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Key Directions of Japan's Economic Development (1950 – Present)

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Abstract: This article examines the impact of deflation on Japan's economy during a specific historical period. The author analyzes the consequences of deflation on various sectors of the economy, such as consumption, investments, exports, and more. Particular attention is paid to the measures taken by the government to overcome deflation. Throughout the article, the author highlights the significant challenges faced by the Japanese economy under prolonged deflation and discusses possible strategies for exiting this situation. By thoroughly analyzing Japan's history and experience, the author draws conclusions about how deflation can influence a country's economic development and what lessons can be learned from this experience for other countries. The main idea of the article is that deflation can have serious consequences for a country's economy and requires a comprehensive approach from both the government and the business community to mitigate its negative effects.

Keywords: Deflation, Currency Depreciation, Economic Growth, Economic Policy, Monetary Policy, Fiscal Policy, Financial Reforms

Introduction

Japan plays a significant role in the global economy, which is attributed to its status as one of the largest economies on the planet. The country is renowned for its technological innovations, high-quality production, and substantial export levels, particularly in sectors such as automotive manufacturing and electronics. With a robust industrial base and technological potential, Japan exerts influence on global financial and trade flows. Japan, having a regulated trade balance, traditionally maintains a high positive trade balance, indicating that the country exports more goods and services than it imports.

Despite this, the country is still plagued by ongoing deflation, despite the government's efforts. Deflation is a situation opposite to inflation, where prices of goods and services decline in order to boost demand in the market. Deflation is often considered an undesirable phenomenon because it can lead to a decrease in production, an increase in unemployment, and a reduction in investments, creating a vicious cycle of economic downturn.

The causes of deflation can be attributed to several factors. These include: Reduction in the money supply: If a central bank reduces the money supply or there is a decrease in the overall level of lending, it can lead to a decrease in demand for goods and services. This reduction in demand can cause prices to fall, resulting in deflation; Decrease in demand: A decrease in consumption and investments can lead to an oversupply of goods and services. This oversupply can cause prices to drop, contributing to deflation; Inflationary expectations: If businesses and consumers expect prices to fall, they may delay purchases and investments, which can further reduce demand and exacerbate deflation.

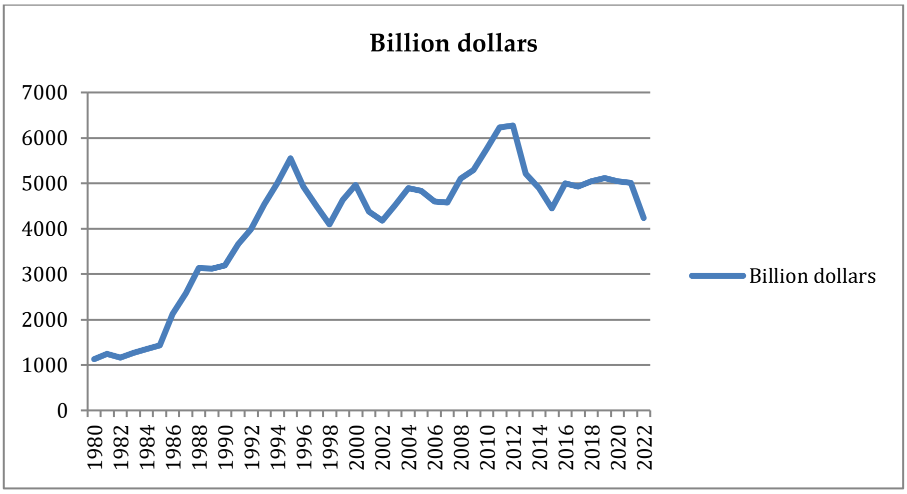
Literature Review

Table 1 Nominal GDP of Japan (billions of US dollars), 1980-2022yy.

