Krugman on the Looming 'Lost Decade' for the U.S.

[This is a letter I sent to friends on May 21, 2010 along with a column by Paul Krugman. –S.H.]

Hi everybody,

In the op-ed column in yesterday's *New York Times* (appended below), the liberal Keynesian bourgeois economist Paul Krugman worries that there is "too much" concern with the possibility that the U.S. might follow Greece into financial insolvency, and too little concern that it seems to be following Japan into a "lost decade" of high unemployment and very low economic growth.

As someone who has been predicting for a dozen years or so that the U.S. would be following along the Japanese path you might imagine that I would welcome this agreement from Krugman. But actually I find a whole lot more to *disagree with* in his column.

1) First of all, Japan has not just been stuck in a single "lost decade"! In reality, Japan has been stuck in a period of stagnation since the early 1990s—almost *two* decades already! During that time it has been in and out of recession, with 4 major episodes of recession (as bourgeois economists measure such things), interspersed with very shallow, weak and short "recoveries".

Like the U.S., Japan currently seems to be in another very weak "recovery" period after going through its worst single recession since World War II. While the "Great Recession" in the U.S. has been quite bad, in Japan it was even worse. Moreover, there is every reason to believe that this pattern of in-and-out-of-recession will continue for quite a while yet.

2) Krugman presents only a *worry* that the U.S. might be following Japan's course in the coming years. Hasn't he noticed that this has already happened for at least two years already?!

Actually this entire past decade has been one of overall economic weakness and stagnation in the U.S. as well as in Japan. For the U.S., this past decade has been by far the weakest economically since the 1930s!

There have been two U.S. recessions this past decade (as the capitalists measure them), with a slow and weak recovery after the "Dot.com" collapse in 2000-2001, then the advent of the "Great Recession" starting in December 2007 and the financial panic of 2008. Only for 2 or 3 years (2005-2007) was there anything like good economic growth, and as we now all know, (like the Dot.com episode) that was also based on a financial house of cards, the housing bubble—sub-prime real estate loans and speculation in securitized debt packages, etc.

3) The fact that the U.S. is currently following Japan does not mean that it won't eventually be following Greece as well! It is a false dichotomy to say that we must worry about one *or* the other.

In fact it is inevitable that both Japan and the U.S. will fall into financial insolvency at some point. (Which one of the two countries *first*, I can’t say for sure, but quite possibly the U.S. first.)

The path of in-and-out-of-recession is merely a prelude to eventual financial collapse. As Japan has shown, it is a prelude that can sometimes go on for a very long time! But the light at the end of the very long dark tunnel is not a true recovery (economic boom), but rather an explosive financial catastrophe and a further qualitative *worsening* of the economy (into depression). Severe chronic illness most often results in death in the end.

4) However, chances are that the U.S. will not be following Japan into multiple “lost decades” and maybe not even one full lost decade (from 2008 on). It is more likely, in my opinion, that while the U.S. will be following Japan for a while, that the financial collapse will come much more quickly than it has for Japan. It could actually happen as soon as a year or two from now, but probably 5 or 6 years down the road is more likely.

The major financial collapse in the U.S. (which was only a close call in 2008) will probably be sparked at some point by an international loss of confidence in U.S. debt. If China, Japan, Britain and other major holders of U.S. government debt decide to jump ship while the jumping is good, that will clearly bring on the collapse. And countries like Japan and Britain (at least) may be *forced* to cash in their U.S. chips because of their own economic crises at home.

5) Krugman is right to call for further Keynesian stimulus to the economy. That would indeed help keep things going for a few more years if it was done more intensively. (That is what China did, for example, with its massive stimulus program.) But Krugman is dead wrong in thinking that more intense Keynesianism would do anything more than interrupt the developing crisis for a few years. Genuine “pump-priming” in a situation like this is total fantasy.

But it appears to me that a combination of disunity within the ruling class (Republicans vs. Democrats) and their erroneous economic theories will prevent the U.S. from applying a sufficient Keynesian stimulus with the (short-term) success that China has had. Instead, they are truly following the Japanese path, of periodic bursts of Keynesian deficits only to the point of easing the crisis for a bit. In and out of recession, with only short and weak interludes... that is the name of the game.

6) Krugman points out that inflation is not a problem at the moment, and even thinks that the possibility of serious prolonged deflation is the greater danger. In the near term that is correct.

But in the long-term there will inevitably be some major episodes of inflation in the U.S. and world economies because of all the massive deficit spending, or in other words because of the massive expansion of the money supply relative to the number of commodities. A lot of this deficit spending has already occurred (without the inflation yet), but much more will be occurring over the next several years. In recessionary times it takes a long while for this debasement of the currency to work itself into the economy (especially when a lot of the money is just being given to banks to erase their past debts).

Stagflation has happened before, and it will happen again, no matter what bourgeois economic theory says on this score.

