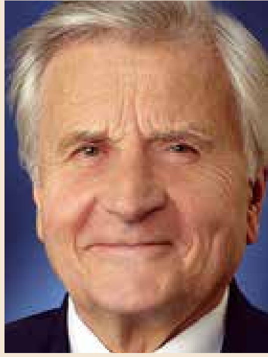
Is the World *Still* at Risk of The "Japan Disease"?

THREE YEARS AGO, *TIE* asked this question:

> *To what extent can the global picture of 2017 be described in one sentence: Significant parts of the world are at risk of becoming more like Japan. In other words, the world's public and private debt today is approaching 300 percent of GDP. Yet despite an extraordinary degree of monetary expansion and relatively tight labor markets, a number of central bankers are finding it tough to meet their inflation targets. Meanwhile, wage growth remains modest. Productivity gains are disappointing. As Japan has done in recent years, some central bank authorities, including those in China, are purchasing equities to stabilize stock markets. Has the world been afflicted with a kind of 'Japan disease'?*

Now, with the world economy in meltdown as a result of the coronavirus, are large parts of the world about to fall into an extended low-growth funk, weighed down by unheard of levels of debt, disinflationary pressures, a non-stimulative monetary policy, low productivity, and an aging population?

More than thirty expert analysts tackle the question.



Sound macro policies are the best vaccine against future instability.

JEAN-CLAUDE TRICHET
Former President, European Central Bank

When looking at the present extraordinary situation created by the global pandemic, there is the temptation to take the worst global crisis in a century as a single event which would *per se* dramatically change the course of the global economy. In my opinion, it might be more enlightening to see it as the addition of two major layers: first, the weak state of the economy before the pandemic; and second, the particular impact of the pandemic applied on the pre-pandemic situation. Before the pandemic, the global situation was already worrying.

First, after the 2008 financial crisis, loose macro policies were pursued in many countries. In particular, several advanced economies posted persistent structural current account deficits, erratic fiscal policies, and timid structural reforms. Many emerging economies embarked on massive indebtedness.

Second, in all countries the main burden was on the shoulders of the central banks, with the other stakeholders, including governments, parliaments, the private sector, and social partners, standing back.

Third, new public and private debt piled up. The consensus is that additional global outstanding public and private debt of an order of magnitude of 40 percent of global GDP was added from 2008 to 2019. What a paradox when it was obvious that the Great Financial Crisis was itself caused by over-indebtedness!

Fourth, the level of investment was abnormally weak in many economies, particularly in the advanced countries.

Fifth, due to a combination of low investment, poor demographics, and a drop of total factor productivity since 2005, economic growth was low.

Sixth, previous factors combined to produce low unit labor cost growth, amplified by weakening of bargaining power of labor, low inflation, and the abnormally low level of nominal interest rates, pushed down by very low neutral rates.

All this was observed before the pandemic. This is not to say that everything was negative. Job creation had made progress in many advanced and emerging economies. Science and technology were making more advances than ever. There were some reasons to think that total factor productivity could be on the rise again in the future, and there were signs that labor would call for more dynamic growth of wages and salaries.

But the bottom line was that the global economy was in a vulnerable financial and economic situation before the virus breakout.

Applied to this pre-pandemic situation, what is the specific impact of the exogenous coronavirus? I see three dimensions.

First, on a short- and medium-term basis, the pandemic alone triggers an artificial "economic coma," a crisis which is the gravest since World War II. There is no doubt that it will be much graver because the previous economic and financial situation was weak.

Second, on a longer-term basis, the virus crisis is a strong call for reinforcing resilience through sound economic, fiscal, financial, and structural management, and risk optimization at national, continental, and global levels, including in terms of diversification of sources of supply. Resilience also means setting up social safety nets and reinforcing social cohesion so that exogenous shocks do not destroy societies.

Third, the present crisis is a strong wakeup call on international cooperation. A pandemic is global by definition: the virus is attacking all members of the human species without exception. Pandemics call for global response for the sake of humanity. It was a pity that at the very beginning of the crisis, the international community was *quasi* absent due to the spread of national populism in both the advanced and the emerging countries. There was no early mobilization of the G20 (contrary to 2008). Renewed multilateralism is more important than ever if we want global public goods to be preserved, in particular global public health, climate change mitigation, and economic and financial stability.

The main lesson to be drawn from the present crisis is that resilience and sustainability should always be of the essence in all domains of human activity. And as regards economy and finance, whatever the enormous difficulties we face with the cost of the crisis, the mottoes should be "Do not let central banks act alone in the future as was the case in the past," and "Do not forget that sound macro policies are the best vaccine against future instability."

Beware the danger of 2 percent inflation targets.

JACQUES DE LAROSIÈRE
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The present coronavirus crisis is shedding light on some of the consequences of monetary policy as it has been operated over the last decades.

As always, financial crises and instability are caused by excessive debt: global indebtedness has increased by more than 40 percent since 2008. And such a debt explosion had been propelled by easy monetary policy. High leverage was becoming problematic and very risky before the coronavirus broke out. Defaults had started, especially in the high-yield and BBB corporate sectors.

Because of quantitative easing, investors have accumulated huge long-duration interest risk without appropriate pricing. In the eye of asset holders, the only way to avoid a collapse of market instruments would be to continue and intensify quantitative easing.

But the dangers of a systemically accommodative stance with long-running negative real interest rates are well known: they weaken the financial system, create asset bubbles, and blur risk differentiation. And, contrary to expectations, they do not foster productive investment, but encourage the hoarding of the most liquid forms of savings.

One reason for this excessively accommodative policy concerns the enigma of the 2 percent inflation target (a little less than 2 percent but close, says the European Central Bank). This reference to 2 percent is incomprehensible and is, in my view, an intellectual mistake given the price-dampening effects of structural factors such as aging populations, technological changes, globalization, and the evolution of labor market behavior. The equilibrium interest rate, avoiding excessive inflation as well as deflation, is closer to 1 percent than 2 percent. And a 1 percent or 1.5 percent rate is not a problem, rather a sign of stability.

Yet central banks have been meticulously anchoring their monetary policy to 2 percent, an unattainable objective. This has entailed an unnecessary expansion of money creation and a huge debt overhang.

Such a monetary stance embodies self-inflicted pessimism. Betting on an unattainable goal brings a psychological cost. Although central banks cannot reach the arbitrary inflation target, they have come to believe they must create enough fiat money to somewhat "force up" prices.

These ideas fix in the public mind the notion that interest rates will remain negative for a very long period, maybe even several decades. This, in turn, depresses public opinion that comes to believe that central banks have no hope for the future and therefore that it is best to keep away from investing.

With the huge expansion of quantitative easing associated to the pandemic crisis, it is important to reflect on this issue and avoid the pitfalls of unnecessary and harmful high inflation targets.

Yes, beware the long, dragging conditions of semi-slump.

DAVID G. BLANCHFLOWER
Bruce V. Rauner Professor of Economics, Dartmouth College, and former member, Monetary Policy Committee, Bank of England

In 2008, the world was hit by a financial shock not dissimilar to the Great Crash of 1929. Both started in the Florida housing market and spread. Economist John Maynard Keynes in 1930 warned what was coming:

> *For it is a possibility that the duration of the slump may be much more prolonged than most people are expecting, and much will be changed both in our ideas and in our methods before we emerge. Not, of course, the duration of the acute phase of the slump, but that of the long, dragging conditions of semi-slump, or at least sub-normal prosperity, which may be expected to succeed the acute phase.*

The Great Depression that followed only ended with war. Unemployment in the United States peaked at 25 percent in 1933, and in the United Kingdom was just under 16 percent. During the Great Recession, the

unemployment rate hit 10 percent in the United States and 8 percent in the United Kingdom, and the authorities threw the kitchen sink at it, but they were late to the case. The United States went into recession in December 2007 and the rest of the world in April 2008, but nothing much happened in terms of solving the problem until after the failure of Lehman Brothers in September 2008. By then it was too late.

It was hardly surprising that after such a late response by governments and central banks, subsequent growth was slow. Economists missed the big one; their models didn't even allow for the possibility of a financial market-induced recession; they were hopelessly hung up on the possibility of surging inflation that never occurred that soon turned to deflation.

In the United Kingdom, based on how long it took for the output loss to be restored, it was the slowest in three hundred years. Only the recoveries after the Black Death and the South Sea Bubble were slower. By March 2020, the employment rate in the United States and real wages in the United Kingdom were still below their pre-recession levels. After a decade of slow recovery, economies were not well prepared for an even bigger economic shock to come—a global coronavirus pandemic.

Austerity that was imposed soon after economies started to recover turned out to be a disaster and led to right-wing populist movements around the world. It made communities especially vulnerable to an economic shock caused by a global pandemic that closed advanced countries around the world.

By the beginning of May 2020, thirty million workers in the United States had signed up for unemployment benefits in a six-week period. It took twenty-two months for the U.S. unemployment rate to go from 5 percent in December 2007 to 10 percent in October 2009, but only two months to go from 3.5 percent in February 2020 to 20 percent in April.

Economic indicators from around the world plunged to new lows at velocities that had never been seen before. The April UK manufacturing Purchasing Managers' Index was typical, contracting at the fastest rate in its twenty-eight-year survey history, but with more declines to come.

This time the authorities moved quickly and central banks held emergency meetings, but clearly not enough has been done again. Ordinary people are struggling to pay the rent and there are long lines at food banks in the United States. The coronavirus continues to spread because workers need to eat. Men with long rifles protested against the lockdown by invading the Michigan state house.

Once again there is bizarre talk of the need for austerity and of a possible inflation surge. These are dark days of sub-normal prosperity. Beware the long, dragging conditions of semi-slump.

The strength of disinflationary pressures indicates that the resulting shock to demand is stronger than the shock to supply.

MARINA V.N. WHITMAN
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In asking whether much of the world is about to descend into a long low-growth funk, it helps to divide the response into two periods, pandemic and post-pandemic. While much of the world is in the grip of Covid-19, the strength of disinflationary pressures indicates that the resulting shock to demand is stronger than the shock to supply, mainly because there are no good substitutes for the goods and services normally produced by the shut-down sectors.

This is one reason why it is rational to postpone consumption until the missing items are once again available, and this decline in demand in turn discourages new investment. The explosion in both public and private debt, the former due to massive stimulus programs and the latter to sudden losses of wage income, along with profound uncertainty about what the future holds, is another brake on spending. Small wonder that inflation expectations have declined, adding to disinflationary pressures.

