A SYMPOSIUM OF VIEWS

An *American* Lost Decade?

Is America economically headed for a 1990s-style Japanese "lost decade" of stagnant growth?

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No, but I worry about something different.

SAMUEL BRITTAN
Columnist, **Financial Times**

I take the question to mean "Is the United States likely to endure a decade of stagnation?" My answer is no. Present problems are due to failure of the banking and monetary mechanism. In other words, insufficient pieces of paper are being created or used to purchase potential output. This problem is not beyond the wit of man to solve, whether by injecting more Federally created dollars, "rescuing" the banks, or supplementing or replacing them with government credit institutions. Fed Chairman Ben Bernanke and presidential counselor Larry Summers are well aware of this. They might make technical or political mistakes, but hardly ones lasting a whole decade. It is sad that "hard money" Republican Bourbons dispute the obvious, but the caravan marches on, leaving them behind.

What could spoil this reassuring prospect? The conventional answer is "international imbalances." The U.S. external deficit and Chinese surplus are probably already being eroded, even though the statistics which would confirm this inevitably lag. This is a most undesirable type of rebalancing due to recession. With recovery the original imbalances could reappear. If the Chinese continue to accumulate paper dollar assets, we have an equilibrium of sorts. If they dump the dollar, this will amount to a currency realignment which will stimulate U.S. exports and discourage U.S. imports in line with what I think you Americans call "Economics 101."

What worries me is something different—that bottlenecks will reappear and that oil and perhaps other commodity prices will start to escalate long before anything like full employment is regained. This was starting to happen in 2008 and accounted for the delay of central banks in relaxing their monetary policies. The policy dilemma will look like the familiar one of inflationary constraints on growth. In fact, it will be the more fundamental problem of physical limits to growth. But it is difficult to feel much sympathy for the United States here so long as a realistic petroleum tax remains politically impossible.

America will face more than one "lost decade."

TADASHI NAKAMAE
President, Nakamae International Economic Research

The United States is in for more than just one "lost decade." Like Japan, which is well into its second lost decade, the United States is dealing with the detritus of its ruptured bubble economy in the wrong way.

In order to define Japan's lost decade, a sketch of the bubble economy that preceded it might be in order. In 1989, the grounds of the Imperial Palace in Tokyo were more expensive than the whole of California. Japanese companies, financial and non-financial, it was said, were about to conquer the world. Both reports built the illusion that the Japanese economy was invincible, making it harder, when the bubble burst, for the old guard to change their ways, their policies, and business practices.

Bubbles are created when economies are weak. Otherwise the monetary easing that caused the Japanese and American economic bubbles would have caused wage and price inflation. Rather, because the underlying economy was weak, they created asset price inflation. This led to a wealth effect, leading people to borrow and spend beyond their means, creating unsustainable demand.

When these bubbles burst, demand dropped to sustainable levels, creating a large gap between supply and demand. How policymakers deal with this excess supply will determine whether an economy will "lose" a couple of decades, or pull out of its decline fairly swiftly.

Policymakers should cut excess supply capacity, including labor. This is not a popular solution, especially for politicians who have constituents to answer to. Nonetheless, the more politically palatable alternative, to raise demand through monetary easing or fiscal spending, is not a sustainable long-term solution. Trying to raise demand to bubble-era levels is futile. People were spending based on an illusion of wealth: how do you recreate something that never existed in the first place?

So the problem is what to do with the ensuing unemployment when excess supply is cut. The best way would be to create and train people for jobs in potential growth industries. This is where Japan and the United

States part ways. In Japan, this means downsizing export-oriented manufacturing industries and expanding domestic areas such as medicare, nursing, education, and agriculture, which are all short on labor.

The United States, by contrast, saw its financial services industry bloat during the past decade. This needs to be downsized. Its other service industries are also mature. Thus it might be time to reconsider its goods-producing industries. Most of these, however, are multinationals, which will probably continue to increase their production abroad, not at home. Looking for non-American manufacturers to produce in the United States (like Toyota) will take time. Convincing policymakers that the likes of GM and Chrysler have had their day and it would be more economically beneficial to spend money enticing foreign manufacturers to the United States rather than bailing out exhausted companies will take even more time.

Meanwhile, bailouts will continue, while other desperate economic measures will probably be taken in the form of even lower interest rates. For Japan watchers this should sound all too familiar. America's debt-to-GDP is likely to top that of Japan. The Federal Reserve will probably have to apply Japan's unsuccessful experiment with quantitative easing. The United States gave Japan some jolly good advice about cutting losses and moving on in the 1990s. Now it needs to take its own advice.

America's outcome will be either much better or far worse than Japan's.

MARTIN WOLF
***Chief Economics Commentator,* Financial Times**

"The United States should be so lucky," is my immediate response. The Japanese have pulled off a remarkable balancing act. The United States has already demonstrated its inability to follow suit.

In the years preceding the current crisis, I worried that the United States would experience a long period of weak growth in demand, similar to that of Japan in the 1990s, once its household sector cut back on borrowing and spending. But I also assumed that U.S. policymakers would manage this period of correction at least as well as the Japanese.

I was wrong. The United States has done far worse, suffering a severe contraction. Japan, in contrast, had no deep recession. Instead, it "merely" suffered a prolonged period of weak growth.

Many argue that this was Japan's big mistake: it did not allow swifter liquidation of the debt overhang and associated resource misallocation. If one believes that, one would argue that the United States has done "better" by doing worse and is, therefore, less likely to suffer a lost decade.

An alternative view is that Japanese monetary and fiscal policy was insufficiently proactive. Again, because the U.S. collapse has been bigger, its fiscal and monetary policy has been more aggressive, sooner. But the Japanese public has also shown itself willing to buy enormous quantities of Japanese bonds, at low rates of interest. That may well not hold for the United States.

In short, the United States will not experience a lost decade. The outcome will either be much better or substantially worse than Japan's. Either the United States will secure a strong private sector-led recovery or it will run out of fiscal and monetary room for manoeuver. Which will it be? We simply do not know.

No, there are too many dissimilarities.

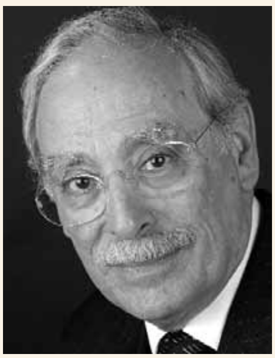
MILTON EZRATI
Senior Economist and Market Strategist, Lord, Abbett & Co., and author of* Kawari: How Japan's Economic and Cultural Transformation Will Alter the Balance of Power Among Nations *(Basic Books)

Though risks are evident, the probabilities say that the United States will avoid Japan's 1990s fate. The two countries and their situations have many more dissimilarities than similarities.

