Effect of 'Gesell' Taxes
in Promoting Japan's Economic Recovery

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I. Introduction

II. Japanese deflation since mid 1990s
- Gradually Accelerating Deflation
- Zero nominal growth
- Deflator fell eleven percent from the peak at the end of 1994
- GDP gap and projection of future deflation
  - Two Phillips curves

III. Monetary policy under deflation and zero lower bound
- Estimated reaction function of the Bank of Japan
- Rising real interest rates
- Demand for base money under deflation
  - Vertical demand curve at positive interest rates
  - Flat at very low interest rates
- Losing effectiveness of traditional monetary policy instruments

IV. Open market purchase operations under zero-lower bound
- Short-term risk-free assets:
  - Exchange of perfect substitutes: Cash and Treasury bills
  - No effects
- Long-term risk-free assets:
  - Marginally lower long-term interest rates
  - Very large risk for the Bank of Japan
- Stocks and REITs
  - A higher stock prices
  - May not last long if “flow” deflation continues
- Foreign assets
  - A weaker yen
  - Weak yen policy requires US consent
  - Requires massive intervention
    - Thirty trillion yen in FY 2003 was not enough

V Gesell tax and its effects

- Achieve negative nominal interest rates on safe assets
- Stimulate economy by raising tax
- Levy tax on all the government guaranteed financial assets.
  - Tax is levied on the balance of the asset.
  - Tax rate should be somewhat higher than the rate of deflation.
    - Two to three percent
  - Tax has to be levied repeatedly as long as deflation continues.
- Taxable assets:
  - All the central and local government liabilities
  - Central and local government bonds and other liabilities
  - All the yen liabilities of the banking sector
    - Yen cash payments on derivative transactions are taxable
  - Postal saving and postal life-insurance policies
  - Cash (BOJ notes)
  - Taxable assets: JPY 1500 trillion or 300 percent of GDP
- Taxation on cash
  - The Bank of Japan prints new bank notes and levy fees for exchange
- Non taxable assets include:
  - Stocks, real estate, corporate bonds, bank loans, foreign bonds, and consumer durables.
- Effects of Gesell Tax
  - Asset substitution
  - Shift assets
    - From "safe" assets to risky assets
    - From taxable assets to all the non-taxable assets:
  - Stock and real estate prices will rise
  - The yen will depreciate against foreign currencies.
  - Credit expansion
    - Banks will shift assets from BOJ deposits and government bonds to loans and corporate bonds.
    - Inter-corporate credit will also expand
  - Expectations effects
    - The expected nominal return on safe assets becomes negative

Different from negative discount rate policy

Banks will invest in cash with borrowed money from the BOJ.

Subsidy to banks

No effects on the real economy

VI. Conclusions

If Japanese economy cannot achieve mild inflation with this cyclical recovery, Japan may have to use Gesell tax

Gesell tax is easy to implement if paper cash is replaced with digital money.