A SYMPOSIUM OF VIEWS

To What Extent, If Any, Is the U.S. Economy at Risk of Becoming "Japanized"?

After the bursting of the Japanese real estate bubble in the 1990s, the ratio of Japanese sovereign debt to GDP soared as Japan initiated massive fiscal stimulus, including unprecedented spending for public investment in infrastructure. Surprisingly, government bond yields plummeted. In addition, both public and private institutions in Japan bought extraordinary amounts of JGBs (ten-year government bonds). As one analyst noted at the time, "For banks, insurance companies, and many other institutions including the Bank of Japan and working families themselves, their attics, basements, closets, and cabinets were stuffed with JGBs. The situation reached the point that an abrupt and sustained rise in interest rates from robust growth would have theoretically bankrupted Japan, Inc." The result led to what some analysts call Japan's "lost decades."

Of course, the U.S. and Japanese economies are not the same. There are differences in demographics. Plus, the U.S. economy enjoys a powerful innovative sector and a culture that tolerates and anticipates start-up failure. But does the Japan analogy to the United States today have any relevance?

Nearly thirty prominent analysts offer their views.

It all depends on whether the U.S. Federal Reserve is willing to learn from the Bank of Japan's mistakes.

TAKESHI FUJIMAKI
Former Member, House of Councillors, Japan, and former Tokyo Branch Manager, Morgan Guaranty Trust Company of New York

The future of the U.S. economy depends on whether the U.S. Federal Reserve is willing to learn from the Bank of Japan's mistakes during the Japanese asset bubble period (1985–1989).

The Japanese economy during the bubble period was a frenzied economy. Trucks ran around all over Tokyo with building materials, restaurants were open until midnight, and there were long lines to enter restaurants. There were also long taxi queues everywhere in Tokyo at midnight. People had to wait for months in order to get Nissan's most expensive model because production could not keep up with demand.

The Japanese bubble was caused by severe asset inflation. The Nikkei stock index soared 3.37 times in five years (¥11,542 at the end of 1984 to ¥38,915 at the end of 1989). There is no official data that tracks the movement of real estate prices, but prices in commercial areas soared at least six times in five years. I personally saw transactions where prices rose by ten times in the same period. It was estimated that the total price of land in Tokyo was greater than that of the whole United States.

People who owned stocks and real estate felt as though they had become rich, and spent money. Nissan's most expensive cars sold very well. People bought Nissan's stocks hearing that news. A virtuous cycle started. This was a typical asset effect.

In spite of a frenzied economy, the consumer price index at that time was very low (overall CPI in the Tokyo area was 0.7 percent for years 1986 and 1987, and 0.9 percent for 1988). The reason for the low CPI was the yen's strong appreciation. The yen appreciated from ¥251.58 to the dollar at the end of 1984 to ¥122.00 to the dollar by the end of 1987. The very strong inflationary pressure caused by a frenzied economy was cancelled out by a very strong deflationary pressure caused by the appreciation of the yen.

The Federal Reserve keeps on saying that the current inflation is temporary. If the current inflation is caused mainly by the lack of supply, I may accept that argument. But judging from my experience of the Japanese bubble, the inflation in the United States this time will last longer and will be much stronger than what the Fed is probably thinking.

U.S. stock prices are recording historical highs these days, just like the Japanese bubble period. Historical highs mean, generally speaking, that anybody who owns stocks is enjoying a profit. Given that there are more Americans who are invested in the stock market than Japanese during the bubble period, the asset effect is likely to be extremely strong in the United States. It means that the inflationary pressures caused by asset inflation are very strong. Furthermore, there is no deflationary pressure because the dollar is relatively stable.

During the bubble period, I cautioned the Bank of Japan that if real estate prices doubled from the current level, businessmen would not be able to buy homes near their offices, so their commuting time would become much longer and their quality of life would deteriorate.

At that time, as I mentioned earlier, Japan's CPI was very low. On the other hand, the overnight call rate was around 4 percent (4.375 percent at the end of 1988), and the long-term rate was around 5 percent (the ten-year JGB rate was 4.811 percent at the end of 1988). So real interest rates were very high, and could not explain the frenzied economy.

So the Bank of Japan should have paid attention not only to the CPI, but also to asset prices to determine its monetary policy.

The Bank of Japan claimed that the price movement of real estate would be reflected in the CPI through attributable rent, so paying attention only to CPI was sufficient.

But the Bank of Japan finally recognized that real estate prices should not be treated as one of the factors of CPI but that the price movements of assets was very important. They tightened the monetary policy quickly, but it was too late, and we experienced the so-called lost decades after that. Satoshi Sumita, the governor of the Bank of Japan at the time, reflected on his mistakes in his book:

> *Real estate prices in Tokyo began to rise in double-digit percentages from around 1987 and stock prices rose very quickly. I regret that the Bank of Japan did not raise interest rates quickly enough. I accept that I did not recognize the importance of asset price movements. It was the first experience for Japan where the CPI was not overheated, but only asset prices went up (later called a bubble). That phenomena was not seen anywhere in the world. … I am responsible for not being able to understand the impact of severe asset inflation (real estate, stocks, paintings, antiques). (*Bubble, *Nikkei Business, December 2000, p. 275, translation by author.)*

Under a similar risky situation in the United States, the Fed continues to accelerate monetary easing.

Some people think that tapering is the beginning of tightening monetary policy. It is not. It should be judged by the size of the balance sheet of the central bank.

Even if the tapering starts, as long as the amount of bonds purchased by the Fed is larger than the amount of bonds which Fed holds to maturity, the balance sheet of the Fed will expand. It means more and more money is supplied to the asset markets, and may continue to push up asset prices.

I think there is the risk that the United States will experience lost decades like Japan if the Fed does not pay strong attention to asset inflation.

After the bubble period, the Japanese government spent a lot of money and piled up huge amounts of debt to cope with severe economic conditions. I feared that Japan would go bankrupt around 2014. But Haruhiko Kuroda, who became governor of the Bank of Japan in 2013, decided to start debt monetization, which had been considered a prohibited strategy because it risks creating hyperinflation.

Today, the Bank of Japan purchases 60–70 percent of the JGBs issued every year. If a person who was not in the market suddenly appears as a monster buyer, the price of any asset will go up substantially.

Because of the extremely low long-term interest rates artificially created by the Bank of Japan, politicians do not feel any pain for spending money.

The Japanese government may have escaped from bankruptcy, but the Bank of Japan now holds 53 percent of outstanding of JGBs (¥530 trillion out of ¥993 trillion). The average interest rate of these holdings is very low.

If long-term rates go up by a mere 0.2 percent, the Bank of Japan will have negative net worth.

If so, the Bank of Japan's debt, that is, the yen's value, may go down significantly and Japan may face hyperinflation.

There is no difference between bankruptcy and hyperinflation for the people.

I hope the Fed will learn from the Bank of Japan's mistake. The good thing in the United States is that there are people issuing warnings of inflation risk. On the contrary, during the Japanese bubble period, everybody was bullish and no one issued any warnings in Japan.

Another good thing is that the United States uses the mark-to-market accounting method. In Japan at that time, everybody used accrual accounting, which made it difficult to cut losses. As a result, recovery time was prolonged.

The highly innovative United States can avoid the Japanification trap.

TAKATOSHI KATO

Senior Adviser to the President, Japan Center for International Finance, and former Deputy Managing Director, International Monetary Fund

The United States and Japan share some common traits in the area of macroeconomic policy orientation such as ballooning fiscal deficits and massive monetary quantitative easing. And decelerating U.S. population growth (0.35 percent for the year ended July 2020) as well as the aging of the population pyramid, if sustained, could potentially be a source of concern, Japanizing the U.S. social structure.

Yet in my view, the social orientation of the two countries is radically different. The Japanese mind tends to avoid "rock-the-boat"-type risk-taking and still favors excellence in bricks-and-mortar manufacturing. The U.S. mind, on the other hand, is constantly in search of new initiatives and new orientations. Politically, Japan has been effectively under one-party rule for many years, where new initiatives that push the envelope are less likely to be tested. In the United States, regular administration turnover is the norm rather than the exception. Society tends to expect revolving-door shifts in policy orientation, which can be a source of dynamism in the United States.

My teaching experience at U.S. universities indicates that U.S. tertiary education rewards excellence for students who come up with untested innovative ideas. In Japan, however, students who neatly summarize the pros and cons of various theories tend to be rewarded. When compared with thirty years ago, the league tables of the largest U.S. companies by market capitalization are composed of a very different set of companies. As a matter of fact, some of the largest companies were non-existent thirty years ago. For Japan, a list of its largest companies would contain a basically similar set of companies.

Digitalization, in such areas as cloud computing, artificial intelligence, or the Internet of Things, is the area that can be counted as a current source of productivity growth to overcome the Solow Paradox. Everybody would agree that the United States maintains a leading edge in digitalization. Japan has been trying to catch up,

but its social structure prevents effective cultivation in the digitalization frontier.