7) Krugman does not understand that what he would consider to be a sufficient Keynesian stimulus would, first, *only interrupt and not really end the current level of crisis*, and second, would *only hold off* the advent of a full-scale financial collapse for a while longer. In fact, the more deficits now, the less it will be possible to employ them later.

So the real choice the capitalists face is limping along like now for a longer period, or a vastly bigger burst of stimulus now leading to a real end to the recession for a few years *and then a quicker financial collapse!*

What would you choose when presented with the alternatives of going out with a prolonged whimper or a spectacular bang?! But, as I say, I think the intra-capitalist politics of the situation dictates that it will be the path of the whimper followed a ways down the road with a financial collapse and outright depression.

(One could argue, however, that the Dot.com bubble and the housing bubble were sort of spectacular final shots before the final winding down began.)

8) Within the framework of the capitalist system there is *no* long-term solution to this crisis, which is why the debates between those who favor further Keynesian stimuli and those who favor attempting to get the out-of-control growth of debt "under control" are ultimately beside the point.

This economic crisis can only be resolved through the massive destruction of the mountain of excess capital that has accumulated since the last depression. It took World War II to do it last time around.

Scott

The New York Times

May 20, 2010

Lost Decade Looming?

By Paul Krugman

Despite a chorus of voices claiming otherwise, we aren't Greece. We are, however, looking more and more like Japan.

For the past few months, much commentary on the economy — some of it posing as reporting — has had one central theme: policy makers are doing too much. Governments need to stop spending, we're told. Greece is held up as a cautionary tale, and every uptick in the interest rate on U.S. government bonds is treated as an indication that markets are turning on America over its deficits. Meanwhile, there are continual warnings that inflation is just around the corner, and that the Fed needs to pull back from its efforts to support the economy and get started on its "exit strategy," tightening credit by selling off assets and raising interest rates.

And what about near-record unemployment, with long-term unemployment worse than at any time since the 1930s? What about the fact that the employment gains of the past few months, although welcome, have, so far, brought back fewer than 500,000 of the more than 8 million jobs lost in the wake of the financial crisis? Hey, worrying about the unemployed is just so 2009.

But the truth is that policy makers aren't doing too much; they're doing too little. Recent data don't suggest that America is heading for a Greece-style collapse of investor confidence. Instead, they suggest that we may be heading for a Japan-style lost decade, trapped in a prolonged era of high unemployment and slow growth.

Let's talk first about those interest rates. On several occasions over the past year, we've been told, after some modest rise in rates, that the bond vigilantes had arrived, that America had better slash its deficit right away or else. Each time, rates soon slid back down. Most recently, in March, there was much ado about the interest rate on U.S. 10-year bonds, which had risen from 3.6 percent to almost 4 percent. "Debt fears send rates up" was the headline at The Wall Street Journal, although there wasn't actually any evidence that debt fears were responsible.

Since then, however, rates have retraced that rise and then some. As of Thursday, the 10-year rate was below 3.3 percent. I wish I could say that falling interest rates reflect a surge of optimism about U.S. federal finances. What they actually reflect, however, is a surge of pessimism about the prospects for economic recovery, pessimism that has sent investors fleeing out of anything that looks risky — hence, the plunge in the stock market — into the perceived safety of U.S. government debt.

What's behind this new pessimism? It partly reflects the troubles in Europe, which have less to do with government debt than you've heard; the real problem is that by creating the euro, Europe's leaders imposed a single currency on economies that weren't ready for such a move. But there are also warning signs at home, most recently Wednesday's report on consumer prices, which showed a key measure of inflation falling below 1 percent, bringing it to a 44-year low.

This isn't really surprising: you expect inflation to fall in the face of mass unemployment and excess capacity. But it is nonetheless really bad news. Low inflation, or worse yet deflation, tends to perpetuate an economic slump, because it encourages people to hoard cash rather than spend, which keeps the economy depressed, which leads to more deflation. That vicious circle isn't hypothetical: just ask the Japanese, who entered a deflationary trap in the 1990s and, despite occasional episodes of growth, still can't get out. And it could happen here.

So what we should really be asking right now isn't whether we're about to turn into Greece. We should, instead, be asking what we're doing to avoid turning Japanese. And the answer is, nothing.

It's not that nobody understands the risk. I strongly suspect that some officials at the Fed see the Japan parallels all too clearly and wish they could do more to support the economy. But in practice it's all they can do to contain the tightening impulses of their colleagues, who (like central bankers in the 1930s) remain desperately afraid of inflation despite the absence of any evidence of rising prices. I also suspect that Obama administration economists would very much like to see another stimulus plan. But they know that such a plan would have no chance of getting through a Congress that has been spooked by the deficit hawks.

In short, fear of imaginary threats has prevented any effective response to the real danger facing our economy.

Will the worst happen? Not necessarily. Maybe the economic measures already taken will end up doing the trick, jump-starting a self-sustaining recovery. Certainly, that's what we're all hoping. But hope is not a plan.