Like the Bank of Japan before it, the U.S. Federal Reserve, with virtually no room for monetary easing through interest rates, has undertaken massive ($700 billion) quantitative easing in an effort the increase the money supply, in addition to creating some $300 billion in direct lending to business. And, unlike Japan, most other industrialized countries have not introduced successive increases in sales taxes. But the underlying deflationary pressures, in the form of slow growth in many countries owing to a shrinking workforce and low increases in productivity, are being exacerbated by the impact of the pandemic. Estimates of the decline in GNP in many countries make clear that the world is in deep recession

Once the worst of the pandemic is behind us and most affected countries are opening up, what will the "new normal" look like? Some disinflationary pressures are likely to remain. Among them are ongoing pressure on services, as a shift from face-to-face to remote fulfillment methods,

developed or accelerated during the pandemic, is likely to become permanent. The expansion of telemedicine and remote surgery are just two of many examples. The same is true for labor-saving innovations developed during the lockdown period.

On the other side, one can imagine the development of changes that would increase national growth rates and stimulate inflationary pressures. One would be policy changes that expanded safety nets financed by increases in progressive taxation. There are rumblings that such developments are becoming more mainstream, particularly in the United States, the stingiest and most tax-averse of the industrialized countries. They would stimulate the consumption-investment cycle because individuals lower down in the income distribution spend more of any increase in income than do those higher up. The same would be true of an expansion of infrastructure projects, also financed by taxation, that would expand the supply of public goods relative to private ones. Finally, just as delayed consumption outran disruptions to supply chains on the downside, the same pattern might prevail during the recovery.

Just now, the disinflationary pressures look more likely to persist than the inflationary ones. But economists have never been good at forecasting turning points.

Central banks, rather than markets, end up determining long-term interest rates. Japan has shown that this policy mix can be extremely hard to abandon.

TADASHI NAKAMAE

President, Nakamae International Economic Research

The world has been turned upside down by Covid-19, a new virus that scientists are still trying to understand. Many economies have "shut down"—or at least slowed down in attempts to contain the pandemic. Central banks around the world have been trying to help governments mitigate the economic damage and societal pain by ramping up purchases of government bonds. Rightly so.

But such policies raise the specter of Japan and its two "lost decades." The Bank of Japan has resolutely pursued quantitative easing since the late 1990s, purchasing enormous amounts of bonds to support an expansion of fiscal expenditure and cope with slack demand. This mechanism transfers resources from the private sector to the government sector (and does not increase total demand). This is because the Bank of Japan financed these bond purchases by borrowing from private sector banks and not by increasing notes in circulation (printing money). Thus, central banks, rather than markets, end up determining long-term interest rates.

This distorts the natural (market) allocation of resources, which has led to inefficiency, low productivity, and deflation. Japan has shown that this policy mix, aimed at maintaining the *status quo* without promoting structural reform through reduction of overcapacity, can be extremely hard to abandon.

In this moment of unprecedented economic crisis and uncertainty, other central banks have had no choice but to commit to this strategy. They must make the best of its few benefits. Ironically, the strategy has actually helped Japan weather the pandemic a bit better than other countries. Deflation (lower prices) helps ease (somewhat) the pain of falling incomes. Also, a lack of incentives has kept productivity low, helping Japan avert a surge in unemployment and maintain societal stability.

Others can learn from Japan's experience. Demand has dropped suddenly and sharply around the world. Quantitative easing provides emergency relief. The resulting deflation helps consumers. Countries that are protecting jobs by tying corporate aid to promises to maintain payrolls, or to provide steady and ample unemployment benefits, are at least ensuring that they mitigate plunging consumer demand. The less wise are merely propping up share prices, leaving them with a longer road back to recovery.

Small businesses will drive economic recovery post-pandemic across the world. Not only have they been hit the hardest, they are also, in aggregate, a huge employer. Take the United States. Since 2009, large companies improved productivity by cutting jobs. These workers were mainly absorbed by small retail and service companies. Government spending should be concentrated on these businesses and deflation accepted as way to cut costs and as an increase in real income. Policies to help cut costs, notably rent, should also be prioritized.

In the longer term, will countries become entrenched in quantitative easing and its accompanying ills? Not necessarily. First, Japan was able to sustain this policy because consumer demand was stable and because its unemployment rate, at 3 percent to 5 percent, was sustainable. The pandemic has raised jobless rates around the world. The United States has seen its unemployment rate soar to more than 20 percent. At these levels, a demand-neutral policy will not be sustainable.

Second, Japan's experiment failed to address the inefficiencies its heavily accommodative policy created and perpetuated. No one knows what will happen when aggressive easing is coupled with real change and reform.

The inefficiencies will differ among countries. For example, one of the biggest mis-allocations of resources in the United States is the overuse of share buybacks, policies to drive up share prices, and other policies that help only large companies and the wealthy.

Meanwhile, as the current pandemic lays bare the weaknesses of the global economy, societal and economic changes in public health, education, tele-commuting and the environment are already starting to emerge. The pandemic—and its restrictions—is even changing Japan, especially its services sector (a domestic industry that has faced less pressure to reform compared with the internationally competitive manufacturing industry). Many of these changes will be painful but they may be inevitable.

The Bank of Japan is like a canary in a coal mine. Central banks that change their policies immediately after they see the failure of the BoJ will survive.

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

Japan has not experienced hyperinflation nor any significant economic shock since *TIE* chose to pick up this topic in 2017. So it is understandable that other countries are tempted to adopt the same fiscal and monetary policies as Japan, particularly when they have to cope with Covid-19.

The Japanese government and the Bank of Japan adopted a very aggressive policy, so other governments and central banks may think they can implement similar policies.

The Japanese government has been, in effect, practicing Modern Monetary Theory. Outstanding Japanese government debt is 240 percent of nominal GDP, which is much higher than that of Greece at 190 percent, and Italy at 140 percent, and by far the highest in the world. Despite this situation, the reason why the Japanese government has not gone bankrupt is simply because the Bank of Japan can print its own currency, unlike EU member countries.

The Bank of Japan started buying huge amounts of Japanese government bonds through its market operations beginning April 2013. As a result, the Bank of Japan's balance sheet grew significantly. Compared with the BoJ's balance sheet of ¥49.6 trillion ($463 billion) at the end of 1991, it has increased by twelve times to ¥604 trillion ($5.64 trillion).

At one point, the Bank of Japan bought nearly 70–80 percent of the annually issued JGBs. For example, in fiscal year 2017, of the ¥141.3 trillion ($1.32 trillion) of JGBs issued, the Bank of Japan bought ¥96.2 trillion ($0.90 trillion). As a result, the Bank of Japan is holding almost 50 percent of outstanding JGBs now. This is clearly a monetization of debt.

When and if the economy recovers, the Bank of Japan will have to shrink its balance sheet. However, it will be very difficult for the government to pay back the debt to the Bank of Japan from its tax revenue alone as the government has run huge fiscal deficits for the last thirty years. Also, other investors may not buy JGBs from the Bank of Japan at such low interest rates. It means that it is almost impossible for the Bank of Japan to shrink its balance sheet.

It will be much more difficult for the Bank of Japan to raise its policy interest rate as well. The average yield of the JGBs which are held by the Bank of Japan is merely 0.26 percent (at the end of September 2019), and the resulting interest income is only ¥1.4 trillion ($13 billion) annually. Further, 97 percent of JGBs held by the Bank of Japan are long-term bonds, hence even when interest rates rise, interest income will not increase as quickly. On the other hand, interest expenses that the Bank of Japan has to pay on its current account will be huge. Deposits at the current account with the Bank of Japan are ¥395 trillion ($3.7 trillion as of the end of March 2020), and a 1 percent increase of its policy interest rate will cost the Bank of Japan ¥3.95 trillion ($37 billion) annually. The provisions and legal and special reserves is only ¥9.5 trillion ($37 billion, as of the end of March 2020). So the Bank of Japan could have a negative net worth.

In comparison, the average yield of bonds held by the Federal Reserve was 2.6 percent (January–June 2018), so the Fed received a reasonable amount of bond-related revenue (for example, $112.2 billion in 2017, far more than what the Bank of Japan earns).

The Bank of Japan's situation is totally different from the Fed. If the Bank of Japan raises its policy interest rate, its net worth will easily become negative.

Other central banks will more or less face the same problem as the Bank of Japan when their economies recover after Covid-19.

The Bank of Japan, on the other hand, may experience difficult problems even while battling Covid-19.

The Bank of Japan is a monstrous holder of JGBs but it will also become the largest stock holder in Japan this year. It also became very influential in the real estate

market through its purchase of REITs. It has become a central bank of a planned economy.

The Bank of Japan's biggest problem is that the prices of these financial instruments fluctuate a lot, so on a mark-to-market accounting basis, the Bank of Japan's net worth may easily become negative. Traditionally, central banks never purchase such assets to prevent the deterioration of their balance sheets.

Last March, the Japanese stock market carefully eyed the Nikkei 225 index because the Bank of Japan would have unrealized losses in its stock portfolio if the index went below ¥19,000.

The more serious problem is the unrealized loss from its JGB holdings. As I mentioned, the average yield of JGBs held by the Bank of Japan is only 0.26 percent. The duration of such JGBs is around six of seven years, so if the ten-year JGB yield goes up to around 0.3 percent, the Bank of Japan's net worth may become negative. The ten-year JGB rate is about zero percent today, so if ten-year JGB yields reach 0.3 percent, the Bank of Japan's net worth may become negative. The Bank of Japan will make every effort to keep long-term interest rates below 0.3 percent. However, I do not think it is possible to keep long-term rates low forever.

Moreover, it will have to buy more JGBs at around zero percent to cope with Covid-19. This means that its break-even interest rate level will be lower. As the amount of JGBs held by the Bank of Japan is so large, even a small increase in interest rates will result in a huge amount of unrealized loss.

When asked about this issue, Governor Haruhiko Kuroda commented that there will be no problem as the Bank of Japan has adopted accrual accounting. Will the market accept his explanation? If not, the Bank of Japan will completely lose its credibility, and, as a result, the value of the yen will collapse. And if that happens, Japan will face hyperinflation.

Once this happens, I think the Bank of Japan will have to be abolished and a new central bank will be established in order to reestablish the value of the currency. Simultaneously, the current yen will be abolished and a new currency will be issued.

This in fact is what happened in Germany after World War II. The Reichsbank was abolished and the Deutsche Bundesbank was established.

The Bank of Japan is like a canary in a coal mine. Central banks that change their policies immediately after they see the failure of the Bank of Japan will survive. However, central banks which cannot learn from the Bank of Japan's failure will follow the same path, and a new central bank will need to be established.

There is no such thing as a free lunch. Governments and central banks should learn from history. Monetization of debt is taboo.

We will all be more Japanese than ever!

HEINER FLASSBECK

Director, Flassbeck-Economics, and Former Director, Division on Globalization and Development Strategies, United Nations Conference on Trade and Development

The answer to your question is yes! After the corona shock, the world is facing a new phase of rapidly growing government indebtedness. We will all be more Japanese than ever!

