

# SOCIO – ECONOMIC DRIVERS OF JAPAN’S DEVELOPMENT IN POST-WAR ERA

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## Abstract

*The impact of Japan's post-war evolution on the modern world is significant. Although the country has not a large territory and it is affected by demographic challenges related to an aging population, being also exposed to high risk of occurrence of natural disasters, it is still a global economic force and an example of successfully overcoming the economic crises. Our research proposes a brief analysis of the main drivers of Japanese economic development in post-war era following the main theoretical approaches. The analysis that we propose is focused on explaining the specific economic context of Japan, in the post-war years, the causes of so called “Japanese miracle” and the controversial theory of “Japan’s lost decades”. Finally, our analytical approach aims to highlight if and how the experience of Japanese economy is relevant for the current economic context, especially for EU economies.*

**Keywords:** post-war economic development, “Japanese miracle”, “Lost Decades”, economic crisis

**JEL Classification:** B22, D03, H, P, E

## 1. INTRODUCTION

Recently, due to the global economic crisis impact on worldwide economies, international policymakers and prestigious economists (Krugman, 2013) started to turn to the Japanese economic model that allowed the transformation of Japan in the post-war period from a country with a “ruined” economy to a great economic power, a trend called in the specialized literature “the Japanese miracle”, a historical phenomenon that can be a positive example worldwide.

Furthermore, some analysts (Wakatabe, 2012) are even suggesting the “Japanization” of other economies as a solution for overcoming crises. In our

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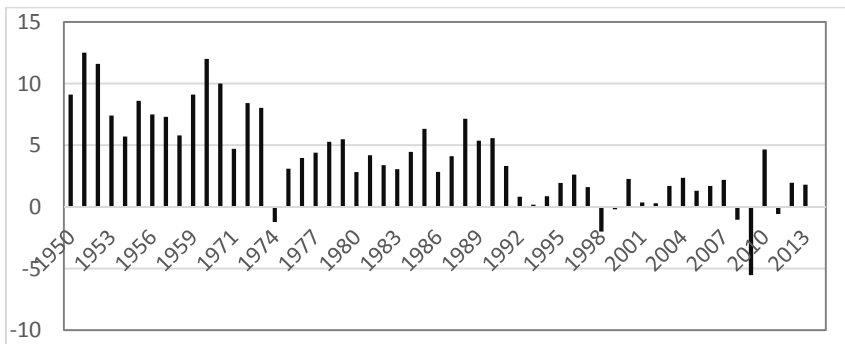
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research, we focus on the Japan's historical responses to crises, on the main issues that the country has been facing all along, the causes that have been generating them and on the measures proposed by the New Abenomics Strategy in order to revitalize the Japanese economy.

## 2. "JAPANESE MIRACLE"- ECONOMIC AND CULTURAL FACTORS

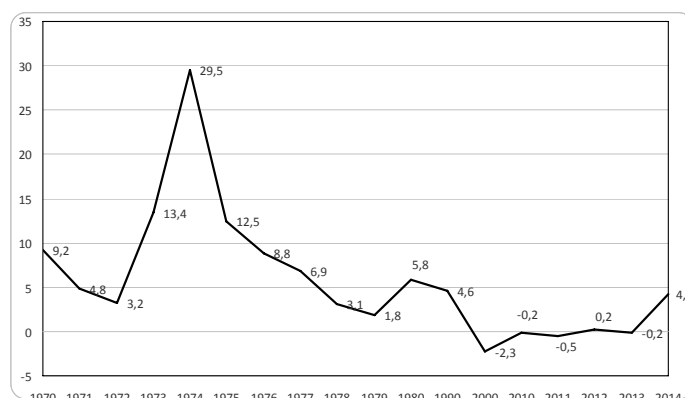
World War II left Japan destroyed but the country undertook the opportunity to restart its entire economy from scratch by allowing investment to be focused on the industry sector. Japan was hence able to advance its economy at an incredible rate from the 1950s to the 1960s by investing wisely and substantially in its manufacturing sector. Accordingly, in the post-war era, Japan's economy grew rapidly, averaging an annual growth rate of 10% (Harari, 2013), as shown in Graph 1.

