JAPAN: The Story of Its Economic Development

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INTRODUCTION

The world witnessed the economic miracle of industrialization for the first time in the Eighteenth Century, when the United Kingdom developed mass production of consumer goods, setting the stage for a revolution in economic development and living standards unprecedented in world history. Industrialization soon spread to North America and Western Europe, which by the Nineteenth Century experienced massive economic, social, and technological change, wrought by an industrial revolution. This progress was limited to countries with a European cultural and ethnic heritage, however. It remained to be seen whether the rest of the world would ever realize modern economic success.

It was Japan that would become the first country with a non-European heritage to achieve industrialization and reach parity with the developed economies of the West, demonstrating the potential of countries throughout Asia, Latin America, and Africa. Japan’s economic development model would be accomplished without extensive Western assistance and backing, pioneering the export orientation that would define the Asian economic miracle of the late Twentieth Century. Japan would become a role model for the world on how to industrialize.

Like all developed economies, including the United States, industrialization did not occur spontaneously and was not preordained; it was a complex process requiring appropriate economic policy, social conditions, international relations, and political economy. What was Japan’s
history of economic development? What can the rest of the world learn from it? This essay will seek to answer these questions, examining the key factors that brought this transformation about and seeking answers to why the miracle has stagnated in the past two decades. From this history will derive lessons that can be applied both to developing and developed economies, as well as provide an outlook for the future of the Japanese economy.

HISTORICAL ROOTS

The roots of Japanese economic success began long before formal development occurred in the late Nineteenth Century. Unbeknownst to the outside world, Japanese cultural traits had set the stage for future economic transformation unlike anything seen before in world history, exemplifying the importance of a cultural background favorable to economic growth and vitality.

From time immemorial, the Japanese were marked by their group-centered dynamics and spirit of cooperation versus competition, which would enable them to work together for their mutual economic success to an extent rarely seen in history. Much of this cooperation can be understood in the relative linguistic, cultural, and ethnic homogeneity of the Japanese people, reinforced for centuries by isolationist policies (Ohno, 223, 2006). Even today, the Japanese are almost entirely of the same ethnic background (CIA, 2013), and thus share the same experiences and aspirations and are able to cooperate to make them a reality. In the 1989 video series, Japan:
The Land and Its People, it was astutely observed that even the Japanese art of miniaturization, seen in the art of bonsai or in the ability to economize the use of living space, would set the stage for the technological prowess that this people would exhibit in later years (Japanese Technology, NCS Video, 1989). Or consider the Japanese cultural esteem for education and high regard for the employee/employer relationship, which would pay huge dividends in the future, permitting an unparalleled commitment to economic success.

The Japanese scholar Dr. Tadao Umesao, quoted by Kenichi Ohno in the study, The Economic Development of Japan, noted geographic similarities between Japan and the Western European nations that were the first industrialists; both had coastal access with a favorable climate, considered a substantial asset in economic development, and both had a feudalistic political economy during the Middle Ages (500-1500 A.D.), which morphed into a preindustrial and then industrial economy. These similarities are even more striking when comparing Japan with the United Kingdom. Both nations are island countries on the periphery of major population centers (Western Europe in Britain’s case and mainland China in Japan’s case). This position enabled both countries to observe and profit from the cultural, economic, and political advancements of their powerful neighbors while having a natural insulation from the invasions and decline and fall of empires, giving them the benefit of developing their economies in light of the greatness of neighbors but in national peace (Ohno, 8-9, 2006).
In light of the cultural and historical roots that tended toward economic development, it might be somewhat of a surprise that Japan developed as late as it did. Indeed, Umesao believed that industrialization would have begun in Japan simultaneously with Great Britain, were it not for the isolationism of the Tokugawa Period, which lasted from 1639 to 1854 (Ohno, 9, 2006).

After initial contact with European traders, most notably the Portuguese, Japan’s Tokugawa dynasty undertook a strict isolationist policy, forbidding trade and travel with Western and even other Asian powers. This policy prevented them from coming into contact with the Industrial Revolution and spread of democratic thought that swept the world in the Eighteenth and early Nineteenth Centuries (Flath, 21, 2005). This does not mean that Japan did not develop economically in this era, however. David Flath in his study of the Japanese economy, noted that the nation’s population increased from 20 million in 1600 to 30 million in 1700, a sign of prosperity, while urban communities grew in population and importance, including Edo, which was later renamed Tokyo (Flath, 26, 2005). This population growth would stagnate after 1700, but improved agricultural methods and trade within the nation would continue to increase, catapulting Japan to a pre-industrial footing (Flath, 26-27, 2005).
Japan’s self-imposed exile from the world ended abruptly in 1853, when the U.S. Navy, led by Commodore Matthew Perry, opened the nation to international trade. Haunted by the experience of foreign penetration, the Japanese ousted their samurai warrior-leaders and reinstalled the successors of their ancient emperors, establishing the Meiji dynasty, which would rule Japan from 1868 to 1912. It would be in this period that Japan would enter the industrial era.