	1980	**1981**	**1982**	**1983**	**1984**	**1985**	**1986**	**1987**	**1988**	**1989**
Billion dollars	1127,9	1243,8	1157,6	1268,6	1345,2	1427,4	2121,3	2584,3	3134,2	3117,1
	1990	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**
Billion dollars	3196,6	3657,3	3988,3	4544,8	4998,8	5545,6	4923,4	4492,4	4098,4	4636,0
	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Billion dollars	4968,4	4374,7	4182,8	4519,6	4893,1	4831,5	4601,7	4579,8	5106,7	5289,5
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Billion dollars	5759,1	6233,1	6272,4	5212,3	4897,0	4444,9	5003,7	4930,8	5040,9	5118,0
	2020	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**
Billion dollars	5048,8	5005,5	4233,5	–	–	–	–	–	–	–

Reference:https://svspb.net/danmark/vvp.php?l=japonija

As seen from the table, the nominal GDP growth of Japan occurs until the 1990s, reaching its peak in 1995 with a result of $5,545.6 billion. Despite a noticeable decline in 1996-1998 for certain reasons, the country's economy starts showing improvement again, with gradually increasing nominal GDP figures clearly indicating high values of $4,636.0 - $6,272.4 billion during the period of 2006-2012. The government cannot sustain a high rating for a long time. Consequently, one can observe a slow economic downturn in the country from 2015 to 2022, but ultimately manages to maintain an average level of its previous indicators ($4,233.5 billion). All these findings can be seen in the graph below, which is drawn in proportion to the table.



During the post-war decades, at least until 1973, Japan experienced high economic growth rates, averaging around 10% annually from 1955 to 1973. Subsequently, due to a sharp increase in oil prices, the average annual production growth rate decreased to approximately 4.3%. From 1977 to 1987, it stood at 4.2%. Until 1990, it was rightfully assumed that Japan would become the world's leading economy. The structure of the national income in the country underwent radical changes. In 1955, agriculture, fishing, and forestry contributed 23% to the total national income, which decreased to 11% by 1965 and plummeted to just 2.1% by 1995. On the other hand, the share of mining, manufacturing, and construction increased from 29% in 1955 to approximately 40.7% in 1995. The service sector, including transportation, trade, finance, and administrative activities, saw its share rise from 48% in 1955 to 58% in 1995. In 1996, the labor force was estimated at 67.11 million people, with 32.7% employed in industry, 26.5% in trade and banking, 24.6% in services, and 5.5% in agriculture and fishing. The practice of lifetime employment for workers and employees is widespread, involving around 25% of the workforce in manufacturing.

Research Method

During the 1980s, giant monopolies (such as Mitsubishi, Mitsui, Sumitomo, Fuji, and Sanwa) dominated almost all sectors of the economy. A distinctive feature of the Japanese economy is the combination of large corporations with a large number of small enterprises. As part of the industrial restructuring aimed at reducing dependence on imported raw materials and fuel, energy-intensive and material-intensive industries were phased out in Japan. For a long time, the country operated under a "lifetime employment" system, where employees could not switch from one company to another, and if they dared to do so, they were considered traitors and despised. The state is one of the largest investors abroad, investing significant funds in various economies around the world. As one of the developed countries actively investing in innovation development and renowned for its achievements in scientific research and technology development, Japan contributes to global technological progress. Consequently, as one of the leading financial powers, Japan has significant influence on global financial markets and investment decisions. Japan engages in international cooperation by actively participating in international economic forums and organizations, including the G7, the World Bank, and the International Monetary Fund.

Japan's economic growth in the 1980s was characterized by a shift from dependence on exports to reliance on domestic demand. This development involved fundamental economic restructuring, moving from an export-oriented economy to one driven by domestic consumption. The boom that started in 1986 was generated by the decisions of companies to increase private plant and equipment spending and of consumers to go on a buying spree. Japan's imports grew at a faster rate than exports, indicating a significant shift in the economy's growth drivers.