Going back to the original proposition asking whether the United States can avoid the Japanification trap, my short answer is "Yes, it can," if it properly conducts its macroeconomic management and further expands its digitalization frontier.

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The U.S. experience over the next decade is likely to be different than the historical Japanese one.

Although some of the parallels are superficially appealing, we are skeptical that the past few decades in Japan's experience will turn out to have direct relevance to the next decade or two for the United States. To be sure, several trends in the United States mimic late twentieth-century Japan: A decadal expansion in credit aggregates realized in under twelve months; concomitant runups in housing prices (the fastest appreciation since 2006 per the Case-Schiller index) and public-market valuations (with earnings multiples approaching pre-dot.com era peaks per the CAPE ratio); and corporate restructurings at historic lows, suggesting sluggish reallocation of labor and capital across firms. And paired with these cyclical factors would be cautionary notice about the drag of population aging on labor-force participation and relatively high public debt levels.

The U.S. experience over the next decade, however, is likely to be different than the historical Japanese one for several reasons—even beyond important differences in demographics, current account balances, and the like.

First, the Japanese experience itself imparted several invaluable lessons about mitigating such vulnerabilities. In the 1990s, for example, outside analysts such as Adam Posen and Ben Bernanke challenged policy conservatism in the Japanese economic establishment, outlining interventionist prescriptions that have since become canonized. It is difficult to critique U.S. policy right now as being overly cautious, whereas that was a central problem for Japanese policy during the 1990s. Indeed, unlike the Japanese experience, the risk of policy inertia in the United States stems from the country's political polarization rather than the timidity of proposals from either party *per se.*

Second, the most significant problems facing the U.S. economy are fundamentally different than those facing the Japanese economy in the 1990s: they are an impetus for dynamism rather than for stagnation. Today, the paramount macroeconomic concerns, beyond inequality, are the aftermath of the pandemic and the coming "carbon shock" associated with the shift away from fossil fuels. Both factors are likely to cause substantial churn in the United States over the next decade, with the ways in which goods and services are produced changing materially (for example, via remote work, shift to sustainable supply chains, and so forth). At its core, the next decade is more likely to be a turbulent and dynamic one than a lost one—as long as U.S. policymakers do not try, in vain, to impede the adjustment processes that are necessary to change how we work and produce energy.

Third, we believe U.S. firms are better positioned to adapt to and capitalize on such changing economic circumstances than were their Japanese counterparts a few decades prior. The Japanese experience, along with recent empirical work elsewhere, has helped highlight the role that dynamics at the sector- and firm-level can play in driving macroeconomic performance. With respect to Japan's growth slowdown, for example, economist Kyoji Fukao and others have cast light on the importance of divergent productivity trends between large firms and smaller firms, as well as on differences in investment in information technology and associated intangible capital by Japanese firms relative to their U.S. and European counterparts. Once again, a potential parallel could be seen in the United States, where bottlenecks in areas such as shipping and semiconductors are significant drivers of economic performance through the post-Covid recovery. But the post-pandemic work environment provides a striking case study of the underlying resilience of U.S. firms, with uptake of remote and hybrid work models seemingly outpacing that of many advanced economies, including Japan. We believe, in short, that the U.S. economy over

the next couple decades will reflect this resilience—a product of organizational capital, technology fluency, corporate governance, and many other intersecting factors.

Japan is very far from any sort of disaster story.

DEAN BAKER
Senior Economist, Center for Economic and Policy Research

The idea of an economy looking like Japan, since the collapse of its bubbles in 1989–1990, is supposed to be a really bad story. Before anyone goes on as to whether the United States will come to look like Japan in the decades ahead, it is worth getting a clearer picture of what Japan looks like.

Contrary to what is often claimed in the media, Japan is very far from any sort of disaster story. Japan's unemployment rate hovered near 2.5 percent before the pandemic. Its government acted quickly to both limit the spread of the coronavirus and to protect its workforce. Its unemployment rate peaked at just over 3.0 percent in its pandemic recession.

It's true that its GDP growth has been weak over the last three decades, but GDP growth is not something that the typical person in Japan sees. The main reason for weak GDP growth has been a stagnant, and now declining, number of people in their prime working years.

This has not stopped the country from seeing improvements in their living standards. According to the OECD, productivity, as measured by GDP per hour worked, grew at an average annual rate of 1.5 percent over the last three decades. The OECD puts the growth rate for the United States as 1.6 percent over the same period. It's hard to get very excited over this difference.

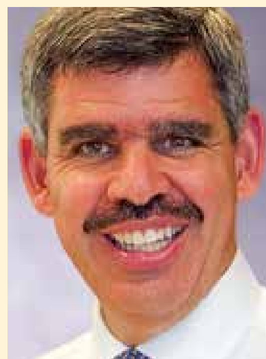
One reason Japan's gains in productivity have not shown up in more growth is that the length of the average work year has been substantially shortened over the last three decades. According to the OECD, the average worker put in 21.3 percent fewer hours in 2020 than in 1990. In the United States, the decline was 3.6 percent. The reduction in hours presumably corresponds to longer vacations, shorter work weeks, and increased use of family leave.

It would indeed be bad news if the United States economy began to resemble the media image of Japan as a stagnant economy that cannot figure out how to lift itself out of a thirty-year long slump, but there is little reason to fear the possibility that the United States will come to resemble the Japan that actually exists in the world. If the private economy lacks the momentum to sustain anything close to full employment, then there is no real problem with the federal government stepping in to fill the gap.

As the Biden infrastructure packages show, there is no shortage of areas where large amounts of public funds can be usefully spent. In some cases, like addressing global warming, the need is very pressing. We should actually be thankful if there is a large shortfall in private sector demand that can be filled with climate-related spending.

And if we run out of useful ways to spend public money, we can always follow the Japanese route of shortening work time. Few workers would see shorter workweeks and longer vacations as something to be feared.

In short, the United States certainly could come to look more like Japan. That is not a development that should scare people.



The risk is low because of notable differences in culture, risk-taking, immigration, entrepreneurship, and social capital.

MOHAMED A. EL-ERIAN
President, Queens' College, Cambridge University, Chief Economic Adviser, Allianz, and author,* The Only Game in Town: Central Banks, Instability, and Avoiding the Next Collapse *(Random House, 2016)

The Japan analogy has relevance for the United States, albeit limited.

Japan's "lost decades" illustrate how a combination of unfortunate economic and financial factors can come together to produce a durable low-level economic and financial equilibrium that develops ever-deeper institutional and behavioral roots. The United States has some of these factors in play and, as such, does face the risk of its own lost decade—though this risk is low because of notable differences in culture, risk-taking, immigration, entrepreneurship, and social capital.

The key message from Japan is for U.S. policymakers at a particularly important moment for the economy.

Given higher levels of aggregate demand currently, every effort needs to be made to ensure the responsiveness and flexibility of the economy's supply side, including a greater long-term enabling of both human and physical resources. Failure to do so would increase the risk of a hybrid Japanification that would be particularly challenging for both markets and policymakers: that is, growth that is too low and inflation that is too high.

While unlikely to last for a decade or more, the risk of stagflation would make it harder to deliver the much-needed long period of high, inclusive, and sustainable growth.

The U.S. economy's flexibility, innovation, and openness to new opportunities will allow it to avoid becoming "Japanized."

SHIGEO KASHIWAGI
Former Executive Director for Japan, International Monetary Fund, and Professor Emeritus, Keio University

I do not think the U.S. economy is at risk of becoming "Japanized" because of its inherent flexibility and innovativeness.

Japan's economy has been suffering from the deflation trap and persistent stagnation despite continuous policy efforts. Slow and inflexible policy responses, together with the lack of political will to implement bold actions, may have been partly responsible, but the private sector also seems to be responsible for the reduced policy effectiveness.

Japanese consumers, faced with increased uncertainties, strengthened their risk-averse behavior, lowered their inflationary expectations, and weakened their consumption, while storing up bank deposits even with rates at virtually zero. Business sectors, faced with the shrinking domestic market resulting from the aging population, also became risk-averse, avoided new initiatives including capital investment, and kept wage increases low to retain employment. As a result, business transformation was slow, the number of start-ups remained very small while zombies were kept alive, and consumption continued to be subdued.

The way the Japanese government tried to overcome the recent challenge of hosting the Olympic games during the pandemic was another example of its slow, inflexible, and uncoordinated way of responding to newly emerging situations, resulting in an unsatisfactory outcome.

By contrast, in the United States, flexible and innovative policy measures have enabled the economy to remain strong, resilient, and dynamic, even during the pandemic. Unprecedented fiscal support was quickly enacted, and very accommodative financial conditions were pursued. Business sectors responded positively by altering their business strategies, hiring new workers, and making new capital investments. Consumers, feeling more confident about the outlook, also contributed by spending more freely. In fact, the pace of the recovery in the United States might necessitate a shift in monetary policy which will create more room to deliver support in the future, if and as necessary.