**Graph 1: GDP growth in Japan during 1950 – 2014 (%)**



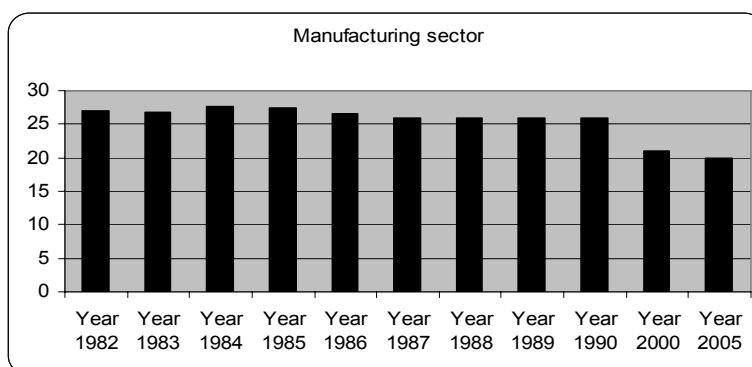
Source: Authors, based on UNCTAD (2014), Eurostat (2015) and FMI (2015) data.

The oil shock (1973) had a profound and lasting impact on the economic condition of Japan (as could be seen in Graph 1), having also a devastating effect on accelerating price inflation, proving the vulnerability of Japanese economy to the external shocks.

**Graph 2: Inflation rate in Japan during 1970 – 2014 (%)**

Source: OECD. Stat (2015) – *Country statistical profiles: Japan*

However, Japan managed to turn the oil crisis into a positive factor by using it as the impetus to improve conservation and cultivate other sources of energy, particularly nuclear. During '70s, the economic performance of the country was around 5%. Hence, in that period when the world was under the great changes of international economic environments such as a transition to the floating exchange rate system and an occurrence of the oil crisis, the Japanese economy maintained the growth largely based on the advances of the industrial technology. By the early '80s, it aggressively adopted new technologies in order to create a range of electronic consumer goods for export, such as cameras and video cassette recorders (VCRs). At that point, Japan had also moved beyond importing innovative technology from the West to exporting its own innovations, such as just-in-time manufacturing techniques. More important, the range and quality of goods offered by Japanese firms forced Western companies to remain dynamic and competitive.

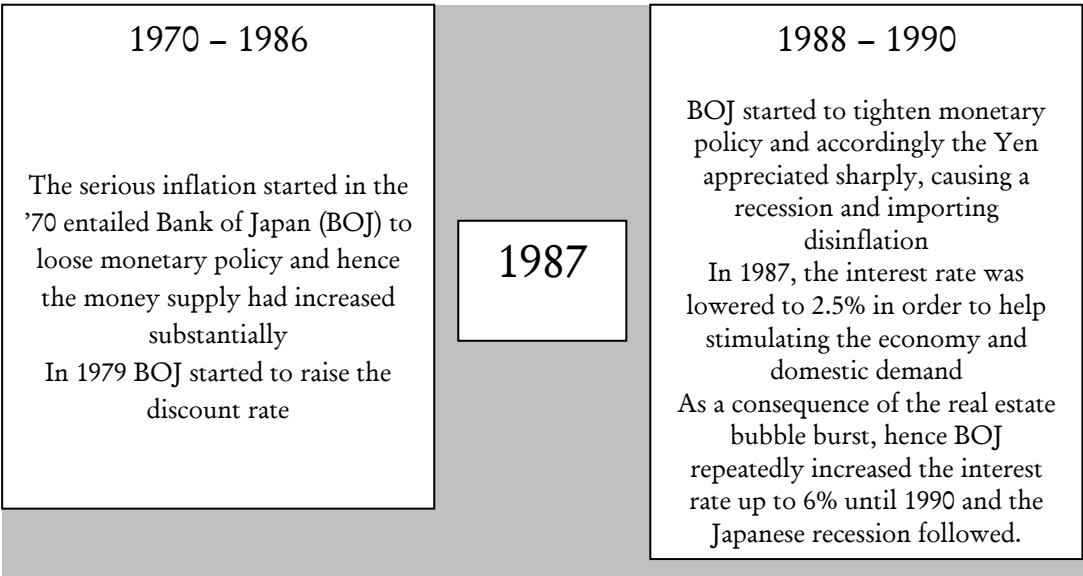
**Graph 3: Contribution of manufacturing sector (value added) on economic activity in Japan during 1981 – 2014 (%)**

Source: OECD. Stat (2015) – *Country statistical profiles: Japan*

Accordingly, in 1987, Japan almost caught up with and seemed to get ahead of the United States in terms of per capita national income. This made much of it as “Japan as number one economy.” (Takashima, 2007).