The Meiji dynasty would break from the isolationist views of its predecessors and seek trade relations with the outside world, while maintaining strong social and cultural homogeneity at home. This would open Japan to new influences, but it would also permit the nation to benefit from the comparative advantage of international trade, as it could compete on price and quality with the established Western powers.

Meiji Japan succeeded in achieving macroeconomic stability and a solid legal system, all-important prerequisites for economic development. The Bank of Japan, a central bank for the control of the money supply and interest rates, was established in October 1882 (Flath, 34, 2005), predating the American Federal Reserve by 31 years. Land tax reform was enacted in 1873, replacing a rice tax with impartial and structured monetary property tax assessments being undertaken throughout the country, supporting private land ownership and encouraging higher national output (Flath, 30, 2005).
During the late Nineteenth Century, Japan rapidly expanded and modernized its infrastructure and communication systems to be at parity with the West. Railroads, telegraph, and postal systems were established throughout the country, quickly earning a reputation for efficiency. Of particular interest was Japan’s novel postal savings system, which allowed the postal system to double as a financial institution, encouraging involvement in the formal economic sector (Anderson, 61-62, 1990). As Anderson states, the postal savings system is no doubt a major factor in the high rates of savings among the Japanese, a major driver of the investment orientation that would characterize the country’s development.

The establishment of corporations required formal financial institutions for the provision of capital. Thus, during the late Nineteenth Century, a large number of national banking institutions arose. These were the country’s first joint stock, limited liability corporations. By 1879, 153 of these institutions existed (Flath, 34, 2005), establishing the Japanese reputation as the regional banking hub. As has been observed around the world, extensive involvement in the financial sector tends to create a robust economy, with impetus for savings and easy access to capital for business projects.

Similar to the experience in Great Britain, Japan’s first globally competitive industrialized industry was the mass production of textiles, a pattern which economists now understand to be a common early industry in
developing economies (Song, 135, 2003). The Japanese were able to obtain a market share in textiles through competitive prices, high quality, and a silk blight in Europe that favored new markets. By 1893, Flath states that textile markets accounted for a third of the nation’s factory production (Flath, 34, 2005). Powering factories required the use of foreign technology, which the Japanese quickly adopted. Japan showed its commitment to quality in manufacturing by establishing a separate college of engineering at the University of Tokyo in 1886 (School of Engineering, the University of Tokyo, 2013), years before this was common practice in leading universities. The institution remains a world renowned center for engineering studies to the present day.
Meiji Japan understood the importance of an educated citizenry in an industrialized society, and thus pursued universal popular education. Schooling at the primary, secondary, and tertiary level were made available at no cost, giving citizens equality of opportunity, a prerequisite for equitable economic growth. Japan’s educated citizenry would compare favorably with that of North America and Europe by the turn of the century. By 1890, Japanese illiteracy was at 50 percent, a high figure by modern standards, but comparable with the illiteracy levels of Western nations at the start of modern economic growth (Flath, 39, 2005).

Meiji Japan saw the development of business conglomerates, a structure that would forever characterize the Japanese corporate model. The acclaimed management consultant Peter Drucker stated that the modern corporation formed in the United States, Germany, and Japan, simultaneously, yet independent of each other (Song, 216, 2003). Yet in each case, the model used was unique. In Japan’s case, a cooperative, rather than the competitive model of the United States, was adopted. *Zaibatsu* (business conglomerates) emerged as interrelated and connected
business enterprises, held by the same family. The most famous of these conglomerates – such as Mitsui, Mitsubishi, Fuji, Yasuda, and Sumitomo – became world leaders in a variety of industries in a relatively short period of time, displaying the Japanese tendency to adopt various industries as necessary in current economic conditions, a hallmark of Japanese enterprise that would permit continued success during shifts in consumer demand (Flath, 46-49, 2005). These powerful conglomerates would put the Japanese in a management position, able to be captains of industry rather than merely profiting from foreign direct investment (FDI) from developed countries, a common fate of developing nations.

While clearly a long way off from the standard of living we enjoy today, Japan at the turn of the century was taking the form of what was at the time an industrialized economy, as was observed in the United States or Western Europe. The street scene of Tokyo, shown in Figure 1, reveals similar technological standing, including streetcars and electricity, as the cities in the West at the time.

