

El American

Lessons From Japan's Post-War Economic Miracle

By Lawrence W. Reed

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If your economy is a mess and your country devastated, what do you do to turn things around? This is a question that Venezuelans are surely asking themselves after a generation of socialist policies. Other Latin American nations that are in various stages of destroying themselves with socialism will soon be asking this too.

We can all learn from the “Japanese Economic Miracle” that stunned the world after World War II. Exactly how did a nation which had sunk so low undergo such a stupendous economic rebound? From the Doolittle Raid on Tokyo in April 1942 to the atomic bombs dropped in August 1945, nearly four years of American bombing wiped out a huge swath of Japan's industrial capacity. In his book, *Ashes to Awesome: Japan's 6,000-Day Economic Miracle*, Yoshikawa Hiroshi tells us that 93 percent of Japan's steel production was obliterated. The country's GNP in 1946 stood at just under half its peak before the war. Astronomical hyperinflation nearly destroyed the currency. Living conditions were “wretched” and the caloric intake of the average person was just two-thirds of its pre-war level.

Japan at war's end was a nation defeated, demoralized, devastated, and, until 1952, occupied by almost a million American soldiers. Its major cities, including Tokyo (and of course, Hiroshima and Nagasaki), lay in ashes.

Thirty years later, the Japanese economy ranked second in the world, behind only the United States. From 1950 to 1973, it grew at [twice the rate](#) of Western Europe's and more than two and a half times faster than that of the U.S. In barely more than one generation, Japan transformed itself from a poor country to a rich one—a feat widely seen as “miraculous.”

Did Japan decide to adopt a socialist path to recovery? Silly question. Nobody outside of academia or who understands either economics or history would ever prescribe compulsory wealth distribution, central planning, massive tax hikes or burdensome bureaucracy as a cure for anything, let alone a half-dead economy. That would simply kill the remaining half. The fact is that Japan's post-war progress owes more to the ideas of Adam Smith than to those of Paul Krugman.

In my belief, the primary factors in the Japanese Economic Miracle are summarized by one concept: *economic freedom*.

From Punishment to Growth

U.S. policy in the early months of the Occupation of Japan tended to be punitive, designed to keep the country down and out. But in 1947, as the Cold War with the Soviet Union and Red China

worsened, the Truman administration decided that a stronger, freer Japan would help stave off communist advances in Asia and the Pacific.

Sky-high taxes kicked in at relatively low-income levels and exemptions were few. Corporate income and “excess profits” were likewise confiscated at high rates. A vast expansion (and higher rates) of excise taxes and a hike in already-high inheritance taxes punished Japanese citizens at all income levels. “Brutal” describes the punitive tax regime imposed on Japan by Americans in the immediate aftermath of the war.

Before economic growth could take off, Japan had to stop punishing its wealth-creating entrepreneurs. As General Douglas MacArthur steered American Occupation toward leniency, that’s exactly what Japan did.

Tax cuts

Over the objections of socialist academics, Washington shifted from punishment to growth, which opened the door for tax cuts. Alan Reynolds of the [Cato Institute writes](#):

In late 1950, following a similar policy coup in Germany, Japan’s highest individual income tax rate was slashed to 55% from 86%. From 1950 to 1974, Japan cut taxes every year (except 1960) often by greatly increasing the income thresholds at which the higher tax rates applied, or by enlarging deductions and exemptions...The sting of high tax rates was further neutralized by exemptions for interest income and capital gains, deductions from corporate and individual taxes on dividends, a deduction for earnings, and various other holes in the tax base, legitimate and otherwise.

Tax cuts accelerated after the end of American Occupation in 1952. Reductions in levies on savings and investment were especially stimulative. With the baleful influence of American academics gone, public policy focused on boosting production instead of leveling and equalizing incomes. Success in the marketplace became a virtue instead of a vice.

Japan also steadily reduced its tariffs (taxes on the purchase of foreign goods). For example: By 1975, Reynolds notes, “the effective tariff on autos fell from 40% to 10%, and the tariff on televisions from 30% to 5%.”

Economic Freedom

Japan’s tax reductions were an important element of a broader liberalization of its economy. Even the World Bank, in a comprehensive 1993 [study](#) of the Japanese Economic Miracle, admitted that liberalization was an indispensable factor. It concluded that “the rapid growth was primarily due to the application of a set of common, market-friendly economic policies, leading to both higher accumulation and better allocation of resources.”

