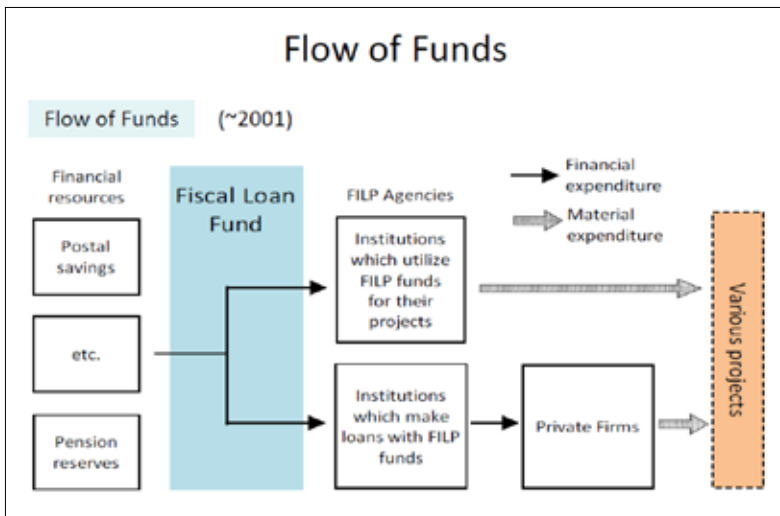


commercial loans as a means of financing. A good example is an airline business, which provides a vital transportation infrastructure service, on a busy route.

There are projects which are not commercially viable but which deliver positive economic returns for the general public and can contribute to an overall increase in economic efficiency and real growth over time. A good example is a ring road around an urban area. Such a modern highway is of great economic benefit, but the fees do not provide a sufficient financial return, therefore making the project not commercially viable. But such projects are economically viable and are appropriate for public financing.

Market fundamentalists argue that only financially viable projects are legitimate, and therefore "soft loan" programs involving government funding and loan guarantees are never justified. This is false. Take the example of an urban subway system. While investments to increase capacity, through the development of double-tracking or the construction of new lines may be commercially viable if increased ridership fees are large enough to justify commercial investments, on the other hand, the additional costs of investment in new subway cars, improved air conditioning, etc., although clearly beneficial to the general public, and are a source of increased productivity, do not represent commercially profitable investments at all. These are good examples of infrastructure needs that are best served by soft-loan programs based on government assistance.

Public-private partnerships (PPPs) can work for commercially viable projects but they are not appropriate for projects that are only economically viable. The frequently cited case of the New Jersey Turnpike as an example of a successful PPP is relevant. The New Jersey Turnpike is heavily used by commuters, long-haul trucks, and passenger cars, which pay sufficient tolls to cover depreciation costs on the initial investment, as well as operating costs. Other instances of PPPs being used to pay for highway projects, such as the Indiana toll road, failed be-



where there are large numbers of users who are prepared to pay for services. In contrast, it is extraordinarily difficult to identify PPP projects that can work in rural areas. Unless government-assisted investments are made in those areas that are not viable for PPPs, the gap in levels of needed infrastructure between urban and rural areas will grow.

Special Measures for Infrastructure Investment

The expected service-life of infrastructure projects like roads, bridges, and tunnels is 50-60 years. Borrowing money now, whether through commercial or government-assisted loan programs, is justified because the benefits to current and future generations from the improved infrastructure are greater than the costs of construction and maintenance in real economic terms.

because they are not able to generate sufficient toll revenues to cover the costs of commercially financed improvements.

During a period when privatization was gaining great popularity, Argentina won praise from the International Monetary Fund for President Carlos Menem's privatization of much of the state sector economy. Those privatization measures ultimately failed, and led to foreign takeovers and other consequences that damaged the interests of the Argentine people. The general welfare was damaged by the over-zealous privatization program. The Menem government failed to see that privatization was only one of a number of options for financing infrastructure, and it led to failure.

