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Japan's GDP Drop Shows Failure Of Keynesian Policies

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Economic Policy: In case you missed it, Japan just reported a big 6.8% drop in second-quarter GDP, thanks to a hefty tax hike that took effect in April. Maybe our own leaders could learn something from Tokyo's mistakes.

If there's a laboratory for exposing the many fallacies and errors of Keynesian thinking, it is surely Japan. Dating back to 1990, when its postwar economic miracle suddenly came to a screeching halt, the country has stumbled from slump to slump, showing barely any growth.

As Cato Institute economist Alan Reynolds noted in IBD just two months ago, Japan's economy grew at an average 4.7% a year from 1983 to 1991. Since then, it has grown at less than 1% — a lost generation of growth with a constant battle against deflation.

Why so slow? Japan followed the Keynesian prescription for making its economy healthy. When its property bubble burst in 1990, its government propped up insolvent banks and passed 10 "stimulus" bills to build infrastructure and such during the 1990s.

To offset all that stimulus, Japan's politicians also hiked taxes sharply in a vain attempt to cut its soaring deficits and debt.

At the same time, Japan's central bank held official interest rates near zero for years. But the Nikkei stock index has only scratched its way back to half its 1990 level, housing remains in a slump and business activity, like the overall economy, is stagnant.

Yet, in spite of these clear failures, Japan continues the Keynesian insanity, passing at least four new stimulus packages since 2008 while again raising taxes.

Even with Prime Minister Shinzo Abe's gimmicky "Abenomics," Japan's economy remains very sick. Total debt has gone from just above 60% of GDP in 1991 to 240% today — a level virtually all economists agree is fiscally dangerous.

And despite government spending rising to well above 40% of GDP, from about 35% as recently as 2007, Japan's economic engine continues to sputter.

This year's tax hike has been particularly devastating. The consumption tax was boosted to 8% from 5% in April in an effort once again to reduce the deficit. Instead, consumer spending crashed and, with it, the economy.

Undeterred, the government plans to raise the consumption tax again next year, to 10%. It has also talked of raising top rates on the highest earners to an incentive-destroying 56%.

The second quarter's GDP plunge — the worst since 2011, after Japan was devastated by an earthquake and tsunami — was the predictable result of these mistakes.