Since, for reasons of logic alone, government savings and consolidation are only ever possible if another sector is willing to run up debt, the industrialized economies have no alternative to going for more government debt as the corporate sector has become a net saver. With the corporate sector as net saver, the question arises whether democratic states can force their private companies to go into debt—by raising corporate taxes for example. If governments lack the courage to try that way, more government indebtedness is logically unavoidable.

Countries with current account deficits in particular find themselves in a hopeless situation. A current account deficit implies that the existing demand gap—created by domestic households and companies—is widened by the surplus countries.

This means that in Europe, for example, the surplus countries of the North are directly responsible for the fact that the austerity efforts of the Italian state have not borne fruit. Anyone who does not take note of this and pretends that it is only a matter of political will in the country concerned, whether or not it is consolidated successfully, lacks the necessary expertise—perhaps even common sense. If a country in the South has Nordic surplus freaks as trading partners and is in a monetary union with them, it is lost, especially in a global economic crisis such as the current one.

Another purely logical consequence of this crisis also escapes most observers. It is argued that in a few months' time, 100 percent debt relative to GDP will be as problematic as it was at the beginning of this year (if it ever was). Italy is projected at 180 percent and this is a startling figure. But it is meaningless. Even according to the prevailing doctrine, it is only meaningful in relation

to the corresponding figures in other countries. If, in the course of the global corona crisis, the ratio of public debt to GDP increases by 30 or 40 percentage points in almost all countries, the economic policy assessment of a state's debt level will depend at most on a comparison with other states, but not on a comparison of the pure figure with any norms that applied previously.

The European Union, with its once-established norm of 60 percent, will also have to learn this. Anyone who insists that all countries must return to this norm after this crisis is making a huge mistake. There has never been a substantive justification for the 60 percent written into the Maastricht Treaty. The attempt to force the entire eurozone to adopt a savings course for public budgets towards the 60 percent target after the corona crisis will not succeed because of the net saving role of companies. On the contrary, any attempt in this direction will cement the savings wishes of both the corporate sector and private households, because they will make any positive macroeconomic development after the crisis more difficult and therefore every single economic actor will anxiously want to keep his money together.

What Japan "disease"?

KISHORE MAHBUBANI
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No one knows what the post–Covid-19 world will look like. But we know it will be very different. Many countries are likely to suffer from low growth and high debt, the "Japanese disease." Poor developing countries will certainly suffer from this condition. Yet for developed economies, the "Japanese disease" could well become the "Japanese cure." Even China could learn a lesson or two from Japan.

Conventional wisdom tells us that America has done well in recent decades while Japan has faltered and stagnated. Economic data confirms this. The U.S. economy has grown at an average rate of 2.6 percent from 1988 to 2018, while Japan grew by only 1.4 percent. Hence, U.S. per capita GDP (current US$) rose from $21,417 to $62,794 in the same period, while Japan's went up slightly from $25,051 to $39,290.

But how did the people fare? Despite economic growth, Americans fared badly. The United States is the only major developed society where the average income of the bottom 50 percent went down over a thirty-year period. Two Princeton University economists, Anne Case and Nobel Prize winner Angus Deaton, have documented how this has produced a "sea of despair," leading to "family dysfunction, social isolation, addiction, obesity, and other pathologies." This "sea of despair" has in turn given rise to populist anger and political polarization. America is not a happy place.

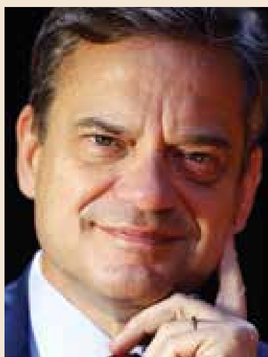
By contrast, when one looks at key data that measures social well-being, including life expectancy, infant mortality, working class incomes, and cost of basic necessities (food, clothing, health, education), the Japanese people are better off. Japan has longer life expectancy and lower infant mortality rates. Japan has lower inequality at 29.9 compared to 37.8 for the United States for Gini inequality. Japan also spends far less on healthcare (9.5 percent of GDP compared with 16 percent in the United States) with far better outcomes, as well as in education where university costs are about one-quarter those in the United States.

John Rawls, the eminent American political philosopher, wisely said that the best society to be born into (if one didn't know which class we would be born into) would be the one where the bottom 10 percent are best off. The bottom 10 percent in Japan lead a far better life than those in the United States.

In short, the contrasting fortunes of those at the economic bottom of United States and Japan raise profound ethical and philosophical questions about the nature of human societies we want to create. American society remains sparkling in many respects. The Japan which was once acclaimed as "Japan as Number One" in 1979 hasn't produced an Apple or Amazon, Facebook or Google, Microsoft or Tesla. Yet it is also clear that the fruits of America's economic growth have been siphoned away by the top 1 percent (if not the top 0.1 percent). As I document in *Has China Won? The Chinese Challenge to American Primacy* (2020), deep structural forces have led to this enormous inequality and social dysfunction. Since powerful entrenched vested interests will prevent U-turns, there is little hope that the condition of the bottom 50 percent in America will improve anytime soon.

China should do a deep study of how the bottom 50 percent have fared in both America and Japan. In Chinese society, like Japanese society, social harmony is prized more than individual achievements. Equally importantly, despite low growth, Japan has preserved a

society with social harmony, a focus on deeper meanings of life, including beauty, care for environment, and self-reflection, as well as a deep sensitivity to fellow citizens. No human society is perfect. Yet the balance that Japanese society has generated between meeting our material and non-material needs is a model worth studying and emulating, even for China.



The key factor is demography. Demographic trends tend to be highly predictable.

LORENZO BINI SMAGHI
Former Member of the Executive Board, European Central Bank

Prior to the Covid-19 crisis, several indicators were suggesting that most advanced economies were gradually moving in a direction similar to that experienced by Japan over the last two decades, with slowing growth, low inflation, and low—in some case even negative—interest rates, and with fiscal and monetary stimuli that end up in an increasing proportion of public debt being held by the central bank. The crisis is likely to accelerate this trend. The shock to the world economy should reduce capacity utilization below potential for several years. The pick-up in activity is expected to be gradual and the excess of savings over investment will persist. The preference for liquidity and the high risk aversion will prevail for a long time.

The unprecedented fiscal expansion which has been implemented in all countries after the crisis is unlikely to affect this scenario. Budgetary stimulus will certainly contribute to supporting aggregate demand, but the availability of spare resources, in terms of labor and unused capital, will not allow inflationary pressures to materialize for a long time. Interest rates will remain low, to stimulate private investment and ensure the sustainability of the much higher public and private debt. Central banks will continue to be involved in purchasing and holding assets in order to accommodate the high preference for safer and more liquid assets and to counteract spurts of market volatility that could stress credit spreads and produce negative consequences for the real economy.

The underlying weak economic growth will not allow a quick reduction of the higher levels of debts. On the other hand, restructurings or defaults would produce major contagious effects on the financial system that the world economy cannot afford. The recovery after the crisis cannot be impaired by financial instability.

This implies that the economy will run at a lower level of efficiency for several years, with many surviving companies and financial institutions being kept in the market through the help of public support and very low interest rates. Restructuring will be possible only when the economy becomes sufficiently strong to absorb the shock, which may take quite some time.

Can we call this scenario a disease? It largely depends on the alternative. The key factor in determining whether an alternative will exist is demography, which commands not only the excess savings and low risk aversion but also the political choices that societies will take and tolerate. Demographic trends are slow to change and tend to be highly predictable.

The risk of a global "Japanification" has increased but is by no means a foregone conclusion.

STEFAN INGVES
Governor, Sveriges Riksbank

"Japanification" is a concept that is multifaceted and not always well defined. To simplify, I would like to narrow down the question somewhat to address monetary policy issues in particular: "Does monetary policy around the world risk facing the same situation as in Japan, where with a policy rate close to the lower bound it is a struggle to raise inflation and inflation expectations?"

Since *TIE* asked the question three years ago, the debate on "Japanification"—or "secular stagnation," which is basically a synonymous or at least a very similar concept—has intensified. Before the corona pandemic struck globally, at the American Economic Association's Annual Meeting in January, former ECB President Mario Draghi and others warned of a similar phenomenon, mainly in Europe—although he also stressed that such an outcome was by no means a foregone conclusion.

The problem for monetary policy is that the combination of a very low real equilibrium interest rate and very low inflation expectations will result in low nominal interest rates on average. The scope for lowering the policy rate in bad times will then be very limited, as it will hit its lower bound sooner. Even before the pandemic there were concerns that the scope for lowering policy rates was not enough to counteract the recession that everyone knew would come sooner or later. This was also an issue in the United States, despite the Federal Reserve being able to raise the policy rate above 2 percent.

So now a recession is rapidly on its way, with a force and in a form that no one could have guessed as recently as six months ago. Those central banks that had raised their policy rates have cut them rapidly, and in most countries the policy rate is now at, or very close to, the perceived effective lower bound. In that sense, more central banks have found themselves in the same situation as the Bank of Japan.

What will happen in the coming years depends on how the pandemic will affect the prerequisites for monetary policy. Different scenarios are possible, both for the real equilibrium interest rate and inflation. It may be that huge government spending and borrowing will reduce the surplus in savings and lead to a rise in real interest rates. At the same time, it is also possible that a high degree of uncertainty will persist after the pandemic has petered out, resulting in high precautionary savings for many years to come. As for inflation, there is concern in some quarters that large increases in fiscal deficits and central bank balance sheets will result in high inflation. An alternative scenario that more people seem to believe in is that factors such as high unemployment and high precautionary savings will contribute to muted inflation in the coming years, perhaps a bit below central banks' targets. The risk here is that long-term inflation expectations will also fall and become entrenched at low levels.

There are, of course, other ways to conduct monetary policy, not least by the measures introduced after the financial crisis, which we by now probably should stop calling "unconventional." We know that they work, but the experiences of them are more limited than those of setting the policy rate. Moreover, monetary policy is not "the only game in town." But even if fiscal policy can be an efficient tool for counteracting recessions, it can hardly be given the task of maintaining confidence in an inflation target.

So yes, there is still a risk that many central banks will have to deal with the monetary parts of economic policies similar to Japan's, and the pandemic has probably increased this risk. Like Mario Draghi, I would like to stress that a "Japanification" is by no means a forgone conclusion. But what is pretty certain is that monetary policy around the world will face considerable challenges in the coming years.

Even if we do get things right, we will not turn our economies into Porsches, but at best into Volkswagens.

