

Matsukata Deflation

The monetary system of Meiji Japan was initially random and chaotic inheriting the gold, silver and copper money system from the Edo period, minting new coins but also issuing inconvertible government notes. There was no central bank, and the "National Bank" system was copied from the US which allowed officially certified private banks ("national banks") to issue currency notes provided that they held certain gold or silver as reserves.

Japan was using gold and silver as true money. Any paper notes or currency that could be exchanged freely for these precious metals (anyone can bring paper money to a bank or the government and get gold or silver with no questions asked) were called "convertible" notes and money with no such guarantee was called "inconvertible" one - just paper.

Before Matsukata's time, the government didn't have any guarantee of this kind so Japan was not on the gold standard although gold and silver were regarded as true money. Gold was internationally preferable as Europe and the US were moving toward the international gold standard, but silver was more popular for trade within Asia. So both metals were honored.

The problem of inconvertible money is government tends to spend too much (there is no restraint imposed by the limited gold reserve). In fact, the Meiji government often faced budget problems (revenue < expenditure) and issued government notes without gold or silver backing. The military expenditure related to 1877 Saigo rebellion worsened the situation. By then, the National Bank Act was revised to require no gold reserves for issuing private money. All this was causing inflation.

In 1881, the outstanding stock of inconvertible government notes was 105.9 million yen, supplementary government notes 14.5 million yen (issued to bridge the timing gap between tax collection and fiscal spending) and inconvertible National Bank notes 34.4 million, with the total inconvertible notes and currencies of 154.8 million yen. Against this, the government reserve of gold and silver (mostly silver) was only 5 million yen.

Matsukata's plan was to get rid of inconvertible money and replace it with money backed by government's metal reserves (called specie). Not only that, he wanted the government to accumulate sufficient specie money so it could exchange convertible money into gold or silver when demanded. This was to establish the credibility of monetary policy and avoid inflation.

The only main way to do this was to cut budget expenditure and increase taxes, and create a budget surplus. This surplus would be used to redeem (get rid of) inconvertible notes and accumulate specie money at the government (there were also administrative techniques and tricks that would accelerate the redemption). Matsukata expected to eliminate inconvertible money within a few to several fiscal years through fiscal squeeze and this was actually achieved - see attached table (fiscal year was July-June then).

In the first few years of Matsukata Deflation, government's silver holding was tiny and there was virtually no gold reserve. Matsukata decided to wait until he was sure that his plan was on track before promulgating the Convertible Currency Act. The act was thus enacted in 1884. (Government didn't have to hold metallic reserve against paper money one-to-one; the ratio of one to three should be enough (as in the UK) but the act was unclear regarding the exact percentage requirement of reserves against paper money issued.)

Matsukata's budget austerity caused deflation and recession, business failures and hardship for farmers. He regarded this as a painful but necessary step to stop inflation and set the Japanese economy on a sound path. The creation of the Bank of Japan as the sole issuer of reserve-backed money in 1882 and the transition to the full (international) gold standard in 1897 had the similar objective of making the Japanese macroeconomy more stable and competitive.

(Main source: 日本銀行百年史編纂委員会編『日本銀行百年史』: BOJ, The One Hundred Year History of the Bank of Japan, published in 6 volumes in 1982-86.)

[Information provided to Nicholas A. Silvers, Grayson School, PA, USA on May 2, 2023]

Table 5-1 Use of Budget Surplus by Fiscal Year (unit: 1000 yen)

表 5-1 財政黒字の年度別使途

(単位：千円)

Year	Redemption of Notes	Addition to Reserve	合TOTAL計	
明治	紙幣消却に即時充当	準備金に繰入れ		
FY1881	14年度	7,000	3,833	10,833
FY1882	15年度	3,300	5,228	8,528
FY1883	16年度	3,340	5,000	8,340
FY1884	17年度		7,007	7,007
FY1885	18年度		5,400	5,400
TOTAL	合計	13,640	26,467	40,107

(出所) 松方正義「紙幣整理始末」(日本銀行調査局編『日本金融史資料』明治大正編第16巻、大蔵省印刷局、昭和32年、所収) 56ページ。

Source: Matsukata Masayoshi, "Redemption of Notes" (BOJ Research Dept.)