Following the Japanese Economic Path

[This is a letter I sent to friends on July 11, 2008, together with Bloomberg News column on the same topic (which is appended below). –S.H.]

Hi everybody,

Starting 10 or 12 years ago, while investigating the long stagnation in Japan which began around 1989, I came to the conclusion that it was a classic overproduction crisis and that it was likely that the U.S. and world economies would soon be following the Japanese path: i.e., in and out of recession, with only short and feeble recoveries in between them brought about by recurring massive doses of Keynesian deficits. How has this expectation panned out so far?

At first, during the late 1990s it appeared that the U.S. was not following this path at all; instead there was the so-called “New Economy” boom, which was generated not by Keynesianism primarily, but rather by rapidly mushrooming consumer debt along with a very nutty speculative boom centered around the telecommunications industry and the new Internet phenomenon. But that collapsed in 2000-2001 with the “dot.com” bust and partial collapse of the stock market. There was a short recession in the U.S., and then a long—and for a long time a very slow and weak—recovery. Despite the somewhat rocky start to my prediction, the 2000-2001 recession and weak recovery tended to support my expectations, I think.

From mid-2004 to mid-2007, however, the pace of GDP growth picked up a bit in the U.S. And in Japan itself, there was a long slow recovery from 2002 to early this year. It is true that in both countries—especially in the U.S.—the recovery was not as strong as the statistics would seem to indicate. (U.S. government economic statistics have been more and more exaggerated in recent years, especially since the start of the Bush Administration.

Three key series are especially exaggerated: the supposedly low unemployment rate, the capacity utilization figures, and Gross Domestic Product. Here is just one way in which GDP is exaggerated: When there is a financial frenzy, as there has been over the past dozen years in the U.S., all the mergers and acquisitions count as part of “production” as far is GDP is concerned. Thus if one corporation buys another, the billions spent count as part of the GDP even though the actual production of the purchased company has not changed, or—in many cases—is actually diminished due the closure of some of its plants!) So all in all, despite this somewhat improved economic situation in the U.S. and Japan over the past several years, I think we would have to rationally say that it still has been part of a rather weak economic recovery.

Still it was a recovery. Since mid-2007, however, the U.S. has been in a continually intensifying mortgage and credit crisis, and this has already spread to a number of other countries in Europe and elsewhere (Britain and Spain, to name two). Moreover, the U.S. and much of the rest of the world (including Japan again) are now either in a new recession or (even if we believe the distorted official statistics) on the verge of one. Almost as soon as the “sinking feeling” was felt, the Bush Administration and Congress passed a new Keynesian deficit measure—the roughly $600/person tax rebates. This has in fact helped to partially stabilize the situation for a quarter of a year or so. But most economists are now predicting that the U.S. economy will further weaken in the last half of the year once the tax rebates have mostly been spent. This has led to increasingly urgent calls by politicians for additional Keynesian deficit measures (either more tax cuts, generally favored by Republicans, or more spending programs, generally favored by liberal Democrats, or both).

All in all, I think I can say that my expectations have been coming true, at least overall. And I think they will continue to come true for the next period. We will be in and out of recessions, with only weak recoveries between them, as round after round of government deficits build to ever increasing heights.

I'll now add an additional prediction: This general situation will continue until some major break in the situation—such as a catastrophic fall in the value of the dollar—brings the U.S. and world economy into even greater crisis.

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The article below, by a bourgeois economics writer, is one of several I have seen recently which wonders if this "U.S. following Japan" or even "the whole world following Japan" scenario might be developing. Curiously, one of the things he proposes is to stop or restrict the Keynesian deficits. This is also becoming a more frequently heard call on the part of bourgeois ideologists who have no understanding of the causes of what is happening. If that suggestion is heeded—even if for just a while—it will only speed up the further development of the crisis.

The only real thing for the economic governors of society to do is to further press on the accelerator of deficit spending—even if that must itself end up in a terrible crash in the end. As long as we remain within the capitalist framework, there is no solution to the problem. Crises of overproduction are inherent in this system of production.

Scott

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Japan's Lost Decade Threatens to Be Global Norm: William Pesek

Commentary by William Pesek

July 11 (Bloomberg) -- It's fitting that Japan chose the Windsor Hotel Toya to stage this week's Group of Eight summit.