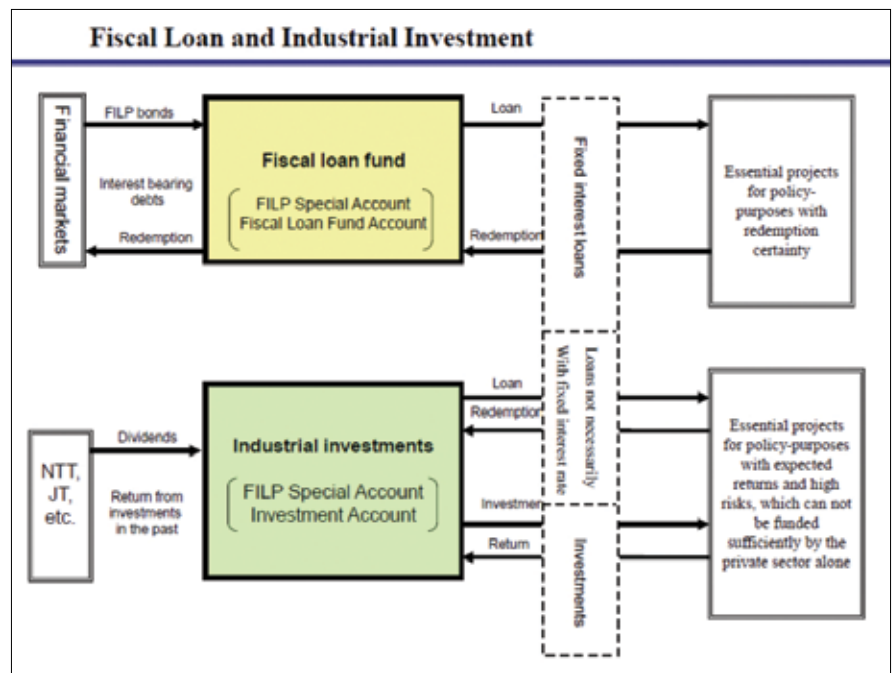
Failure to properly understand which projects are commercially viable and which are economically viable has led, in recent instances, to the intervention of vulture funds and the further decline in the welfare of the nation.

Effective political leadership must be based on a commitment to the general welfare. Such politicians can successfully argue for taxpayers' investment in infrastructure on the grounds that the economic benefits of such investments are worthwhile and will improve the conditions of life.

PPPs, in general, can be successful in areas of dense population

because the benefits to current and future generations from the improved infrastructure are greater than the costs of construction and maintenance in real economic terms.

Bonds for infrastructure projects can be issued at low interest rates when they are guaranteed by the government. These bonds can be equal to the yields on Treasury Bonds. The current low interest rates offer an excellent opportunity for large-scale infrastructure investment, as borrowing costs are at an historic low. In addition, the excessive liquidity in the market, created by the post-2008 quantitative easing programs of the



Background

1. History of FILP before WWII (-1945)

- Concept of Fiscal Loan Fund was created in 1870's, since private financial institutions were not developed.
- The investments resulted in a huge loss when the war was over.

2. The Fiscal Loan Fund Act (1951)

- Respond to demands for long-term funds for post-war reconstruction
- Three objectives are specified:
 - United Management of state funds
 - Postal savings, Pension reserves and etc. were required to deposit the Fiscal Loan Fund
 - Investment of funds in secure and efficient ways
 - The recipients of loans are limited to the government, local governments and government related institutions that are fully owned by the government.
 - Contribution to the promotion of public interest



future tax revenues that will come after the economy recovers.