Why have the Japanese people not responded positively to the various policy efforts? An answer could be that the society has reached a mature stage, with perceptions of having achieved a satisfactory level of economic and materialistic prosperity. Even though the economy continues to be sluggish and people are not entirely happy about it, most seem to be content with the status quo and prefer not to go through big changes in their lifestyle.

In contrast, the U.S. economy's flexibility, innovativeness, and embrace of opportunities for change are expected to continue to contribute to its resiliency and dynamism. This does not mean that U.S. society is without problems. The United States must address issues such as wealth inequality, racial disparity, and ensuring democracy functions, but these are not directly related to the question at hand.

The key lesson of "Japanization" is that post-bubble, policymakers must implement policies appropriate for a private sector that is minimizing debt, not maximizing profits.

RICHARD C. KOO
Chief Economist, Nomura Research Institute

The United States is the only country that utilized the lessons of Japan's post-1990 experience to fight the balance sheet recession that began in 2008. Such recessions are rare and are typically triggered by the collapse of a debt-financed bubble. When such a bubble

bursts, much of the private sector is left holding liabilities at their original values while assets must be written down sharply, pushing balance sheets underwater. Businesses and households facing the insolvency constraint are then forced to repair their balance sheets by minimizing debt, in contradiction to the textbook assumption that the private sector always seeks to maximize profits.

Restoring financial health is the right and honorable thing to do for individual households and businesses, but the additional savings and repaid debt cannot re-enter the income cycle when much of the private sector is unwilling or unable to borrow money even at zero interest rates. The economy thus falls into a deflationary spiral called a balance sheet recession. The only way to counter such a recession is for the government to borrow and spend the excess savings of the private sector.

Ben Bernanke and Janet Yellen at the U.S. Federal Reserve, together with Larry Summers at the National Economic Council, all realized early on that the United States was suffering from the same balance sheet recession Japan had been facing since 1990 and pushed for aggressive fiscal stimulus by warning about the danger of falling off the "fiscal cliff." Indeed, the United States is the only country where the central bank counseled the government not to reduce the fiscal deficit. Other central bank governors, including Haruhiko Kuroda at the Bank of Japan, Mervyn King at the Bank of England, and Mario Draghi at the European Central Bank, failed to realize they were in balance sheet recessions and pushed their governments to cut deficits, all with devastating consequences. That is the key reason why the United States, the epicenter of the global financial crisis, ended up doing better than the rest.

The U.S. economy remained lackluster for years because the Republicans, who won control of the House of Representatives in the 2010 elections, did not understand balance sheet recessions and did not allow enough fiscal stimulus to absorb the private sector's excess savings. Japan stagnated not only because of numerous premature efforts at fiscal consolidation under the Hashimoto, Koizumi, and Abe administrations, some of which actually increased deficits, but also because of the massive balance sheet damage it sustained when commercial real estate prices plunged 87 percent nationwide.

Additionally, many economists failed to understand that when the private sector is minimizing debt in spite of zero interest rates, fund managers at financial institutions have no choice but to lend those excess savings to the government because it is the only borrower left. That drives government bond yields down to levels that would be unthinkable when the private sector is in profit-maximizing mode. These low bond yields allow governments to build necessary infrastructure at the lowest cost to future generations while supporting the economy for the present generation.

The key lesson of "Japanization" is that when the post-bubble private sector emerges as a huge net saver despite zero interest rates—which has been the case in all of the advanced economies since 2008—policymakers must implement policies that are appropriate for a private sector that is minimizing debt and not one that is maximizing profits.

I do not expect the U.S. economy to become "Japanized." The main reason is that I expect U.S. inflation to rise on trend.

THOMAS MAYER
Founding Director, Flossbach von Storch Research Institute, and former Chief Economist, Deutsche Bank Group

If we define "Japanization" as a condition in which the economy is characterized by low growth, low inflation, and high government debt, then I do not expect the U.S. economy to become "Japanized." The main reason is that I expect U.S. inflation to rise on trend whereas inflation in Japan has remained low for decades.

Japan experienced low inflation for two reasons. First, as pointed out by Charles Goodhart and Manoj Pradhan in their book *The Great Demographic Reversal,* Japan imported deflation from neighboring China and India as these countries opened up to international trade in the 1990s and 2000s. This increased the global supply of goods and services and depressed prices. Second, the Japanese authorities did not engage in large-scale money printing to finance government debt. Following the fourteen-year period after the crash of the bubble economy in 1990, Japanese money supply (M2) grew at annual rate of 2.5 percent, just one percentage point faster than nominal GDP. Hence, money velocity declined gradually without any visible disruptions. Japanese government borrowing was not financed with newly created money but with private sector savings of outstanding money, either through straight purchases of Japanese government bonds or in the form of yen cash balances, which the Bank of Japan provided by exchanging JGBs against money savings.

Against this, the U.S. economy today and in the future operates in a global environment where aging populations in the OECD countries and China will experience a decline in their working age populations and hence a shortage of

labor. The consequence will be structural upward pressure on wages. Moreover, the United States (and other western countries) have funded a large part of the increase of government debt through money printing of their central banks. During the period from the beginning of the financial crisis in 2007 and 2021, U.S. money supply (M2) grew at an annual rate of 7.5 percent, 4 percentage points more than nominal GDP. Money velocity fell significantly after the Lehman collapse in September 2008, and it took a big dive after the beginning of the coronavirus pandemic in early 2020. Thus, monetary funding of government spending has created a monetary overhang, which will allow companies to pass on rising wage costs into prices. Instead of Japan in the 1990s, the United States (and other western countries) of the 1970s provide the blueprint for mapping the future.

I see troubling signs of Japanification.

DESMOND LACHMAN
Resident Fellow, American Enterprise Institute

Even before the onset of the Covid-19 pandemic, the U.S. economy displayed troubling signs of Japanification. Following the 2008 bursting of its housing and credit market bubble, the United States experienced its slowest economic recovery on record while inflation remained consistently below the Federal Reserve's inflation target. Meanwhile, the country seemed to lose any real constituency for budget discipline and its highly leveraged companies borrowed heavily at low interest rate spreads.

The excessively expansive U.S. monetary and fiscal policy response to its once-in-a-century health crisis makes it all too likely that in the years immediately ahead, the Japanification of the U.S. economy will pick up pace.

By increasing the size of its balance sheet by more than $4 trillion in less than a year and by keeping interest rates at ultra-low levels, the Fed has created a troubling "everything" bubble in the U.S. equity, housing, and debt markets. U.S. equity valuations are now at lofty levels experienced only once before in the last one hundred years, housing prices now well exceed their 2006 peak level, and high-yield debt spreads are now close to their all-time lows.

By providing budget stimulus of as much as 12 percent of GDP in 2021 at a time when the Fed has its monetary policy pedal to the metal and when the Congressional Budget Office estimates that the country's output gap is currently only some 3 percent, the Biden administration has increased the risk of economic overheating and higher inflation. It has also increased the risk of high budget deficits and an unsustainable debt path for as far as the eye can see.

With inflation already picking up, it has to be only a matter of time before the Fed is forced to slam on the monetary policy brakes to meet its inflation objective. That in turn is more than likely to burst the everything asset and credit market bubble, which has been premised on the assumption that ultra-low interest rates will last forever.

In much the same way as the bursting of its property and equity bubble in the early 1990s cost Japan a lost economic decade, the bursting of the U.S. everything bubble must be expected to usher in a prolonged period of disappointing economic growth, low inflation, unusually large budget deficits, the proliferation of zombie companies, and yet another round of Fed quantitative easing. That is bound to increase the Japanification of the U.S. economy that already seems to be well underway.

Unless the United States gets its policy choices badly wrong, the strongest and still most innovative economy of the world is not heading for anything akin to Japan's lost decade of the 1990s.

HOLGER SCHMIEDING
Chief Economist, Berenberg

The surge in U.S. public debt goes well beyond that in the eurozone. It makes the United States more vulnerable to a sudden and major rise in yields. Some painful adjustments to taxes, spending, and entitlements will be inevitable in a few years' time. But unless the United States gets its policy choices badly wrong, the strongest and still most innovative economy of the world is not heading for anything akin to Japan's lost decade of the 1990s.

Unlike Japan at the time, the United States is not saddled with a financial system rendered dysfunctional by the legacy of a burst asset bubble and a reluctance of policymakers to fix it. America's financial system as well as the balance sheets of its households and companies look on

average even more healthy than usual, partly as a result of unusual government largesse during the pandemic.

Nonetheless, the United States faces serious challenges. Thanks to its surplus savings and its current account surpluses, Japan only needed to maintain the trust of a somewhat domestic investor base. With its need to finance gaping twin deficits, the United States may eventually find itself at the mercy of bond vigilantes from all over the world. As the still unrivalled purveyor of the world's lead currency, the U.S. starting position remains strong. But to secure global trust in the long run, the United States must show that its economy can generate the revenues needed to service its public debt mountain. Beyond some fiscal adjustments, that means to keep the jobs machine humming, upgrade the skills of its workforce, and preserve and enhance the innate dynamism of the U.S. economy.