The biggest difference concerns questions of inflation and deflation. In the 1990s, Japan's ongoing deflation depressed spending growth, stymied deleveraging by effectively raising the real value of outstanding debts, and confused monetary policy so that it could not respond promptly to the situation. The yen's admittedly uneven rally from ¥159 to the dollar at the start of the decade to ¥102 by decade's end exacerbated the deflationary pressure and all the complications it brought.

The United States has none of this. Inflation remains moderate, but critically, positive, and commodity price movements suggest that it will stay positive, making the needed deleveraging go smoother and removing the impediment to retail sales growth that so bedeviled Japan. The Federal Reserve, facing a less difficult problem than the Bank of Japan did, seems to have learned from Japanese experience. It engaged in quantitative easing much more quickly than the Bank of Japan. Nor has the U.S. dollar behaved as the yen did, sparing the American economy the added problems that Japan faced in the 1990s.

Neither has the United States pretended, as Japan did, that the bad debts were still good. On the contrary, the American market and authorities insisted on write-downs, allowing the banks, with government assistance, to recapitalize themselves faster than the Japanese banks could and putting them on track to resume lending sooner. Further helping American markets recover faster than Japan's could are its much better developed commercial paper and corporate bond facilities.

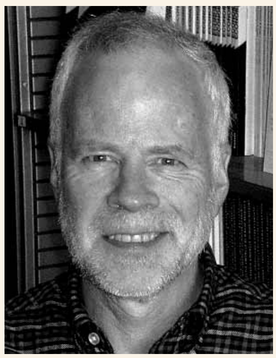


Perhaps, but the end result will depend on government policy.

IRWIN STELZER
Director of Economic Policy Studies, Hudson Institute

The clear answer is "perhaps." I say that because the question calls upon skills other than those possessed by a mere economist. What sort of decade is in store for us will be determined more by government policy than in any time in recent memory. We are not trying to forecast whether General Motors can turn out cars that consumers will like, but whether the cars its government masters order it to turn out will prove salable. We are not trying to figure out whether the costs of an optimal energy system will be attained, adding to our competitiveness, but whether the costs imposed by government will be so high as to add to our export woes. We are not trying to decide whether economic forces will restore balance to our trade, but whether the government can persuade the Chinese to stop manipulating their currency. Our ability to do that will, in turn, depend on whether the government can restore fiscal sanity so as to reduce our need to continue begging China to buy and hold more and more of our IOUs.

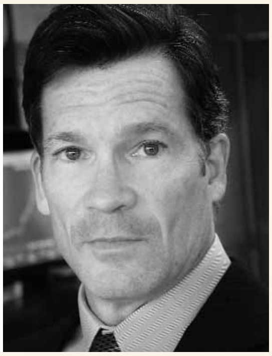
Since economics cannot take one very far in the game of "Will we have a lost decade," we must rely on our imaginations and our faith in American entrepreneurship. My imagination leads me to believe that we are entering a decade of very high taxes, levied on entrepreneurs and small businesses. This will be true whether or not the President pushes through his health care plan. My faith in American entrepreneurship tells me that we will avoid a "lost decade." Neither war, nor plague, nor flood, nor Jimmy Carter succeeded in discouraging American entrepreneurs from taking the risks essential to continued material progress. They shall once again overcome. But that's more theology and ideology than economics.



Slow growth is not the same as a lost decade.

BARRY EICHENGREEN
Professor of Economics and Political Science, University of California, Berkeley

Financial crises leave legacies. For the United States, the legacies of the recent crisis will include a heavy burden of public debt, weakly capitalized banks, publicly owned auto companies, and once recovery commences a mix of tight monetary policy and loose fiscal policy that will be unfriendly to investment. All these are reasons to expect us to grow more slowly than before. But slow growth is not the same as a lost decade. It is implausible that U.S. growth in the 2010s will average only 1.5 percent per year as was the case in Japan in the 1990s. The American electorate would not stand for this. American voters would be quicker than Japanese voters in the 1990s to demand new policies—and new policymakers—if U.S. growth were that disappointing. Hopefully those new policies would include a more growth-friendly policy mix, a more robustly capitalized banking system, and auto (and other) companies left to float on their own bottoms.



The U.S. economy should avoid the worst aspects of Japan's deflation.

LOUIS MOORE BACON

Founder, Chairman, Chief Executive Officer, and Principal Investment Manager, Moore Capital Management

The U.S. economy will probably grow more slowly over the next ten years than over any prior post-war decade but should avoid the worst aspects of Japan's deflation.

The U.S. authorities have responded more quickly and aggressively than the Japanese authorities did. It took Japan fifty-six months to achieve what the Fed managed in twelve months on official interest rates. Fiscal support packages have been bigger, too, in the United States compared with those implemented at the early stages of the Japanese cycle.

The U.S. banking sector—more profitable than in Japan—has been quicker in recognizing losses and raising capital, though it does face a much bigger foreclosure overhang. The U.S. non-financial corporate sector has started from a healthier position and has protected profit margins more aggressively; this should enable firms to return to expansion once demand warrants it.

Japanese equities were more clearly overvalued when they peaked in 1989 than U.S. equities were in 2007. And while both housing bubbles appear to have been close in scale, U.S. prices have fallen more quickly, raising the prospect of an earlier stabilization.

However, not all factors favor a more benign outcome for the U.S. economy. U.S. households started this cycle with a saving rate of 1 percent in contrast to 15 percent for Japanese consumers in 1990. Japanese export markets grew by 9 percent a year during the 1990s; with many countries now in retrenchment mode U.S. exporters may find overseas demand less generous. And while U.S. demographics in the next decade are not as bad as Japan's were in the 1990s, they are deteriorating with slower population growth and a sharp rise in dependents relative to workers. Finally, U.S. Treasury issuance is subject to the vagaries of overseas appetite thanks to the current account deficit, unlike Japanese issuance during the 1990s.

Yes, recovery of confidence will take time.

MAKOTO UTSUMI

President and CEO, Japan Credit Rating Agency, Ltd., and former Vice Minister of Finance for International Affairs, Japan

If a 1990s-style Japanese lost decade scenario means around 1 percent growth for almost a decade, my answer is yes, because of the following reasons.

The contraction of the bank lending would remain for two to three years and the banks would not return to easy lending. The regulators would not allow banks to practice risky activities.

