**Notes on THE JAPANESE ECONOMY** © John Freedman 2025

It is only a slight over-simplification to say that Japan's economy was almost purely agricultural for thousands of years. Rice was not only the staple, but also the tax currency, and dominated the economy to the extent that only some other agricultural foodstuffs and some handicrafts entered into the economic picture. Japan's ascent as a military power, which began apace at the time of the Meiji Restoration in 1868, paralleled and was fed by its dramatic economic ascent into the league of world industrial superpowers. The roots of that economic bloom were really planted in 1854 when Commodore Perry and his "black ships" forced open the trading gates of a mostly (but far from completely!) closed Japan. As an inflection point. The Perry visit had the unintended consequence of turning Japan's focus from inward to outward in a most destructive way.

Rapid industrialization had as its very first focus the textile industry, which in some sense was an extension of Japan's agricultural history and its longstanding tradition of exquisite craftsmanship. Cotton and silk were the raw materials and coal-fed steam power was the energy source. Soon came machinery, weaponry, mass food production, and Japanese refinements of almost every manufactured product that the West had modeled for them. Economic growth put the final nail in the coffin of the feudal system, since new wealth and opportunity allowed social and political mobility. Just as we see today, invention and innovation would breed enormous wealth and power. In a felicitous cycle, wealth begat more educational opportunity, which begat more wealth creation and dispersal. Japan's industrialization and rapid economic growth led to the emergence of large conglomerates known as *zaibatsu*, which dominated the economy and did concentrate wealth, but also spread a lot of wealth around and proffered that all-important transformative process: jobs creation. Perhaps most importantly, the *zaibatsu* provided economies of scale. Concomitant with and underpinning Japan's first cycle of miracle growth was the development of a very strong central banking sector which persists to this day. Positive parts of the Tokugawa legacy that were retained and enhanced in the post-feudal period were a strong focus on highly developed transportation infrastructure, a sophisticated government bureaucracy, and urbanization.

Japan's period of most rapacious conquest from its 1937 invasion of Manchuria through its massive land seizures in China, southeast Asia, and the Pacific in the early 1940s was driven largely by the need to acquire natural resources - without which Japan could not secure economic independence. Coal from China, petroleum from Borneo and Burma, tin and bauxite from Indonesia and Malaya, as well as sugarcane from the Philippines and rice from Thailand and Vietnam, were some of the major drivers of imperial conquest and annexations into what the Japanese euphemistically termed "The Greater Asia Co-Prosperity Sphere." To the Japanese, their conquest of Asia was an economic necessity. Likewise, when the US instituted an embargo and blockade which prevented oil and coal from reaching Japan, the Japanese felt that attacking America's Pacific Fleet at Pearl Harbor was a matter of economic *necessity*. Their goal was to end the oil embargo, and the historical record shows that they were not expecting a protracted war and certainly did not expect America to wage war with such fierce and dogged determination with the single unshakable goal of Japan's full and unconditional surrender. When that occurred, the Emperor put it succinctly in his famous radio broadcast at 12 noon on August 15, 1945: "We must endure the unendurable."

The post-war period saw Japan's emergence from *utter destruction* (those were Truman's exact words in the Potsdam Declaration of July 1945 : "surrender unconditionally or face utter and complete destruction") in a remarkably short time. That emergence was triggered by and fed by a phenomenal second Japanese economic miracle. An interesting irony is that Japan had to rebuild virtually all its factories, and thus by the 1950s had much more modern and efficient industrial equipment than the victor states. The extraordinarily benign US Occupation (1945-52 on the main islands) fed almost $2 billion into the Japanese economy, about a third of which went into industrial capacity and transportation infrastructure. These factors and the tremendous will, discipline and capabilities of the Japanese people jump-started the economy such that industrial output had returned to pre-war levels within 10 years of the 1945 surrender. From 1955-1965, GDP grew an average of 10% per annum. At the same time and as another key ingredient, Japan emphasized education and has held the world's highest literacy rate since the 1960s, briefly challenged only by Cuba and Denmark.