At a time when much of the Western world embraced Keynesian economics of higher taxes, spending, budget deficits and debt, Japan’s recovery was fueled by lower taxes, less spending, more saving, increasingly secure property rights and conservative fiscal policies. Education, always highly prized in Japan, was kept local with an emphasis on high-quality K-12. Even today, most Japanese people will tell you they studied harder in grade schools than in universities. The result was an explosion in both human and physical capital.

Toshio Murata, a long-time friend of the Foundation for Economic Education (FEE) in America, was a Japanese economist of the “Austrian School.” He translated *Human Action* by Ludwig von Mises into Japanese. In an article for FEE in 1994, he explained why the World Bank was correct

in its assessment, noting that the favorable tax treatment of savings played a key role in generating a robust capital market for business start-ups and investment:

The true explanation of Japan's successful post-war economic development rests...on good old-fashioned virtues—saving, hard work, reduced government spending, and innovative entrepreneurship—combined with ingenious marketing techniques and relatively free world trade. On the basis of 1971-1991 figures, the average gross saving rate in Japan was twice that in the United States; the saving rate per household in Japan was 2.7 times that in the States.

Industries that had been run or heavily regulated by the old imperial government or by American occupiers were set free. Many of the monopolies (“*zaibatsu*”) that held sway for generations in Japan, thanks usually to government-granted privileges, were broken up, sold off or deregulated to compete on a more level playing field.

Japan never became the libertarian paradise that was Hong Kong (before recent subjugation by Beijing), but it did become far freer economically during the decades of economic liberalization than it perhaps had ever been before. Today, it still ranks an impressive 35th in economic freedom among the world's nearly 200 nations, according to the Heritage Foundation's Index of Economic Freedom.

Dodge and Deming

While it was fashionable for many governments around the world in the 1940s and 1950s to seek advice from “whiz kids” and “planner” types in the ivory tower, Japan to its credit didn't pay them much attention. In fact, by taking advice from two notable men from the entrepreneurial private sector, Japan avoided the stagnation that left-wing academicians usually produced. Their names were Joseph Dodge and W. Edwards Deming.

President Harry Truman dispatched Joe Dodge to Japan from his perch as Chairman of Detroit Bank in 1949. He was to be financial advisor to the Supreme Commander, General Douglas MacArthur, and help the nation emerge from the economic doldrums.

What became known as “The Dodge Line” did the trick. By implementing a balanced national budget and shutting down the printing presses, it ended hyperinflation. It stabilized the exchange rate between the yen and the dollar. It drastically reduced government economic intervention across the board. Dodge's intention was not to “plan” the Japanese economy but rather, to finally leave it alone. He aimed to choke every subsidy and price control he could get his hands on, and MacArthur cheered him as he did it. (Back in the U.S. later, Truman made Dodge his Director of the Budget and in barely a year, he cut the federal deficit in half.)

1. Edwards Deming was another private sector genius with both feet planted firmly on solid ground. He was an engineer, statistician, and management consultant who introduced quality control techniques to Japanese manufacturing—techniques that achieved previously unheard-of levels of productivity. Japanese exports, once considered “junk,” became high-tech quality marvels.

General MacArthur's Constitution

Yet another factor in Japan's Economic Miracle was by no means the least important. Without the vision and personality of Douglas MacArthur, it's difficult to imagine that either an economic recovery or Japanese-American relations would have emerged as robust.

MacArthur [worked so amiably with Japanese](#) leaders, including Emperor Hirohito, that most people in Japan mourned his departure in 1951 as American Occupation neared its end. He

personally supervised the writing of a new Constitution that included many provisions to ensure a limited, representative government, free and fair elections, private property, and individual liberties. It took effect in May 1947. For seven and a half decades, that Constitution has governed Japan, as one commentator put it, “without the change of a comma”.

In April 1951, the man who proved as indispensable to the new, peaceful Japan as he was to winning the war in the Pacific, was able to tell Congress, in person, this good news:

The Japanese people since the war have undergone the greatest reformation recorded in modern history. With a commendable will, eagerness to learn, and marked capacity to understand, they have from the ashes left in war's wake erected in Japan an edifice dedicated to the supremacy of individual liberty and personal dignity, and in the ensuing process there has been created a truly representative government committed to the advance of political morality, freedom of economic enterprise, and social justice.

Fortunately for Germany, a similar economic miracle took shape at the same time as Japan's. There, as I've [written before](#), it was largely due to similar free market policies of economist and statesman Ludwig Erhard. Ironic, isn't it, that two of the nations most responsible for World War II emerged from it as economic miracles because of freedom and free markets.

It's a lesson that needs to be told, re-told, and told again.