Opinion

Japan's lost decade is a lesson for us all

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In the 1989 film *Back to the Future Part II*, Michael J. Fox travels in a time machine to 2015. This American boy then meets himself 30 years later. He is working for a company that is Japanese owned. His life is controlled from Tokyo and he is sacked by his Japanese boss – via an international television hook-up.

At the end of the 1980s, many Americans envisaged that would be their future. Influential books like Herman Kahn's *The Emerging Japanese Superstate* had forecast Japanese economic dominance. Japanese cars challenged car makers in the US and around the globe. Sony bought out Columbia Pictures prompting fears Japanese interests would take over Hollywood.

Then the Japanese property bubble burst. Japanese banks were swamped by bad debts. The value of their securities plummeted. The Japanese government announced a stimulus plan. When it didn't do much good, it concluded that the first plan hadn't been large enough. It announced a second, larger plan. When that failed, a third plan larger again was announced. Over the decade from 1990, Japan had at least 10 stimulus plans which in total amounted to about 30 trillion Yen. There were at least three recessions during the decade – a decade described as a lost decade for Japan. Japan emerged with crippling government debt – greater than the size of its GDP.

No one thinks Japan is the likely global economic super power of tomorrow.

Now, the United States has seen a property bubble collapse, its banks are riddled with bad debts and it is in recession. It has reacted with massive stimulus packages. When Japan was receiving this treatment in the 1990s, the Clinton administration was in office. Two of the key figures urging Japan on to large budget stimulus were Larry Summers and Tim Geithner. Now they are key advisers in the Obama Administration.

But the spend, spend, spend mantra is meeting some resistance in Europe, particularly from Germany. Perhaps the Germans remember the Japanese experience of the 1990s. Fiscal stimulus is no answer to structural problems in an economy. It's the structural problems that have to be dealt with.

When all the stimulus packages are over, the debt is still there. And it has to be borrowed from someone. And when confidence returns to the market, and there are higher competing returns on offer, the interest rate to service that debt will be so much higher.

If we were to make *Back to the Future IV* and take Michael J Fox forward to 2039, we would more likely locate his boss not in Tokyo, but Beijing. China's trade surpluses have generated massive financial reserves for the country. Rather than distribute these earnings to its own people, the Chinese Government has invested abroad or "sterilised" them from the domestic economy. A large part is held in US dollars. In fact, around $US700 billion is held in bonds issued by the US Government. That's the same amount as Obama's recent unprecedented fiscal stimulus. One way of thinking about it is to consider that the Chinese are now financing America's "rescue" package.

The Chinese are obviously worried about the high concentration of their assets in US treasuries, with the Premier Wen Jiabao recently saying: "We are concerned about the safety of our assets." This prompted an immediate response from President Obama assuring investors about America's ability to honour its obligations.

Get it? The Americans need Chinese money to fund their budget deficits. The Chinese are getting worried about the level of their US exposure.

I believe this is one of the reasons the Chinese Government is looking to diversify its investments into things like resource projects – projects like Rio Tinto's iron ore mines in Western Australia. They don't want to be overexposed to US treasuries and they want higher returns. The Chinese Government thinks long term and strategically. Today's price for these strategic assets will look exceptionally low when the global economy recovers and the Australian dollar appreciates. The Chinese have a 3000-year history, and they work on long time frames. China has every right to pursue its national interest within a framework of agreed rules, cooperation and reciprocal treatment. Australia has every right to pursue its national interest within that same framework.

One of the reasons a government should keep its debt low is so its decision-making is not compromised by the need to square off its financiers.

Countries rise and countries fall. We should be careful about drawing recent past performance as a linear projection over long time periods into the future. That's the mistake Herman Kahn made about Japan.

But if the Americans now find it necessary to appeal for Chinese financing, we can observe a profound shift has occurred in the global economy. There is no longer a single economic super power. The global economy has gone bipolar.

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