The inevitable correction of the balance sheets of the household sector combined with job insecurity would continue to depress the private consumption.

The effect of the stimulus measures would evaporate in three to four years. Sound budgets and the relatively tight monetary policy would emerge, instead (the exit strategy).

The winds which dominated all over the world were totally reversed during the Crisis of 2008, inflicting a deep loss of confidence. The recovery of confidence might take time. Incidentally, the average annual growth in 1930s was 1.3 percent.

No, this crisis is different in nature.

TAKESHI FUJIMAKI
CEO, Fujimaki Japan, and former Tokyo Branch Manager, Morgan Guaranty Trust Company of New York

I do not think America will follow the same path as Japan because this crisis is different in its nature from the collapse of the Japanese bubble economy.

First, the level of the bubble is different. Yes, it is the same word, "bubble," but the degree of the bubble is different. In Japan, stock prices quadrupled in five years (from ¥11,542 at the end of 1984 to ¥38,915 at the end of 1989), while property prices soared as much as ten-fold in central Tokyo. It was from that level that prices plummeted, and that was why the crisis was so serious. U.S. stock prices and property prices have not gone up that far.

Second, America has already moved to mark-to-market accounting, while Japan had full accrual accounting in those days. This accounting issue is significant because speeds of loss recognition are different. We hear remarks from the U.S. side that "Japan hid losses at the time the bubble burst," but this is due to accrual accounting. Because accrual accounting was in use, companies owned a massive amount of real estate and stocks (crossholding stocks) that were not related to their core businesses. And when the prices of these assets began falling, corporate managements resisted selling them since they did not want to record losses. Thus, the improvement of balance sheets took forever. The United States will not need to follow the Japanese path, where Japan exacerbated the situation by procrastinating actions, as long as the United States sticks to its current thorough mark-to-market accounting.

Financial institutions—the source of this crisis—were also largely affected by accounting differences. Japanese financial institutions owned properties, and held large amount of stocks through cross-holding. Their U.S. counterparts do not possess such stocks or properties. With mark-to-market accounting, all assets, related or unrelated to core businesses, are evaluated at market prices. For U.S. corporate managers, who receive bonuses that are incomparably larger than what Japanese managers receive, it is unbearable to see non-core businesses dragging down the otherwise good performance of their core businesses. Thus, they do not cross-hold stocks unrelated to their core businesses. The current subprime loan problems therefore are nothing more than losses incurred by core businesses. Once all the subprime loan-related products are sold off, or loan loss reserves set aside, it will be done.

In contrast, when the Japanese bubble collapsed, loans of Japanese banks turned into bad debts. And when write-offs of those debts was almost complete, prices of the stocks and properties they owned fell, further deteriorating bank balance sheets. It was a bottomless pit. It makes a big difference in terms of recovery whether "the end is in sight" or "we face a bottomless pit."

Third, Japan did not learn lessons. Politicians, mass media, and economists alike still have no idea about "wealth effect," that is, how changes in asset prices affect consumption. The United States, however, recognizes it, and seems to be taking measures to increase asset prices appropriately. And even without such measures, the New York Dow Jones index has soared by 40 percent since March 9. This rise in stock prices will generate a wealth effect, and will help bolster the real economy. If that happens, the United States will not become another Japan, which suffered a long recession.

Absolutely not.

DANIEL ROSEN
Principal, Rhodium Group, LLC, and Adjunct Professor, Columbia University

Absolutely not—the United States does not face a lost decade. The Fed did not fail to respond rapidly to contractionary conditions, unlike the Bank of Japan; and the American power elite are under no illusions that a vast structural adjustment is somehow avoidable. It is already taking place, and we are talking about it directly. It's not a Japan-style lost decade; but quite likely one of our own styling!

If peace of mind from having more sustainable household balance sheets had a monetary value, then we would think of the coming years as just a shift in consumption. But standard accounting being what it is, the shift into savings, debt repayment, and higher taxes that lies before us portends slower growth in the decade ahead. Whether one calls that consumption lost or peace-of-mind found is a matter of personal values. The adjustment we are pushing through will ultimately give birth to major growth in new industries such as clean energy and climate change adaptation, and these sources of growth could get in gear well before a decade runs its course.

Here is what I said in 2001.

JEFFREY A. FRANKEL
Harpel Professor, Harvard Kennedy School, Harvard University

A very similar question appeared in the January/February 2001 issue of *TIE*, and history has stayed close enough to on-course that I didn't feel the need to write a new answer. My response from nine years ago certainly bears a second look:

The conventional wisdom of 1990, that the Japanese model "could do no wrong," resulted from Japan's strong economic performance in the 1980s. Similarly, the conventional wisdom of the year 2000, that the U.S. model can do no wrong, was based on America's strong economic performance in the 1990s. This view, too, may somehow fall by the wayside over the coming decade, especially if the macro policies of the last eight years are abandoned. The question is how.

Will the heights achieved by the Nasdaq at the turn of the millennium come to look foolish, with stock prices declining in the coming decade, as did Japanese asset prices in the early 1990s? Probability: 90 percent

Will the U.S. real economy slow down from the rapid growth rate of the Clinton years, as did Japan in the 1990s? Probability: 80 percent.

Will Republicans try to apply pro-cyclical fiscal policy, keeping taxes low when the economy is strong and raising them when the economy is weak, thereby exacerbating the business cycle—as did both the government of Japan and President George H.W. Bush? Probability: 70 percent.

Will the dollar decline in the coming decade, as did the yen from 1995 to 1998? Probability: 60 percent.

Will American credibility as a global leader be undermined by a lack of willingness to participate in and contribute to multilateral initiatives? Probability: 40 percent.

Will the excessive indebtedness of the boom years contribute to a recession, as it did in Japan? Probability: 30 percent.

Will the American economic model become tainted by the failure of variants in crisis-prone emerging markets, as did the Japanese model in the Asian crises of 1997–98? Probability: 20 percent.

Will the rapid U.S. growth of the boom years turn out to have been less New Economy, and more illusion, like Japan's bubble economy of the 1980s, that is, attributable to unsustainably high levels of labor input (hours worked), requiring a corresponding period of below-trend growth to prevent inflation from accelerating? Probability: 10 percent.

Will American culture and the English language no longer dominate the world? Probability: Zero percent.

No, the United States won't repeat Japan's mistakes.

GINA DESPRES
Senior Vice President, Capital Research & Management Co.

