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JAPAN FACT SHEET

ECONOMY

Japan's economy in an era of globalization

The Tokyo Stock Exchange
The Tokyo Stock Exchange is the oldest in Japan, having been established in 1878. (Photo courtesy of Getty Images)

The High-Growth Era

The Japanese economy is the second largest market economy in the world as of 2009. Japan's postwar economy developed from the remnants of an industrial infrastructure that suffered widespread destruction during World War II. In 1952, at the close of the Allied Occupation, Japan was a "less-developed country," with per capita consumption roughly one fifth that of the United States. Over the following two decades, Japan averaged an annual growth rate of 8%, enabling it to become the first country to move from "less-developed" to "developed" status in the postwar era. The reasons for this include high rates of both personal savings and private-sector facilities investment, a labor force with a strong work ethic, an ample supply of cheap oil, innovative technology, and effective government intervention in private-sector industries. Japan was a major beneficiary of the swift growth attained by the postwar world economy under the principles of free trade advanced by the International Monetary Fund and the General Agreement on Tariffs and Trade, and in 1968 its economy became the world's second largest, following that of the United States.

Between 1950 and 1970, the percentage

Automobile factory
Employees work by hand adding requested details to cars on an assembly line. (Photo courtesy of Toyota Motor Corporation)

of Japanese living in cities rose from 38% to 72%, swelling the industrial work force. The competitive strength of Japanese industry increased steadily, with exports growing, on average, 18.4% per year during the 1960s. After the mid-1960s, a current account balance surplus was achieved every year except for a couple years following the oil crisis of 1973. The economic growth in this era, supported by strong private-sector facilities investment based on a high personal savings ratio, was accompanied by significant changes in Japan's industrial structure. Whereas formerly the mainstays of the economy were agriculture and light manufacturing, the focus shifted to heavy industry. Iron and steel, shipbuilding, machine tools, motor vehicles, and electronic devices came to dominate the industrial sector.

In December 1960, Prime Minister Ikeda Hayato announced an income-doubling plan which set a goal of 7.8% annual growth during the decade of 1961-1970. Government economic planning aimed at expansion of the industrial base proved exceedingly successful, and by 1968 national income had doubled, achieving an average annual growth rate of 10%.

A Mature Economy

Prime Minister Tanaka Kakuei's Basic Economic and Social Plan (February 1973) forecast continued high growth rates for the period 1973-1977. However, by 1973 domestic macroeconomic policy had resulted in a rapid increase in the money supply, which led to extensive speculation in the real-estate and domestic commodity markets. Japan was already suffering from double-digit inflation when, in October 1973, the outbreak of war in the Middle East led to an oil crisis. Energy costs rose steeply and the yen's exchange rate, which had not reflected its true strength, was shifted to a floating rate. The consequent recession lowered expectations of future growth, resulting in reduced private investment. Economic growth slowed from the 10% level to an average of 3.6% during the period 1974-1979, and 4.4% during the decade of the 1980s.

A second oil crisis in 1979 contributed to a fundamental shift in Japan's industrial structure from emphasis on heavy industry to development of new fields, such as the VLSI semiconductor industry. By the late 1970s, the computer, semiconductor, and other technology and information-intensive industries had entered a period of rapid growth.

As in the high-growth era, exports continued to play an important role in Japan's economic growth in the 1970s and 1980s. However, the trade friction that accompanied Japan's growing balance of payments surplus brought increasingly strident calls for Japan to further open domestic markets and to focus more on domestic demand as an engine of economic growth.

The "Bubble Economy"

Following the 1985 Plaza Accord, the yen's value rose sharply, reaching 120 yen to the U.S. dollar in 1988—three times its value in 1971 under the fixed exchange rate system. A consequent increase in the price of Japanese export goods reduced their competitiveness in overseas markets, but government financial measures contributed to growth in domestic demand.

Corporate investment rose sharply in 1988 and 1989. With higher stock prices, new equity issues swiftly rose in value, making them an important source of financing for corporations, while banks sought an outlet for funds in real estate development. Corporations, in turn, used their real estate holdings as collateral for stock market speculation, which during this period resulted in a doubling in the value of land prices and a 180% rise in the Tokyo Nikkei stock market index.

In May 1989, the government tightened its monetary policies to suppress the rise in

A major intersection in downtown Marunouchi (Tokyo)
Office workers crowd the streets of Marunouchi, one of Tokyo's largest business centers.

value of assets such as land. However, higher interest rates sent stock prices into a downward spiral. By the end of 1990, the Tokyo stock market had fallen 38%, wiping out 300 trillion yen (US $2.07 trillion) in value, and land prices dropped steeply from their speculative peak. This plunge into recession is known as the "bursting" of the "bubble economy."