The economy diversified in the 1960s and Japan also received great economic benefits from its role as a supplier to the US and its allies in the Vietnam War (as it had in the Korean War of 1950-1953). By the mid-1970s Japan was an economic superpower (#3 in total GDP after the USA and the Soviet Union) with world-leading market share of automobiles, electronics, ships, and machine tools. A robust service sector also grew, and by the late 1970s finance and information technology sectors contributed heavily to Japan's GDP. In a sense the 1973 "oil shock" shocked Japan worst of all, and the Japanese turned this to their advantage. Highly dependent on imported energy sources, the Japanese responded with a massive Improvement in energy efficiency, dramatic refinements of manufacturing processes to increase efficiency, and leveraging the microprocessor revolution. Japan also had the notable luxury of not maintaining an expensive military, thanks to its US protector and Article 9 of its pacifist constitution. The result of all of the above was spectacular growth, especially in the latter 1980s when a square meter of Tokyo real estate was worth $1.5M USD and the Nikkei 225 stock index reached an **ALL-TIME high of 38,915 on December 29, 1989**. Japan had earned the position as the world's second largest economy after the US, and in fact was buying up much of the US. And then the bubble burst. Trillions were lost. Many factors, some better understood than others, contributed to the bust. As in almost all bubble economies, speculation was rampant, particularly in real estate and equities, due to the ready availability of money and a strong yen. Risky loans became the norm. The Japanese government tried, largely unsuccessfully, to subsidize failing banks and businesses, which became known as "zombie businesses." The 1990s are known as The Lost Decade, and to a great extent the Japanese economy still has not fully emerged from the rupture of its engorged 1989 bubble. It has struggled with deflation due to fallen asset prices, insolvent companies including banks, and loss of world market share in several sectors. The US's self-resuscitated economy allowed it to compete more in the automotive and electronics sectors, and to rule the emergent high tech sector. The Nikkei bottomed out in 2003 at 7,603. In October 2012, a resurgent China surpassed Japan as the world's second largest economy.

The new millennium has not been much easier for Japan. On top of the factors above, Japan was pummeled by the two global recessions of 2000 and 2007, and the tsunami damage including the Fukushima nuclear reactor disaster triggered by the 9.0 Tohuku Earthquake of March 2011, dealt a cruel blow to Japan. In addition to the $362 billion in damages, "The Triple Disaster" set back Japan's nuclear energy program which had supplied 30% of the nation's electricity, thus raising energy costs. The disaster occurred in a key industrial zone of northern Japan, resulting in the shutdown of major plants including those of Toyota, Nissan, Honda, Mitsubishi, and Sony. Compounding Japan's economic problems is its Silver Society – it has the highest median age in the world with 33% of the population over age 60. Being "the oldest country in the world" carries attendant expenses of social programs for the elderly and lowered per capita productivity.

The 21st century has been marked by political instability in terms of frequent Prime Minister changes, partially if not mostly due to economic malaise. Attempts to tame deflation and avoid recession have included an aggressive quantitative easing program since 2000, which continues apace to this day. This involves the central Bank of Japan (BOJ) buying assets to increase the money supply. It has been partially successful, though Japan technically sank back into short recessions in 2012 and 2014. The BOJ under Abe also reduced interest rates to zero as a form of fiscal stimulus, and even resorted to slightly negative interest rates (you pay to have the bank hold your money) in early 2016. Most observers feel that this has not yet been effective in fighting deflation. Despite his right-wing hawkishness, Japan's PM 2012-2019, Shinzo Abe, was highly interventionist from a fiscal standpoint. This included spending on large government projects to create jobs and revive the economy, and sustained, aggressive quantitative easing. Abe's program was known as "Abenomics" and survived major referendums in 2014 and 2016. China's slowdown in 2015 hit Japan hard but the Japanese economy bounced back and had a record-breaking 7 consecutive quarters of growth in 2016-2017. The past few years have seen Japan's GDP return to slow growth without a technical recession (2 consecutive quarters of negative growth) except during the COVID period in 2020 which ushered in an historic contraction. Despite global supply chain bottlenecks and labor market weakness weighing on Japan as elsewhere, the economy came roaring back and the Nikkei surged to over 30,000 in 2021 before tapering off in 2022 and then surging back in 2023, a pattern similar to that of US major stock indices, with market drivers being similar. **The Nikkei finally attained and surpassed its Dec 1989 high in February of 2024** - momentously completing a 34-year recovery and officially ending 'the lost decades'. It continued its climb and peaked in July 2024 at an all-time high of 42,224 before retreating in response to Japan's first quantitative tightening in 3 decades. Persistent low interest rates in Japan (still near-zero) have weakened the yen but this has stimulated exports to record levels, offsetting the high price of oil. Japan's economy is currently robust once again.

Currently, a big issue in Japan is the consumption tax, which increased incrementally from 5 to 10% under Abe in the face of strong and contentious opposition. The need for the tax is largely due to budgetary shortfalls in social services programs related to the aging population. Opponents say the Japanese economy cannot handle the headwind of higher taxes and this remains a hotly contested issue. Japan's Prime Minister Kishida floated the idea of increasing consumption tax to 12% as part of his program to 'take unprecedented measures' to combat Japan's low birth rate. The revenues were to be applied to fund incentives for child-rearing. PM Fumio Kishida dropped the plan in the face of widespread opposition and thus far the new PM Shigeru Ishiba has not shown any interest in pushing for this unpopular tax.