Germany has demonstrated with its transformation from the "sick man of Europe" of the early 2000s to the continent's powerhouse in the 2010s how supply-friendly policies can raise the employment rate and hence the tax take. In Germany, that did much more to correct entrenched fiscal deficits than simple austerity. If the United States pursues supply-friendly policies, it may even enjoy a "golden 2020s," with faster gains in productivity and living standards than in the post-Lehman period. The pandemic has shaken ingrained habits. That may accelerate the adoption of frontier technologies in greater sectors of the economy. If so, the fiscal problems and the risks from a likely rise in bond yields in coming years would look much less challenging.

The U.S. situation has nothing to do with Japan's failure.

HARUYUKI OSHIMA

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The Japanese bubble in the late 1980s and early 1990s was brought about by soaring land prices. The Bank of Japan responded by rapidly tightening monetary policy, which led to the bubble bursting and left the economy in a state of non-growth.

A non-growth economy is the worst kind of economy, especially in terms of robbing young people of their dreams.

But more than anything, the critical failure is that the government has kept Japan's economy in a state of non-growth for nearly two decades by postponing the decisions they should have made. They were afraid of being criticized for failure.

The government took every possible measure to prevent ailing companies from going bankrupt due to the fear of a potential chain reaction of bankruptcies of banks.

As a result, the Bank of Japan has been investing huge amounts of money into the stock market in the form of mutual funds, and is now a major shareholder in half of all listed companies. A huge amount of public pension funds has also been invested into the stock and bond markets, which the OECD has repeatedly warned could undermine the health of the market.

The manufacturing industry, the leading player of "Japan as Number One" until the late 1980s, is also responsible for falling into a non-growth economy.

As product life cycles were shortened and new technologies were introduced one after the another, the *keiretsu* system, which used to be called the strongest part of Japanese manufacturing, became a shackle for companies. The *keiretsu* system was originally made by serializing materials, parts, and assembly companies, and it is not good at responding to changes in the system.

But the most significant defeat may be the loss of confidence in Japan's ability to speak English and to cope with shareholder supremacy in a global economy.

Japan's inaction continues as the government and large corporations fail simultaneously, and as the population ages and declines rapidly. There is no way out.

But then, what about the United States? The standard of living of Americans began to decline in the 1970s, and the trend continued for half a century.

In the 1980s, American electronics and automobile industries were losing to those of Japan, as were their banks.

But by the 1990s, the computer and finance industries in the United States underwent a revival and the internet was created. The reason for this revival has always been the country's ability to create new rules of the game and apply them to the world.

Furthermore, the United States is highly receptive to changes brought about by population growth and the resulting racial diversity.

There is no time to postpone problems or lose confidence. The conclusion is indisputable: The U.S. situation has nothing to do with Japan's failure.

The U.S. economy has been "turning Japanese" for some time now.

STEVEN B. KAMIN
Senior Fellow, American Enterprise Institute, and former Director, International Finance, Federal Reserve Board of Governors

While definitions of Japanization (or Japanification) abound, I associate the term with the softening of private demand that former Treasury secretary Larry Summers has labeled "secular stagnation." Exactly what accounts for this stagnation remains unclear, but it likely reflects a number of factors, including the aftereffects of financial crises, the aging of the population, and the reduced capital-intensity of new technologies. By this view, the U.S. economy, along with many other economies around the world, has already been "turning Japanese" for some time now. First in Japan and then later in the United States, business investment dropped below profits, leading to the emergence of a corporate saving glut. The equilibrium rate of interest (r*) has fallen in both economies, requiring their central banks to provide increasing amounts of monetary stimulus—including through quantitative easing—to maintain economic activity. But even with this stimulus, Japan has suffered from deflation while the Federal Reserve has struggled (until this year!) to push inflation back to its 2 percent targets. And by the same token, substantial expansions of fiscal deficits and debt have failed (again, until this year!) to push these economies anywhere close to overheating.

In all these respects, of course, the process of Japanization has been most evident in Japan itself, likely reflecting its slowness in addressing its financial crisis in the 1990s, the more pronounced aging of its population, and its failure to take full advantage of the information technology revolution of recent decades. Despite the stagnationist tendencies described above, the United States has maintained a strong innovative and entrepreneurial business culture, and even after slowing in recent decades, its pace of economic growth has continued to outrun that of Japan and most other advanced economies.

Indeed, the most worrisome consequences of Japanization for the United States may center less around growth and more around financial stability. The low-for-long interest rates engendered by the decline in r* over the past decade, reinforced more recently by extraordinary monetary stimulus in response to the Covid-19 pandemic, have propelled substantial increases in corporate leverage, razor-thin credit spreads, and precipitous asset valuations. As long as interest rates stay low and validate the expectations of investors, financial markets should continue to operate smoothly and support the ongoing recovery from the pandemic. But if the current surge in inflation does not subside, and if the Fed is forced to tighten monetary policy sooner than currently anticipated, this would exacerbate already elevated debt burdens and could burst the bubbles in equity, bond, and real estate valuations. The sustainability of the U.S. government's finances would likely escape unscathed, as Treasuries remain the world's premier safe asset. But the U.S. economy might fall back into recession, many weaker corporations would go under, and the spillovers to emerging markets would be dire indeed.

Japan and its "lost decade" would not be at the top of my list of concerns for U.S. policymakers.

THOMAS FERGUSON
Director of Research, Institute for New Economic Thinking

These days so many specters haunt the world that finding a truly grandiose, certified, Grade-A disaster that isn't relevant to the United States and other countries is not easy. But Japan and its "lost decade" would not be at the top of my list, save in one special sense.

I basically accept Richard Koo's "balance sheet recession" analysis as a first approximation of what went wrong there. This can be readily summarized: Not only banks, but vast numbers of enterprises of all kinds could not resist the siren song of the epochal surge in real estate prices that capped the final stages of Japan's ascent as a major industrial power in the late 1980s. Like many Americans later, Japanese companies and investors borrowed heavily as they bid properties to almost astronomical levels. At one point, famously, the land on which the Imperial Palace stands in Tokyo was said to be worth more than the entire state of California.

When this mother of all real estate bubbles burst, most of Japan, Inc., was left holding a big, empty bag. Many of their assets were gone or greatly diminished in value, but they still had to pay off their debts. As a result, their top priority became making payments on debt service and paying down principal, not using cash flows for normal operations, investment, and profits. Many were really bankrupt, but indulgent bank regulators and the Ministry of Finance mostly looked the other way, as they had in the boom itself. With private lending and investing way down, only the willingness of the government to come in and borrow and spend on a colossal scale saved the day. This expansion of the public sector kept everybody afloat for years, interrupted from time to time by disastrous efforts by fiscal conservatives to go back to the old-time religion.

For years, financial watchdogs have pointed out the advantages of occasional direct controls on lending for obvious bubble candidates like property and stocks. But the Federal Reserve has faithfully echoed the American establishment's predilection for *laissez faire* except when the financial sector requires rescue—then of course Single Payer Insurance becomes the order of the day. After years of cut-price money and Covid's dramatic restructuring of work and living patterns, you can be sure that a lot of property out there is not worth what banks and their regulators pretend it is. And many stocks will look much less appealing when analysts start plugging in higher interest rates to estimate valuations. So there's likely more than one bubble waiting to burst.

When and if that happens, though, I doubt the damage will be on the scale of Japan's inglorious Golden Oldie for more reasons than we can inventory here. But the key point is this: The Japanese response shows you how to cope if the worst does happen.

The Biden administration began with an audible fiscal bang: It immediately put through a substantial relief package. Now it is trying to pass another large, multi-year infrastructure spending program, as it greases the skids for an even bigger one to support investment in human capital, education, health, and other areas that the United States has neglected for years. On top of that, the chaotic final stages of the U.S. withdrawal from Afghanistan are swelling demands for more defense spending.

Right now, with war hawks and inflation hawks circling everywhere, the Biden administration is under real pressure. Despite the huge rise in the wealth of the 1 percent documented by recent Federal Reserve statistics, not a single major business organization was willing to support the president's quite modest tax proposals, now being scaled down even further. But if bubbles burst—which I do not take as a given—then the Japanese example shows us all the way out. If you don't like rising deficits, then clam up, support raising taxes on the rich and let balanced budget multipliers work. The Japanese example vividly illustrates how sustained government spending can fill in when the private sector is too debt-encumbered to spend. That, not more quantitative easing, actually works. And it is good to remember that all through that period, life in Japan was still fairly decent—unemployment rose, but to a high of just over 5 percent, and even household earnings grew a touch.

The views expressed here are the author's own.

The temptation to make a comparison with the Japanese situation of persistently low bond yields is very strong.