Arguments Against Government Funding

Instead of increasing general tax rates, infrastructure construction in the United States can be financed by special-entity bonds, earmarked for infrastructure projects. With government guarantees, the bonds will be low yield. Such “infrastructure bonds” would be attractive to financial institutions, both domestic and foreign. They have the added advantage that they are investments in future economic growth, while regular Treasury bonds finance current operations. Increases in government debt associated with infrastructure bonds

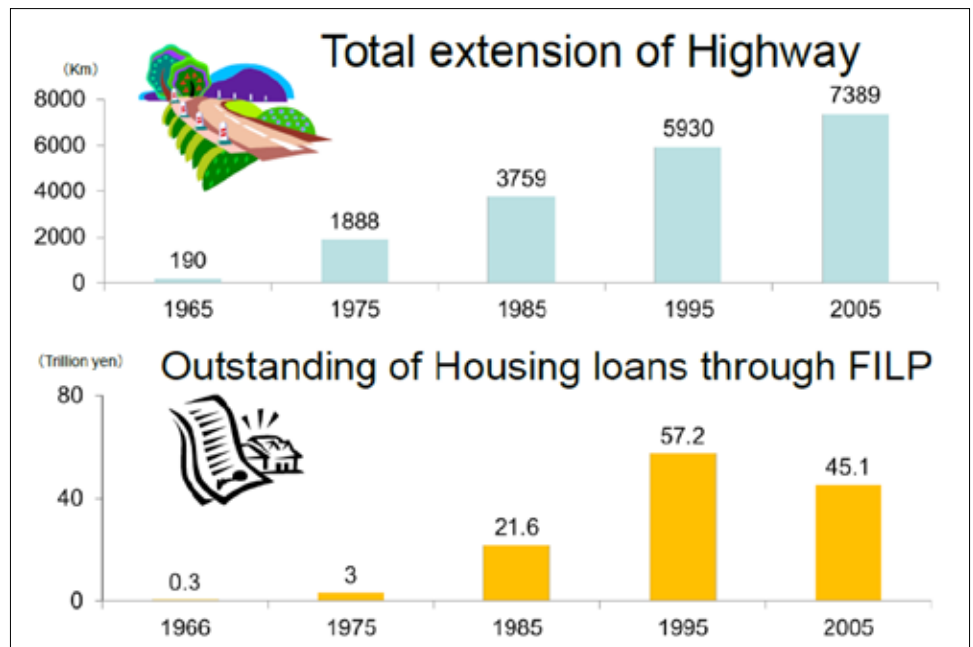
Federal Reserve and Treasury, can be channeled into infrastructure investments, rather than being used for bailouts, stock buy-backs, derivatives and other speculative activity.

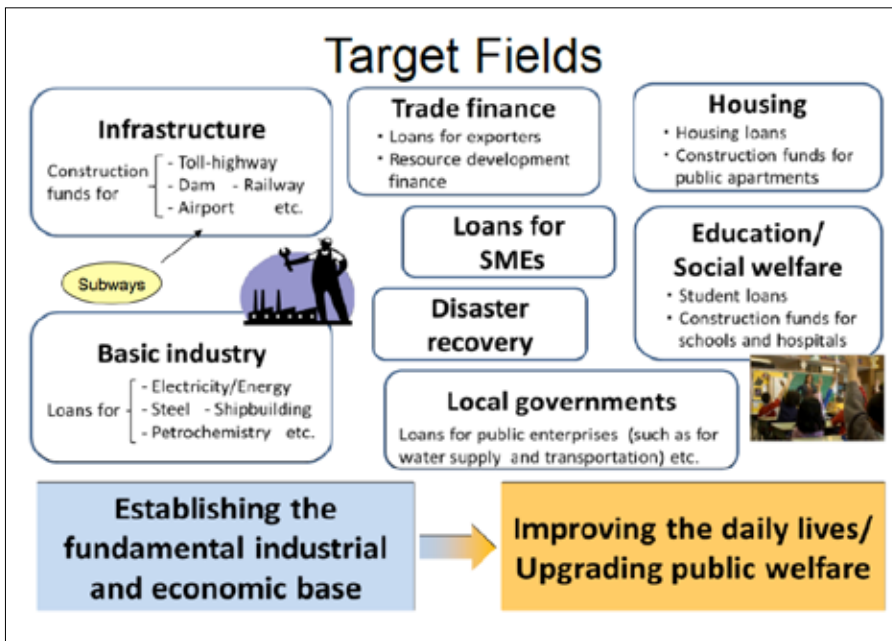
Infrastructure expansion and improvements create large numbers of productive jobs, and will boost household wealth and overall GDP growth. This is an instance where Keynesian stimulus can be effective, by reducing the unemployment rate, increasing disposable income and stimulating national economic growth. The risks to governments providing the new sources of investment are minimal compared to the benefits, if the infrastructure programs are properly conceived and managed.

