Recession in Japan: Part II

Historical Aspects



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Japan experienced terrible devastation at the end of World War II, especially because of the firebombing of Tokyo and the two atomic bombings of Hiroshima and Nagasaki. Considering the number of victims, and the destruction of homes and businesses, recovery seemed hopeless. When the war ended, the Japanese people throughout the country were in a stupor, living in extremely improvised shacks without much food. In fact, the Japanese narrowly avoided starvation by subsisting on food released by the United States occupation forces. One of the most curious questions about Japan is how Japan grew out of the ashes of the war to become one of the world's strongest economic powers within a short period, and why Japan has been suffering such a prolonged recession today. The reasons for the current recession in Japan come from the historical events in its post war economic development. This development can be divided into four stages: the occupation era which was the recovery period from 1945 to 1952,[1] the high-growth period from late 1953 to 1974,[2] the bubble economy in the 1980s, and the economic recession from the early 1990s to the present.

The recovery period

At end of World War II, Japan accepted the Potsdam Declaration on August 15, 1945 and Japan became completely under United States government control until on April 28, 1952. During the occupation period, the Supreme Commander of Allied Powers (SCAP), led by General MacArthur, established political, social, and economic reforms including a new Constitution, land reform, dissolution of financial factions called the *zaibatsu*, and labor legislation.[3] These reforms became a framework for Japan's postwar principles in democratization and liberalization.

As one of three major economic reforms, the land reform was stipulated several times between 1945 and 1952. The first reform was enacted in December 1945 to distribute wealth

from landlords to cultivator tenants and to limit the ownership of arable land to 12.25 acres. The second reform was enacted in March 1946 to prohibit absentee ownership of agricultural land. As a result, the productivity of agricultural land rose by 56 percent by 1949. The agricultural land reform, which enacted in 1952, made further severe restrictions on land ownership.[4] Dissolution of the *zaibatsu* was intended to allocate wealth and resources more evenly throughout the economy. The four major *zaibatsu*, powerful respected families, included Mitsui, Mitsubishi, Sumitomo, and Yasuda. They had exclusive financial powers and were considered to be the chief supporters of Japan's strong military government, and which then turned into an aggressive military power.[5] The major purpose of the labor legislation was to establish rights for the labor unions, and this helped to promote the solid foundation for labor-management relations. The labor standard law, passed in 1947, increased wages for overtime work by 25 percent. [6]

The SCAP established some of the economic principles in order to recover the Japanese economy. For example, some resources that were lacking in Japan, other relief goods, and food were brought to Japan from the United States. The SCAP also introduced its technology to Japanese companies with partnership arrangement.[7]

The Korean War, the clash between North and South Korean armies, broke out in 1950 and lasted until 1953, also had a tremendous impact on Japan which became a base for the United Nations Army. The huge demand for war supplies from Japan into the war zone created an economic boom which promoted an end to Japan's long-term economic stagnation.[8]

The High-Growth Period

Japan's economic development was promoted by both internal and external factors. One external factor was the Korean War, mentioned earlier. The United States enthusiastically supported the recovery of the Japanese economy for the purpose of including Japan in the "anti-

Soviet bloc." The United States sponsored Japanese membership in international trading organizations such as the Colombo Plan and the Organisation for Economic Co-operation and Development (OECD), and provided Japan immediate access to the American market.[9] By the 1970s, the United States also demanded that Japanese trading partners have access to Japanese markets as a part of strategic reasons during the Cold War period.[10] There has been increasing U.S. pressure for opening up Japan for trade. During the "oil shock" period of the 1970s, Japan experienced an actual decline of Gross Domestic Product (GDP) in 1974.[11] The constant rise of oil prices led to the enactment of a new law to stabilize economy: Japanese industries had to shift from mining, textile, and intermediate goods industries to high technology industries such as semiconductors, computers, bio-technology, and robotics[12]

The Bubble Economy

By the 1980s Japan became the world's second strongest industrial economy. Steel production was higher than that of the United States, especially; approximately, six million units of automobiles were exported every year. "Exports as a whole produced a large and rising trade surplus, much of it used to finance investment overseas. Japan became a major international creditor for the first time in her modern history."[13] This means that the values of Japanese companies listed at the stock exchange around the world appreciated dramatically and created a huge financial bubble. It was predicted that the prosperity would last through the final decade of the century. But the predictions were wrong.[14]