LUDGER SCHUKNECHT
Deputy Secretary-General, Organisation for Economic Co-operation and Development, and former G20 Deputy and Chief Economist, Federal Ministry of Finance, Germany

There is indeed a high probability that our economies will continue plodding along when the crisis dust has settled. We will see low economic and productivity growth, constrained by population aging and high private and public debt.

We can master these headwinds and maintain stability with the help of reasonably well-functioning markets and sustainable policies. But there is a risk of a much less benign scenario, and instability could be stoked by three factors that may mutually reinforce each other.

First, debt accumulation and zero interest rates can continue for a long time—much longer than we thought a decade or two ago—but not forever. There is a macro financing constraint that will bite at some point. But we do not know when it will hit. Inflation may not stay ultra low. The forces that reduced price pressures for three decades may now be reversing—for example, as post-covid value chains may deglobalize. In the long run, the global savings-investment balance may change as populations in advanced and emerging economies age (witness the strong decline in household savings in Japan in the past twenty-five years). Stability will be most at risk when low growth and high debt prevail and come together with higher inflation *cum* interest rates.

Second, who is seen to benefit from crises and cheap money? Here, perception is often reality. Bankers profited in the boom and were saved in the bust. Asset owners are now bailed out again. This is not good for social cohesion and popular support of the market economy model, even if our systems today are often more social and redistributive than at any point in history (witness record social spending).

Third, the nature of our economies is at risk of changing. We seem to expect public insurance from financial to corporate to social challenges. This is more than governments can reasonably do. And incentives to build buffers and limit risks have thereby declined. We need the Schumpeterian process of creation and destruction;

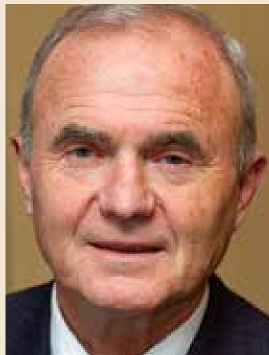
zombie firms and banks are not a sign of responsibility and economic dynamism.

As regards growth, structural reform should be the way to rebuild confidence and incentives and master the digital transformation that this crisis will speed up. More sustainable macro policies will also help. Tax incentives favoring debt over equity should go.

What to do about public debt? Some economists do not seem to mind and believe that an orderly deleveraging of government debt via financial repression/inflation is possible. But do we have the knowledge or ability to engineer such processes? Some believe that governments can default in an orderly manner. But can this be orderly, especially for large, systemically relevant countries?

Economic history and reform experiences show that comprehensive fiscal and structural reform are the way to go to boost growth, reduce debt, and maintain stability. Many countries have successfully done this. Ireland, Portugal, and Spain were the latest examples after the euro crisis. Such programs succeed but they take time—there is no reason to discredit them as seems the temptation now.

Even if we do get things right, we will not turn our economies into Porsches but at best into Volkswagens. Still, fasten your seat belts!



The great risk is productivity-damaging conservation.

OTMAR ISSING

President, Center for Financial Studies, Goethe University Frankfurt, and founding Member of the Executive Board, European Central Bank

As a consequence of the corona crisis, the euro area economy is falling into the deepest recession since its start. Governments and the European Union have reacted forcefully with huge programs of subsidies, credit, guaranties, and of public partnership. Deficit spending on a grand scale will contribute to stabilizing demand. The European Central Bank has started a special asset purchases program and has offered additional lending facilities at negative interest rates implying massive subsidies (banks can get funds at rates which are up to 50 basis points below the rate at which they can deposit funds at the central bank).

The statement that the dimension of a crisis determines the size of the chance to improve policies thereafter exists in various forms. The dramatic corona crisis would therefore entail a tremendous chance in the sense of economist Mancur Olson to overcome the manifold entrenched impediments to economic activity and start a revival of the economy. However, analyzing the policies already adapted and/or announced, it would need a lot of optimism to expect such a result.

In times of great crisis, the state is called upon to counteract the manifold negative effects for all spheres of society. Governments react not only by spending huge amounts of money but with all kinds of direct interventions in markets. When companies seen as systemically relevant such as airlines are in danger of insolvency, nationalization or partial state ownership will be enacted.

Overall, the role of the state in the economy will substantially increase. The corona crisis has revealed dangerous gaps in the health systems of all countries. To establish an intelligent system of greater security in this field is a daunting challenge. However, politics will hesitate to renounce the gain in power due to some interventions once the economic downturn has receded. All kinds of new ownership in the form of state holdings or partnerships in key industries will hardly result in higher productivity. In the low-interest-rate environment, weak banks and via their lending weak companies were already being kept alive. While the zombie problem so far has been relevant for only a small number of countries, this effect might become stronger in the future euro area economies, not least due to policies enacted during the crisis. On the one hand, emergency programs implemented in the middle of the corona crisis unavoidably will also keep companies alive that were in difficulty before. Generous lending, guaranties, state aid, and asset purchase programs by the European Central Bank often "rescue" shareholders and creditors and shift the credit and income risk to taxpayers. They dis-incentivize a quick and orderly reduction of debt overhangs via a program of debt relief. In an environment of dramatically increased public and private debt, the European Central Bank might be trapped by fiscal and financial dominance and continue its massive asset purchases and low interest rate policy beyond the time of economic recovery. On the other hand, political pressure to secure employment will induce governments to continue support for large companies in which they are invested, which would otherwise go bankrupt.

No doubt there will be sectors of the economy where the experience of digitization and other innovations during the crisis will bring substantial gains in productivity. However, there is a great risk that Schumpeterian constructive destruction with strong benefits for growth will not dominate, but instead productivity-damaging conservation.

Given the "headwinds" that debt poses to growth, the global economy will "fall into an extended low-growth funk" unless this problem is addressed.

WILLIAM R. WHITE
Former Economic Adviser, Bank for International Settlements

The global economy is a complex, adaptive system, similar to other systems in nature and society. All these systems suffer non-linear breakdowns with a regularity determined by Power Laws. In the economy, debt accumulation has often been the crucial factor leading to such breakdowns.

Today, the global economy is more exposed than ever. Prior to the Covid-19 pandemic, it already had worrying preconditions. According to the Institute of International Finance, the ratio of debt to global GDP rose from 280 percent in 2007 to 320 percent in 2019. Then the pandemic struck, along with "social distancing," reducing output and the underlying capacity to service debt. In response, both monetary and fiscal policies were eased significantly. While providing life support to an ailing patient, this easing has significantly worsened the underlying preconditions. Debt levels, both private and public, threaten to rise much higher in both advanced and emerging market economies.

Given the "headwinds" that debt poses to growth, the global economy will "fall into an extended low-growth funk" unless this problem is addressed. Only three solutions are possible. First, raise the rate of real growth to make debt service more manageable. Second, restructure existing debt in an orderly way. Third, raise inflation to some moderate level to reduce the burden of debt in real terms. Unfortunately, each of these solutions has risks and is subject to "power politics."

Raising real growth, against a backdrop of high debt, is almost an oxymoron. Fiscal and monetary expansion work to increase demand today, but only by making it harder to do tomorrow. Monetary easing is further constrained by the zero lower bound and the risk of unintended consequences. Aggregate supply will be held back by declining work forces in most parts of the world and protectionist threats to global supply chains.

A second possible solution is orderly debt reduction through cooperative agreements between debtors and creditors. This is the least unpalatable of the alternative solutions. However, it will be strongly resisted by creditors, not least powerful financial institutions and overstretched pension funds. The near-term prospect could then be a disorderly process of debt-deflation in which deflation compounds the difficulties of debt service. Ironically, creditors would lose far more from such a process than from an upfront recognition of debts that are unserviceable.

Trying to raise inflation moderately to cut the burden of debt also has limitations. If macro policy no longer works effectively to raise real growth, through what mechanism would it raise inflation? Moreover, if inflation does rise, can interest rates be held down sufficiently to get the benefit of a reduced real service burden? So this strategy might work, but it also might not. If not, the likelihood is that the official sector would then "double down" on fiscal and monetary expansion, encouraged by the creditor lobby. The danger this poses, as in all complex systems, is that some tipping point might eventually be reached. Inflationary expectations, inflation, and longer rates might rise suddenly to very high levels. We have seen this repeatedly in history, with fears of fiscal dominance always the root problem.

Japanification is a global phenomenon.

JOSEPH E. GAGNON
Senior Fellow, Peterson Institute for International Economics

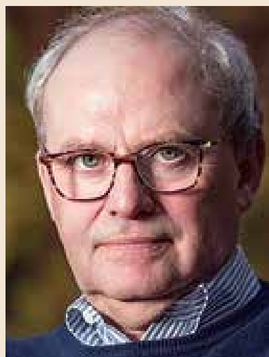
Japanification, also known as secular stagnation, is a global phenomenon. The main cause is a declining birth rate, but productivity growth also has slowed in many countries for various reasons, and another contributing factor may be a shift to economic activities that require less physical capital. Secular stagnation implies a trend decline in the economy's equilibrium real interest rate. For central banks that are slow to recognize and respond to this trend, the outcome is undershooting of inflation targets and persistently high unemployment: the classic symptoms of Japan's disease. The Bank of Japan's about-face under Prime Minister Abe since

2013 had partially ameliorated these symptoms before Covid-19 struck.

The Covid-19 global recession is unlike anything the world has seen before. It is too soon to predict the pattern of recovery, which will surely depend more on the nature of the virus and the progress of medical research than on economic policies. But if an effective vaccine becomes available, a return to something like normal should be possible. People will be willing to return to crowded theaters, restaurants, subways, and airplanes after they have been vaccinated. They may be more sensitive to news of any new infection breaking out somewhere in the world, but the pressure to report outbreaks quickly will intensify, the policy response will be faster, and the public will have news of looming threats weeks and even months before they circle the globe. If a pandemic this rapid and deadly happens only once in a hundred years, it is probably not going to force a total overhaul of our economic structures and way of life.

Some will point to the massive rise in debt, especially public debt, as a threat going forward. That is misguided. The transfers that drive the debt increase are essential to supporting household consumption and the survival of businesses of all sizes. A wave of bankruptcies would make recovery impossible and only serve to perpetuate our poverty. Moreover, the jump in government bonds will be seen as a valuable asset in private hands once consumers are ready to spend again, encouraging a more rapid recovery and perhaps even reversing some of the decline in interest rates caused by secular stagnation.

Rather than accelerating Japanification, the policy response to Covid-19 may end up providing a modest, but perhaps temporary, reprieve.



The whole developed world appears to have caught the Japanese disease of the 1990s.

ANDERS ÅSLUND
Senior Fellow, Atlantic Council

The whole developed world appears to have caught the Japanese disease of the 1990s, and it is likely to last. Arguably, Europe got infected in the global financial crisis and was never cured. Now the United States has fallen ill. The Japanese disease is so long-lasting because it has several dimensions. It involves financial crisis, excessive public and private debt, and demography.