The Economy since 1995

A shop-lined street in Akihabara (Tokyo)
Shops specializing in computers, DVDs, and other electronic appliances are concentrated here. (Photo courtesy of Akihabara Shopping District Promotion Cooperative)

The post-bubble recession continued through the second half of the 1990s and into the new millennium. Some temporary improvement in the economic outlook was seen in 1995 and 1996, partly due to a fall in the value of the yen and additional demand generated by recovery efforts for the January 1995 Great Hanshin-Awaji Earthquake. In 1997, however, a variety of factors, including a rise in the consumption tax rate, a reduction in government investment activity, and the bankruptcies of major financial institutions, quickly worsened the recession. Burdened with a huge volume of bad debt aggravated by still-falling land prices, financial institutions tightened their lending policies, thereby forcing companies to reduce plant and equipment investments. This, combined with falling exports caused by the Asian economic crisis, resulted in lower profits in almost all industries. Employment salaries and wages also fell, further dragging down consumer spending, and in 1998 the Japanese economy suffered negative growth.

In 1998 the government established a 60 trillion yen funding framework to provide the public funds necessary to promote economic recovery, and it also allocated an additional 40 trillion yen for emergency measures to deal with reduced lending by financial institutions. The national budget for fiscal 1999 included a large increase in public project spending, and action, such as an increase in tax credits for new home purchases, was taken to reduce taxes. Beginning in February 1999, the Bank of Japan instituted a 0% short-term interest rate policy to ease the money supply, and in March the government poured 7.5 trillion yen in public funds into 15 major banks.

As a result of these measures and growing demand for Japanese products in Asia, in late 1999 and 2000 signs of recovery were shown, such as increasing stock prices and revenue growth in some industries. In 2001, however, the economy slid back into recession because of domestic problems—sluggish domestic demand, deflation, and the continuing huge bad-debt burden carried by Japanese banks—as well as international factors that included a decline in Japanese exports due to deterioration of the U.S. economy. The unemployment rate, which had been only 2.1% in 1990, climbed up to 4.0% in 2008.

The economy bottomed out at the beginning of 2002, entering a period of slow but steady recovery that has continued through the middle of the decade. After lingering for more than 10 years, the negative aftereffects of the bubble-economy collapse finally appear to have been largely overcome. The non-performing loan ratio of major banks fell from over 8% in 2002 to under 2% in 2006, and this has contributed to a recovery in bank lending capacity as banks are once again able to fully function as financial intermediaries.

Reflecting the business recovery, stock prices rose strongly between 2003 and 2006. However, the period of economic recovery and expansion that began in February 2002 abruptly reversed with the Lehman shock in the fall of 2008, which originated with the U.S. subprime mortgage crisis. Annualized gross domestic product for January–March 2009 fell 15.2 percent from the previous quarter, the worst drop ever recorded. In addition to a dramatic plunge in exports, which had been an engine of growth during the period of expansion, purchases of automobiles and other aspects of consumer spending are weak, and the vulnerability of Japan's reliance on external demand has been thrown into relief.

During the recent period of economic expansion that began in 2002, corporate revenues were not passed on to households. As a result of factors such as the increased use of non-regular employment in the manufacturing industry, declines in average wages and income disparities were sharply illuminated.

There is growing concern over the consequences that the aging of Japanese society will have for the economy. In 2008 approximately 22 percent of the population was 65 or older, but by 2055 this figure is projected to be about 41%. To minimize the effects of the contraction of the working population, it will be necessary to both increase labor productivity and to promote the employment of woman and people over 65. In addition, fundamental reforms will be necessary in pension and other social welfare systems in order to avoid large inequalities between generations with respect to the burdens born and benefits received.

Growing Asian Connection

The share of manufactured goods as a percentage of all Japanese imports has greatly increased since the mid-1980s, exceeding 50 percent in 1990 and 60 percent in the late 1990s, and this has spurred fears of a hollowing out of Japanese industry. Growing trade friction in the second half of the 1980s and the steep rise in the value of the yen impelled many companies in key export industries, notably electronics and automobiles, to shift production overseas. Manufacturers of such electrical products as TVs, VCRs, and refrigerators opened assembly plants in China, Thailand, Malaysia, and other countries in Asia where work quality was high and labor inexpensive. For such products, the market share of imported goods now exceeds that of domestic items.

In recent years, a rapid increase in manufactured imports from China has caused particular concern. Between 2001 and 2005, Japan's imports from China rose by 170%. During the same period exports to China rose by an even faster rate, 235 percent.

Moreover, the share of Japan's trade occupied by China grew to 17.7 percent in 2007, surpassing the 16.1 percent held by the United States to become the largest of any country. Japan's digital home electronics and automobile-related exports are robust, and in that same year exports to China topped 100 billion dollars for the first time ever. Since 1988 Japan has run a continuous trade deficit with China. However, a large portion of Japan's exports to Hong Kong end up being exported to China, and if this is taken into account and Japan–China trade is examined from an export basis, Japan is actually running a trade surplus.

The simultaneous increase in the volume of both product exports and imports with China and the rest of Asia is partly the result of an international division of labor occurring as part of manufacturing globalization. Japanese companies export capital goods (machinery) and intermediate goods (components, etc.) to production facilities built through their direct investment in China, and then they import the finished goods back into Japan. At present there is still a vertical division of labor, with Japan specializing in knowledge- and technology-intensive modules and processes and China specializing in labor-intensive modules and processes. As China and other developing nations continue to improve their technical capabilities, however, the challenge for Japan's manufacturing industry will be to maintain a comparative advantage in knowledge- and technology-intensive sectors.