JIM O'NEILL
Former Commercial Secretary to the Treasury, United Kingdom, and former Chairman, Asset Management, Goldman Sachs International

Given the persistence of low U.S. bond yields, and in circumstances where the Federal Reserve has pursued an extremely friendly monetary policy going back to the 2007–2008 financial crisis, the temptation to make a comparison with the Japanese situation of persistently low bond yields is very strong. And of course, it could be right despite the obvious differences. It is certainly the case, in advance of the collapse of the Japanese financial system, that very few if any predicted Japan would be stuck in a seemingly persistent world of quantitative easing and markets that were highly dependent on the activities of the Japanese central bank. Indeed, the 1990s are characterized by repeated beliefs by many, including noteworthy contributors to this magazine, that Japanese bonds would experience an emerging market-style meltdown as a result of their supposedly unsustainable debt.

So why couldn't the same happen in the United States? It could, for two basic reasons right now, although it seems to me on balance it is unlikely. First, the United States has a quite different demographic profile, and even though the era of mass immigration appears to have dented the future growth potential of the U.S. population, it remains a country with different demographics than Japan. At the end of the day, a country's growth trend depends on its working population and its

productivity, and Japan has a rather lethal combination: a declining workforce with a rising dependency ratio, and weak productivity. As a consequence, Japan's growth potential is quite weak, probably barely positive. This is not seemingly the case in the United States, and indeed, there are some tentative signs of a pickup in productivity post–Covid-19.

The other notable difference is that the U.S. financial system recovered significantly from its own version of the Japanese bubble bursting, namely the 2007–2008 financial collapse. The U.S. financial system seems to be reasonably robust, notwithstanding the possibility, or perhaps probability, that both equity and bond markets will test that robustness as and when the Fed decides to start tightening monetary policy. Perhaps this will be the real test of the validity of the comparison between Japan and the United States, because if the financial system were to implode again and the economy struggle, then the comparison will have stronger grounds.

At least in Japan's case, their average GDP per capita has crept higher in recent years, which ultimately is what each individual will feel, and this might be an area where the United States needs to demonstrate greater success, even if comparisons more broadly are overstated.

Will the United States become another Japan? Very likely.

CHEN ZHAO

Founding Partner and Chief Global Strategist, Alpine Macro

"Japanization" has a negative connotation, which may represent some misunderstandings of Japan's situation. I would argue that zero rates and zero nominal growth could eventually be a steady state for all high-income economies. Japan has been and will continue to be in a fundamentally stable situation as far as public sector debt is concerned.

First, Japan's public sector debt has soared since the 1990s and Bank of Japan began to monetize JGBs as far back as 1995. None of these is a sign of trouble and Japan has been in perfect equilibrium: The private sector savings surplus (savings in excess of desired investment) has been running at 4–5 percent of GDP per year since 1990, and as such, the public sector must borrow that amount and spend it in the economy, otherwise Japan's nominal GDP would fall 4–5 percent a year—it is a simple math.

In other words, Japan's rising public debt simply mirrors rising cumulative savings surpluses in the private sector, or one group of Japanese lending their surplus incomes to the other group of Japanese. Why should anyone worry about these inter-sectorial asset-liability swaps? Besides, the Bank of Japan has been monetizing debt for decades to bring up inflation and bring down the yen, but price levels have kept falling while the yen has strengthened all the time. This is why many debt-mongers have kept calling a Japanese debt implosion, but to no avail, for nearly thirty years.

Second, it is a misunderstanding to say Japan's economy has been mired in economic stagnation. Here is the fact: Japan's labor productivity growth has been on par with that of the United States since 1980. Even during the 1990s when Japan was struggling with deleveraging, the country still maintained labor productivity growth of 2.7 percent per annum.

For the last decade, Japan's labor productivity was on par with that of the United States again, averaging about 1.0 percent. In other words, the standard of living for the Japanese population has been improving at about the same rate as that of the Americans for all these years. This is why Japanese people have continued to become more affluent, even though many say Japan has suffered "a lost decade, or decades."

The problem with Japan's economy is its labor force decline: Japan's labor force topped out in 1997 and fell 4 percent by 2014. Since then, the female participation rate has risen and retired workers have reentered the labor markets, causing a temporary rise in the labor force. The U.S. labor force has grown by nearly 20 percent since 1997. As GDP growth is the sum of labor productivity growth and labor force growth, Japan's real GDP growth was barely at 1 percent for decades.

Third, will the United States become another Japan? It is very likely. The U.S. population growth has fallen to 0.3 percent a year and its labor force has only grown 0.34 percent since 2007. The labor participation rate has fallen sharply as baby boomers continue to retire. Yes, immigration will slow down the aging population, but the impact of immigration on the labor force will incrementally diminish, unless the United States dramatically increases the intake of foreign workers. I don't think the American public is ready for that.

In the meantime, desired capital investment has been and will likely stay weak, as evidenced by a large accumulation of cash positions by the U.S. companies. Technological advances and the post-industrial economic

structure have all greatly reduced capital spending but have sharply increased capital efficiency—meaning a same amount of output increase will require an incrementally smaller amount of capital investment.

On the other hand, the forces behind the rising saving rate are getting stronger. With an aging society, people retire later and this drives up the savings rate. Increasing longevity also needs more savings to support retirement lives. After the housing crises, American households are much more into building net worth than borrowing and spending.

All of this tends to tip the savings-investment balance toward the side of over-saving, generating secular deflationary pressures. This is a key reason that bond yields have kept falling. In fact, the Fed may not be able to raise rates very much, if at all, for a long time. Besides, the over-saving problem is also the fundamental reason why the U.S. fiscal deficit and public sector debt have begun to escalate in recent decades: The U.S. government must take actions to borrow and spend to offset periodic surges of excess savings in efforts to reduce the depth of recessions and prevent deflation.

The key point here is that there is nothing wrong with this picture for a high-income economy. As long as the United States can keep its productivity growth reasonably high, Americans' standard of living will keep increasing and real income will rise, but price inflation will be low or even falling. In many ways, this may be an inevitable result.

The U.S. economy is not at risk of becoming "Japanized."

ROBERT SHAPIRO

Chairman, Sonecon, and former U.S. Under Secretary of Commerce for Economic Affairs

The question recalls the farfetched claims in 2009 that the stimulus President Obama proposed to address the Great Recession would turn the United States into Greece, which at the time teetered on the brink of sovereign debt default. To be sure, most economists believe that Japan's outsized national debt has contributed to its slow growth, and recent U.S. spending to address the pandemic-based recession pushed our gross national debt as a share of GDP from 108 percent in the first quarter of 2020 to 126 percent in the first quarter of this year. But nearly all of that new debt represented one-time spending to address the pandemic, so its claim on the economy declines as the economy expands. In fact, U.S. national debt's share of GDP has declined every quarter since the second quarter of 2020, when it peaked at 136 percent.

Over a longer view, our gross national debt as a share of GDP jumped 150 percent from 2000 to 2020, or nearly as much as the 165 percent increase in Japan over the same period. But the economic burdens imposed by national debt are very different in the two countries. To begin, Japan's national debt represents 266 percent of its GDP or more than double the current share here.

The United States also has greater resources to support its national debt. The days of high personal savings in Japan ended long ago; and the OECD reports that from 2000 to 2018, the U.S. personal or household saving rate averaged 6.2 percent, compared to 3.5 percent in Japan. In addition, the rest of the world is more willing to invest its excess savings in U.S. government debt. In 2020, foreign and international investors held $7 trillion of U.S. debt instruments or 26 percent of the gross total—including $1.24 trillion held by Japanese investors and their national government—while foreign governments and international investors held just $660 billion or 5 percent of Japan's national debt in 2020.

One reason for that disparity is that the U.S. economy is much more productive than the Japanese economy, producing both higher returns for investors and greater resources to support government debt. While measuring productivity across countries is challenging, the OECD reports that in 2019, U.S. businesses produced $72 of GDP per hour worked—the highest among the G-7—compared to $48 per hour worked produced by businesses in Japan. Moreover, the productivity gap has grown over the last decade even as the ratio of U.S. debt to GDP increased sharply. One reason is that U.S. companies invest at much higher rates than Japanese companies: From 2010 to 2019, fixed business investment grew at an average rate of 1.0 percent per quarter here, compared to 0.4 percent per quarter in Japan.

The result is that while the ratio of gross debt to GDP increased at nearly the same rate in the United States and Japan from 2000 to 2019, real GDP grew three times faster here than in Japan, averaging 2.4 percent per year compared to 0.8 percent per year in Japan.

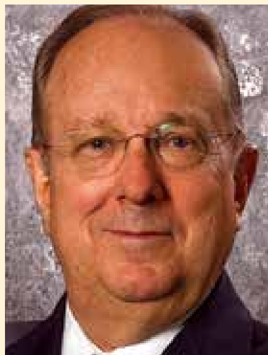
Looking ahead (and ignoring the past), the Biden administration's political opponents now warn that his proposed new spending will ignite inflation as its associated debt slows growth. The World Bank pays more attention to the data than Biden's critics, and its latest forecast projects GDP growth of 7.0 percent in 2021 and 4.9 percent

in 2022—again, leading the G-7. By contrast, the World Bank's GDP forecast for Japan is 2.8 percent in 2021 and 3.0 percent in 2022.