In 2008–2010, several EU countries experienced bursting housing bubbles, banking crises, and public debt crises. The European Union and government responded by pouring money on the crises, but doing too little about the underlying structural problems, leaving the EU public debt at 82 percent of GDP at the end of 2019, while GDP growth averaged 1.0 percent a year from 2009–2019.

The European Central Bank opted for massive quantitative easing, bringing down interest rates to around zero, but inflation refuses to rise to the desired level of 2 percent a year. Having adopted a Japanese zombie economy, the European Union appears to suffer from ever-less innovation. There is no obvious reason to presume that the European Union will be healed from its very own Japanese disease.

Until March 2020, the U.S. situation looked so much healthier. The country enjoyed long-lasting growth averaging 1.8 percent from 2009–2019, almost twice the EU growth rate. Until recently, U.S. Treasury yields were decent, but now they have collapsed to a European level.

Other indicators look worse. The actual U.S. public debt at the end of 2019 was far higher than in Europe at 107 percent of GDP. Unfortunately, U.S. commentators use the misleading term "public debt held by the public," giving the U.S. Treasury the benefit of the Social Security Trust Fund, but that should be seen as a contracted federal obligation. U.S. unemployment is skyrocketing and set to reach 20 percent of the active labor force by the end of the second quarter.

While the Europeans are providing social benefits to workers on their jobs, keeping private enterprises intact, the current U.S. policy is to concentrate funding to the biggest and richest enterprises, letting people and small- and medium-sized enterprises fall by the wayside. Just like Japan, the United States seems to have pursued a crisis policy that concentrates all the wealth in a limited number of big, tired monopolies, also known as zombies.

With its relentless subsidization of the biggest corporations, the current U.S. administration is likely to outdo the European Union with larger government subsidies, a far-larger public debt, little investment, and low growth. Having blocked immigration, the United States is set to age like Japan and Europe, which will restrict demand and thus investment.

What is the U.S. government likely to do? My bet is financial repression, as Carmen Reinhart has coined the term: low interest rates and Federal Reserve purchases of public debt to erase it, leading to big, tired, zombie companies and minimal growth.

Japan has been surprisingly proactive.

ANDREW DEWIT
Professor, School of Economic Policy Studies, Rikkyo University

Japan's pre-eminence as the most challenged major economy abruptly appears uncertain. There is an accelerating diffusion of the Japan Disease's mix of macroeconomic, demographic, and other morbidities. Now that so many countries are turning Japanese, perhaps it's instructive to examine what Japan has been doing about its afflictions. Certainly Japan is waging a surprisingly aggressive campaign against Covid-19; so much so that in the May 7 *Financial Times,* the former head of the UN Framework Convention on Climate Change, Christiana Figueres, included Japan among the few countries that "acted in line with the risks."

Japan's fiscal policy is similarly proactive. Wary of wasting yet more money, the Japanese invest in smart projects to reduce the cost of crucial public goods; diversify access to the thirty-odd other critical raw materials essential to any new economy; further decarbonize the energy economy; and bolster multilateral collaboration. Indeed, while most other countries are still debating whether to aim at a "green recovery," Japan already is.

The evidence includes Japan's largely misunderstood fiscal stimulus. As of April 20, Japan's Covid-19 fiscal countermeasures total ¥117.1 trillion (about US$1.1 trillion). Most media commentary dismissed the headline total as exaggerated, pointing out that much was not new finance, but rather built on Japan's ¥26 trillion fiscal stimulus from December 2019. This criticism deflected attention from the spending's content and its role in framing ongoing efforts. To be sure, the December stimulus had nothing to do with Covid-19, *per se.* Rather, it focused on all-hazard resilience in the wake of unprecedented floods, blackouts, and the other shocks during 2018 and 2019.

Hence, the December 2019 stimulus had three pillars: National Resilience Plans and disaster reconstruction; economic risk countermeasures; and "Post 2020 Olympic Games" legacy investment in 5G and other elements of Japan's "Society 5.0" industrial policy and sustainable development goals.

Japan's National Resilience Plans are underpinned by the idea that "coping with climate change is also conducive to disaster prevention," and the Society 5.0/ sustainable development goals initiatives explicitly target zero-emissions technology (such as natural refrigerants), energy efficiency, and related decarbonization. And though the now-postponed Olympic Games may never be held, that hardly means the legacy investment in critical infrastructure is squandered.

By April, Japan's initial fiscal stimulus was more than quadrupled, with additional spending on National Resilience, sustainable development goals, and Society 5.0. The package also included ¥15 trillion for restructuring supply chains to re-shore or at least further diversify (for example, among ASEAN countries) the production of a host of critical raw materials. Moreover, consistent with the December 2019 approach, the April package ramps up the efforts on digital transformation, decarbonization, and other measures specifically to reduce the risks of future pandemics. The package also emphasizes sustainable development goals-style multilateral engagement on overseas water systems, public health, and other critical infrastructure via Japan's aid agencies plus the International Monetary Fund, the World Bank, and other multilateral institutions where Japan has a record of close collaboration.

Japan's recipe for resilience may not be a panacea, but it certainly alleviates several rapidly spreading symptoms.

Our fate could be a lot worse than Japan's—a loss of trust.

IVO WELCH
J. Fred Weston Professor of Finance, Anderson School at University of California-Los Angeles

Could we suffer a fate as bad or worse as that of Japan—low inflation, wage growth, productivity? I am afraid our fate could be a lot worse if we lose the essential trust our economy needs to function.

We are indeed fortunate that the world has so much trust in the power of our Federal Reserve that it has not been panicking. This has prevented a self-fulfilling prophesy, in which all of us believe in the breakdown of our

economy, retreat to preserve ourselves, and as a result suffer exactly such a breakdown.

Money, too, is all about a self-fulfilling prophesy of trust. Tinker with that trust through capricious economic policies and inflation will surely follow—in the extreme, destroying money as a viable medium of exchange.

Credit is based on the confidence that a debtor will repay. If creditors believe that they will be repaid on good terms, default premiums can be low and debtors will be able to repay. But if creditors believe that they may not be repaid, the interest rate may rise to the point where debtors can no longer afford to repay.

In short, our economy is built on trust—trust in the economic system, in the government, in the central bank, in the medium of exchange, in the ability of the government to repay its obligations on the expected and promised terms, and in the future. This trust is maintained in an equilibrium. Without it, modern economies collapse.

What can governments and central banks not do? There is a simple "summing-up constraint." Collectively, we can only consume what we produce. If we do not make stuff that allows us to live better, we cannot live better. But governments rarely invent the kinds of new technologies that raise our standard of living and make our lives better. Of course, they can try to redistribute towards activities that are more likely to increase our collective pie—especially when there are public externalities that limit private companies. Without any education and research sponsorship, we would be worse off. But the overall government track record is spotty; and even where it does good, it does so far less efficiently than it should.

The Japanese problem is not one of misguided monetary policy or deflation. It is much more basic. Japan has failed to create the great technological and social inventions that would have made its next generation better off than the last.

The U.S. problem is different. We have been pulling the most talented minds from all over the world to our U.S. universities (although this is now under threat). We have excelled in inventing the future.

Our problem is that we are collectively heading for far worse than the Japanese disease. I am worried about loss of trust, most urgently the trust of our creditors. Right now, they are so confident that they charge us almost no interest. But how realistic is it for our creditors to be repaid on the terms they expect? The following is a good steady-state sketch.

In 2019, our standing debt was about $80,000 for each American, about the same as annual GDP. The average American earned $56,000 per year, paid $17,000 per year in taxes, and borrowed a deficit of $3,000 per year. By the end of 2020, our national debt will likely reach around $100,000 per person, to be paid for by the steady-state "good-times" income tax receipts of about $17,000 per year.

Well, no! Assuming that Social Security, Medicare, and debt repayment are untouchable, we only have about $10,000 per year to repay debt and interest. If defense is untouchable, too, only about $7,000 per year. As the baby boomers begin to retire, the amount drops to about $2,000–$4,000 per year. These discretionary tax receipts also have to cover education, welfare, research, and so forth, plus more interest on more debt. In the best of years, the debt-to-GDP ratio has increased by about 3 percent per year, doubling about every twenty-five years.

How long can this go on? Our creditors' confidence today implies that they believe the United States will either enjoy long-term GDP growth in excess of 5 percent per year, and/or raise income taxes by 20 percent, and/or cut all discretionary government spending—or that the government will not make good on their promise to them (for example, by inflating their debt away).

Unless we can stabilize our debt-to-GDP growth soon, our creditors can best be described as willing participants in a Ponzi scheme. Trust can maintain a Ponzi scheme for a while, but not forever. But what really worries me is that trust is a self-fulfilling prophesy—more likely to flip suddenly than to erode gradually.

How much time do we have? What if creditors lose trust in repayment or the power of the Fed? What could happen if the dollar lost trust, or the public lost trust in the economy? And who will we be able to rely on to restore trust?

The world economy will look very different in the coming post-pandemic years.

RICHARD N. COOPER
Maurits C. Boas Professor of International Economics, Harvard University

Japan has a number of distinctive characteristics: an aged and rapidly aging society, a declining population and labor force, exceptionally high public debt but all in yen and mostly owned by the Japanese public and institutions, very large net foreign assets accumulated

as a result of decades of current account surpluses, a large under-employed well-educated female population (which Prime Minister Abe has had some success in re-introducing to the labor force), and exceptional hostility to immigration (which Japan has been exploring at the margins). Taken together, these characteristics have led to slow growth (less than 1 percent a year) over the past three decades, before the pandemic of 2020.

Other major countries have some but not all of these attributes: old and rapidly aging society (Germany, Italy, China, South Korea), declining labor force (Germany, Russia), large public debt (Italy), large net overseas assets (Germany). The eurozone also grew under 1 percent 2007–2017, having been hit by two recessions. It did well in 2018, but faltered in late 2019, again before the pandemic hit.

Then came the coronavirus-19 pandemic, leading to the sharpest drop in quarterly GDP in recorded history in the first quarter of 2020. The second quarter will be even worse for most countries, leading to the highest unemployment in rich countries since the 1930s—over 20 percent. Workers will be eager to go to work after the paid furloughs and unemployment compensation runs out, maybe earlier. Production will rise, unfinished buildings will be completed, and so forth. But some businesses will not reopen, leading to loan defaults. Fortunately, the banks are better prepared than they were in the 2008 financial crisis to deal with them.

But will the demand be there to absorb the resumed production? Some sectors have been hit so hard—particularly air travel and hospitality—that they are not expected to recover until 2022 at the earliest. Investment has been deferred and will continue to be deferred. Colleges may reopen on campus in fall 2020 (Purdue has so announced; University of California has announced most students will be remotely taught; Harvard will announce its decision by early July; all will squeeze their spending.)

