

# Japan's Third Opening

By Robert Genetski

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Japan's economy was struggling even before the recent nuclear disaster. The much-publicized news that China replaced Japan as the second most powerful economy was a blow to the nation's reputation.

Sometimes great tragedies open the door to great opportunities. Some have suggested that Japan use this occasion to embark on a third "Great Opening." In the mid-19<sup>th</sup> century, the first opening involved extensive trade with the rest of the world. The second opening involved rebuilding following World War II.

Japan's recovered from the war to such an extent that its economy became known as the Japanese miracle. Many attempted to examine its policies to discover the key to its success. Some predicted that Japan's economy would dominate the world.

Instead of fulfilling its promise, Japan's economy stagnated. Real growth has averaged just over 1% a year for the past two decades. Those looking for the keys to economic success no longer look to Japan. Instead they look to China and India where growth has often been 6%-10% a year.

To undertake a third "Opening" Japan will have to make a clear distinction between destructive and constructive policies.

The keys to economic success are not given to any specific country. Most experience periods of economic success as well as periods of economic failure. The recent economic failure in the United States is its fourth such period in the past century. Fortunately for the US, each of its previous failures was followed by an "opening" that restored rapid growth and prosperity.

Japan's economic problems over the past two decades are similar in many respects to the failures the US has experienced. While the details differ, in each case destructive policies undermined the incentives for growth and prosperity.

The keys to economic success are not new. They were first presented over two centuries ago by classical economists led by Adam Smith. These economists described certain principles that would enable nations to achieve maximum growth and prosperity.

From a broad perspective, classical economic principles involve placing maximum power and faith in the hands of individuals as opposed to government. To accomplish this, a nation needs low tax rates, strong limits to government spending and regulation, free markets, protection of individual property rights and a stable currency.

From a classical perspective, government plays a key role in promoting economic growth. The proper role is providing individuals with the maximum incentives to create wealth. When government attempts to redirect resources or control free markets, it destroys a nation's wealth.

Japan's economic stagnation started in 1989 as policymakers introduced new taxes on sales, land, capital gains and income. When the economy stopped growing, policymakers increased government spending and increased the national sales tax. Each of these moves violated classical economic principles. Each undermined growth.

All “openings” occur when policy changes significantly improve incentives for individuals to create wealth. China’s “Great Opening” began in the late 1970s and has continued to the present. India’s “Great Opening” began in the 1990s.

Both China and India have enjoyed rapid growth by pursuing classical economic policies. China’s output passed Japan ten years ago, based on the purchasing power of its currency. Similarly, with the aid of a population that is ten times larger than Japan’s, India’s economy will become the world’s third largest economy within the next few years.

For Japan to begin its “Third Opening” it will have to undertake the type of major policy shift that dramatically increases incentives to create wealth. Doing so would involve major cuts in tax rates, perhaps eliminating taxes on income and capital gains. It would also involve major cuts in government spending and regulations. Such changes are not easy.

When a country relies heavily on government programs to create wealth, it is difficult to make the transition to relying primarily on individuals. There is always strong resistance to dramatic policy changes. Those with vested interests in current policies claim that major changes are simply not practical.

There can be little change in Japan’s economic performance with its current policies. Great openings require great changes. When considering such changes it is essential to pursue classical policies. Such policies have a proven record of success. Policies that rely on the creativeness of individuals to create wealth have stood the test of time. Whether recently, as with China and India, or previously as during Japan’s golden age, classical policies are essential to breathe new life into a stagnant economy.