Result and Discussion

The post-WWII Japanese economic development was a process of catch-up to the other industrialized economies. Economic policies and corporate strategies were geared towards this goal, with a focus on strengthening international competitiveness among tradable-goods-producing industries. Although the domestic markets were heavily protected in the early stages of Japan's post-war development, the potential threat of global competition provided sufficient incentives for productivity growth as Japanese industries looked for export markets. However, investments in non-tradable sectors were not sufficiently funded, leading to a lag in their development.

Japan's economy is one of the largest and most developed in the world, with a well-educated, industrious workforce and a large, affluent population making it one of the world's biggest consumer markets.

The country's services sector, including financial services, plays a far more prominent role in the economy, accounting for about 75 per cent of GDP. The Tokyo Stock Exchange is one of the world's foremost centers of finance. International trade contributes significantly to the Japanese economy, with exports equivalent to approximately 16 per cent of GDP. Japan has few natural resources and its agricultural sector remains heavily protected. Recent economic reforms and trade liberalization, aimed at making the economy more open and flexible, will be important in helping Japan cope with its challenges.

Despite its economic prowess, Japan faces challenges such as a rapidly aging population, which is set to reduce the size of the workforce and tax revenues, while placing increasing demands on health and welfare expenditure. Labour-market reforms to increase participation are among the measures being used to counter this trend. Japan's close ties to Asia, the world's fastest-growing economic region, and its strong balance sheets among large corporations, as well as a steady current account surplus, position it well to meet the needs of a growing middle class in the region. Innovation has remained an important driver of growth, with comparatively high spending on research and development.

Japan's economic policy, both monetary and fiscal, has had a significant impact on global economic trends and currency exchange rates. The country's prolonged period of deflation, primarily caused by government intervention to regulate the decline of the national currency in the market, is a prime example of this influence. Japan followed the example of the United States, which decided to lower the value of the dollar to strengthen its leadership in the global market. As a result, the dominance of Japanese companies in the market led to low prices and intense competition, which hindered inflation. The government's efforts to stimulate the economy, such as lowering interest rates and extending credit terms, proved ineffective. The money supply did not grow quickly enough to maintain inflation, resulting in persistent deflation.

The Lost Decade typically refers to the 1990s in Japan, although some definitions extend this period to 1991-2011 or even 1991-2021. This period is characterized by prolonged economic stagnation, which has become one of the most protracted economic crises in history. The zaibatsu, large family-controlled vertical monopolies that dominated the Japanese economy from the Meiji period to World War II, were dissolved by the Allied occupation forces after the war and succeeded by the keiretsu, groups of banks, manufacturers, suppliers, and distributors. Japan's economic policy has also influenced developing countries through bilateral aid programs and international organizations. The country's prosperous economy and diverse industries, with a GDP of $4 trillion, make it an important player in the global economy.

The concept of the "Lost Decade" was first used to describe Japan's decade-long economic crisis in the 1990s. Japan's economy experienced rapid growth in the decades following World War II, peaking in the 1980s with the world's highest capital per capita gross national product (GNP). Japan's export-based economic growth during this period attracted capital and contributed to a trade surplus with the US. To mitigate global trade imbalances, Japan joined other major world economies in the 1985 Plaza Agreement.

According to this agreement, Japan embarked on a period of loose monetary policy in the late 1980s. This loose monetary policy led to increased speculation and a surge in stock market and real estate prices. In the early 1990s, as it became evident that a bubble was forming, the Japanese Ministry of Finance raised interest rates, ultimately causing the stock market to crash, triggering a debt crisis, halting economic growth, and resulting in what is now known as the Lost Decade.

During the 1990s, Japan's GDP averaged 1.3% annually, significantly lower compared to other G7 countries. Household savings increased, yet this growth did not lead to increased demand, resulting in deflation for the economy. In the following decade, Japan's GDP growth was merely 0.5% per year, as sustained slow growth persisted until the global financial crisis and the Great Recession. As a result, many refer to the period between 1991 and 2010 as the "Lost 20 Years", characterized by prolonged economic stagnation and minimal GDP expansion.