One reason for the strong U.S. forecast is that the first tranche of proposed new spending on physical infrastructure includes revenue measures that cover the cost, so no additional debt there. The second tranche of new spending for community college tuitions and additional safety net supports also includes some revenue measures. However, nonpartisan analysis suggests that those tax measures will cover at best half of the second tranche of proposed new spending.

Nonpartisan analysis has also found that spending on infrastructure, higher education, and childcare generally contributes to productivity, which in turn generally spurs higher growth. But let's set that aside and simply assume that Congress enacts a $3 trillion ten-year package with $1.5 trillion financed through new debt. A little simple math shows that such additional debt would have little or no impact. CBO forecasts that over those ten years, from 2022 to 2031, U.S. GDP will total $292.3 trillion. So, $1.5 trillion in additional debt-financed spending will increase our debt-to-GDP ratio by 0.5 percent.

By any economic measure and reasoning, the U.S. economy is not at risk of becoming "Japanized."



Japan's dilemma is that debt service already swallowed 22.7 percent of the country's FY2020 general budget despite near-zero interest rates.

ALAN REYNOLDS

Senior Fellow, Cato Institute and American Institute for Economic Research

Since at least 1997, the Japanese economy has become increasingly Europeanized—suffocated by rapidly rising government consumption and transfer payments that evaporate rewards to private labor and capital though ever-increasing social security, VAT, and/or income tax rates.

The United States may be racing toward fiscal Europeanization, with recent tax and spend proposals now measured in trillions. But being "Japanized" could also add the potential long-term debt service burden of perpetual Japan-style short-term stimulus plans. Since 2008, the United States has embraced the Japanese policymaking elite's unshakable faith that economic salvation will surely come from another "fiscal stimulus" spending spree and/or another central bank bond-buying binge.

Cutting taxes in recessions and cutting spending in booms would be entirely in keeping with Keynesian doctrine. But politicians prefer to turn that around, raising spending in recessions and raising taxes between recessions. Since 1997, Japan has added a novel twist by announcing periodic increases in the VAT, thereby inviting brief consumer spending spikes beforehand followed by tax-induced slumps. The resulting recessions then provide another excuse for still more debt-financed public spending, with the central bank serving as the government's lender of first resort.

The net effect of periodic bursts of taxing and spending in Japan has been more government, but less private wealth. Japanese savers seek superior investment opportunities abroad. Growth of real private demand averaged 1.6 percent a year in 2010–2013, for example, before the stimulus of Abenomics got going. But private demand then slowed to 0.37 percent a year in 2014–2019. Only government consumption grew faster.

Deficit spending schemes in Japan already had ample time to demonstrate their ineffectiveness. Cyclically adjusted structural budget deficits averaged 5.8 percent of GDP since 1997, with gross debt rising from 105 percent of GDP to 235 percent by 2019. If fiscal stimulus could accelerate an economy's supply of real productive resources or entrepreneurial innovation, Japan would have had the fastest growing economy since 1997. Instead, that year marked the start of two "lost decades."

From 1961 to 1996, Japan's real GDP per capita (in 2010 dollars) grew by 4.6 percent a year, according to the World Bank, compared to 3.0 percent in the euro area and 2.3 percent in the United States. Japan's "lost decade" is usually dated from 1992 rather than 1997, but growth was strong in 1995–1996. From 1997 to 2007, however, annual per capita growth slowed to only 0.9 percent in Japan and to 2.0 percent in the euro area, remaining at 2.2 percent in the United States.

Setting aside the 2008–2009 oil shock and housing crisis, and the 2020 pandemic, per capita GDP growth rates from 2010 to 2019 were 1.4 percent in Japan, 1.2 percent in Europe, and 1.6 percent in the United States. Europe endured its own lost decade, and Japan a second one.

Like the endless fiscal stimulus experiments, periodic bond buying sprees by the Bank of Japan (quantitative easing) also exemplify the nation's propensity to rely on nominal nostrums instead of reducing real tax and regulatory impediments. The *Statistical Handbook of Japan* notes that the Bank of Japan in 2016 "decided to introduce 'QQE with a Negative Interest Rate' … in order to achieve

as early as possible the 'price stability target' of a 2 percent year-on-year increase in consumer prices." Those twin goals of negative interest rates and 2 percent inflation were contradictory, of course. The only way for interest rates to remain near zero for a long period of time is for real investment opportunities to remain weak and nominal GDP to stagnate. From 1997 to 2019, for example, inflation averaged 0.18 percent a year in Japan, according to the International Monetary Fund, so the six-month LIBOR interest rate averaged 0.30 percent. In the same period, average inflation was 2.15 percent in the United States, so the LIBOR rate was 2.67 percent.

Japan's dilemma is that debt service already swallowed 22.7 percent of the country's FY2020 general budget despite near-zero interest rates. Achieving higher inflation (or investment growth) and therefore higher interest rates would result in debt service absorbing a fearsome share of the budget.

With only about half as much debt to service, relative to GDP, the United States is not yet quite so vulnerable as Japan to higher rates, but nonetheless faces the same predicament. The recent experience of American politicians joyfully handing out borrowed "stimulus checks" to grateful U.S. voters must have seemed to many as if the elusive free lunch had finally been discovered. But it was a dangerous precedent. And there is no such thing as free money.

Japan's growth over the past two decades has been better than the popular myth.

EDWIN M. TRUMAN

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The risk is low that U.S. debt as a percent of GDP will soon reach the Japanese level. Moreover, Japan's growth over the past two decades has been better than the popular myth.

In 2019, Japan's gross general government debt was 235 percent of GDP and U.S. debt was 108 percent of GDP, according to International Monetary Fund data. In 2001, the percentages were 145 and 53 percent respectively. And in 2026, they are projected to reach 254 and 134 percent respectively. U.S. debt is unlikely to reach the "Japanized" level in the foreseeable future as both continue to increase. If the level of U.S. debt threatens U.S. and global financial stability, as occurred in the late 1980s, the United States has substantial capacity to increase its general government revenue, which at 30 percent of GDP was the lowest among the G-7 countries in 2019.

Aside from the level of debt, what is meant by an economy's becoming "Japanized"? The popular myth is that Japan has suffered from secular stagnation over the past several decades, with not only very low inflation but also low growth. The myth is incorrect. Japan has had very low inflation for many years, but from 2000 to 2019 its per capita growth on a purchasing-power-parity basis (10.5 percent) exceeded the G-7 average, lagging substantially behind that of the United States and Germany, essentially the same as for Canada but well ahead of the United Kingdom, France, and Italy. As we now understand, if the long-term real growth rate of the economy exceeds the risk-free real interest rate on average, increases in government debt are sustainable. If the increase in government debt supports an increase in the productive capacity of the economy, the criterion is more likely to be met.

The Biden administration is in many respects following a Japanese model.

DANIEL SNEIDER

Lecturer in East Asian Studies, Stanford University

For economists and observers of Japan, Japanization usually refers to the somewhat unique combination of four phenomena—chronically low growth, extremely low or even negative interest rates, massive government borrowing and expansion of debt, and negative inflation, or deflation.

During Japan's so-called lost decades following the collapse of the speculative bubble in the early 1990s, the Japanese GDP was stagnant. By the end of the 1990s,

interest rates in Japan became zero and the Bank of Japan introduced quantitative easing, while the government repeatedly resorted to fiscal stimulus. At the same time, however, Japan experienced sustained deflation unprecedented among advanced economies in the post-World War II era.

Some aspects of Japanization became evident in Europe and the United States following the global financial crisis of 2008–2009. Growth slowed, inflation rates remained below target levels, and quantitative easing was adopted by the Federal Reserve and the eurozone to counter fears of stagnation and deflation.

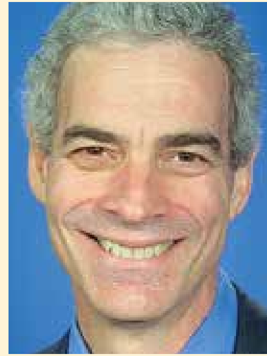
Japanization of the global economy is most evident in the use of public stimulus packages, despite concerns over the huge increase in debt-to-GDP ratios. This hyper-Keynesian approach has become even more prevalent in response to the pandemic induced crisis.

The Biden administration is in many respects following a Japanese model—combining massive fiscal stimulus and low interest rates to drive growth. There is a view that one of Japan's mistakes was that it kept trying to balance government borrowing with tax hikes even though there was no sign the debt was an immediate problem. Now, apparently partly shaped by the Japan experience, many U.S. policymakers believe that when interest rates are near zero, it makes more sense to borrow heavily, lock in low borrowing costs, and use that money to fix all your long-term problems, putting you on a faster growth trajectory that will help you curb your borrowing through growth in the long run.