Household savings have risen abruptly while economies have been locked down. No doubt there will be a surge in household spending as the lockdowns ease up, but will it be enough to absorb the increased output? Given recent experience, some increased saving may be permanent, or at least last many years. Thus at least for several years, and maybe longer, the world economy will experience a period of secular stagnation: desired private spending will fall short of desired production. One way to deal with it would be to promote infrastructure investment in developing countries, a global extension of China's new Silk Road initiative, perhaps financed by the World Bank and regional development banks, which would provide high-quality securities to absorb the higher savings. In any case, the *status quo ante* will not be restored; the world economy will look very different in the coming post-pandemic years.

The world will not follow Japan.

THOMAS MAYER

Founding Director, Flossbach von Storch Research Institute, and Professor, University Witten/Herdecke

If we mean by "Japan Disease" mildly deflationary stagnation, then my answer would be no. Many economists and market participants expect the era of low inflation to continue or even turn into an era of mild deflation. They probably assume that the sharp rise in unemployment generated by the "lockdowns" imposed to combat the corona pandemic will depress wages and prices. They regard the vast amount of money freshly created by central and commercial banks in response to the crisis as tantamount to "liquid labor," which should coagulate into new jobs instead of unleashing inflation.

However, unemployment in the lockdown has not been caused by a collapse in demand, but by work restrictions that lead to the closure of production capacities. Supply and demand therefore fall equally. Potential demand is supported by credit-financed government grants and direct bank loans. Some services cannot be made up for later, but the demand for many other goods is postponed. As long as labor restrictions continue, a demand overhang builds up (and not only for haircuts). If the work restrictions are relaxed, it is questionable whether supply will react flexibly enough to reduce the excess demand and satisfy current demand. This could be the case if the structure of demand were to remain the same after the relaxation and thus correspond to the structure of supply. However, this is rather unlikely. It is more likely that after the crisis, some goods will be permanently more in demand and others less. This will create excess demand in certain areas, while other areas will become partially obsolete. All in all, supply potential can thus decline, while demand returns to pre-crisis levels thanks to the extensive support measures taken during the crisis. Price increases and rising inflation expectations would be the consequence—unless people hoard the newly created money instead of spending it.

Many economists fear this will happen, as Grand Master Keynes warned of a "liquidity trap." In theory, this trap snaps shut when consumers expect falling

prices. It is then worthwhile to buy only what is absolutely necessary and to postpone larger purchases into the future when the desired product is cheaper. Increased uncertainty about their own economic future could also prompt consumers to hoard money out of caution. In practice, however, these phenomena are rare. Prices would have to fall very quickly to get people to postpone consumption into the future. Also, as the pandemic subsides, confidence is likely to increase rather than decrease. And even if none of this is true, one thing is certain: the central banks would not hesitate to turn the money rain into a cloudburst to drive up inflation. For inflation is necessary to make the huge debt burden created in the wake of the financial and corona crises sustainable and prevent mass bankruptcies.

The risk of the Japan disease is very real for some, a growing risk for more, and not relevant for others.

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

Japan's disease of persistently weak real GDP growth is, primarily, a consequence of having a declining population, and especially a declining workforce. Ultimately, economic growth is determined by two simple forces: the change in the size of a country's workforce, and its productivity. If you have a young and dynamic workforce, it makes it a lot easier to have faster increases in GDP.

This is why the United States has outperformed Europe for the past thirty years, much more so than relative productivity. The same has been the case, with occasional exceptions, for the United Kingdom relative to the likes of Germany and Italy, which also have poor demographics.

In Japan's case, in addition to very poor demographics, they have not managed to boost productivity much outside their traded goods sector, nor have they especially embraced immigration, which of course, can be a substitute for a country's own weak demographics. Japan's own growth potential is probably somewhere between 0 and 0.5 percent, which means that when there is some kind of global crisis, Japan slips into negative growth quite easily.

What is worth remembering though is that, for each individual Japanese person, their own wealth does not necessarily struggle. In this regard, over the last decade, due to various economic policy support measures, Japan recorded real GDP growth of close to 1 percent, which meant in terms of GDP per capita, or per person, Japanese wealth actually rose, perhaps as much as any other G7 country.

The debate as to whether this can be sustained, or is simply piling up more and more national debt since government spending efforts depend so highly on the Bank of Japan for finance through its purchase of government bonds (and equities), is set to continue. It is far from clear as to what the ultimate consequence may be.

Turning to other major economies to observe how similar to Japan many will be, the natural starting place for comparison should be their demographics and their productivity, and to some degree, their stance on immigration. Of the G7 countries, historically the largest democratic countries—Italy and Germany—share many of Japan's characteristics, especially Italy. Indeed, since the euro commenced in 1999, Italy has experienced stagnant nominal GDP growth, with the rigidity of the euro area's economic policy framework compounding Italy's inability to grow. In this sense, Italy is indeed a nation that suffers from the Japan disease, and Germany is probably also quite vulnerable.

Among other G7 countries over the past decade or so, Canada, the United Kingdom, and the United States have seen more favorable demographics, and until recent years, embraced immigration. But they have also experienced deteriorating productivity and therefore have become more vulnerable to the Japan disease. In terms of the current Covid-19 crisis, they must try to boost productivity in order to reduce the increasing risk of the Japan disease inflicting their economies, too.

In this regard, in recent days, I have increasingly begun to think that perhaps the time has finally arrived for the major economies to more formally adopt a new policy framework for their central banks, replacing narrow inflation targeting with nominal GDP targeting. In such a world, the central banks would be mandated to pursue monetary polices that were likely to be compatible with achieving some degree of positive nominal GDP, with the split between real GDP and inflation not prescribed. In the post-Covid-19 world, such a framework strikes me as highly desirable, not least because it would raise the probability of a so-called V-shaped recovery, but also provide a framework for reducing debt as a share of overall GDP.

As for other large G20 economies, especially so-called emerging nations, the same general parameters hold true. Russia has extremely weak demographics, and China's are not promising. Brazil is in a less worrying position, and of course, India has the best demographics of any large economy. Among other countries, Indonesia, Turkey, Nigeria, and to some degree Mexico are in a better position, and in principle should manage to avoid the Japan disease more easily than most.

So the risk of the Japan disease is actually very real for some, a growing risk for more, and almost definitely not relevant in the near term for others.

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With chronically low "r," everyone starts to look like Japan.*

Following the Covid-19 shock, will all advanced economies be like Japan—stuck for years with near-zero nominal interest rates and high government debts?

If r^* is low enough, the answer is yes.

What is r^*? It is the real interest rate that prevails when unemployment is at its natural or neutral rate, so the economy is in equilibrium. Over the medium term, which can persist for years, r^* moves to equilibrate saving and investment. Over the long term, when all wages and prices adjust, it reflects the marginal product of capital.

When r^* is low, it can be difficult, or impossible, for monetary policymakers to secure price stability and maximum sustainable employment. Even using a range of balance sheet tools, forward guidance, and explicit commitments ("yield curve control"), zero or modestly negative nominal interest rates may not provide sufficient stimulus.

We doubt that r^* currently is greater than zero. Indeed, the U.S. ten-year inflation-indexed bond yield has plunged to nearly -0.5 percent.

Following the Covid-19 shock, there are four reasons to believe that r^* will remain low for years to come:

- First, advanced economies are ill-prepared for pandemics. Making economic activity biologically safer and more resilient will require changes in practices that add to the cost of doing business and reduce the returns to production.

- Second, the value of cruise ships, airplanes, trains, retail space, office buildings, dormitories, and the like has almost surely collapsed. Meanwhile, the value of other productive capital, such as high-speed internet connections, has risen, but these investments appear to be far less costly to undertake. So, on average, the observed return on investment is likely to decline for some time.

- Third, diseases like COVID, with their age-related morbidity, both diminish labor mobility and exacerbate the demographic trends that are already reducing labor supply. The new awareness of pandemic risk may discourage many workers from "risky" commuting and urban office work, while spurring earlier retirement. As a result, declining mobility will reduce the efficiency of the workforce even as its growth continues to slow. Stagnation of the effective labor force diminishes the marginal product of capital, further adding to downward pressure on r^*.

- Fourth, for many years, households, businesses, and governments will be looking for ways to pay down elevated levels of debt. If governments were reluctant to undertake public investment in the aftermath of the 2007–2009 crisis, they will be even more cautious now. Furthermore, to the extent that they can, both individuals and firms will seek to build precautionary savings buffers. All of these efforts to save (and to restrain investment) will hold down the real interest rate over the medium term.

To conclude, in our view an increased desire to save, combined with poorer investment opportunities, will result in a lower level of r^* for some time to come. And, with chronically low r^*, everyone starts to look like Japan.

The outlook for global economic activity wasn't heady to begin with. The coronavirus will only make it less so.

MARK SOBEL
U.S. Chair, Official Monetary and Financial Institutions Forum, and former Deputy Assistant Secretary for International Monetary and Financial Policy, U.S. Treasury

Even prior to the coronavirus crisis, the global growth outlook for the 2020s was nothing to cheer about.

Japanification, stall speed, secular stagnation, and lowflation were already watchwords. If prior to the global financial crisis, world growth had been in the 4–5 percent range, readings around 3 percent were becoming the pre-coronavirus norm.

Japan's potential growth was seen as around 0.5 percent per annum for the early 2020s, with Europe around 1.25 percent and the United States below 2 percent.

All advanced economies confronted aging to varying degrees. Leverage was high. Populism and protectionism were on the rise. Structural and institutional reforms were not advancing.

China was a key global growth engine over the last decade. Yet its potential growth was already poised to slow sharply in the 2020s due to a demographic kink and the continued transition from an investment-intensive economy to consumerism and services. China's economy is highly leveraged, masking enormous financial vulnerabilities. President Xi's statism will hurt efficiency.

The outlook for many emerging market countries was also not bright, given reliance on global demand via commodity prices and exports. Latin America has long experienced anemic productivity growth.

The coronavirus crisis and its aftermath will only reinforce these trends. How long the crisis lasts remains an unknown, but the longer, the more damaging. Regardless, it will take years, especially for advanced economies, to get back to pre-crisis activity levels.

Nor will adjustment to the post-coronavirus economy be easy. Fiscal policy—after a huge buildup in debt to bridge the virus lockdowns—will shift toward a more conservative stance. Society will fundamentally change, unpredictably transforming economies. What will happen to demand for air travel? Will globalization continue? Will citizens cut back on the consumption of services amid continued social distancing and boost personal saving sharply? What will be the new sources of demand? And so forth.

