

Economic Development of Japan after WWII

Based on “The Japanese
Economy” written by Takatoshi Ito

The Two Stages

Japan's economic development after WWII is divided into two stages:

1. The hyper-rapid growth stage (1944-1973)
2. The stable or slow growth age (1973-now)

What happened in 1973? – The **Oil Shock**.

The Reforms

- Before WW II, of course, Japan was one of the advanced countries,
- However, the production capital was totally destroyed by bombing during the war.
- With little production capacity the Japanese population was near the starvation.
- The **Allied Occupation Force** introduced drastic reforms aimed at **democratizing Japan** politically and economically.

Anti-trust measures

- The prewar **Zaibatsu** were groups of large companies across different industries controlled by family-owned holding companies.
- The Occupation Force required the shares owned by their holding companies to be sold to public by auction.
- Thus the Zaibatsu were dissolved in 1947.

Land reforms

- In 1946 and 1947, land was confiscated from absentee landlords with little compensation and resold to tenant farmers at bargain prices.
- The land reform has played two roles, which work into the **opposite directions**.
 1. The reform created a large **middle class**, contributing to the income equity and political stability, and enhancing growth.
 2. The reform has prevented farmers from taking advantage of **scale economies**, contributing to the slow improvement of the productivity of the agriculture sector.

Labor democratization

- Workers were granted the rights to organize in unions and to engage in collective bargaining by the **Union Law** of 1946.

Other Institutional Reforms

1. Education

- a. The education system was reformed on the **American model**, with all children required to attend elementary school for 6 years and junior-high school for 3 years.
- b. **Coeducation** was introduced throughout the public schools.

2. Political Institutions

- a. The **emperor** (“**Ten-noh**”) became a "symbol" of the nation.
- b. Military forces were permanently banned by the **Constitution**.

The Pre-Recovery

- There were three stages before the take-off to occur.
 1. Hyper inflation.
 2. Austerity Plan
 3. The Korean War

The Hyper Inflation and the Austerity Plan

- After the war, there remained a huge stock of war debts.
- The monetization of it resulted in a three-digit inflation, which was eventually controlled by an austerity plan imposed by the Allied Occupation Force in 1949. The Plan is called the **Dodge Plan**.
- The Plan required the government to balance its budget. As the fiscal budget was tightened, the economy went into a severe deflationary spiral.

The Korean War

- The harsh recession was averted by the special export demand created by the **Korean War**.
- As the world entered in the **Cold War** period, the priority shifted to encouraging greater production by existing companies rather than ensuring a competitive market by closing them.

The Growth Age (1950-1973)

- Rapid economic growth in the 1960s is at the heart of the post war Japanese economic "miracle".
- Prime Minister Hayato Ikeda took his office in 1960, and announced his goal of "doubling income in ten years", which became the focus of policy discussion and media attention.
- But the doubling of national income (measured by real GNP) was in fact achieved in seven years.

The Sustained Growth: Reasons

1. The prices of the raw materials which Japan had no choice except to import, were relatively low during the period.
2. The government took sound monetary and fiscal policies in 1950s and 60s.
3. The **high saving rate** provided enough funds to support a high investment rate.

The High Saving Rate

- Capital controls against foreign investment worked to translate the high saving into high investment.
- Without its high saving rate, Japan would have had to borrow from abroad to maintain its high investment.
- The exposure to the global capital market would have made Japan more vulnerable to such external shocks as oil-price increase and world-wide interest-rate increase.

The Role of the Government

- Due to the balancing budget rule, government expenditures **did not crowd out** private investment.
- The government was prohibited by law from issuing deficit bonds until 1965.
- The Fiscal Investment and Loan Program (**FILP**), of which funds are provided by the **Postal Saving System**, was utilized to finance government investment

The Exchange Rate

- The value of the Yen was fixed at 360 yen per dollar under the **Bretton-Woods System** and was sustained until 1971.
- The fixed exchange rate greatly contributed to ensuring international competitiveness.

The “Economic Plans”

- They started as rationing plans with a socialist flavor, but soon became "indicative" in order to demonstrate the government's commitment to growth.
- Firms' investment does not take place unless sales projections are favorable. Uncertainty might make investors pessimistic and keep the economy in a low-demand equilibrium.
- If the government's announcement provides credible information, it stimulates investment in private sectors.
- As the private sector believes the plan and behaves accordingly, the plan becomes self-fulfilling.

The Slowdown

- Toward the end of 1960s, Japan's economic growth accelerated and was accompanied by large trade surpluses, which indicated that the yen fixed at 360 per dollar since 1949, had become undervalued.
- On the contrary, the United States was recording persistent trade deficits, which partly reflected the persistent trade surpluses of Japan and Germany among industrialized countries.

The Regime Change

- Under the Bretton Woods fixed-exchange rate, devaluation was allowed, but rarely invoked, because it was seen as a political embarrassment of the devaluing country, while it was opposed by competing countries.
- In August 1971, **President Nixon** suspended the **gold convertibility** of the dollar.
- The fixed-exchange-rate system was abandoned, giving way to floating rates in early 1970s.

The Inflation

- Since the Japanese were used to the fixed exchange rate, the transition was expected to be harsh.
- There were two ways to accommodate the Japanese economy to this new environment.
- One is a speedy **evaluation** of the Yen. The other is moderate **inflation**.
- The political opinion took the second way.

The Oil Shock

- Announcing its political goal of "transforming the Japanese archipelago," Prime Minister Tanaka's government increased money supply and lowered the interest rate in 1972, which created inflationary pressure.
- When the OPEC countries announced the oil embargo in October 1973, inflation took off.
- The "Wild Inflation" [Kyo-ran Bukka] reached 30% in 1974.

The Pessimism

- It took several years for Japan to reallocate resources from unconditionally growth-oriented sectors to energy-saving sectors.
- The two oil crises (1973-74, 1979-80), drawing attention to Japan's heavy dependence on nonrenewable resources, gave many people a pessimistic growth outlook in the future.
- Since expected future earnings fell, investment demand also fell. The decline in investment slowed the adoption of advanced technologies, which turned into the low productivity growth.

The Catch-Up

- Moreover, Japan finally caught up with the United States and the Western European Countries technologically at some point in the mid 1970s.
- It is harder to develop a country's own new technology than to merely obtain licenses.
- Japan's growth rate was doomed to fall.