**THE POSTWAR MIRACLE**

Japanese industrialization in the late Nineteenth Century established the country as a key global economic player, though the early Twentieth Century was anything but successful for the Japanese. While the nation began the century as the only non-European country to attempt colonization (two Japanese colonies were Taiwan and Korea, which became economic
powers in their own right later in large part to exposure to the Japanese model and was relatively insulated from the devastation of World War I, the 1920’s saw a devastating earthquake in Tokyo and fiscal misadministration with the debut of party politics (Flath, 51-57, 2005). During the 1930’s, militaristic leaders sought Japanese territorial domination through the Pacific Rim, embarking in a massive military buildup that led to the conquest of China and much of the Pacific Rim. This was rebuffed by the United States and its allies, culminating in massive human and economic suffering as Japan’s cities were firebombed by conventional and atomic warfare. The Japanese were forced to surrender in 1945, with a devastating loss of honor and prestige, and an incredible toll of millions of war dead. Few expected that Japan would soon rise again as an economic power.

American occupation after World War II forced a revolution in the Japanese economy. Radical land reforms were enacted that broke up the Japanese social structure and monopolies were banned (Flath, 72-80, 2005). Japan was forbidden by international decree to have a functioning military and was forced to renounce expansionist aims, defense becoming the responsibility of the United States. Reconstruction was expected to be a long and arduous process, yet in 1952, Japan regained national sovereignty.

Much to the surprise of the world, postwar Japan staged a robust recovery with high growth rates unknown at the time. Without defense as a major expenditure, the Japanese were freed to concentrate on civilian
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manufacturing, developing the world’s first export-oriented economic system. Attentive to global consumer trends, the keiretsu (the scaled-back successor of the zaibatsu), developed quality products from automobiles to electronics at lower costs, shipped to the U.S. and Europe. In 1964, when Tokyo hosted the Summer Olympic Games, Japan displayed to the world an economy miraculously recovered from the horrors of war and just as competitive as any nation.

During the 1965 to 1975 decade, Japan’s annual economic growth rate averaged 7.85 percent (Flath, 89, 2005), peaking at over ten percent for several years (see Figure 2 below). While unheard of at the time, in retrospect it can be understood as the advantages of backwardness coupled with a business-friendly political economy, seen in developing countries today that are experiencing similar growth lasting for a few decades until the technological plateau is reached. In 1968, Japan became the world’s second largest economy based on GDP, outranking West Germany (Hamada, ii, 1996). Japan seemed likely to outpace the United States as the world’s largest economy if its spectacular growth continued.

The causes of postwar prosperity in Japan are multi-faceted, but among the most striking is the unique political economy that set the precedent for a “developmental state” (Routley, 11, 2012), with neither pure neo-classical noninterventionism, a command economy, or a socialist welfare state, but rather an economy committed to using whatever method achieved economic
development. This form of political economy would be seen in many
countries of the Pacific Rim by the end of the Twentieth Century, an
adaptation of a Japanese innovation. Japan’s most visible intervention into
its economy was the Ministry of International Trade and Industry (MITI),
which would coordinate economic activity in each of the country’s major
industries, directing Japan’s global success and encouraging its private
sector to excel in marketable industries.

**FIGURE 2**: Japanese GDP growth from 1963 to 2003. *SOURCE:*


**ECONOMIC SUPERPOWER**

By 1980, Japan was the prototype of economic success in the world.
Nations and businesspeople everywhere wished to “learn from Japan” to
replicate the island nation’s stunning success, while many in the West
began to push back against Japanese-owned enterprise in their countries, fearing a threat to their own national competitiveness (Flath, 175, 2005).

There are two unique outstanding features of the Japanese economy as a superpower. First was its low unemployment rate, which dipped as low as 1.1 percent and remained below three percent for a generation (Flath, 121, 2005), much lower than unemployment rates in America or Europe, even in good times. This was partly due to the cultural model of lifetime employment, which was by no means universal, but held a significant percentage of the workforce into permanent employment (Flath, 122, 2005). The second was the extensive outward FDI in emerging economies in East Asia as well as established powers in the West, with conversely very little inward FDI in the Japanese economy (Flath, 167-168, 2005). As lower-skilled industries began to decline in Japan in the face of a highly educated and high wage workforce, Japanese corporations began to participate in extensive outward FDI (Flath, 167-168, 2005), which would fuel economic miracles in other countries of the Pacific Rim and beyond.