The United States is not headed for a Japanese-style "lost decade." (The "lost decade," which began with the collapse of the Japanese real estate and stock markets in 1989, is actually two lost decades!)

Despite the well-deserved opprobrium heaped on the U.S. government and the financial sector over the past eighteen months, I doubt the United States will repeat Japan's policy mistakes of the 1990s and suffer from similarly protracted stagnation. This doesn't preclude the possibility that premature tightening of monetary policy or the imposition of heavy new taxes in the next year or two could delay the American economic recovery. Nor does it discount the likelihood that the U.S. economy will grow more slowly for much of the next decade than it has in the past.

But unlike Japan, which persisted in obscuring or denying the severity of its banking problems, the U.S. financial system and capital markets will be subject to much more rigorous scrutiny, supervision, and reform. While critics lament the depressing effect of regulation on innovation, there is just as much reason to expect that we'll find a reasonable balance.

No, Japan spent a decade in denial and delay.

RICHARD KATZ
***Editor,* The Oriental Economist Alert**

The claim that America is reprising Japan's "lost decade" is no truer today than it was when alarmists made similar claims during the dot.com bust. There are three big differences between the two crises: the cause, the scale, and the response of policymakers.

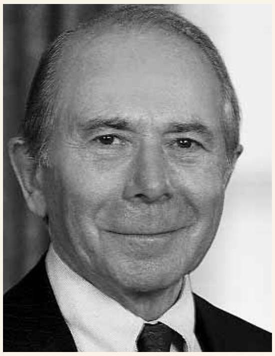
In Japan, the primary problem was pervasive dysfunction in the real economy, which was reflected in a debt crisis. Tens of thousands of companies produced goods and services that were worth less than what they cost to make. Insufficient competition and bailouts by the banks and government allowed these so-called zombie companies to survive in the name of avoiding job losses.

In the United States, the converse is the case: pervasive dysfunction in the financial sector led to a severe recession in a mostly sound real economy. Japan's dysfunction was the result of deep-seated structural flaws that required the remedy of thorough institutional overhaul. In the United States, by contrast, this was an avoidable crisis caused by grave policy mistakes that were then compounded by investor panic. The primary mistake was excessive and misdirected deregulation driven by the combination of market fundamentalist ideology and financial industry lobbying. This was turbocharged by an executive compensation system that gave CEOs an incentive to take outrageous risks with other people's money and to create securities based on reckless disregard of true underlying creditworthiness (or lack of such). How do those who deny the pivotal role of financial deregulation explain the much lower rate of home foreclosures in cases where traditional regulations about down payments and documentation of ability to pay were enforced?

In Japan, the mountain of bad debt, reflecting those tens of thousands of zombie companies, added up to 20 percent of Japanese GDP. By contrast, the April 2009 "Global Financial Stability Report" of the International Monetary Fund forecasts that the total U.S.-originated bad debt will end up at $1.06 trillion, or 7.5 percent of U.S. GDP. The real losses in the U.S. financial system are not caused by companies or households being unable to pay, but write-downs of unregulated derivatives and other losses in the so-called "shadow banking system." As of August, it looked as if U.S. housing prices were bottoming out at around 30 percent below the peak, equal to the levels of 2003. In Japan, real estate prices finally bottomed out in 2004 at a level 90 percent below the peak, a level below those of 1979, or twenty-five years earlier.

Japan lost a decade (and more) because it spent that decade in denial and delay. It took the Bank of Japan nearly nine years to bring the overnight interest rate from its 1991 peak of 8 percent down to zero. The U.S. Federal Reserve did that within sixteen months of declaring a financial emergency in August 2007. The Fed also applied all sorts of unconventional measures to unfreeze panicked credit markets, an effort which succeeded within months. It took Tokyo eight years to finally stop denying the severity of the banking crisis and to use public money to recapitalize the banks; Washington began to do so in less than a year. Worse yet, for several years, Tokyo used government money to help the banks keep lending to insolvent borrowers. By contrast, U.S. banks have been rapidly writing off their bad debt. Although Tokyo did eventually apply many fiscal stimulus measures, it did so too late and too erratically to have a sufficient impact. The Obama administration by contrast applied massive stimulus early on.

None of this means that Washington has done all that it should do, either in terms of fiscal stimulus or, especially, financial reform. Nor does it deny that the United States will probably suffer a U-shaped recovery much weaker than after most recessions. But to say that the United States is reprising Japan is to say that, in the United States, manufacturing will still be below 2007 levels as late as 2025. I don't believe that.



No, the two political cultures are different.

MAURICE R. GREENBERG
Chairman and CEO, C.V. Starr and Co.

The political situation in Japan and culture of its people is much different from the political environment in the United States and the American people.

The culture of the Japanese people is not to aggressively organize and speak out for change. By and large, they accept the political situation the way it is and seldom organize the strength to combat the political machine.

The LDP, which dominated politics in Japan since World War II, may now reaching an end in its influence, but for many years the Japanese simply suffered in silence. There were numerous incidents of corruption at fairly high levels, and economic growth is nonexistent and fiscal policy and interest rate policy simply out of step with reality.

In the United States, any prolonged period of "no growth" would result in a far more outspoken population and an aggressive reaction by the opposition party. Even the party in power would have difficulty in supporting a "no growth" policy. The United States is not Japan. I do not fear a ten-year malaise in our country or economy.

No, but the cost of oil will complicate our future.

JAMES SCHLESINGER
Chairman, MITRE Corporation, former U.S. Secretary of Energy, and former Director, Central Intelligence Agency

No, we are not going to run into a Japanese-style "lost decade." That frustrating reality was due to an insufficiency of domestic demand, which was insufficiently compensated for by Japan's substantial export surplus. Nonetheless, the United States (and other developed nations) will likely experience a parallel phenomenon reflecting stringency in the oil market. Even the International Energy Agency now recognizes that, either for geologic or so-called "above ground" (that is, lack of access) reasons, the oil supply will not grow in a way to match the prospective growth of demand. Decline rates in existing oil fields have increased and the IEA acknowledges that the oil supply future is "patently unsustainable." The reduced level of investment, reflecting lower oil prices, has simply exacerbated the situation. In brief, as the global economy revives, the recovery is likely to be partially aborted by the run-up in oil prices—as oil demand comes to exceed the capacity to produce a supply that matches the prospective growth of demand.

Over time, think of the challenge of finding and producing the equivalent of six Saudi Arabias in order to continue to fuel the international economy in the decades ahead. All consuming nations should—but probably won't—begin now to make adjustments to cope with that day of reckoning.