Consequently, over the post–World War II period, Japan has implemented a variety of monetary regimes. The world can learn valuable economic lessons from Japan by studying its monetary history. Japanese monetary policy divides naturally into two time periods separated by 1987 (As shown in Figure 1). The first part includes the high inflation of the early 1970s and the establishment of price stability by the mid-1980s. The second part includes the boom-bust episode known as the bubble.

**Figure 1: Japan’s monetary policy between 1970 -1990**



Source: Authors’ synthesis, based on the literature in the field (Metzer, 2002).

Besides all these undertaken economic measures illustrated above, we should mention the strong relationship between culture and economy in Japan. In this regard, culture which encompasses that middle ground between universal characteristics of human species and the individual’s idiosyncratic characteristics, applying to the traits, behaviour and models of thinking shared by the members of the Japanese nation-state. In this context, the term culture refers also to the Japanese model of patient unremitting work, studious and creative efforts and respect for the whole economy, for a company, co-workers, costumers with an incredibly powerful indoctrination (Tabb, 1995). Hence, it could be relevant the usage of the term *culture* in order to describe the Japanese economic behaviour, considering the national manner of combining an incomparable traditionalism with a ready adaptability to

extreme innovation. Also, the Japanese restraint during the post-war period was embedded in a larger sense of hierarchy and proper relationships that allowed a development based upon a symbolic collectively of a nation.

Accordingly, we could also consider the dynamic advantage of embodying organizational-specific capital, human and physical that is uniquely appropriable by the firms that give cohesiveness to the Japanese enterprises as a competitive unit in relational transactions worldwide.

### **3. “THE LOST DECADE”- A MYTH OR AN ECONOMIC SCENARIO THAT CAN BE REFLECTED IN THE EVOLUTION OF THE EU ECONOMY DURING POST-CRISIS PERIOD?**

#### **3.1. What caused the '90 recession?**

During 1988-1989 the yen demand collapsed and Japanese currency was devaluated 16% against the dollar. Besides, asset prices in the real estate and stock market were highly inflated hence a boom-bust economic cycle was set in motion. In response, BOJ tightened monetary policy raising the discount rate five times up to 6% during 1989-1990. After this episode, the Japanese market collapsed. During 1990s and even after the first decade following the stock market collapse, GDP had a rather flat evolution from 3,103 USD billion to 3,180 USD billion in 2002 (UNCTAD Database, 2015).

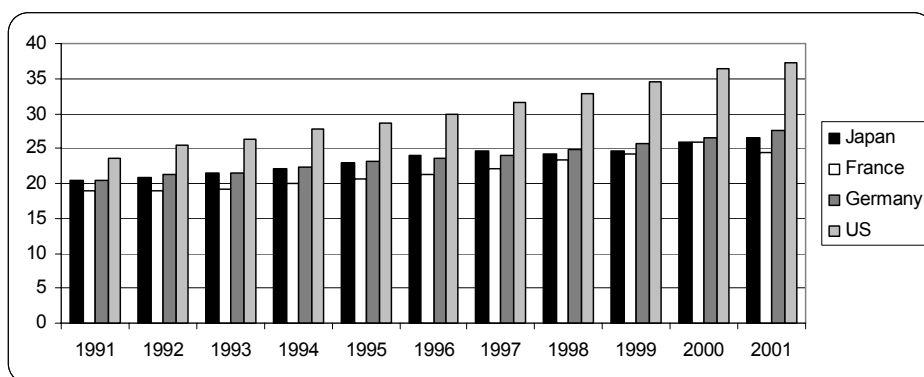
Unemployment rate rose from 2.1% in 1991 to 4.7% at the end of 2000. Although an unemployment rate of 4.7% may seem unimportant, nevertheless it is significant for Japan, given the cultural and historical precedent of lifetime employment and given the fact that it was never above 2.8 in the 1980s (Powel 2002). In our opinion, it should be noted that the tendency of the Japanese people to build their savings meant that Japanese banks were flushed with funds, and credit flowed freely. At the same time, Japan's booming export sector was creating enormous trade surpluses, causing the value of the yen to rise. This meant that Japanese companies could invest even more in themselves. In most cases, this conducted to a further increase of exports, widening those trade surpluses even higher.

