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Perspective

# U.S. Shouldn't Repeat Japan's Pre-Tsunami Economic Errors

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Japan had a horrible natural disaster. But Japanese politicians had already created an economic train wreck, and U.S. political leaders are emulating the Japanese model.

Japanese leaders placed their country in the untenable economic situation of running up their outstanding gross debt to GDP ratio from 68% in 1990 to an estimated 230% in 2011. That is a 20-year man-made disaster created by politicians.

Japanese politicians suffocated the future growth and job-creation ability of their country with a massive load of central government debt. Perhaps Japanese politicians have some unique trait that forces them to rob future generations of economic opportunity.

But wait! U.S. politicians have the same trait.

In 1990 gross outstanding central government debt to GDP was 64% for the U.S. compared to Japan's 68% — very similar outstanding central government debt levels.

In 2008 the U.S. outstanding debt load was 71% while Japan's had climbed to 195%. So by 2008 Japanese leaders were already well past the debt load that had sapped the economic strength of their country.

The 2008 number for the U.S. may have seemed like a debt load that the U.S. economy could cope with. After all, it increased by only 7 percentage points from 2000. But real economic growth in the U.S. was a subpar average 2.6% from the first quarter of 2000 to the fourth quarter of 2007.

That was subpar growth compared with the prior decades and doesn't even consider the 2008-09 recession. Real economic growth for the entire last decade was 1.9% — the slowest growth for any post-WWII decade. Did the regulatory burden and debt load of the federal government create a slow-growing economy last decade?

If it did, the U.S. economy is locked into subpar economic growth because gross outstanding debt for the U.S. is estimated at 99% by the IMF in 2011, up from 71% in 2008. That is an increase of 28 percentage points.

Should the outstanding gross debt burden increase at that pace for the remainder of this decade, the U.S. outstanding debt-to-GDP ratio would be over 180% in 2020. That would approach the 20-year politician-made disaster of Japan.

Politicians across many different countries seem to have a unique ability to create economic train wrecks. U.S. political leaders are driving recklessly down the same road that Japan chose. President Obama appointed a Deficit Reduction Commission last year. That commission's recommendations were to reform entitlements, cut federal government outlays and reduce the outstanding debt burden.

But President Obama's budget included no ideas from his Deficit Reduction Commission. Is that leadership? U.S. business formation, job growth and economic growth are being suffocated with Treasury debt and regulations such as ObamaCare in a fashion similar to the Japanese model.

Japanese politicians were able to stifle their economic growth with debt because nearly all of the debt buyers were internal and did not depend on foreign buyers. In contrast, the marginal buyer for U.S. Treasury debt is the foreign sector.

Over the past year the foreign sector bought $750 billion of Treasury securities. Meanwhile, the Federal Reserve is buying $600 billion of longer-term Treasury securities by the end of this year's second quarter. Yes, the U.S. can run $1.5 trillion annual federal deficits with the Fed monetizing nearly half of it. But QE2 is ending, and the Fed is unlikely to have a QE3.

China has been the major foreign buyer of Treasury debt over the past year, buying an incremental $265 billion of Treasuries. Treasury yields will likely be driven higher in the second half of this year as China and other countries demand higher yields to compensate for expected higher inflation and likely downgrades of Treasury securities in the future.

Higher Treasury bond yields mean higher mortgage bond yields. Large annual federal deficits along with a large outstanding debt work through channels such as higher interest rates to slow business formation, job growth and economic growth.

Other channels include the expectations channel and central government dominance channel. Clogging the channels with a huge outstanding Treasury debt burden and regulatory controls is a time-tested means to create slow economic growth and puny job creation.

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