Japan's economic growth, measured by its Gross Domestic Product (GDP), has been sluggish, averaging less than 1.0% annual growth from 2011 to 2019. The Covid-19 pandemic led to a global recession in 2020, as governments implemented fiscal policies to restrict economic activity. A study by the Federal Reserve Bank of St. Louis suggests that, at current growth rates, Japan's GDP will take 80 years to double, a significant slowdown from its previous doubling every 14 years. The causes of Japan's prolonged economic stagnation, known as the Lost Decade, are still a subject of debate among economists. The bursting of the economic bubble and the subsequent recessionary period are seen as triggers, but underlying demographic factors, such as Japan's aging population, and geopolitical shifts, including the rise of China and other East Asian economies, may be contributing to the country's economic challenges.

Discussion

Japan's economy has been experiencing a prolonged period of stagnation, and researchers have identified several factors contributing to this phenomenon. From a Keynesian perspective, the stagnation can be attributed to a lack of aggregate demand, which is the total amount of goods and services that all buyers in an economy are willing and able to purchase during a given period. Paul Krugman's liquidity trap theory suggests that consumers were hesitant to spend due to uncertainty about the economy's future, leading to a decrease in aggregate demand and subsequently, economic stagnation. The concept of a liquidity trap is closely related to the idea of a bear market, where investors are pessimistic about the market's prospects, leading to a decrease in investment and consumption. The Lost Decade of Japan, a book published in 2017, points to the "vertical investment-savings curve" as a key factor in Japan's economic woes. This curve represents the relationship between investment and savings in an economy, and a vertical curve would indicate that savings are not being translated into investments, thereby hindering economic growth.

Monetarists, on the other hand, point to Japan's monetary policy before and during the Lost Decade as too tight and insufficiently adaptive to resume growth. Milton Friedman, regarding Japan, wrote that "the most reliable path to a healthy economic recovery is to increase the pace of monetary growth to move from a tight monetary policy to an easier one, to rates of monetary growth close to those that prevailed in the 1980s. This will facilitate the necessary financial and economic reforms." Despite various attempts, Keynesians and monetarists argue that the prolonged economic inactivity of Japan has been largely insufficient, with the Japanese government implementing repeated massive fiscal spending (a Keynesian solution to economic depression) and expansionary monetary policy (a monetarist prescription) without noticeable success. This suggests that Keynesian and monetarist explanations or solutions (or both) are likely not entirely wrong.

Austrian economists, on the other hand, argue that the period of prolonged economic stagnation is not inconsistent with Japan's economic policies during this period, which acted to support existing firms and financial institutions, not allowing them to fail and allowing entrepreneurs to reorganize them into new firms and industries. They point to the repeated economic and financial measures as the cause (rather than the solution) of Japan's Lost Decade(s).

Conclusion

The "Lost Decade" refers to the prolonged period of slow to negative economic growth in Japan's economy during the 1990s and early 2000s. This decade-long stagnation was primarily attributed to the government's misguided policies following the bursting of the real estate bubble. The "Lost Decade" resulted in significant economic losses, both direct and indirect. Direct economic losses included the destruction of physical assets, such as homes, businesses, and infrastructure. Indirect economic losses manifested through declines in economic value added, revenue losses due to business interruptions, and negative impacts on the stock market and GDP. The sunk costs associated with the government's failed policies and the real estate bubble contributed to the prolonged economic stagnation. Sunk costs are expenditures that have already been incurred and cannot be recovered, yet they often influence future decision-making. The desire to avoid appearing wasteful and the psychological factors underlying the sunk cost effect, such as loss aversion and personal responsibility, may have led policymakers to persist with ineffective strategies. The opportunity cost of the "Lost Decade" was the potential economic growth and prosperity that Japan forfeited during this period. The real cost included lost time, resources, and the benefits that could have been realized had alternative, more effective policies been implemented.

In summary, the "Lost Decade" in Japan's economy was a prolonged period of economic stagnation characterized by significant direct and indirect economic losses, sunk costs associated with failed policies, and the opportunity cost of foregone economic growth and prosperity.

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