

# The Washington Times

## Tale of two economic styles

*Degree of spending restraint determines growth rate*

By: Richard Rahn - January 15, 2013

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Will 2013 be a better year? A number of economic commentators have been saying the worst is behind us. I think they are wrong, and here is why. In most major countries, including the United States, government is growing faster than the private sector. As Mitchell's Golden Rule explains, when the private sector grows faster than government, prosperity increases, and when government grows faster than the private sector, misery increases.

As can be seen in the accompanying table, in most of the major nations, debt-to-GDP ratios are increasing, because the deficits as a percentage of gross domestic product (GDP) are greater than economic growth -- meaning these countries are getting deeper in the hole each year. The optimists think that the United States might experience a 3 percent growth rate this year and only a 4 percent deficit as a share of GDP. If this optimistic scenario turns out to be true, the U.S. debt as a share of GDP will still increase. Many forecasters believe the United States will grow less than 2 percent at most because of all the new tax increases and regulations, and the deficit will again be more than 7 percent of GDP. As a result, at year's end, the U.S. will be much deeper in the debt hole. Federal Reserve's purchases of U.S. government debt, coupled with paying banks interest on their reserves with the Fed, merely temporarily mask the underlying problem.

Japan, France, Italy and Spain are all likely to be back in recession in 2013 or continue to be, with their debts getting larger as a percentage of GDP. It is widely believed that a number of countries, notably France, are understating their real debt-to-GDP ratios. Germany is being dragged down by its European neighbors so it will not show much if any growth. It also has a high debt-to-GDP ratio (83 percent), so there is little margin for error. Greece continues to be a basket case with a debt-to-GDP ratio of an estimated 171 percent and growth at a negative 7 percent.

The only large country that is still growing rapidly and does not appear to have a major deficit problem is China. However, much of the Chinese financial sector is still state-owned, not well-managed and opaque in its reporting. The real debt and nonperforming financial liabilities are unknown. Both Brazil and India are growing but have major, although not yet critical, financial problems -- and so are unlikely to be engines of world economic growth in 2013.

Not every country is being irresponsible, but the problem is that most of the responsible countries have relatively small economies and hence, cannot be engines of global economic growth by themselves. As can be seen in the table, Australia, Chile, South Korea, Sweden and Switzerland have been responsible in that all have higher growth rates than their fiscal deficits and relatively low levels of debt-to-GDP. Australia has been

doing well for many years. However, it is highly dependent on China as a market for its natural resources. Chile continues to be the superstar of Latin America. After the reforms of three decades ago, it has been able to maintain a modest-sized government with very little debt and high growth, giving the country the highest per capita income in South America. South Korea has also practiced high-growth, limited-government policies for more than three decades, making it a rich country. Sweden has spent two decades downsizing its government and freeing up and privatizing its economy. As a result, it has performed much better than most of the EU. Finally, Switzerland is surviving nicely despite being surrounded by a group of economically sick countries, which try to blame many of their problems on their more responsible and prudent neighbor.

Many of the oil-rich nations, such as Saudi Arabia, Kuwait and Norway, continue to do well primarily because oil funds their welfare programs -- but that will not last forever. As a result of greatly improved economic policies in recent years, Mexico and Turkey have had solid growth, relatively low deficits and manageable debt -- all of which have served to elevate them to middle-income status with good future prospects, provided they can improve their governance. Hong Kong continues to have a very free economy with manageable debt, despite being under the thumb of the Chinese.

In sum, the economic future for the large, old, rich nations looks bleak for 2013, while many smaller countries are doing well by avoiding the mistakes of others or correcting for past mistakes. The open question is how much more stagnation, inflation or worse will the big, rich, developed nations suffer before their citizens force change?