

Six lessons Japan can teach the West

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By Michael Schuman

If you are living in the U.S. or Western Europe and feeling pretty bad about the miserable state of the recovery, political paralysis, and growing unease about your country's future, remember things could be worse. You could be in Japan.

Japan has been experiencing those same woes for the past 20 years. And there is no end in sight. Prime Minister Naoto Kan is likely to step down by the end of the month. An announcement could come as early as Friday. His replacement will be the third PM since the Democratic Party of Japan won its historic electoral victory two years ago. Kan leaves behind an economy that has contracted for three consecutive quarters. Yes, part of the reason is the devastating earthquake and tsunami that slammed into Japan in March. But a bigger reason is the continued failure of Japan's political leaders to tackle the economy's deepest problems. Kan had a few good ideas – reforming the distorted agricultural sector, for example, or connecting even more to a thriving Asia – but in the end he achieved little. Japanese politics just doesn't seem to allow for any new ideas ever becoming actual policy.

As the U.S. and Europe find themselves in a protracted downturn of their own, while their political leadership bickers, dawdles and vacations, more and more voices have started asking if the West is entering an endless, Japanese-style economic funk. HSBC's chief economist Stephen King made that point in a report this week:

We have consistently taken the view that the Western world was suffering from 'Japan-lite' problems: weak money supply growth, high levels of debt, lots of deleveraging, structurally weak growth and a rapidly deteriorating fiscal position. Given recent economic developments, perhaps 'lite' should be replaced with 'heavy'...The West is increasingly looking like a bad version of Japan. And, like Japan, our political leaders are offering few answers.

I asked a few weeks ago in this column [if America was facing a Japanese future](#). My answer then was no – mainly because of the strength of the U.S. corporate sector, something missing from Japan after its 1990s financial crisis. But as the U.S. continues to drift, it will become harder and harder to avoid a Japanese fate. Japan has some important lessons to offer the West, on how to avoid getting into a long-term economic decline, and why it can so hard to get out of one.

First, **don't count on monetary policy to solve all your economic problems**. With all eyes waiting for the Fed's Ben Bernanke to ride in on his white horse (by the name of "quantitative easing") and save the recovery, [Japan's experience](#) is extremely telling.

Japan shows there are clear limits to what central bankers and monetary policy can do to turn around economies in trouble. Japan has relied on low interest rates to jumpstart its flailing economy for well over a decade, with little meaningful impact. The Bank of Japan's key rate was at zero almost continuously between 1999 and 2006, and it's back down in that neighborhood today. And yet those rock-bottom rates have never done much to repair Japanese growth prospects. Why? Japan's busted bubble economy left banks gutted and companies with too much debt and capacity. No one had any incentive to borrow or lend, no matter how low interest rates became. The problem in Japan has not been the availability of money, but the demand for it. The U.S. may be facing a similar problem today. With consumers deleveraging, unemployment high and growth slow, the real economy isn't providing opportunities for companies to borrow and invest. When the problem isn't money, then more money can't solve the problem.

Secondly, **realize economic problems can be structural, not just cyclical.** One reason the Japanese relied so heavily on monetary tools to fix their economy was because of their unwillingness to acknowledge their economic problems weren't cyclical. Policymakers thought a bit more cash in the system, or some more fiscal spending, would finally return Japan to the good old days. The reason this never worked is that the government never admitted, let alone addressed, the serious structural problems that have been obstacles to growth. Overbearing bureaucrats and excessive regulation has stymied entrepreneurship and competition, hurting the efficiency of the domestic corporate sector. Inflexible labor markets have created an underclass of young workers without benefits, job-training or security. Without fixing such underlying structural problems, the economy can't return to health, no matter how much Japanese politicians spend. The end result is a stagnant economy with a dangerously indebted government. The U.S. and Europe could be looking at the same. Fiscal and monetary stimulus won't work unless the real issues of the economy are confronted. In the U.S., for example, that means a smarter workout in the housing market, extensive job retraining for the unemployed, and a large-scale improvement in infrastructure. Otherwise, the U.S., like Japan, will end up with meager growth and a government paralyzed by debt.

Third, **fix your banks – quickly.** One of Japan's biggest failings was waiting a half-decade to begin restructuring its banking sector after its financial crisis. And then the problem was tackled only slowly. Though the U.S. has done a better job on this score, Europe has not. At the core of the euro zone's problems are undercapitalized banks, and the unwillingness of Europe's politicians to really deal with them. The Europe-wide “stress tests” used to measure the health of the sector have bordered on being a joke. Without stronger banks, you can't have stronger growth. Nor can Europe resolve its sovereign debt crisis. Waiting, as in Japan, will only make matters worse.

Fourth, **understand that past performance doesn't ensure future performance.** One of Japan's biggest problems has been its refusal to admit that its old economic model failed. During the 1960s, 70s and 80s, Japan was the darling of the global

economy, the China before China. Yet that model – government-led, export-dependent, manufacturing-focused – fell out of touch with the times as Japan didn't adapt to the changing global economy. To this day, [Japan is still wedded to its old ways](#), despite 20 years of evidence they no longer work. The West is under risk of the [same mental paralysis](#). The Europeans are so attached to their welfare-state system that they can't imagine [reforming it](#). The U.S. is so devoted to its own version of the free market that it has become ideologically resistant to finding new solutions to new problems. Washington isn't building infrastructure due to an ideological predisposition against the worth of government investment. Income inequality continues to grow because of an inability to reform corporate and tax systems to recognize the new realities facing the American workforce. The scariest part of the sad story of Japan is its denial of the need for change. Hopefully the West won't make the same mistake.