It's possible, but it's a bit early to make the call.

SUSAN M. PHILLIPS
Dean and Professor of Finance, George Washington University School of Business, and former member, Board of Governors of the Federal Reserve

It is possible, but I do not think the United States is headed for a scenario similar to the 1990s-style Japanese "lost decade." We are not yet through our recession, so it is a bit early to make a final call, but already we are seeing some signs of economic improvement or at least a slowdown in the rate of deterioration of the U.S. economy.

Why are the U.S. and Japanese situations different? There are some fundamental differences between the two countries' economic and regulatory environments. For example, the Japanese have a greater propensity to save than do U.S. consumers, and I would expect the latter to increase their personal consumption more quickly than the Japanese did. Indeed, we can already see evidence of increased spending, some of which is being encouraged by government stimulus programs. Not only are there direct government subsidies for U.S. spending (such as the Cash for Clunkers program), but there are other programs to help homeowners who are financially strapped retain their homes. In the business sector, there have been U.S. government bailouts to stabilize capital markets or boost long-term employment. Such programs were not widely available during the Japanese "lost decade."

Another major difference between the current U.S. situation and the earlier Japanese recession is the financial institution regulatory response. Although the results have been mixed to date from U.S. regulatory efforts, they have been creative, aggressive, and intrusive, with massive capital infusions into systemically important institutions. Such was not the case in Japan in the 1990s.

U.S. government intervention seeks to shorten the recession, but improvement in the job market is crucial before we can see a return to sustainable growth. In addition, the Fed must continue to be successful in keeping us out of a downward deflationary spiral like the one which plagued Japan in the decade of the 1990s. In short, I am optimistic, but we are not out of the woods yet.

Not a "lost decade," but one that will feel that way.

CATHERINE L. MANN

Professor of International Economics and Finance, Brandeis International Business School, and Senior Fellow, Peterson Institute for International Economics

I worry that the U.S. economy will experience a low-growth decade (perhaps not lost but certainly not vibrant). First, risk has become a four-letter word: Financial institutions refuse to take risk and borrowers refuse to price it in. Second, while perhaps counterintuitive, this zero-interest rate equilibrium is not conducive to innovation. The "next big thing" is important to break the hunker-down mentality that is capturing the market. Third, a long period of slow growth atrophies worker skills and undermines the incentives to pursue higher education. All this undermines the positive attitude to embrace the changes in business processes and workplace practices that are the hallmark of a vibrant economy. So, the United States faces perhaps not a lost decade, but one that will feel that way compared to the high productivity period and boom of the last fifteen or so years.

There are two obvious differences, and the question is China's role.

YOSHIHIRO SAKAI

Senior Economist, Development Bank of Japan, Adjunct Fellow, Center for Strategic and International Studies, and former Senior Examiner, Bank of Japan

Although the current situation in the United States is similar to what happened in Japan in 1990s, there are two obvious differences in the economic scenarios. The Japanese government and central bank took reflationary measures such as massive capital spending and a "zero-interest rate" policy. However, the decade-long economic slump resulted from the government's delay in taking action on undercapitalized banks; scanty asset assessment for banks caused it to inject capital repeatedly.

First, Japan's slump was rooted in balance sheet problems on the part of both banks and corporations. By contrast, America's is that of off-balance-sheet numbers of derivatives—much more difficult to calculate and wipe out. Also notable is that the loss volumes of American banks are much bigger than Japan's. Furthermore, high-performing companies such as Toyota, Nintendo, Sony, and Honda that were not weighed down by nonperforming loan problems kept the Japanese economy from catastrophic knockout. American corporations are different from their Japanese counterparts in that they were created in an environment of Wall Street capitalism and are in a situation where it is now almost impossible to be independent of the financial institutions. These fundamental differences indicate that America's national debt and current account deficit will kill its economy—making the Japanese "lost decade" appear pale in comparison.

More important, it is prudent to note that Japan's bubble economy of the late 1980s was a side effect of reckless yen appreciation policy. The malaise of the bubble burst was worsened by overly severe property-related loan regulations (real estate comprised 70 percent national wealth). Japan was not irrational but implemented crazy policies at the request of mainly the United States. And as a result of prolonged assistance of the U.S. economy, at the United States' bequest, Japan knowingly or unknowingly destroyed itself as the lost decade ensued. America's problem was purely born in America. The housing bubble took over as the IT bubble burst. The U.S. government and the Federal Reserve of late seem prepared to create the next bubble from "environmental fever." The question is whether China will play Japan's role this time.

No, but watch the Fed closely.

ARTURO ESTRELLA
Professor and Department Head, Department of Economics, Rensselaer Polytechnic Institute

What causes recessions? Simply stated, the answer is monetary policy. The next time you hear that the Fed is blameless for the current U.S. recession, consider that the Federal Open Market Committee raised the federal funds rate by a hefty 4.25 percentage points over the two years ending June 2006. Every recession since the 1950s has been preceded by a period of substantial monetary tightening and this was no exception. Even after tightening caused the yield curve to invert in August 2006 (a sure sign of impending recession; see *TIE*, Summer 2005), the FOMC did not react for more than a year, until September 2007. Fed officials repeatedly spoke about distortions in the yield curve, about how this time it would be different. It was not.

Once the central bank slams on the brakes, lifting the foot is not enough to get the economy going again. Balance sheets deteriorate, problem assets abound, business and consumer confidence are low, and distrust of counterparties is high. No amount of quantitative or credit easing will change these fundamentals overnight, or magically induce sustainable private lending to nonfinancial business. Fiscal policy is more likely to provide the spark that breaks the impasse and averts a Japan-like scenario.

What happens now? With large doses of monetary and fiscal stimulus in place, the stage is set for a recovery. The yield curve has again steepened, financial positions are starting to come around, and there are hints that general sentiment is beginning to follow. The process may be slow at first, but barring future policy gaffes, the odds of a Japan-like scenario are low. The more troublesome danger going forward is that the Fed is again slow to react. The FOMC must be extremely vigilant for signs of overheating, or run the risk of multiple boom-bust cycles.

Definitely not. American leadership has responded quickly.

DANIEL GROSS
Columnist and Economics Editor,* Newsweek, *and author of* Dumb Money: How Our Greatest Financial Minds Bankrupted the Nation *(2009)

Definitely not. Why not? In a word, leadership. To a large degree, poor leadership—at the Federal Reserve, at regulatory agencies, at the White House, and, most egregiously, at large financial institutions—helped create the conditions for the credit crisis that plunged the United States into a deep recession.