According to Flath, during the years from 1987 to 1990, "the growth of Japan's money supply fueled massive increases in land and equity prices …[which was] widely referred to as the period of the 'bubble' economy. A speculative bubble is a situation in which an asset price gets pushed upward by purchasers who expected to resell at an even higher price for no

particular reason except the plausible existence of still other purchasers just like themselves. When the bubble bursts, the price crashes back down to the level supported by non-speculative demand."[15]

The Recession Period

In 1990, Tokyo stock market, which had already begun declining since the end of 1989, severely crashed, and at the same time land prices were expected to decline with similar magnitude.[16] "At the beginning of the 1990s, property prices, which had been raised to unsustainable levels by generous lending policies on the part of financial institutions in the 1980s, suddenly fell. Banks were left with huge outstanding loans, many of them irrecoverable. Credit grew tighter. The government made the situation worse by raising taxes to strengthen revenue. From this point on, Japan moved rapidly into recession. Business confidence declined, unemployment began to rise, and consumption fell. In the summer of 1992 the Tokyo stock exchange index stood at less than half its earlier peak."[17] The value of land actually dropped by in November 1991. *Nihon Keizai Shimbun*, Japan's leading business paper, showed that rent prices in new buildings in central Tokyo dropped by as much as 20 percent where it was normally believed that the price would not go down because of the limited amount of land.[18]

As a part of an expansionary monetary policy, the Japanese government lowered the discount rate from a high of 6 percent to 4.5 percent in 1991, 3.25 percent in 1992, 1.75 percent in 1993 and 1994, and 0.5 percent from 1995 to 2000, but it failed to stimulate the economy because many banks ended up increasing their liquidity instead of increasing its lending.[19] Although the Japanese government attempted an income-tax cut in 1994 and 1998, so that the top-income tax rates were reduced from 65 percent to 50 percent and the corporate rate from 46 percent to 40 percent, government-services spending kept increasing 9 percent from 1995

through 1999. In 1997 the Japanese government increased Japan's consumption tax from three percent to five percent.[20] The consumption tax is similar to the sales tax in the United States, but Japanese people have to pay the consumption tax even on food. This has been hurting many Japanese people. Their government made various efforts to overcome the crisis for several years, but the efforts were not successful. By 1998, all economic miracles came to an end, the financial structure became gradually unstable, and the yen became frail. The Liberal Democratic Party lost its credibility, and the prime minister resigned.[21]

Reasons for the Recession

In Japan there is a belief in the land myth which has existed since Japan was a feudal society. The Japanese people believe in the value of land, regardless of business cycles, which makes property increase in price.[22] This can be explained by the fact that the physical size of the United States is twenty-five times larger than the size of Japan. The Japanese government estimated that Japan's property market at end of 1989 was worth over ¥2,000 trillion, or four times the estimated ¥500 trillion value of American property.[23] It makes sense to think that Japan's land value is higher than in the U.S because the land of Japan is so small in proportion to its large population and the productive land is extremely limited. The largest proportion of Japan's land is forest (66%); only 14% is agricultural, 4% for residential, and 8% for other uses.[24] The land myth was still persistent in 1990 when Tokyo stock market crashed, and the problems with the stock market began to shake investors' confidence. Gaps between what sellers want for their property and what buyers intend to pay have been widening since 1990.[25]

In 1991, the value of residential land dropped by 19 percent, and commercial property in Osaka prefecture dropped by 10 percent in, according to the Japanese National Land Agency.[26] Since Japanese people use land as the most convenient form of instant collateral to mortgage

when they borrow money from banks, if the price of the land declines both the bank and the borrower are in trouble. For example, a broadcast by NHK, Japan's public television corporation, demonstrated in a hypothetical situation that if the land price had a sharp decline—50 percent over four years—it could trigger ¥10 trillion of bad debts.[27] A Ministry of Construction survey also reported a sharp drop in the price of land for houses and apartments area by 37 percent in their value, while suburban dropped by 41 percent.[28] Some economists said that the "1980s economic boom was artificial which was caused by the Bank of Japan's expansionary monetary policy. The 1985 discount-rate reduction began the central bank-induced boom. Following this reduction, the Bank of Japan expanded the money stock by an average of 10.5 percent year from 1986 until 1990. When the central bank stopped the monetary expansion, the stock market dropped, investment dropped, and recession followed…."[29] The fall in property prices and the economic sluggishness that has put many borrowers out of business have left Japanese banks with a huge impending problem: loans backed by collateral worth around 60 to 80 percent less than when the loans were taken out.[30]