So far, we have not seen any sign of deflation. Instead, economists like Larry Summers worry about a return to inflation, which if it transpires would suggest that the U.S. is not being Japanized.

There are some important ways in which the U.S. economy is not Japanized, ones that may be crucial to sustaining high growth beyond the emergence out of the pandemic downturn. One driver of Japanese stagnation has been its shrinking population, prompting concerted efforts by the Japanese government in the last decade to encourage higher birth rates and even the import of foreign labor. The United States has not had that problem until recently—but that depended on immigrants with higher birth rates, now threatened by anti-immigration politics.

Most importantly, the U.S. economy has been able to maintain a culture of innovation that drove growth in key sectors of the economy. Ironically, Japan is now making serious efforts to open up its digital sector and to foster a more startup-friendly business climate. If they are successful, the U.S. and Japanese economies may come to resemble each other to a far greater degree that is even the case today.



Japan's fiscal and monetary policies provide important cautions to U.S. policymakers.

MICKEY D. LEVY
Chief Economist for the Americas and Asia, Berenberg Capital Markets

The United States has some clear characteristics that distinguish its economic performance from that of Japan: healthy demographics and in-migration, remarkable technological innovations, a risk-taking mindset, and entrepreneurship that together generate the highest sustainable growth among all advanced economies. However, persistently high U.S. deficit spending and the Federal Reserve's ongoing zero interest rates and massive purchases of government debt are contributing to ultra-low bond yields, mirroring Japan's huge debt and the Bank of Japan's ever-growing balance sheet to a lesser degree. Japan's fiscal and monetary policies provide important cautions to U.S. policymakers.

Following decades of robust economic growth as Japan caught up to advanced economies' standards following World War II, Japan's growth began slowing significantly in the mid-1980s. The Bank of Japan tried to stimulate growth with artificially low rates, which resulted in a massive bubble in the Nikkei and real estate values. The bubble collapsed, followed by the lost decade of the 1990s, with on-and-off recession and deflation. Deficits and debt soared as the government recapitalized the severely impaired banking and insurance sector and engaged in misguided Keynesian fiscal stimulus, including spending on unnecessary infrastructure, while the Bank of Japan imposed ZIRP—zero interest-rate policy—and engaged in closely managed quantitative easing. Expectations of deflation became embedded and bond yields ratcheted down. The 2000s wasn't a lost decade as Japan's very high GDP per working age population (one of the highest among advanced nations) offset deteriorating demographics.

Fast forward, and Japan still struggles with the negative economic impact of an aging population and low birth rates that constrain labor supply, although in-migration of foreign workers in the years before the pandemic was impressive. Japan's very high government debt, mostly attributable to spending on pensioners, is purchased and

held almost exclusively by domestic creditors. The ongoing massive Bank of Japan purchases of government debt and zero yields on bonds add up to financial repression.

The high and rising U.S. debt is primarily attributable to entitlement spending for retirees, medical assistance, and income support and redistribution. Following the pandemic surge in deficit spending, the Biden administration is pushing more deficit legislation. This will temporarily address income and wealth redistribution but eventually will slow potential growth. The Fed's ongoing massive asset purchases, like the Bank of Japan's, are not providing any benefit to the economy, but along with zero interest rates are distorting financial behavior. The Fed should learn from Japan's experience and should begin to unwind its pandemic asset purchases and gradually normalize interest rates. Doing so would enhance economic performance by extending the expected length of the economic expansion.

The United States has benefited from ongoing high in-migration that fuels increases in the labor force and productivity gains fueled by technological innovation and entrepreneurship. But those advantages will erode if misguided deficit spending continues to add excessively to debt and the Fed's balance sheet and artificially low interest rates become a crutch.

The Japan analogy is relevant.

JAMES E. GLASSMAN
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For sure, Japan's economy is very different from that of the United States, but its evolution over the past couple of decades offers important insights into the challenges the United States and other developed economies will face. That's because demographic shifts account for much of Japan's growth "stagnation" and fiscal strains. Japan's population has been declining 0.1 percent annually since 2008 and has shrunk almost 1.5 percent altogether since then. Japan's demographics have a lot in common with those in the United States and Europe because they were shaped by the events of World War II. The population growth of the United States has slowed to 0.7 percent annually in the last decade, down from 1 percent annually in earlier times, not as much as Japan's because immigration flows tend to temper a country's demographic trends. And the population growth of the European Union members in the aggregate has slowed to 0.2 percent annually since 2008.

A slowdown in the growth of a nation's population, although leading to a slowdown in economic momentum, isn't necessarily a "stagnation" story if it doesn't harm the growth of the country's living standard. However, in the case of Japan and other developed economies, a slowdown in economic growth restrains the growth of the public sector's revenues and, because the obligations of many social programs are "carved in stone" relatively speaking, a demographic-related growth slowdown lies at the heart of the growing fiscal imbalances in those countries.

The same forces leading to Japan's economic struggles have been evident in the U.S. economy since 2008. This was most visible in the normal job market recovery from the 2008 financial crisis, with the unemployment rate falling to 3.5 percent, the lowest in half a century, despite the paltry 1.7 percent average annual pace of growth. It was popular to characterize the slow U.S. pace as "secular stagnation." But that popular label failed to recognize that the source of the U.S. economy's slow growth pace, like that of Japan, was a result of supply-side forces (demographics) and not, as happened in the Great Depression, inadequate aggregate demand.

And the "secular stagnation" label ignores what matters most to the well-being of a nation: the evolution of its living standard. The evolution of Japan's living standard is far more similar to that of the United States and Europe than might be imagined based on a comparison of absolute growth rates. For example, Japan's real GDP increased 5.8 percent between 2007 and 2019, just prior to the global pandemic, but its real GDP per capita climbed 7.3 percent, according to the World Bank. The U.S. economy expanded 22.2 percent from 2007 through 2019 but its real GDP per capita increased 12.1 percent over that span of time. The real GDP of the EU economies in the aggregate increased 12.3 percent in the last decade and the real GDP per capita of the European Union has climbed 10.2 percent.

Demographic forces may prove to be less of a drag on the U.S. economy compared with Japan. Immigration flows tend to be more significant for the United States than for Japan. And the economic impact of a slowdown in the growth of the U.S. population is tempered by sizeable internal migration flows. Infrastructure doesn't migrate with the population and infrastructure needs follow the trail of population.

The Japan analogy is relevant for the United States, but more so when it comes to its fiscal challenges.

A more salient comparison is to the tragically slow economic growth that haunts Western Europe's welfare states.

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It is always wise to try to understand, and where relevant learn from, history and comparisons to others. And my baseline assumption is that when different people, or populations of different countries, face virtually identical circumstances, the distribution of potential outcomes, if not necessarily identical, will considerably overlap. It is the height of hubris to believe "it can't happen here." But of course, when there are important differences, such as less severe demographic pressures in the United States than in Japan, there is an opportunity for different outcomes. And even when important factors such as demography are quite similar or will inevitably become so, policy choices can produce different outcomes. So could the United States follow in Japan's stagnation footsteps? Yes. Is that inevitable? No.

Perhaps a more salient comparison is to the tragically slow economic growth that haunts Western Europe's welfare states. After-tax GDP per capita at PPP is 50 percent higher in the United States than in the American Left's darlings, Sweden and Denmark. The issue will be whether the United States can slow the growth of entitlement spending to prevent crushing levels of debt and taxes. The unfunded liabilities of Social Security and Medicare are several times the national debt, which itself is already at a share of GDP experienced only in World War II. Just to pay for the projected spending on these programs would require tax rates of 60 percent on the broad population of workers and savers, something never seen before. It is difficult to imagine an innovative, robustly growing economy delivering sizable gains in living standards generation after generation when a majority of workers are minority partners in their own (marginal) work incentives.

And of course, there is now a renewed attempt to add expensive new cradle-to-grave entitlements to the existing ones due to go broke in the near future. If the boat is leaking, the first priority should be to plug the leak, not add, or even risk, new ones. That will require political will and leadership not seen fiscally for decades. The last big reform attempt was squandered when President Obama walked away from the proposals of the Simpson-Bowles Commission he himself had appointed. He went on to run the largest deficits, adjusted for the business cycle, of any president since World War II, until President Trump. And now President Biden looks set to hit new record high deficits. So while the United States certainly can, and I hope will, avoid at least much of the slow motion slide to mediocre growth that has befallen Japan and Western Europe, it pains me to say that I am not optimistic we will do so.

It is hard to see a serious "Japanization" of the American economy. Europe maybe, but not the United States.

RICHARD JERRAM
Chief Economist, Top Down Macro

Differences in demographics and institutional structures make it very unlikely that the United States is at risk of becoming "Japanized." To take one example, the U.S. population is set to grow by 15 percent in the next three decades, compared to a 16 percent decline in Japan—where it has already been falling since 2009.

However, there is one area where we can find similarities, which could impair U.S. economic performance in coming years. This is the high level of corporate debt and socialization of risk that is only partly a function of emergency policies stemming from the pandemic.