#### **3.2. Are the “lost decades” really lost?**

During 1991-2001, Japanese asset bubble burst and because Japan's GDP growth in that era was virtually flat, those years are commonly considered to be a “lost decade” for Japan economy. However, there are analysts that challenge this characterization of Japanese economy, pointing that during the so-called “lost decades” Japanese economy performed similar with other advanced economies concerning the evolution of GDP per capita (Fingleton 2012).

Kelly (2011) sustains that although there is evidence that there was a decline in Japan's money supply and therefore in consumer prices, asset markets and GDP growth, these economic indicators are not relevant for real economic growth of Japan. While Japan's GDP has grown at a snail's pace, real economic growth has been rather robust, approximating real economic growth in other developed countries, as Kelly explains (2011). If Japan's economy has truly remain mostly flat compared with most of the Western countries that have mostly risen, then Japan's GDP per capita *as measured in dollars at purchasing-power parity (PPP)* should be almost at the same level as it was in 1990 at the beginning of the so-called "lost decade(s)" and above the level of other western countries. But in fact, Japan's GDP per capita at PPP (as illustrated in Graph 4) has increased consistently (Kelly 2011).

**Graph 4: GDP per capita during 1991 – 2001 in Japan, comparing with other advanced economies (10 000 USD)**



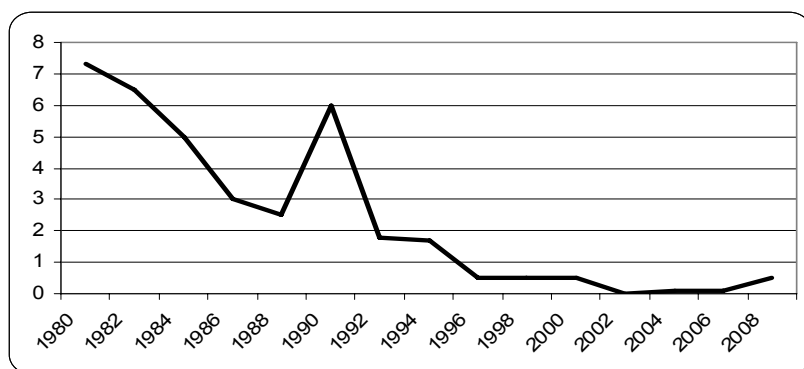
Source: OECD. Stat (2015) – *Country statistical profiles: Japan*

### 3.3. Is the Japanese experience relevant for European countries?

We consider that the experience of Japanese response to the economic stagnation of the lost decades could show to other economies the dangers of interventionism. As it is well known, during 1992-2000, Japan applied 10 fiscal stimulus packages, totalling more than 100 trillion yen: 1992-1995 – 6 spending programs of 65.5 trillion yen; April 1998 – stimulus package of 16.7 trillion yen; November 1998 - stimulus package of 23.9 trillion yen; November 1999 - stimulus package of 18 trillion yen; October 2000 - stimulus package of 11 trillion yen.

During the same period 1992-2001 (as shown in Graph 5), Bank of Japan lowered progressively the discount rate. Thus, the official discount rate was lowered from a high of 6% in 1990, to 4.5% in 1991, to 3.25% in 1992, to 1.75% during 1993-1994, to 0.5 during 1995-2000, and to 0.25% after 2001.

Graph 5: Japanese central bank's interest rate, 1980-2008



Source: BOJ, 2008

Unfortunately, all those policy measures failed to powerfully boost the economic growth. The latest estimations (2015) of International Monetary Fund, European Commission and World Bank related to the evolution of Japan's GDP for 2015-2016 show a relatively modest evolution (1.1% for 2015 and 1.4% for 2016).