Productivity will be weakened. Labor will be scarred by the crisis. Firms may be slow to rehire. Immigration will likely face tougher restrictions. Labor force participation may be permanently reduced. Capital formation will be set back—slow growth will harm investment, bankruptcies will impose losses on increasingly risk-averse financial institutions, and leverage will be reduced. Total factor productivity could be hurt by increased protectionism, re-shoring, the disruption of global supply chains, and slashed research and development budgets.

Perhaps advances in artificial intelligence and increased investments in a green economy and infrastructure may boost activity.

But the outlook for global economic activity for the 2020s wasn't heady to begin with, and the coronavirus and its aftermath will only make it less so.

The real driver of the phenomenon referred to as Japanization was a balance sheet recession.

RICHARD C. KOO
Chief Economist, Nomura Research Institute, and author,* The Other Half of Macroeconomics and the Fate of Globalization *(2018)

The real driver of the phenomenon referred to as Japanization was a balance sheet recession. In this type of recession, a debt-financed bubble bursts and forces the private sector to pull itself out of a negative-equity hole by paying down debt even at a time of zero interest rates. But if someone in a national economy is saving money or reducing debt, someone else must borrow and spend those funds or the economy will seize up. If businesses and households are collectively saving or paying down debt, only the government is capable of borrowing those funds and returning them to the income stream.

Countries where government was both willing and able to act as borrower of last resort, such as the United

States and Japan, fared better than those where it was not, such as the eurozone. Because the process of balance sheet repair tends to be long and painful under the best of circumstances, those who live through it, including Japanese corporations after 1990 and Western households post-2008, often develop a strong aversion to debt, not unlike Depression-era Americans. The private sectors in all of the advanced economies thus remained huge net savers in spite of zero interest rates up until the coronavirus outbreak.

The pandemic is likely to leave a lasting impression on economies and societies, and especially on those who lost income and had to dis-save in order to make ends meet. One key impact is likely to be a renewed appreciation of the importance of saving for a rainy day—especially if a second or a third wave of infection is considered likely. If this awareness dominates other economic effects, the private sector will probably resume running a financial surplus.

The end of the lockdown may well bring a sharp pick-up in economic activity fueled by pent-up demand. But after an initial burst of consumption, households and businesses that have returned to more normal conditions are likely to begin rebuilding the savings they exhausted during the pandemic. That means the entire private sector may become more financially prudent than it was, leading to a process of slower and less-leveraged economic growth some might call Japanization.

Monetary policy's inability to resolve the balance sheet recession, when the private sector is in financial surplus, was amply demonstrated by central banks' failure to achieve their inflation targets. This aspect of Japanization may also be true after the pandemic, for the same reason.

During the pandemic, however, central banks have a critical role to play: they must serve as lenders of last resort, effectively monetizing budget deficits via quantitative easing and thereby enabling governments to deploy fiscal policy quickly to rescue affected industries and workers. Once the pandemic is over, however, central banks will need to reverse these policies to forestall runaway inflation.

This reversal will be much easier if the private sector resumes its net-saver status, since private investors will then be eager to absorb the government debt being unloaded by the central bank. Higher inflation and interest rates are therefore unlikely to materialize as long as the central bank times the normalization of monetary policy to coincide with the private sector replenishment of savings.

Instead of pushing the world into a permanent low-growth trap, the virus may do the opposite in the end.

HOLGER SCHMIEDING
Chief Economist, Berenberg

The virus is not spreading a Japanese disease. Of course, in some respects, the entire advanced world will look more like Japan after the pandemic. In the next two years, public debt will surge while price levels will be even more stable than before. As in Japan, central banks will hoover up almost the entire increase in public debt. Because households, companies, and financial institutions will want to hold more precautionary liquid balances after such a crisis than before, central banks will not have to shrink their balance sheets significantly again for many years to come.

However, instead of pushing the world into a permanent low-growth trap, the virus may do the opposite in the end. The unique health emergency is shaking up ingrained habits in a way that has rarely happened before. Crises are the mother of innovation. We are learning to work in different ways with digital tools that were unfamiliar to many of us before. The crisis exacts a heavy toll on us all. But it is also rewarding those who have adjusted to the digital age, or who are now ready to catch up fast.

While the pace of technological change has been breathtaking over the last two decades, the diffusion of such innovations has been slow. OECD research shows that the gap between frontier firms, who largely exploit the potential of new cutting-edge technologies, and the vast majority of firms, who do not, has widened. In services, the average lags more behind the leaders than in manufacturing

As a first step, the crisis is widening the gap between frontier firms and laggards even further. But companies will be under greater pressure to shape up once the initial survival support from government expires. Expect key technologies and innovations—such as big data analysis, three-dimensional printing, and advanced robotics—to quickly spread more widely. The additional debt which companies are taking on will have a similar effect. The best-in-class will get through the pandemic with only a modest additional debt load, while the laggards will need to borrow much more. Once labor markets are recovering,

governments will rein in their support. Interest rates may also rise a little. Expect this to force more rapid change among the laggards. It may also cause a second delayed wave of bankruptcies among more heavily indebted firms some two to three years from now. A faster degree of corporate churning if and when the labor market can cope with it again will likely result in stronger gains in productivity.

This optimistic assessment comes with two potential snags: First, countries need to pursue pro-growth supply-side policies rather than simple fiscal austerity to control their public debt burden after the corona shock. Second, countries need to learn to adequately regulate and tax the big digital platform companies in a way that tames these quasi-monopolies without stifling the incentive to innovate. Countries which get these policies right can thrive. Others may indeed fall victim to some variant of a "Japan disease."

The Japanese scenario can be avoided.

GUSTAV A. HORN

Professor of Economics, University of Duisburg-Essen, Head of Economic Advisers, Socialdemocratic Party (SPD), and Chairman, German Keynes Society

The coronavirus crisis has caused the debt levels of many states to skyrocket dramatically. So are Japanese conditions threatening? The answer is not clear. It depends on which policy mix is used in and after this probably most serious crisis of the post-war period.

A Japanese scenario is likely if economic policy acts as in Japan. This means that the burden of active stabilization is essentially placed on monetary policy. In this scenario, monetary policy tries to stimulate the economy by keeping interest rates as low as possible. However, this stimulus only works indirectly and the effects are partly uncertain. Low interest rates lead directly to easier credit conditions, price increases on stock exchanges, and a devaluation of the domestic currency.

All this undoubtedly improves conditions for an economic recovery, but it is not yet an economic recovery. If the economic environment is too uncertain, firms will not take advantage of favorable credit conditions or a price rally at stock exchanges to significantly expand their investment activities. Devaluations are also uncertain at a time when all major economies are in crisis and all central banks are simultaneously pursuing very expansive monetary policies.

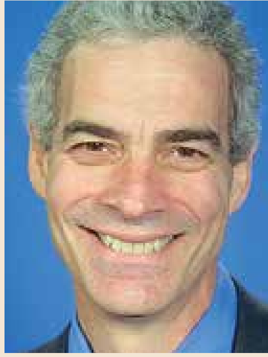
At the end of the day, it may turn out that all these efforts of monetary policy are largely futile, because they do not lead to the desired increases in corporate spending. The upturn will not happen.

Unlike in Japan, an active wage policy and an appropriate fiscal policy stance are needed to ensure that the monetary stimulus really kicks in. Neither of these took place. Wages in Japan are to a large extent linked to economic development. Stagnation is therefore reflected in correspondingly weak wage development. Stagnation is not broken in this way because of continued weak purchasing power dynamics. Moreover, fiscal policy has been passive at best. As a rule, it accepted the higher budget deficits resulting from the weak economic development. At times, it made economic stimulus packages, but these were largely ineffective because they did not include additional expenditure or flowed into sectors where they trickled away. Occasionally, tax increases were even adopted to reduce the debt level, but this went completely against the expansionary monetary policy. Thus, Japan's poor economic policy design prevented it from breaking out of stagnation.

There are other ways. If wages rise noticeably in real terms in this situation, which is anything but unrealistic in view of the low inflation rate, the purchasing power of the employees and thus consumption increases. If fiscal policy is simultaneously expansive and, above all, public investment is increased, companies have good sales opportunities and are themselves encouraged to invest.

This is where the favorable credit conditions come into play in two ways. The state can more easily finance the increased debt. Future budgetary leeway is restricted to a lesser extent. At the same time, in this brighter economic environment, firms will also be more willing to take advantage of the favorable credit facilities and use the high share prices to increase equity.

All this together forms a good basis for a thorough economic recovery. The Japanese scenario can be avoided. The precondition is that economic policy is appropriately coordinated. Whether this will happen remains uncertain.



The Fed should learn from the Bank of Japan's mistakes.

MICKEY D. LEVY
Chief Economist for Asia and the United States, Berenberg Capital Markets, and Member, Shadow Open Market Committee

I will focus on the United States. Is it taking on Japan's bad economic characteristics? Yes, but primarily in terms of monetary policy and mounting government debt. Like Japan, these pose significant risks to U.S. economic performance and longer-run potential. Presently, as soon as the United States emerges from the deep pandemic economic contraction, the timely unwinding of its emergency fiscal and monetary responses to the Covid-19 pandemic is critical.

Unlike Japan, the United States benefits from a growing population, reflecting in-migration (despite much needed policy reform) and a relatively high birth rate, particularly among new immigrants. But let's not overlook some of Japan's favorable economic trends that have been underestimated. Its sizable labor force participation of women and influx of foreign workers have offset its declining population and boosted its workforce. Those are certainly not "diseases." Moreover, its productivity per working age population is among the highest of all advanced nations.

Even before Covid-19, reflecting Japan's experience, the United States' government debt burden was rising and projected to increase significantly, although not nearly as high as Japan's 200 percent-plus of GDP. Similar to Japan, U.S. deficit spending has been driven by entitlement programs, specifically pensions and health care for the elderly, and its population is aging. Japan's response has been to increase its VAT, which has harmed its economy.

Obviously, the spike in U.S. deficit spending in response to the deep economic and employment contraction—estimated to be $3.8 trillion in fiscal year 2020—adds significantly to current and future government debt levels. Even if government debt service costs, inflation, and interest rates remain low, current and future U.S. citizens will incur the costs of the government spending in a variety of ways, including mis-allocation of national resources and constrained potential growth.

Unfortunately, since the financial crisis of 2008–2009, the Fed has followed the Bank of Japan's ultra-low interest rates and large-scale asset purchases, but not to the same extreme. But like Japan, the Fed's excessive monetary ease has not achieved its objective. The Fed's QEII and QEIII pumped up prices of financial assets and encouraged risk-taking, but like the Bank of Japan's experience, they failed to stimulate any acceleration in aggregate demand or economic growth or lift inflation to 2 percent. In both cases, the high-powered money created by the central banks has generated excess reserves that are sloshing around in the financial system and have not been put to work in their respective economies.

