

U.S. financial response mirrors Japan's meltdown

By Fergus Hodgson

Special to McClatchy-Tribune

GREAT BARRINGTON, Mass. — U.S. politicians and Federal Reserve officials are attempting to put the economy back on track with aggressive deficit spending and severely reduced interest rates. Nearly 20 years ago Japan tried the same approach, with little success. What happened in Japan's "lost decade" provides an insight into what Americans may expect in the coming years.

After a credit-induced boom in the late 1980s, Japan's stock and real estate markets tumbled. From a high in December 1989, the Nikkei Index fell in less than a year by 46 percent. Within two years it had fallen by 59 percent. Following the crash, loan defaults soared — sound familiar? — and Japan's Urban Land Price Index began an unbroken decline that continues to this day. As of the latest measure, 2008, the index was well under half its 1991 level. Japan's economic growth also stalled, averaging less than 1 percent per year from 1991 to 1999 — and actually declining in 1993, 1998 and 1999. The rate of unemployment doubled during the 1990s as well and has never recovered.

The Japanese government responded with a succession of deficit-driven stimulus policies, with a similarly aggressive monetary policy from the Bank of Japan. While Japan approved temporary tax cuts, the primary emphasis was on increased infrastructure spending. The small seaside city of Hamada, for example, gained its own bridge to nowhere, along with a new highway, university, prison and art museum, among other government-funded projects. Rural Japan is littered with recently built infrastructure, warranted by hopes of job creation, not necessarily constituent need.

Consequently, the government's 1990 surplus, equal to 2 percent of gross domestic product, plunged into the red and increased as the decade wore on, hitting 7.4 percent of GDP by 2000.

Government expenditures also increased during the period, rising from 30.5 percent of GDP in 1990 to 38.6 percent in 2000.

The Bank of Japan's strategy was to simply lower interest rates, holding rates at 1 percent or less for most of the 1990s. (In fact, the central bank's discount rate still sits at 0.1 percent, as it has for almost a decade.) Confidence in the Japanese economy had fallen to such a large degree, however, that the interest-rate cuts had no apparent effect on employment or economic activity.

By the end of the 1990s, Japan's economy was in even worse shape than it was after the crash in 1990, and the "lost decade" is now stretching into two lost decades. The only prize the strategy achieved for Japan was the largest national debt in the developed world: 200 percent of GDP.

The United States today stands in an economic position similar to Japan's in the early 1990s. The federal government's and Federal Reserve's response to date is also strikingly similar to Japan's.

If anything, American leaders are being even more aggressive than Japan's leaders were. The Obama administration's projected deficits for the next 10 years, \$9.1 trillion, would be more than 5 percent of GDP for the entire decade, while Japan's was 4 percent for the decade following the 1990 collapse. On the monetary side, the cost of borrowing is now cheaper here than it was in Japan in the 1990s.

If one is to go by the Japanese experience, Americans should expect little from the current stimulus policies.

With the likely limp and drawn-out recovery will come inevitable deficits, a larger government sector, an expanded debt, and interest burdens that will plague American taxpayers far into the future.

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