The failure of these policies of stimulating Japan's economic growth was explained by some Keynesian economist by the so-called "*liquidity trap*" concept: a "liquidity trap" appears, according to Keynesians, when injection of liquidity into the banking system by the central bank's policies fails to lower interest rate and to stimulate investments and GDP growth.

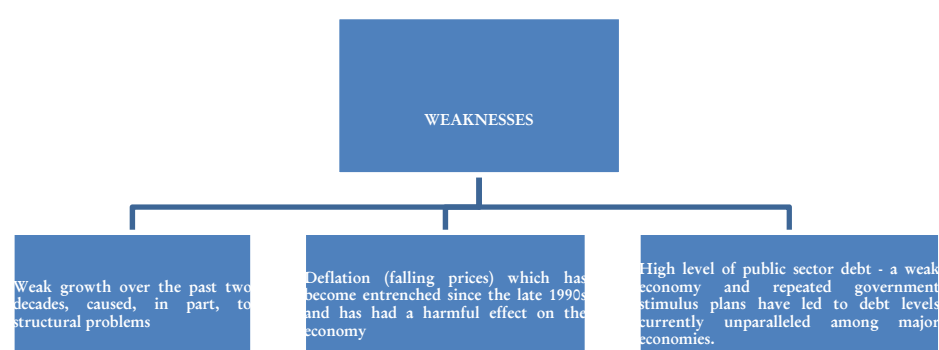
Keynesian policy solution for the "liquidity trap" problem is *direct government lending to businesses* (instead of creating liquidity in the banking system). Therefore, to solve the "liquidity trap" problem, Japan created the Federal Investment and Loan Programme (FILP). The funds of the program were allocated to borrowers through the Ministry of Finance Trust Fund Bureau and the bureau's various agencies, but funds were not allocated according to market-based consumer preferences (i.e. to the most efficient projects) but to the most politically connected businessmen and this led to a higher cost of borrowing for all those seeking private funds. The Japanese policymakers undertook gradual but persistent reductions in money growth in order to lower inflation, approach that is much closer to the monetarist prescription (Melzer, 1993) for policy based on rules than to Keynesian activist meddling. Consequently, the Great Inflation in Japan was suppressed rather quickly because BOJ used the monetarist rhetoric in the late '70s, preventing another round of inflation (Asada, 2014). Furthermore, as the specialists have concluded (Miwa&Ramseyer, 2006), the story of Japanese industrial policy was not at all about an interventionist bureaucratic policy. Among the advanced capitalist economies, it was the norm, because the policymakers never empowered an interventionist

bureaucratic policy to grow the economy through interventions, even though they implemented the pork barrel<sup>3</sup> programs as well.

**4. THE FUTURE OF THE JAPANESE ECONOMY- ESTIMATED IMPACT OF ABENOMICS**

Currently, Japanese economy is confronted with some structural weaknesses (as it is illustrated in Figure 2), the most important ones being the deflation and the weak economic grow

**Figure 2: Structural weaknesses of Japanese economy**

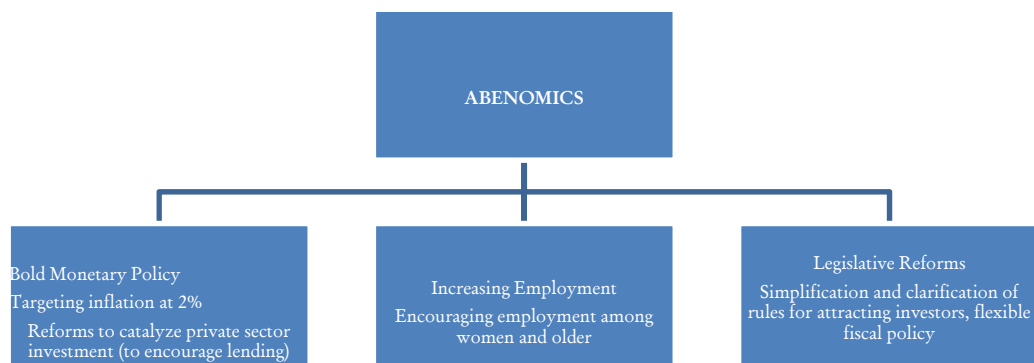


Source: Authors’ synthesis, based on the specialized literature in the field.