And in the initial phases, poor leadership aggravated the situation. But after a halting start, the system responded with alacrity. Since last fall, we've seen the implementation of a series of unpopular, imaginative, controversial, expensive, swift, and, by and large, successful efforts to halt the economic decline, stabilize the financial system, and create the conditions for growth. Within two years of the onset of this crisis, the Federal Reserve slashed interest rates to zero, two administrations rolled out the TARP, Congress enacted a large stimulus, and plenty of ailing companies failed or merged into stronger hands. Enacting and implementing all of these efforts required bold leadership and significant risk. That sense of the public and private sectors seizing the initiative and acting rapidly was largely absent from Japan in the early 1990s. Sure, the United States has its share of zombie companies. But they're largely the outliers. The U.S. economic system may be more naturally resilient than Japan's. And part of the difference can be ascribed to culture. But leadership matters, too. The actions of Federal Reserve Chairman Ben Bernanke, a scholar of the Great Depression determined not to relive it, of former U.S. Treasury Secretary Henry Paulson, whose reputation is being rehabilitated as banks rush to pay back the TARP funds, of President Obama, who spent political capital on the stimulus, and of his highly competent economic team have all helped avert disaster.

It depends on whether the financial sector is cleaned up.

ANNE O. KRUEGER

Professor of International Economics, School of Advanced International Studies, Johns Hopkins University, Senior Fellow, Stanford Center for International Development, and former First Deputy Managing Director, International Monetary Fund

The outcome all depends on policy. If the financial sector is finally cleaned up and recapitalized and the looming fiscal deficits are brought under control, there is no reason why the United States should have a "lost decade." The Japanese mistake was to believe that they could stimulate the economy and that that would result in a reduction in the banks' difficulties. But until the Japanese banks had worked down their nonperforming loans, stagnation continued. In the United States, questions about the commercial real estate market and credit cards still hang over the financial sector. If those are satisfactorily resolved and a credible exit strategy for the Fed and for bringing prospective future fiscal deficits under control is developed, the impediments to economic growth will have been removed.

The bad news: stagnant U.S. growth for some time. The good news: The U.S. government responded quickly.

TATSUYA TERAZAWA

Director, Economic and Industrial Policy Division, Ministry of Economy, Trade and Industry, Government of Japan

The bad news is that the magnitude of balance sheet adjustment the U.S. financial sector and the U.S. household needs to go through, as a percentage of GDP, is probably as great as the adjustment that the Japanese financial sector and the Japanese corporate sector had to go through in the 1990s. While Japan benefited from strong global demand, especially that of China after 2002, the United States cannot hope for global demand to help her out of the problem in the same manner this time.

The good news is that the U.S. government and Federal Reserve have taken the necessary steps in a much faster and bolder manner. While it took seven years to inject public money into Japanese banks, it took less than eighteen months to inject public money into U.S. financial institutions after the subprime loan issue had surfaced. As the securitized products had been purchased mainly by foreign financial institutions, the adjustment needed by the U.S. financial sector should be smaller. The non-recourse nature of mortgage loans in the United States should expedite the adjustment process of household balance sheets. The substantial ownership of stocks by U.S. households should accelerate the repair of household balance sheets once the stock market recovers.

In sum, I believe that we will have to face a few more years of sub-par growth in the United States. This may sound discouraging, but it's better than repeating Japan's "lost decade."

Yes and no.

RICHARD C. KOO
Chief Economist, Nomura Research Institute

Yes and no. All the unusual features of the current U.S. recession, including the huge budget deficit and the need for fiscal stimulus, the inability of zero interest rates and quantitative easing to turn the economy or real estate prices around, the emergence of a serious banking crisis and the need for government guarantees and capital injections, were seen in Japan fifteen years ago. Both recessions were triggered by the bursting of a debt-financed asset price bubble which forced private sectors in those countries to shift away from their usual profit maximization to debt minimization in order to repair their battered balance sheets. That shift nullified the effectiveness of monetary policy because people with negative net worth are not interested in increasing their borrowings at any interest rate. When people are minimizing debt or increasing savings, even with zero interest rates, only government borrowing and spending can keep both the economy and money supply from shrinking. Furthermore, since the economy will not enter a self-sustaining growth period until private sector balance sheets are repaired, fiscal stimulus must be maintained until the repair work is completed.

The bursting of a debt-financed bubble also means a systemic banking crisis where many banks are having the same problem at the same time. With so few buyers and financiers of assets left, forcing banks to dispose of their non-performing loans quickly will only make the situation worse. Instead, a credible ten-year NPL amortization program coupled with a program of capital injection to keep the banks lending is needed.

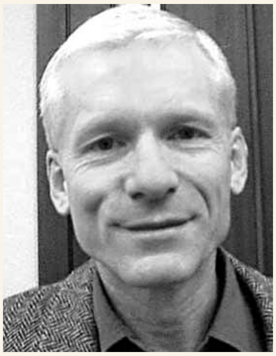
When Japan fell into the "balance-sheet recession," nobody realized that it was driven by a completely different virus compared with ordinary recessions, and much time and taxpayer funds were wasted trying everything from quantitative easing and tax cuts to structural reforms. By utilizing Japan's lessons and concentrating its efforts on seamless medium-term fiscal stimulus centered on government spending and a credible ten-year NPL amortization program for its banks, the United States should be able to shorten its recession by many years.

Long-term growth will depend on productivity.

DAVID D. HALE
Chairman, David Hale Global Economics

The U.S. economy is not headed for a lost decade. U.S. business has produced remarkable gains in productivity, which suggests that the U.S. economy may be able to achieve output growth close to 3 percent without provoking inflation concerns. Many economists think the economy's new growth trend line is only 2.0–2.5 percent. The challenges for the United States will center on the Obama economic program. His proposals to hike the top marginal tax rate to 45 percent will hurt small businesses and dampen employment growth. His proposals for cap-and-trade legislation in carbon emissions will ultimately raise electricity prices by 50 percent. Such price increases will dampen both business and consumer spending. The Obama fiscal program will create multi-year trillion dollar deficits which could raise bond yields significantly when the economy recovers from the recession. There is little doubt that Mr. Obama will have to raise taxes at some point. Such tax hikes could also dampen growth for several quarters.

The U.S. economy has experienced a severe downturn because of a crisis in the mortgage market brought on by highly speculative lending and a total lack of risk management at major financial institutions. The United States will now experience slower growth because of deleveraging, but the economy's long-term growth potential will depend upon productivity. If U.S. business can sustain the productivity gains apparent in the recession, there is little risk of a lost decade.