The Bank of Japan's negative rates and massive Quantitative and Qualitative Monetary Easing asset purchases are harming commercial banks' intermediation and imposing financial repression. The Fed must avoid this situation. Disturbingly, both the Fed and Bank of Japan are quick to justify their monetary policies, stating that if they had not pursued the policies they did, things would have been much worse. The Fed should learn from the Bank of Japan's mistakes and understand the limits of monetary policy and be more circumspect about its efficacy. U.S. economic performance would benefit.

The "low-growth funk" of the developed economies likely reflects supply side factors, in particular demographics.

JAMES E. GLASSMAN
Managing Director and Senior Economist, JPMorgan Chase & Co., and Head Economist, Chase Commercial Banking

The response of the United States and other developed nations to the coronavirus threat, if anything, lessens the prospect of an extended low-growth funk, because it demonstrates Washington's resolve and ability, despite a polarized body politic, to respond to a serious crisis.

The decision to shutter many businesses to promote social distancing and contain the spread of the coronavirus certainly has led to unprecedented economic upheaval. But unprecedented policy responses demonstrate a resolve and ability to take actions to cushion the blow of selected

economic quarantines. New policy responses take time to put in place and take hold and that is why the economy may seem unresponsive to these actions so far. But if the policies work as intended, they will go a long way toward re-connecting workers with their employers and bringing unemployment back down quickly.

Also, if the $4 trillion of financial support authorized by congressional legislation and executive actions seem to be ineffective, that's because the bulk of the $4 trillion financial support from Washington comes in the form of income transfers that don't directly affect demand and GDP but provide substantial income that workers have lost by being unable to operate in their shuttered workplaces. The nearly $2 trillion surge in retail deposits in March and April is a testimony to that support.

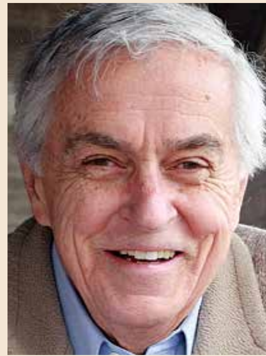
At the same time, the low-growth funk that has been visible across the developed economies appears to be less of a disease, then a Japan-style stagnation weighted down by massive public sector debt burdens. For public sector debt burdens to be the cause of anemic economic growth, that burden would first have to be revealed in an unusually high level of real interest rates that dampens business capital investment. Instead, the unprecedented levels of public sector debt have accompanied a historically low level of interest rates.

The "low-growth funk" that describes much of the developed economies likely is mostly a reflection of factors affecting the supply side of the economy, in particular, demographics. The aging of populations, a result of the well-known aging of the baby boom population from Japan to Europe to the United States, has slowed the growth of the working population.

The greatest counter to the "funk" idea in the "low-growth funk" description is the recovery of the U.S. and other economies from the 2008–2009 recession despite quite slow growth. Prior to the coronavirus, the shortage of workers—reflected in seven million unfilled job postings—is evidence that U.S. aggregate demand had fully recovered in line with aggregate supply and that the economy was not stagnant in the sense that it was in the Great Depression.

If slow labor productivity is seen as another culprit behind slow potential growth, that runs counter to the popular impression that technological innovation is transforming the way the economy works—accelerating efficiency. And it clashes with high valuations of the U.S. equity market and the historically high level of after-tax profits. In other words, there is very little in the technological innovation arena that fits the "secular stagnation," low-growth mold.

The coronavirus shock is an unprecedented disruption to global economic progress, but most developed economies are not likely to fall into the trap that seemed to hamper Japan's economy.



I disagree with those who characterize Japan's "extended low economic growth" and "disinflationary pressures" as diseases.

RICHARD D. ERB

Former Deputy Managing Director, International Monetary Fund, and Research Professor, Economics Department, University of Montana

Given the corona virus meltdown, *TIE* has posed the question of whether large parts of the world are still at risk of what is sometimes referred to as the "Japan Disease": "with extended low growth, unheard of levels of debt, disinflationary pressures, a non-stimulative monetary policy, low productivity, and an aging population."

I disagree with those who characterize Japan's "extended low economic growth" and "disinflationary pressures" as diseases. Ironically, Japan's fiscal and monetary policies designed to cure those perceived diseases have had negative consequences for Japan and also infected other countries.

During the 1980s, Japan's high output and consumption growth was an unquestioned measure of Japan's success. Foreigners admired and feared "Japan Inc." Japanese commentators, including government officials, suggested that the Japanese economic system provided an alternative model for economic development in other countries.

Following an economic and financial blowout in the early 1990s, Japan's "extended low growth" has been viewed as an unquestioned measure of weakness requiring extraordinary fiscal and monetary stimulus to increase demand. That led to massive increases in Japanese public debt and extraordinary central bank financial market intervention with purchases of a wide array of public and private bonds and large-scale equity market purchases. Unfortunately, other countries pursued similar policies after the 2009 financial crisis rebound.

For a highly developed country, "extended low growth" *per se* is not a "disease." Given environmental and other considerations, including global warming and the desirability of allowing less-developed countries to catch up, Japan should have paid more attention to the composition of its economic growth and consumption. That would have been, and still is, a better policy approach for other developed countries.

Since the 1990s, Japan, other countries, and the financial markets have feared Japan's "disinflationary pressures." For a number of years, Japan's central bank and other major central banks have been anxiously pursuing an annual 2 percent inflation target. Although market-based indicators suggest that price stability had been achieved, inflation rates below 2 percent during the past decade have been perceived as a central bank policy failure for Japan and other major central banks.

But, like Japan's low growth, I do not consider the magnitude of "disinflationary pressures" experienced by Japan since the 1980s a "disease." For one thing, official inflation indices include prices of goods and services but not the prices of assets including bonds, equities, and real estate. Between February 2009 and January 2020, the Nikkei increased by 207 percent; during the same period, Japan's Consumer Price Index increased by 5 percent. Monetary policies aimed at curing one perceived disease ended up feeding asset inflation with all of its risks. Similar differences are found in other major central bank areas.

In sum, economic models, performance measures, and policy prescriptions developed during a previous era are not the right tools to use when evaluating a highly developed country's economic performance.

Japan remains a prosperous and well-ordered society, albeit one with dreadful demographics and horrible public finances.

RICHARD JERRAM
Chief Economist, Top Down Macro

I previously argued that Japan's weak growth was due to a combination of avoidable poor policy decisions and unavoidable demographics. At the time, the Japan disease seemed to be less of a threat to the United States than to Europe and this is still likely to be true after the coronavirus fades.

The current pandemic-driven crisis is of a different nature and magnitude, and the costs of Japan's policy errors look marginal compared to the damage from Covid-19. However, there are some lessons from Japan that are relevant as the world tries to plot a path for recovery.

In many cases, the challenge is to prevent the necessary short-term emergency response from causing longer-term problems. One example is Japan's experience with zombie firms, where distressed borrowers were preserved at the cost of lower long-term productivity growth, in order to limit the disruption from unemployment. This seems more likely to be a problem in Europe, where policy aims to keep people employed, even if their wages are largely funded by the government.

Similarly, the Federal Reserve's "Weimar 2.0" monetary policy shows that it continues to put the cart of high asset prices in front of the horse of a healthy economy. Japan initially took a similar approach after its bubble burst, fearful of the impact on the financial system, but ultimately recognized that manipulating asset prices was a form of denial, not a solution. Rightly, the urgent first step is to prevent system collapse. The second is to allow balance sheets and cash flows to drive valuations. Transitioning is treacherous.

At least when Japan socialized risk, it did so alongside tight regulation. The U.S. version looks more dangerous as aggressive private sector risk-taking is, effectively, ultimately backed by the public purse. Socializing risk is not just dangerous in an economic sense, in terms of fiscal costs and resource mis-allocation, but also in a political sense as the system drives inequality. In Japan, it is mainly businessmen with an innovative concept who have prospered in the past couple of decades, not winners in a zero-sum financialization of the economy.

More generally, the problem is how to withdraw emergency policy support. Both the speed and the scale of the shock means that this is a far greater challenge than anything Japan has faced and, remember, they had several cases of premature policy tightening. It is necessary to change the nature of the support to avoid entrenched distortions, but without triggering renewed recession.

The magnitude of budget deficits and central bank liquidity creation across the developed world is terrifying, but as a long-time observer of Japan, I would note that dire predictions of default, inflation, pestilence, and social collapse have not come to pass. It remains a prosperous and well-ordered society, albeit one with dreadful demographics and horrible public finances.

Yes, large parts of the world are facing the prospect of an "extended low-growth funk."

WILLIAM BROCK
Former United States Trade Representative and former U.S. Secretary of Labor

The Covid-19 pandemic is doing incalculable damage to the economic and social fabric of nations, large and small, rich and poor. To exacerbate the difficulty, the world economy is now closely linked by technology and strongly rooted supply chains. Thus, what happens to one affects all. If that "one" is the United States, the impact on the world can be virtually catastrophic. This is the negative side, the "risk" side of the enormous challenge we now face, both domestically and internationally.

Economically, the positives for the United States are obvious. This country has prospered incredibly as the dominant player in a knowledge-based, technology-driven and highly competitive economic world, one truly linked together in ways inconceivable even half a century ago. In similar fashion, the global economy has grown and improved. As a complement to that positive economic evolution, governments and central banks have developed a remarkable set of fiscal and monetary policy tools designed to address some of the most pressing of the normal problems which often beset many governments.

Those problems have not included a health affliction and pandemic of such magnitude as to literally shut down many, and seemingly soon, most, national economies. Thus, in a perverse way, the interwoven global economic system, normally such a positive factor, carries with it a commensurate hazard of contagion—economic, as well as physical.

In such a situation, it is fair to ask if the actions of relatively competent national governments, working with often capable and generally well-led central banks, can pull a nation out of the challenges it faces as we seek to find answers to this dangerous pandemic.

In truth, desperate governments and central banks are throwing every tool available at their problem in hopes of averting domestic economic disaster. As they do so, the ratio of debt is rising far beyond the capacity of virtually any government, even when supported by their central bank and international institutions such as the International Monetary Fund. Many will also make considerable efforts to employ stimulative monetary policy—yes, the "Japan" model, but with an equal lack of success.

Simply put, the pandemic-caused global economic shambles has left all but the strongest nations (and even many of these) in such dire straits that they cannot pull themselves out of their economic misery for some considerable time to come.

To your highly relevant question posed, then, yes, large parts of the world are facing the prospect of an "extended low-growth funk," and yes, it will be one weighed down by unheard of levels of debt, disinflationary pressures, and desperate monetary policies which fail to stimulate. ◆

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