In addition, Japanese people have been losing their incentive to buy their houses as well as durable goods, while increasing their savings patterns. Net national saving rates of Japan and selected other nations between 1960 and 1994, in which percent of national income at market prices, shows that Japan's savings rate is the highest at 23.6%; it is 7.8% in the United States, 13.5% in Germany, 14.3% in France, and 7.5% in UK.[31] Japanese society itself also encourages personal saving. The postal saving system has been available since it was founded in 1875 in which the postal deposits were transferred from individuals to the Ministry of Finance so that the government could invest exclusively in national government bonds until 1885, but later the local government diverted some portion of the postal deposits.[32] This tendency of higher national

saving rates in Japan occurred only after World War II. One of the psychological factors suggested to explain the Japanese saving consistency is that during the devastations of the war the Japanese people had significantly lost their wealth below target levels, which abruptly promoted the current tendency in high rate of saving. In addition, the Japanese relatively low expectation of nuclear war, and great anxiety of natural disasters such as earthquakes have been contributing to their dependency on saving. The depleted stock of capital caused by the aftermath of war also made the Japanese incline toward saving.[33]

Conclusion

The current recession is caused by both short-term and long-term factors. The short-term causes of the recession are the failure of economic policy by the Japanese government, such as the expansionary monetary policy which let to the bubble economy in the 1980s and extremely tight monetary policies which resulted in the collapse of the bubble economy in the 1990s. The long term factors may include the Japanese way of life, their myth of land, their horrible experience of the atomic bombs. These factors, combined with a sense of insecurity due to the lack of natural resources and the fear of possible impoverishment in the future, make Japanese people hesitate to spend money on the enjoyment of life, even if they can afford to do so. Thus, they tend to save money, encouraged by its government such as postal saving system.

There are a number of other reasons, of course, such as a tendency toward a strong yen which is hurting export-oriented industries, the collapse of equity prices, huge debts by financial institutions, and other problems with Japan's banking systems. The shift in industrial policy after the second oil crisis probably helped to boost international competition, and the increase in productivity of automobiles and electric products became a major cause for trade friction between Japan and the United States as well as Japan and EC countries in the 1980s and 1990s.

The various reforms made by the United States Occupation Forces were part of strategy for the democratization and liberalization of Japan during the Cold War. One of the most effective reforms was the dissolution of the *zaibatsu*. As a result, new conglomerate groups had emerged during the 1950s, centered on the banking industry, and they rapidly expanded during the high growth period. Banks in the former *zaibatsu* became strong enough to influence companies through their loans and investments. It can be said that the former *zaibatsu*-family system was replaced by a group system with a bank as its financial center. It was the United States who rebuilt Japan after 1945 by "surgically implanting a Western-style liberal democracy,"[34] and some of the economic reforms done by the SCAP could be partially responsible for the current recession as a long term affect on Japan's economy.

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Notes and Resources

[1] David Flath, *The Japanese Economy.* (Oxford: Oxford University Press, 2000), 194.

[2] Ibid., 196.

[3] Ibid., 71-72.

[4] Ibid., 74.

[5] Ibid., 75.

[6] Ibid., 79.

[7] W.G. Beasley, *The Japanese Experience: A Short History of Japan* (Berkeley: University of California Press, 1999), 258.

[8] Ibid.

[9] Marius B. Jansen, *The Making of Modern Japan*. (Boston: Harvard University Press, 2002), 727.

[10] Ibid., 730.

[11] Flath, 130.

[12] Flath, 207-209.

[13] Beasley, 261.

[14] Ibid.

[15] Flath, 132.

[16] Christopher Wood, *The Bubble Economy: Japan's Extraordinary Speculative Boom of the '80's and the Dramatic Bust of the ''90's.* (New York: Atlantic Monthly Press, 1992), 51.

[17] Beasley, 261.

[18] Wood, 57.

[19] Benjamin Powell, "Explaining Japan's Recession," November 19, 2002, Ludwig von Mises Institute. Available from http://www.mises.org/fullstory.aspx?control=1099#; Internet; accessed March 3, 2005.

[20] Ibid.

[21] Beasley, 261.

[22] Wood, 49.

[23] Ibid., 50.

[24] UCLA Asia Institute, "Land and Climate of Japan: Land Use." 1992. Available from http://www.isop.ucla.edu/eas/japan/geography/landuse2.htm; Internet, accessed March 3, 2005.

[25] Wood, 51

[26] Ibid.

[27] Ibid., 55.

[28] Ibid., 57.

[29] Powell.

[30] Ibid.

[31] Flath, 100.

[32] Ibid., 198.

[33] Ibid., 103.

[34] Wood, 5.

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