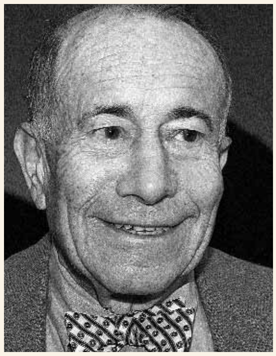


It's a contest between an American hare and a turbocharged Japanese tortoise.

ANDREW DEWIT
Professor of the Politics of Public Finance, School of Policy Studies, Rikkyo University

Actually, Japan is nearing the end of its second "lost decade," and it's highly unlikely that America can match this performance. Losing a decade or two, Tokyo-style, after a bubble bursts requires the debauched institutions of an economic miracle and a deep pool of "no voice nor exit" savings. Via ramping up the national debt to cocoon the status quo, Japan is soon to see the other side of a 200 percent gross debt-to-GDP ratio, having broke through the 100 percent barrier in 1997. But America depends on overseas financiers who have plenty of voice and are already scouting potential exits. This dependency on uncharitable strangers will presumably limit America's capacity to deal with deleveraging by simply shifting an ever-increasing load onto the public sector.

What remains unclear is whether America—despite its political regime change—can override legions of vested interests in energy, finance, health, and education, and produce a truly robust and sustainable growth dynamic. Matters don't look pretty at present, but let's keep our fingers crossed over the coming months. And with the conduits of savings shifting and shrinking, rapidly aging Japan now seems no longer able to give the old economy at home (let alone in America) yet another lease on life. So we have sort of an informal contest between, if you will, the American hare and a possibly turbocharged Japanese tortoise, with the latter driven to avoid losing a third decade.



No, America's differences will be decisive.

CHARLES WOLF
Senior Economic Adviser and Distinguished Corporate Chair in International Economics, and Professor, Pardee Rand Graduate School, RAND, and Senior Research Fellow, Hoover Institution

No, America is not headed for a Japanese-style lost decade, and frankly, I've never fully understood why Japan's recession lasted so long!

That said, several principal factors characterized the Japanese scenario. Monetary policy reduced short-term interest rates to zero (as the Fed has done in the United States). The huge expansion of Japan's budget deficits was an intended "stimulus" whose effects were severely blunted because it was mainly channeled through a part of the bureaucracy—namely, the Transportation Ministry—renowned for its heavy exactions of pork, corruption, and other inefficiencies. (The limited effectiveness of the U.S. stimulus package is another worrisome similarity between the U.S. and Japanese cases.) The Japanese macroeconomy was decisively steered by government industrial policy which, when it no longer worked, left the economy rudderless and lacking in vitality, innovation, and entrepreneurship. A set of political and societal factors made protracted stagnation acceptable to a surprising degree, including a homogenous, internally cohesive population, and a social and economic system marked by discipline, mutual respect, and predictability. (These characteristics are quite remote from the U.S. system, and tend to make protracted stagnation less acceptable here.)

The United States won't replicate the Japanese scenarios for many reasons. The U.S. central bank has more adroitly managed monetary policy—for example, by reducing long-term rates in addition to short rates through massive Fed buying of Treasury notes, reducing the spread between long- and short-term rates, and discounting lower quality commercial paper to ease credit. The United States has developed innovative programs like the FDIC's Term Liquidity Guarantee Program designed to lower banks' borrowing costs to help thaw a frozen credit system. Multiple stimulus packages, huge fiscal deficits, and other bailout measures are collectively having some positive effect even if none has been well-designed. And finally, I believe that various forces of resilience continue to be manifest in the United States to a far greater degree than in Japan: entrepreneurial zeal, openness to start-ups, ease of entry, and "animal spirits."

No, but America needs to clean up its financial system.

CHI LO
Director of Research, Asset Allocation and Investment, Ping An of China Asset Management (HK) Ltd, and author,* Asia and the Subprime Crisis *(October 2009)

Policy speed makes a difference. The United States' faster reaction in combatting the subprime crisis with aggressive monetary and fiscal easing deserves the benefit of the doubt that it may avoid a Japanese-style economic quagmire. Quantitative easing is providing relief for borrowers, while fiscal spending is helping to fill the hole in private demand.

Japan's "lost decade" was a result of overly tight monetary and fiscal policies after its asset bubble burst in 1989. This, in turn, reflected an insensitivity to the debt-deflation environment in the post-bubble environment. The Bank of Japan even hiked rates by 200 basis points after the stock market bubble burst and kept them elevated for eighteen months before it started easing in mid-1991. There was no decisive fiscal expansion for some years, and quantitative easing did not start until March 2001, eleven years after the bubble burst.

Massive wealth destruction and weakening aggregate demand had by that time eliminated any underlying core inflationary pressures, but the Bank of Japan kept its overly hawkish anti-inflationary stance. This created a strong—and self-fulfilling—deflationary expectation among the public. The Bank of Japan even broke its promise on keeping quantitative easing in place until deflation was gone by ending it March 2006, and started tightening July 2006, eighteen months before the non-food-CPI inflation became decisively positive! This policy mistake allowed deflationary forces to become entrenched in the economy.

Reacting quickly is only half of the crisis management job. U.S. authorities must keep loose monetary and fiscal policies long enough to diffuse the deflation bomb in this post-bubble adjustment period. In the end, they still cannot escape tough decisions on fixing the structural flaws in the American financial system, as the Japanese example also shows. It was not until 2003 when Japan finally took action to force a major banking overhaul—including nationalizing a major bank (Resona), merciless audits of bank books, and massive write-offs—that the economy showed signs of revival.

To turn the benefit of the doubt into the "benefit of no doubt" that America will not head towards a lost decade, the administration needs to act decisively to clean up the financial system, even if that may inflict short-term pain.

No, America's ability to Google forward will prevail.

NORBERT WALTER
Chief Economist, Deutsche Bank Group

For a one-handed economist like me the answer is obvious: no, the United States is not embarking on a lost decade. It is going to go through a period of five years of turbulence with quite a lot of adjustment pain—and it will not go back to the exuberance of the preceding years. The trend growth rate will be closer to 2.5 percent rather than 3.5 percent, and the financial sector will shrink by one-third (in income). The U.S. dollar's role as the global reserve currency will be questioned in this transition period. The world's savings will not be available for the free-spending Americans as cheaply and as amply as in the last few decades.