In order to address these structural weaknesses, the Japanese government has implemented a strategy (Abenomics Program, named after the prime minister who initiated it, Shinto Abe) based on three levels: fiscal pillar, the monetary and labour (as it is illustrated in Figure 3).

<sup>3</sup> Term used in reference to the utilization of government funds for projects.

Figure 3: National Strategy Abenomics



Source: Authors' synthesis, based on the specialized literature in the field.

The aggregation of the three components - monetary policy, the fiscal and labour market represents the very essence of Japan's strategy to stimulate economic growth and draws on the example from the parable told by Mori Motonari (Japanese feudal "daimyo", 1497-1571) to his three sons<sup>4</sup>. This parable has inspired other expression – the symbolic "three arrows" that defines philosophy of "Abenomics". In our opinion, in terms of monetary policy, the measures proposed by the government should focus on government spending and a weaker yen, in order to compensate high costs of labour force and regulatory barriers. Moreover, Japan's government should encourage foreign investments by providing short-term fiscal stimulus necessary to make up for the fall in demand while broader structural reforms are still needed.

An important and little noted component of Abenomics, Japan's information and communications technology (ICT) growth strategy propounded on June 2013, ostensibly aims at the evolution of a new model of efficient, resilient and green urban and rural infrastructures. Together with domestic businesses, Japan's central agencies, big local governments, and the Abe regime's regulatory and fiscal initiatives have been working to deploy cutting-edge innovation in a swath of smart city initiatives as well as special zones.

Abenomics also aims to reduce corporate taxes, ease regulations, relax labour law and sign free trade agreements to revitalize industries and create new markets for ICT and other sectors. Some analysts (Mitchel, 2013) have noted that most of Abenomics measures are expected to boost the demand for ICT specialists (9,000-

<sup>4</sup> After urge to break one arrow, the father suggests to his three sons to join each other and to find that the three arrows bound together cannot be broken.

11,500 new jobs are expected to be created in ICT services and software development by 2015). Moreover, since Abenomics calls for Japan to raise annual public and private expenditures on R&D to 4% of GDP in five years, foreign ICT players, many of whom are already in the market, should look for regulatory changes to anticipate new business opportunities.

## CONCLUSIONS

Japanese economy has gone through a number of stages since the end of the WWII. After a recovery period during which Japan built its economy back up to the pre-war level, a high growth period followed which was driven by the manufacturing sector, then after the oil crisis, a stable growth period emerged, driven by technology intensive industries. In the 1990s, Japan was confronted with a prolonged recession triggered by the expansion and contraction of an economic bubble in the latter half of the 1980s. It is considered that the evidence of prolonged economic decline lies in Japan's 50-year-old post-war economic system as well as in an increasing inability to respond flexibly to internal and external changes. Japan's revival was being promoted with policies to improve efficiency in areas such as labour allocation, fund allocation and research and development. Major changes have been taking place in the corporate world as companies strive to increase competitiveness by moving away from traditional employment practices such as lifetime employment and seniority-based wages. Presently, the Japan's Strategy regarding economic development can be summarized by a single word: Abenomics.

Currently, Japan, in spite of the "stagnation" of the '90s, is one of the world's leading economies. The Japanese miracle, based on economic development focused on knowledge and investment in ICT, led to an unprecedented advance of high technologies development. Given the government support for developing the ICT sector, Japan is now among the leading countries in the field of ICT with high rates of connectivity and utilization of computers and smart devices. Japan has a good world market share of home appliances and audio-visual equipment, although progress can be made regarding PC and related equipment and mobile telephone terminals.

The experience of Japan's recession is highly relevant for current economic situation because it offers an unexpected counterexample that challenges the conventional opinions of mainstream economists and conventional opinions of policymakers. Further economic and historical research may be needed to take into account all relevant factors that influenced Japan's economy, but the bottom line is that Japan's experience could illustrate how economic growth in real terms is

possible without bank loans and credit growth and considering the actual conditions of falling prices. Nominal GDP growth in the short term may entail boom-bust business cycles, capital misallocation, malinvestment and hence losses in the long run. It follows that the key for growth in real terms and in the long run is to avoid capital destruction (misallocations of capital, malinvestment) rather than to rely on fiscal stimulus, credit expansion and inflation that ultimately erode real savings and lead to capital consumption.

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