Important economic lessons from the Land of the Rising Sun

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In some ways, Japan is an impressive role model. It's post-World War II economic renaissance shows how strong growth is possible if you combine a market economy with the rule of law, while also not going overboard with taxes, spending, and regulation.

But the Japanese economic engine has been sputtering in recent years. Indeed, ever since a property bubble burst in the late 1980s, Japan's economy has been in the doldrums, and its politicians deserve much of the blame.

They've engaged in repeated binges of so-called Keynesian stimulus. But running up the national credit card hasn't worked any better in Japan than it did for President Barack Obama. Instead of economic rejuvenation, Japan is now saddled with record levels of debt.

Moreover, Japan's politicians also decided to impose a value-added tax (VAT) on the nation. As so often happens when a VAT gets adopted, it turns into a money machine, as legislators start ratcheting the rate higher and higher. That happened in Europe back in the 1960s and 1970s, and it's happening in Japan today.

The result of these bad policies is that Japan, which used to be in the top 10 for capitalist policies, is now ranked only No. 40 according to Economic Freedom of the World.

But the biggest economic threat to the country is the way Japan's welfare state interacts with demographic changes. It's not that the welfare state is enormous, particularly compared with European nations, but the system is becoming an ever-increasing burden because the Japanese people are living longer and having fewer children.

Most nations, at least historically, have had “population pyramids.” This simply means that they had a relatively small amount of old people, a significant population of working-age people, along with an even-larger number of children.

When there is a traditional pyramid, it’s feasible to have a modest-sized welfare state featuring redistribution from workers to retirees. As a libertarian, I don’t think that’s a good idea because of the deleterious impact on incentives to work and save, but it’s mathematically sustainable.

But because Japanese life expectancy has been increasing and birth rates have been falling, the population pyramid is becoming a population cylinder. That means Japan’s long-run fiscal outlook is catastrophically grim. The country desperately needs structural entitlement reform to avert disaster.

Unfortunately, America faces some of the same problems. No, our debt levels aren’t as high as they are in Japan. No, our birth rates haven’t dropped as low as they have in Japan. But we’re moving in that direction.

Our population pyramid also is going to become a population cylinder. Not as fast, to be sure, but we’re still heading in the wrong direction. That means if we don’t reform our entitlement programs, it’s just a matter of time before we also have a fiscal crisis.

The good news is that we’re not repeating all of Japan’s mistakes. We’ve had a couple of silly episodes of Keynesian profligacy, but nothing close to the debt explosion in Japan. We’ve also dodged the VAT bullet, so our politicians (hopefully) can’t put off entitlement reform by using that pernicious levy to prop up an unsustainable welfare state.

Immigration is another difference between Japan and the United States. It is quite difficult for foreigners to live and work in Japan. Our immigration laws are not exemplary, of course, but at least the United States is relatively open to foreigners who want to contribute to our economy. This is good news, both because new blood slows down our demographic decline and because we attract a lot of high-income entrepreneurial talent.

Let’s conclude by learning lessons not only from Japan, but from two other Asian jurisdictions. The same demographic changes that are occurring in Japan and the United States are also taking place in both Hong Kong and Singapore. Indeed, those two nations not only have aging populations, but they also have even lower birth rates than in Japan.

Yet there’s no looming fiscal crisis in Hong Kong and Singapore. Why? Because they were too smart to create welfare states. Yes, there is some redistribution in both places, but the general rule is that people are expected to save and invest for their own retirement. So instead of debt and unfunded liabilities, they have savings and wealth.

Let’s hope American policy makers will learn the right lessons from what’s happening across the Pacific Ocean.

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