The resort on the northern island of Hokkaido opened in 1993 under the name Hotel Apex Toya. It was an inauspicious start amid the deflationary funk that followed the bursting of the bubble economy. Its fortunes became emblematic of Japan's ``lost decade'' and revival today.

Hokkaido Takushoku Bank, the hotel's main creditor, went bankrupt in November 1997, and the hotel suspended operations early the next year. It reopened as the Windsor Hotel Toya in 2002 -- the same year, as fate would have it, that Japan's longest post-World War II recovery began.

And so, leaders such as George W. Bush of the U.S. and Angela Merkel of Germany converged in a building that's as good a symbol of 10 years of squandered growth as any. It was a fitting locale as economists debate what lessons Japan holds for the G-8.

Count Hong Kong real-estate mogul Ronnie Chan firmly among those who think Japan's 1990s experience is highly instructive. The reason: Lost decades may become the rule, not the exception.

``What if the lost decade in Japan becomes the global norm?'' Chan, chairman of Hang Lung Properties Ltd., said at the Asia Innovation Initiative conference in Fukuoka, Japan, on July 8. ``Can you imagine that? Perhaps we should. Perhaps people should get used to slower growth, or no growth.''

Different Picture

It's not that Chan, who runs Hong Kong's fourth-largest real-estate development company by market value, is a pessimist. Property developers don't often relish 10 years of lost growth here and 10 years of declining asset values there. Chan sees a rare confluence of economic and demographic trends that bode poorly for a global rebound.

No one should be surprised by the rapid pace of economic expansion after World War II, Chan says in an interview over lunch. It began from a low base, following the devastation of economies in Europe and parts of Asia. Next came rapid population growth and a boom in innovation. Then there were new social and institutional paradigms as democracy spread and organizations such as the United Nations and the World Bank offered support.

Today, the picture looks vastly different. As everyone tries to stabilize growth, things are hardly at a low base. Population growth is fueling demand for commodities, driving up inflation and increasing poverty rates. Innovation may slow as investment dries up. And institutions such as the International Monetary Fund hardly seem up to today's challenges.

Democracy's Flaws

Oddly, one of Asia's potential failures is democracy, Chan says. It simply isn't proving to be the panacea that leaders in the U.S. and Europe promised. Poverty rates remain stubbornly high in many Asian democracies, and so does corruption. The former is often a result of the latter.

It's certainly not that democracy is bad. Yet there's something to be said about what Chan calls ``premature democratization'' in Asia.

Elections matter only when nations build strong institutions such as independent courts, ministries, a free press, credible central banks and ample systems of checks and balances. Their absence means many governments don't operate as transparently or successfully as expected.

All this may be a problem for the region as it tries to avoid the worst of the credit-market crisis. Chan wonders if the type of prosperity during the decade before the 1997 Asian crisis will be more unusual in the future.

Golden Years

``Those 10 golden years of rapid growth and high returns may well have been an aberration,'' Chan says.

The combination of surging energy and food prices will challenge economies with political rifts, such as Thailand and Malaysia. Nor does it bode well for high-poverty ones such as Indonesia and the Philippines, or those trying to compete amid China's boom -- South Korea, Singapore and Taiwan, for example.

Slower growth is absolutely necessary, of course. Economists, including Kenneth Rogoff of Harvard University, argue that accelerating inflation is a clear sign the global economy needs to cool to let commodity supplies and fuel alternatives catch up. Yet a sharp slowdown in Asia may be devastating.

Take China, which needs to expand about 10 percent annually to raise the living standards of 1.3 billion people. Slowing growth will place dangerous pressure on Asia's second-biggest economy. For a nation at China's level of development, 5 percent growth is essentially a recession.

Careful Balance

A balance needs to be found. The world may require a bit less John Maynard Keynes and bit more Milton Friedman. Keynesian stimulus will only delay a necessary slowdown and lead to even more of the monetary-fueled inflation of which Friedman warned.

Policy makers are merely putting off the inevitable and treating the symptoms of what ails the global economy. If they aren't careful, Japan's experience during the 1990s will become a familiar one.

``It's not a scenario many expect for the West or for Asia,'' Chan says. ``But I'm not sure it can be ruled out.''

(William Pesek is a Bloomberg News columnist. The opinions expressed are his own.)

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