In those instances where infrastructure investments cannot be paid for out of projected user fees, tax revenues can justifiably be used for financing. The use of such tax revenue sources was successful in Japan, when rural railroad lines were improved through double-tracking and expansion. This approach is also effective during periods of economic downturn, in which government-assisted loans can be secured by the

are not a burden, because they will grow the economy, and generate increased wealth and tax revenue. This is not the case with other government bonds, which cover operating costs and do not contribute to future economic growth.

While the United States does not have the equivalent of Post Bank savings and large public sector pension funds, this does not preclude efforts on the model of Japan's successful Fiscal Investment and Loan Program. A national infrastructure bank, authorized to issue infrastructure bonds secured by Federal govern-





crease the GDP of the United States. Such investments in other parts of the United States would produce the same increases in GDP.

Infrastructure investment in underdeveloped areas of the country spurs economic growth and new enterprises. Investment in infrastructure in these “new frontier” areas reduces costs of business expansion. Even a once-deserted area can be revitalized with new infrastructure, which would provide a better business environment at a lower cost. This would further close the gap between rich and poor.

Flood control and sewage management were important elements of Japan’s Fiscal Investment and Loan Program.

Power companies can make use of beneficial low-interest loans with long maturity to build dams and other vital water projects at lower costs. Protection of vital assets from natural disasters is a national priority, and timely investment in infrastructure reduces costs from natural disasters.

Flood control programs benefit agriculture, which suffers in the western United States from obsolete systems of irrigation. Demand for agricultural products is expected to increase rapidly, with the rise of Asian and African states as modern economies. The United States must be prepared to boost agricultural production with the assistance of improved infrastructure.

Concerns that Chinese investments in U.S. infrastructure bonds would give China increased political leverage over the United States are largely unfounded. Investments in infrastructure bonds allow for Chinese investment with less leverage than ownership of critical infrastructure.

Japan’s experience of half-a-century of postwar investment in infrastructure offers important lessons for those planning out the new U.S. infrastructure investments and methods of implementation. Given that the United States played such an important role in the immediate postwar recovery of Japan, which employed methods first developed during the formative years of the United States, these lessons should be readily adopted in the present U.S. efforts.

ment guarantees, would be attractive investments for individual retirement accounts, mutual funds, and private-sector pension programs. They would be as attractive for foreign investors as U.S. Treasury Bonds.

The continuing position of the U.S. Dollar as the world’s leading currency is a further reason that the United States can launch a large-scale infrastructure investment program without fear of speculative attack. At the same time, however, the Obama Administration’s sanctions against Russia have somewhat eroded the status of the U.S. Dollar, as nations wishing to maintain trade with Russia are seeking alternatives to U.S. Dollar-denominated transactions, to avoid possible asset seizures. If the United States continues to adopt such self-destructive policies, the strong position of the U.S. Dollar could, over time, erode. That could open the United States to speculative attack.

The lack of adequate infrastructure investment in the United States over recent decades has led to a reduction in potential GDP growth. Consider the following example: Amtrak trains take three hours between Washington and New York City, with frequent delays. The distance between Washington and New York is equal to the distance between Tokyo and Nagoya. The bullet train between those two Japanese cities takes one-and-a-half hours, and trains operate every seven to ten minutes. This creates a substantial amount of economic activity, spurring economic growth. Improved Amtrak service between Washington and New York would in-