One of Japan's problems during its lost decades was a failure of creative destruction. That was tied to forbearance from a distressed banking system, forced to prop up large, troubled borrowers. Not enough weak firms were made to exit and this depressed expected returns for their more dynamic competitors or potential new entrants. New company formation dried up. There is not a direct parallel with the United States—market financing is more important relative to bank lending, compared to Japan—but the consequences could be similar. Ultra-low interest rates act as a barrier to creative destruction.

And perhaps it is circular, as we saw with the Fed's policy flip-flop at the end of 2018, where even a moderate

policy tightening caused such alarm that it was soon abandoned. The Fed is in thrall to an over-leveraged corporate sector, dependent on an endless flow of cheap credit.

But this is a relatively minor problem compared to the many challenges Japan faced in the 1990s. It is hard to see a serious "Japanization" of the American economy. Europe maybe, but not the United States.

All the leading economies in the world are to a certain extent "Japanized."

HEINER FLASSBECK
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The answer is simple: All the leading economies in the world are to a certain extent "Japanized."

Beyond rising government debt in the wake of the coronavirus shock, the macroeconomic conditions in the industrialized world are such that rising government is unavoidable. Steadily rising government debt first became a normal feature of the Japanese economy after the bursting of the big financial bubble at the beginning of the 1990s. The Japanese business sector began to repair its balance sheet, as Richard Koo called it, and became a net saver. However, this behavior of the business sector in Japan was not just the answer to the deep recession, but became the new norm in many countries. Meanwhile, most of the industrialized countries have had to live with this new institutional arrangement. The attempt of the neoliberal revolution to revitalize the market economy by deregulation and more labor market flexibility has brought about a fundamental shift concerning the role of companies—unfortunately, a shift in the wrong direction.

At this point, I have to repeat what I said in an earlier *TIE* symposium (Fall 2020): "The original idea about market economies was based on the belief that private companies would do what has to be done in a world where private households are not spending the whole of the income that they receive from companies. For more than two hundred years, every good economist was sure that the net debtor position of companies would be the natural counterpart to private households who are net savers. To deliver investment based on net debt was the role to be expected from the company sector. But this is no longer true."

The fact that the U.S. economy was able to achieve rather high growth rates and a good employment performance after 2008 is only due to the fact that the government was willing to adopt a very pragmatic fiscal policy by accepting very high government deficits even when full employment was reached immediately before the corona crash. Including public debt that was accrued during the corona crisis, the world will see levels of government debt as never before. However, this is not a major problem. It just reflects that in the modern times of saving companies, a reasonable economic development is not possible without a permanently greater financial commitment on the part of the state. Japan learned that lesson a long time ago. The United States is learning by doing. Only Europe and some conservatives are refusing to acknowledge that someone must give if everyone wants to be a saver.

We are living in a world of diminished expectations on the side of employees. Wages are not rising even when the economy touches full employment. With diminished private demand, business investment remains sluggish and only the state can fill the demand gap. But this creates a new and very serious problem. Governments can fill a demand gap, but they are not able to fill the productivity gap that results from sluggish private investment. A poor productivity performance reinforces the weakness of private demand and puts the government in charge forever.

"Japanization" may be simply another term for a new normal in twenty-first century managerial capitalism.

MICHAEL LIND
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When used in a broad rather than a narrow sense, "Japanization" can be a useful shorthand term for trends that are shaping the future of all developed economies, including those of Japan and the United

States. The most important are demographic, technological, and employment-related institutional trends.

First is demographics. The U.S. native fertility rate fell below replacement in the 1970s. In 2019, before the Covid-19 pandemic, it was 1.69, not that much higher than Japan's 1.4 total fertility rate. Fertility among foreign-born immigrant women in the United States is 2.02—above that of natives, but below the 2.1 fertility rate needed to prevent the population from shrinking. To contribute to rapid GDP growth, the United States would need to dramatically expand legal immigration—something that neither the United States nor other Western democracies are likely to do, given populist backlashes against high levels of immigration. Nor is increasing immigration to the United States a plausible answer to the gap between the cost of entitlements like Social Security and Medicare and their existing funding mechanisms. Politically unimaginable levels of expanded immigration would be necessary to reduce the aging of the U.S. population only slightly—and subsequent expansions would be necessary, once those immigrants themselves retired.

Next is productivity growth. Apart from a blip in the 1990s, which may have reflected the short-term gains from the installation of information and communications technologies, productivity growth has been low for the last generation in the United States, as well as in other OECD countries including Japan. Because the trend is similar in otherwise quite different nations, the reason for the productivity slowdown probably has to do with technological trends common to all developed countries. If the school of thought associated with economist Joseph Schumpeter is correct, productivity growth is not continuous, but comes in bursts associated with new, unforeseen, general-purpose technologies—the steam engine, the internal combustion engine, the electric motor, the computer. Because the low-hanging fruit has already been picked, breakthrough technological innovation becomes ever more difficult for succeeding generations, if it is possible at all. Individual countries and international consortiums, along with corporations, can and should invest in research and development at the technological frontier. But it is possible that there are inherent limits imposed by physics and chemistry to technological innovation in areas like energy, manufacturing, and computing. The long-term pattern of technological progress may be an S-shaped curve that turns into a plateau, rather than an upward diagonal line or exponential growth.

Last is the proliferation of bad jobs and low wages. In the late twentieth century, analysts distinguished free market Anglo-American capitalism from more corporatist "Rhenish" capitalism and paternalistic Japanese capitalism. In the last generation, however, a growth in the low-wage, insecure "precariat" class of workers has occurred in Japan, the Anglophone world, and continental Europe alike, while labor union density has eroded everywhere.

All of these suggest that "Japanization" may be simply another term for a new normal in twenty-first century managerial capitalism. Governments can try to counteract the three trends described above. But it is not clear how to boost below-replacement fertility among natives and immigrants alike. The next transformational set of technologies cannot be willed into being and may not even exist. And national reforms to raise wages and improve jobs will meet determined resistance from the interests that have profited from low labor costs. Like Japan, the industrial world as a whole may need to lower its expectations and muddle along.

The similarities between Japan's predicament and the United States are exaggerated.

ATMAN TRIVEDI
Managing Director, Hills and Company

In the 1990s, Japan's economy famously experienced anemic growth and price deflation, initiating a painful period often referred to as the country's "lost decade." Experts may look at Japan's predicament and see some eerie similarities to the United States today. Their concerns are not without merit but more likely than not are exaggerated.

Even before the onset of Covid-19, the U.S. economy experienced a prolonged period of slow growth following the 2008 financial collapse. A chorus of voices points to the dearth of political leaders who have argued for budgetary discipline amid the secular stagnation and well into a historic health crisis. U.S. sovereign debt relative to GDP has increased, similar to as it did in Japan. Asset prices are high, invoking fears of a bubble.

Yet a current snapshot of the U.S. economy, an almost $23 trillion juggernaut, is largely encouraging. In the second quarter of 2021, GDP grew at 6.5 percent according to the Commerce Department. The Bureau of Labor Statistics reports that unemployment has steadily declined to 5.2 percent in August 2021. Wages continue to rise, while equities are soaring with the S&P 500 climbing above 30 percent in the past year.

Not everything is coming up roses, however. Consumer prices reached a thirteen-year high this summer, and the economy seems to have encountered speed bumps as the Delta variant ravages the unvaccinated. More fundamentally, many Americans have been unable to participate in the recovery—a condition that long predated the pandemic.

Recent fiscal and monetary stimulus has targeted left-behind residents to prevent them from falling deeper into the cracks created by Covid-19 and Washington's chronic inattention. Outside the United States and China, much of the global economy is sputtering. For decades, the U.S. government did not invest in areas such as (physical and digital) infrastructure, research and development, education, and cutting-edge technologies such as new types of transportation infrastructure that rely on low-carbon fuels.

A once-in-a-century crisis has opened a fleeting window into a once-in-a-generation opportunity to support the international economy, unleash higher long-term growth rates, and begin to address profound societal inequalities.

There are, of course, limits to public spending. Ever-increasing debt will eventually push rates higher. The essential question of where to draw the line depends on factors such as the likelihood of the virus mutating into virulent forms faster than vaccines and therapeutics can keep pace, the resulting impact on the economy, and the merits of the proposed public investment. Maintaining the United States' strategic economic advantages over China's state-backed model calls for selective public intervention.

Finally, the summer spike in inflation appears to owe primarily to pandemic-induced shortages and supply delays, from semiconductors to workers to homes. That situation might persist for longer than anticipated, but it seems too early for the Federal Reserve to tighten policy in response.

Beyond these manageable near-term challenges, however, there are reasons to be optimistic that the U.S. economy can avoid replicating Japan's experience. U.S. demographics are more favorable, U.S. tech and biopharmaceutical companies operate at the frontiers of innovation, and entrepreneurs benefit from the rule of law and deep, liquid financial markets. A divided public just needs competent and compassionate leadership that can harness these unique strengths. ◆

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