The decline in investment opportunities that occurred as Japan reached full economic development in the 1980’s, combined with the continuing Japanese cultural trait of saving, encouraged investment in property and stocks. This contributed to the property asset and stock bubble that was in full swing by the late 1980’s and peaked in 1989. At that time, reports in the news media estimated that the sum of all of the real estate in the city of
Tokyo was worth the sum of the real estate in the entire United States (Powell, 2009), while the nation’s benchmark Nikkei 225 stock market soared from a level of 10,000 points in 1985 to a peak of 38,915 in 1989, increasing its value six fold in one decade (Nikkei, 2013).

**STAGNATION AND OUTLOOK**

While the Japanese economy was the envy of the world in the 1980’s, the economic giant suffered a sharp slowdown in growth during the 1990’s, marked by several painful recessions. The country’s dominance as the leading economy of East Asia was challenged by upstarts that had borrowed heavily from the Japanese model, including the four Asian Tigers (Taiwan, Hong Kong, Singapore, and South Korea), as well as mainland China. Much of Japan’s malaise was tied to the collapse of the property and asset price bubble, which left its banking conglomerates with large amounts of bad debt, similar to the situation seen in the United States in the late 2000’s (Powell, 2009). Natural disasters, such as the 1995 Kobe earthquake, also played a role. Still, the primary reason for Japan’s slowdown was its new position in the world economy – it had become a mature, industrialized economy, and thus shifted to consumption and away from industrial investment. As wages and costs rose, Japan lost many of its manufacturing activities to other nations in the region. This transformation from a robust upstart to a mature industrialized economy would require a major change of expectations and direction for the Japanese people (Mead, college lecture,
Now, Japan’s high savings rates was becoming a liability (Anderson, 61, 1990), as spending outranked saving as the required fuel for continued economic prosperity. The aging of the Japanese population, the decline of the lifetime employment model, and recent natural disasters and environmental catastrophes (such as the 2011 Fukushima nuclear disaster), are among the future headwinds facing Japan.

Even a cursory look at the Japanese economy of the early 2010’s reveals a sharp decline in prestige from the glory days of the 1980’s. Japan has lost its position as the world’s second largest economy to the People’s Republic of China and most of the attention paid to East Asia’s economies bypasses Japan (IMF, 2013). Still, Japan holds the distinction of being the first non-Western nation to achieve industrialized status, and it remains the regional leader in stability, standard of living, and human development.

While Japan’s growth rate has slowed to a crawl, unemployment remains low by international standards – perennially less than five percent of the workforce – far below the levels of Western Europe and the United States. Japan continues to be a regional center of business and trade and Japanese education continues to rank among the world’s highest. According to the annual human development index (HDI), Japan ranks as the highest in East Asia, with South Korea coming in a close second (UN, 2012), demonstrating a commitment to social welfare for the entirety of the population as well as a high standard of living for the majority of the population.
While the People’s Republic of China has outpaced Japan as the world’s second largest economy in terms of GDP, it must be remembered that China is still far below the level of Japan in per capita income, since the same level of total output must be divided among over one billion people, as compared to Japan’s population of less than 130 million. Thus, in 2012, Japan had a per capita GDP of about $47,000 U.S. dollars, while China’s stood at only $6,000 (IMF, 2013). China’s GDP would have to be nearly ten times that of Japan in order to reach the same per capita income, which would require sustained growth over many years.

CONCLUSION

The Japanese economic history of the past two centuries has been the first development story to occur outside of the European West. It has been an inspiration and role model to East Asia and developing nations everywhere. The achievement of a cohesive and stable social and political structure in the process is but a further reason to follow Japan’s model. The export-oriented model that Japan used to reach economic superiority was at the time a novel approach, becoming the prototype for the development stories of countless upstarts in the region and beyond.

But despite its unique experiences, the cycle of Japan’s development bears many similarities to the Western industrialized economies: mass production began in the textile trade, eventually moved into heavy manufacturing, then to high quality goods as price competition waned, and
finally to a service-oriented economy, and ultimately to lower rates of
growth as the technological horizon had been reached (Ohno, 184, 2006).

From Japan the world can learn how embracing free trade with the
world, as it reluctantly did in the Nineteenth Century, can transform an
economy, and how an export orientation can power an economy. Japanese
commitment to education and to developing its human resources is an
invaluable lesson for the world, for an educated and employed citizenry can
accomplish great advancement for an economy. But the perils of stagnating
when attaining economic maturity is also evident in Japan’s story,
demonstrating the importance of continued vigilance in economic policy in
developed nations.

Perhaps most importantly, Japan has taught the world that a nation with
few natural resources and an isolationist past can quickly rise to economic
power by utilizing its most important asset – the human resources of its
people – to work economic miracles.
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