U.S. households need to rebalance their accounts, including saving some 10 percent of their income. U.S. corporations need to restructure to meet the challenges of increasing international competition. The U.S. government must provide better physical and soft infrastructure and still exit from excessive government debt. This implies higher user fees and higher indirect taxes (gasoline tax), since emission certificate trade will be very difficult to implement.

The implosion of the real estate market will not be over soon. Office space and other commercial real estate are still on their way down. Thus shrinking construction will be a drag on the economy until 2012 (with the exception of government structures). Exports will be unable to boost the U.S. economy since the rest of the world is not in upbeat mood—not even the more dynamic Asia can fix it.

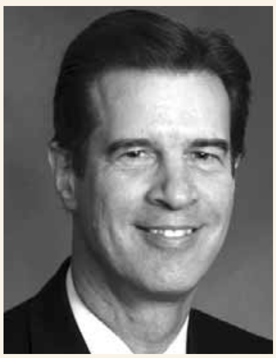
But U.S. fertility and its implications for dynamic household formation supported by ongoing immigration into the United States will absorb the capacity excesses in real estate markets. A dynamic president and a supportive Congress will regenerate U.S. society. The willingness and ability to restructure, to "Google forward," as I call it, will prevail. The U.S. dollar will recover from its weakness and get back to its fair value of some $1.15 per euro. This will be the case not least because the United States is the only military superpower and the only country with effective political clout and good economic strength. China will not be number two because it will have to deal with domestic problems such as its environment and demography. Europe, while remaining number two, will not be at eye level with the United States because of its EU integration fatigue. This is a pity, because a stronger Europe would be in everybody's interest.

Unlike the United States, Japanese officials dallied for years before recognizing their problems.

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

No, America will not experience a decade like Japan did in the 1990s in which economic growth averages only 1 percent a year, and exceeds 2 percent only in one year (1996). Like Japan, the U.S. economy has had a major financial and economic shock, partly caused and accompanied by a sharp decline in household wealth (by $12 trillion, nearly 20 percent, from the end of 2007 to March 2009) that will reduce household consumption and act as a drag on the economy for several years. And the quality of bank assets, both securities and loans, has been severely impaired. Central bank interest rates have been reduced to near zero (although not until over three years after the crisis started in the case of Japan). But the comparisons end there. The Japanese authorities dallied for years before recognizing the problems of their banks, and even after recognition their actions were dilatory, and involved official complicity in understating their non-performing loans.

The Federal Reserve, in contrast, acted swiftly and boldly to revive stalled financial markets, while the U.S. government introduced a modest fiscal stimulus in 2008 and a much bolder one in early 2009, and moved to recapitalize major banks in the fall of 2008. As in Japan, U.S. bank lending has not revived. But the U.S. economy is far less dependent on bank lending than Japan, and the U.S. capital market is showing signs of life, if not yet vigor. Finally, U.S. demography is far more favorable to growth than Japan's. The number of young adults, and new household formation, was falling in Japan, whereas (thanks both to higher birth rates and to immigration), it continues to rise in the United States, bringing with it new demand for housing, consumer durables, and education for young children.



No, but one can still imagine a troubling U.S. scenario.

WILLIAM H. OVERHOLT
***Senior Research Fellow, Harvard University, and author of* Asia, America and the Transformation of Geopolitics (2007)**

America shares key Japanese problems. It has a balance sheet recession, in which people save rather than spend until balance sheets recover. Both governments failed to recapitalize their banks fully due to popular/legislative resistance, and both failed to acquire early, accurate information about the scale of bad assets because they feared to know.

But the differences are decisive. While most of Japan's banks, corporations, and families fell into balance sheet recession, the typical U.S. non-financial corporation and a broad range of families did not. Japan's much worse bubbles caused property prices to fall well over 50 percent and the Nikkei fell to the equivalent of a Dow at 2776. Adjustment is faster in the United States because its government has rescued only a few non-financial zombie companies whereas Japan rescued many. U.S. officials acted much more promptly. (It took Japan nine years to reach near-zero interest rates, the United States sixteen months; Japan eight years to recapitalize banks with public money, the United States less than one. Japan's banks were extremely slow to recognize bad assets, the United States much faster albeit incompletely.)

More broadly, Japan has an insular economy, with limited domestic competition, total dependence on exports for economic growth, and very internationally competitive sectors. The United States has a globalized economy, intensely competitive both domestically and internationally, with diverse sources of growth. Moreover, U.S. politics is diverse, competitive, and often capable of acting in the national interest, while Japanese politics was the immobilized, wholly owned subsidiary of a handful of interest groups.

Hedging these hopefully decisive differences: one can still imagine a scenario where commercial property prices collapse, the Obama administration loses credibility after using stimulus as a cover for social transformation, and Congress balks at a further necessary recapitalization of the banks. The crisis isn't over until it's over, and competent policies remain vital.

Japan's "lost decade" was hardly a time of misery.

GEORGE R. PACKARD

President, U.S.-Japan Foundation

Without fully answering the question, let me take exception to the common view that Japan's "Lost Decade" was a time of misery for the Japanese people. In fact, while Japan's banks were foundering and GDP growth stalled, this was a time of ferment and experimentation, with some amazing achievements.

The 1990s marked the beginning of the end of tight bureaucratic control of the economy by the rigid bureaucrats of Kasumigaseki, and a rise in the power of elected political leaders. It saw, briefly, the collapse of the Liberal Democratic Party in 1993—a seed that has taken root and flowers today. It saw a continuation of Japan's high savings rate that has produced mountains of cash in the hands of the older generation, cash that will be available for investment and innovation.

On the foreign policy front, it saw the strengthening of the U.S.-Japan security arrangements, and, despite the growing nuclear threat from North Korea, its voters steadfastly rejected the siren song of the nationalist right wing to go nuclear. It moved away from its earlier mercantilist policies to accept World Trade Organization rules for trade. The Hashimoto-Kantor talks in 1995 on auto disputes led to peace on that front. Its advances in research and development in that period now make it the world's leading producer of non-polluting cars. The Japanese are leaders in conservation and environmental protection.

George Kennan once wished aloud that we could drop GDP figures as a way to measure a nation's wellbeing. I share that view. Nor do I believe that Japan's declining and aging population should be a cause for concern. Workers will (and should) work for more years, and women will (and should) be recruited into the work force in larger numbers.

The Japanese, despite their penchant for seeing disaster around the corner, are among the happiest, best-fed, best-clothed, most literate, and well-traveled people in the world, and they have created, out of the rubble of 1945, a civilized, democratic society living in clean, orderly cities that should be the envy of most of the rest of the world.