Fifth, **don't fear globalization. Embrace it.** While the rest of Asia has become more and more integrated, Japan has somewhat stood aside. Yes, its most vibrant economic sectors are those that are connected to supply chains feeding the Asian manufacturing machine. But fears about the potential negative impact of liberalization on special interest groups (like farmers), Japan has kept its economy generally resistant to foreign investment and foreign influence. The result is that Japan gets hurt by globalization – in the form of a “hollowing out” of industry to low-cost countries – without enjoying the benefits – lower costs to spur consumer spending, foreign investment-created jobs. The U.S., with its growing anti-trade mentality, runs the risk of falling into the same trap. The answer to the West's economic problems is capitalizing on the opportunities generated by globalization, not retreating from them.

Sixth, **don't put off until tomorrow what you can do today.** The danger of the political gridlock gripping the U.S. and Europe right now is that it will delay the decisions that ultimately need to get made, making the cost of reform more painful and limiting the flexibility governments have to implement it. That's the truly most tragic part of Japan's story. Japan's political leaders, beholden to special interests, have missed opportunity after opportunity to change the course of Japan's future. Now, with government debt at 200% of GDP, its options are more constrained than ever. As the recent debt-ceiling fiasco in the U.S. shows all too clearly, Washington is, like Japan, kicking the can down an uncertain road, allowing political divisions to undercut what the country badly needs. Ditto in the euro zone. As German Chancellor Angela Merkel caters to political interests back home, the monetary union comes under ever greater strain. What Japan's example shows is the importance of political will.

Without it, we'll all be [turning Japanese](#).

7 comments

[Jeff Beveridge](#)

"more taxes, more spending, more debt, more regulations..."Snowleopard, your analysis makes no sense. Federal tax levels are at the lowest levels in generations, as are regulations which have been systematically been taken apart since the 1980's. Your point about debt is somewhat relevant however most of this debt was caused by a combination of the Bush tax cuts, the wars in Iraq and Afghanistan, increased homeland security spending, drug benefit, and the recession (the biggest factor). Every one of these things was the result of policy decisions made by President Bush. And this article clearly advocates spending on infrastructure, and...

[Alaric DeArment](#)

The U.S. isn't becoming like Japan for a number of reasons. Despite all articles you see in the American media about the decline of Japan, displaying what often borders on Schadenfreude, Japan's unemployment rate is still lower than ours. Its infrastructure is in far better shape and is far more high-tech. And despite its huge levels of debt, most of that debt is held by Japanese citizens, whereas a large percentage of our debt is held by foreigners, including foreigners whose interests don't match with ours. It has maintained a much larger amount of its manufacturing capacity than we have...

Kaleberg

1) "When the problem isn't money, then more money can't solve the problem." Have you considered the possibility that the money was spent on the wrong stuff? You don't try to fix your roof a plastic tarp, then say, "Well, I spent money fixing my roof and it failed. I need a new house, but I'll need a free one because money has failed."

2) But Japan's problem may not be structural. If you look at the numbers, they've tried stimulus spending once, for the better part of a year, and the economy responded. Then, they got worried about deficits...

Halston Howard

Thank you Kaleberg for the most accurate analysis of of the real world so far. I find it difficult to believe that economists still fear losing they're jobs and academic standings in 'worldly institutions by stating the obvious:

Globalization hurt America...and more free trade will continue to hurt America. Japan has an unemployment rate of 5.3% clearly we are different countries with different issues. Also lets be clear - Japan's rise and China's rise are totally different. Japan sold us innovate products developed in Japan...we bought them and they made money. China sells us American products...they have innovated nothing. Name...

[snowleopard \(cat folk gallery\)](#)

Interesting is it not we have a President and the Democratic socialist left who are determined to repeat the same mistakes, on a more massive level at that, shown in Japan over the last twenty years?

We have a generation of experience recorded there of what not to do in handling of their own economic downturn; and all we hear from the DC club of the left and President Obama is the same destruction of "more taxes, more spending, more debt, more regulations...more blame, blame, blame..."

They are so caught up in their self-delusional righteousness they will not see just how...

Halston Howard

Speaking of Japan has anyone read this?

[Gaëtan Voyer-Perrault](#), Software Developer, Economics Buff, Science Lover.

*...**fix your banks** – quickly. One of Japan's biggest failings was waiting a half-decade to begin restructuring its banking sector after its financial crisis. And then the problem was tackled only slowly. Though the U.S. has done a better job on this score...I won't argue the general premise, yes the US banks are receiving good support. But let's not forget that many US banks are basically insolvent if not for some shady accounting changes in their favor. With large amounts of housing still on the books and commercial real estate suffering from the recession, these banks are still...*

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