

## Why is Japan building roads nobody wants to use?

A few years ago, Japanese officials decided to build a 160-mile-long toll road on the northern island of Hokkaido. Thus far the costs of the road have been about \$60 million per mile. Very few drivers use the road, largely because an existing highway that runs parallel to the new toll road is free. Officials tried to attract drivers by offering prizes and running promotional contests. Though the campaign succeeded in increasing the average number of cars on the road to 862 per day, the route is still the least used highway in Japan (*The New York Times*, 25 November 1999, p. A1). Why is Japan building roads nobody wants to use?

As noted in Thinking like an economist 7.3, Japan spent the 1990s in a deep slump. In response, the Japanese government periodically initiated large spending programs to try to stimulate the economy. Indeed, during the 1990s the Japanese government spent more than \$1 trillion on public works projects. More than \$10 billion was spent on the Tokyo subway system alone, an amount so far over budget that subway tokens will have to cost an estimated \$9.50 each if the investment is ever to be recouped. (Even more frustrating to passengers, the subway does not run in a

and relaying of cobblestone footpaths. Despite all this spending, the Japanese slump has dragged on.

The basic Keynesian model implies that increases in government spending such as those undertaken in Japan should help to increase output and employment. Japanese public works projects do appear to have stimulated the economy, though not enough to pull Japan out of recession. Why has Japan's fiscal policy proved inadequate to the task? Some critics have argued that the Japanese government was unconscionably slow in initiating the fiscal expansion, and that when spending was finally increased, it was simply not enough, relative to the size of the Japanese economy and the depth of the recession. Another possibility, which lies outside the basic Keynesian model, is that the wasteful nature of much of the government spending demoralised Japanese consumers, who realised that, as taxpayers, they would at some point be responsible for the costs incurred in building roads nobody wanted to use. Reduced consumer confidence implies reduced consumption spending, which may to some extent have offset the stimulus from

## THINKING LIKE AN ECONOMIST

### 7.4



## Thinking like an economist

Short, analytical pieces challenge you to apply economic principles to explain and answer situations that confront us—for example Thinking like an economist 5.2 explores the fact that the 1970s, 1980s and 1990s produced very distinctive labour market outcomes in Australia, and asks why. See page 149. Thinking like an economist 6.1 asks which factors influence the natural rate of unemployment (see page 179), while Thinking like an economist 7.4 asks if military spending stimulates the economy (see page 219).

## The World Trade Organization and the case for free trade

Among the many important changes to the world economic environment in the aftermath of the Second World War was the establishment of the General Agreement on Tariffs and Trade (GATT). This was an attempt to bring order to international trade. Chaotic trading arrangements prior to World War II, and in particular, the aggressive use of tariffs and trade barriers, were seen as one of the contributing factors to the Great Depression of the 1930s. A coordinated approach to trade and a more formal dispute resolution process when countries disagreed over trading arrangements was thought to be an important step towards easing international tensions and promoting prosperity across nations.

The GATT has subsequently evolved into the World Trade Organization (WTO), which formally came into existence on 1 January 1995 as an outcome of the so-called 'Uruguay Round' of trade negotiations. Whereas GATT focused almost exclusively on trade between nations in goods, the WTO deals also with trade in

government trade should reflect market conditions and not be distorted in any way. And, fourthly, that the special circumstances of developing countries be recognised and assistance offered where appropriate to allow these countries to participate in the world trading system.

The WTO operates through the implementation of periodic trade rounds. These are gatherings of the member countries of the WTO aimed at securing consensus about further reform and liberalisation of the international trading system. There have been nine trade rounds since 1947. The most recent, the Uruguay Round, began in 1994. It involved 123 countries, and has been described as the largest negotiation of any kind in human history. As part of the Uruguay Round, WTO members most recently met in Doha, Qatar, in November 2001 to discuss a range of issues, most prominently the difficulties experienced by developing countries in implementing the various Uruguay Round accords, and the need for further reform of trade in agricultural

## BACKGROUND BRIEFING

### 2.1



## Background briefing

These sections provide interesting, factual background information on aspects of the economy covered in the chapter topics, helping to deepen and expand understanding. See page 49.

### Okun's law and the output gap in the Australian economy

Following are the actual unemployment rate, and estimates of the natural unemployment rate, and potential GDP (in millions of dollars) for the Australian economy in three selected years. Using Okun's law, estimate the output gap in each year, in millions of dollars.

Year	$u$	$u^*$	$Y^*$
1983	10.0%	7.5%	378 877
1991	9.3%	8.6%	484 519
1998	7.7%	7.7%	686 617

Sources: Unemployment rate, Australian Bureau of Statistics. Natural unemployment rate and potential GDP, Authors' calculations.

## EXAMPLE 6.1



## EXAMPLES

Key points are often made in the examples. They are not just add-ons to the text but are designed to reinforce learning and provide simple examples of theory in action. See Example 3.2, page 75 or Example 6.1, page 181.