Lesson

JAPAN'S ECONOMY

Organizing Questions

- What is Japan's SEID model of economic development?
- What were some factors behind Japan's economic success?
- What were some factors that led to Japan's continuing recession?
- What current economic challenges face Japan?

Introduction

In this lesson students gain an understanding of the key concepts related to Japan's economy. What accounts for Japan's rapid economic growth after World War II? What were the factors behind Japan's economic slowdown, and what were its consequences? What economic challenges does Japan currently face? Are these challenges unique to Japan? Students will consider these questions and more. Prior to beginning the lesson, students read an informational handout about the financial crisis of the 1990s for homework. Students take a quiz on what they learned and share their current knowledge about the Japanese economy with the class. Students familiarize themselves with economic terms and concepts and then read an overview of Japan's economy. The class views a Video Lecture, "Japan's Modern Economy: A Pioneer at the Crossroads," on which students take structured notes. The class revisits the responses about their knowledge at the beginning of the lesson. Then, they complete an assessment activity in which they write about what they have learned.

Objectives

In this lesson, students will

- learn how Japan achieved rapid economic recovery after World War II;
- examine demographic changes and how they relate to Japan's economic outlook;
- analyze the pros and cons of Japan's SEID model for economic development;
- compare and contrast Japan's economic issues with those of other countries;
- theorize what Japan will need to accomplish to regain its economic vitality; and
- become familiar with economic terms and concepts pertaining to Japan.

Connections to Curriculum Standards

This lesson has been designed to meet certain national history, social studies, economics, and common core standards as defined by the National Center for History in the Schools, the National Council for the Social Studies, the Council for Economic Education, and the Common Core State Standards Initiative. The standards for the lesson are listed here.

National History Standards (from the National Center for History in the Schools)

World History

Era 9, Standard 1A: The student understands major political and economic changes that accompanied post-war recovery.

- Grades 7–12: Explain how the Western European countries and Japan achieved rapid economic recovery after World War II. [Employ quantitative data]

Era 9, Standard 2A: The student understands how population explosion and environmental change have altered conditions of life around the world.

- Grades 7–12: Analyze causes of the world's accelerating population growth rate and connections between population growth and economic and social development in many countries. [Analyze multiple causation]

National Social Studies Standards (from the National Council for the Social Studies)

- Culture; Thematic Strand I: Social studies programs should include experiences that provide for the study of culture and cultural diversity.
- Time, Continuity, and Change; Thematic Strand II: Social studies programs should include experiences that provide for the study of the past and its legacy.
- People, Places, and Environments; Thematic Strand III: Social studies programs should include experiences that provide for the study of people, places, and environments.
- Individuals, Groups, and Institutions; Thematic Strand V: Social studies programs should include experiences that provide for the study of interactions among individuals, groups, and institutions.
- Power, Authority, and Governance; Thematic Strand VI: Social studies programs should include experiences that provide for the study of how people create and change structures of power, authority, and governance.
- Production, Distribution, and Consumption; Thematic Strand VII: Social studies programs should include experiences that provide for the study of how people organize for the production, distribution, and consumption of goods and services.
- Global Connections; Thematic Strand IX: Social studies programs should include experiences that provide for the study of global connections and interdependence.
- Civic Ideals and Practices; Thematic Strand X: Social studies programs should include experiences that provide for the study of the ideals, principles, and practices of citizenship in a democratic republic.

Voluntary National Content Standards in Economics (from the Council for Economic Education)

- Content Standard 1: Scarcity. Students will understand that productive resources are limited. Therefore, people cannot have all the goods and services they want; as a result, they must choose some things and give up others.
- Content Standard 3: Allocation. Students will understand that different methods can be used to allocate goods and services. People acting individually or collectively must choose which methods to use to allocate different kinds of goods and services.
- Content Standard 5: Trade. Students will understand that voluntary exchange occurs only when all participating parties expect to gain. This is true for trade among individuals and organizations within a nation, and among individuals or organizations in different nations.
- Content Standard 6: Specialization. Students will understand that when individuals, regions and nations specialize in what they can produce at the lowest cost and then trade with others, both production and consumption increase.
- Content Standard 7: Markets and Prices. Students will understand that a market exists when buyers and sellers interact. This interaction determines market prices and thereby allocates scarce goods and services.
- Content Standard 8: Role of Prices. Students will understand that prices send signals and provide incentives to buyers and sellers. When supply or demand changes, market prices adjust, affecting incentives.
- Content Standard 9: Competition and Market Structure. Students will understand that competition among sellers usually lowers cost and prices, and encourages producers to produce what consumers are willing and able to buy. Competition among buyers increases prices and allocates goods and services to those people who are willing and able to pay the most for them.
- Content Standard 10: Institutions. Students will understand that institutions evolve and are created to help individuals and groups accomplish their goals. Banks, labor unions, markets, corporations, legal systems, and not-for-profit organizations are examples of important institutions. A different kind of institution, clearly defined and enforced property rights, is essential to a market economy.
- Content Standard 11: Money and Inflation. Students will understand that money makes it easier to trade, borrow, save, invest, and compare the value of goods and services. The amount of money in the economy affects the overall price level. Inflation is an increase in the overall price level that reduces the value of money.
- Content Standard 15: Economic Growth. Students will understand that investment in factories, machinery, new technology, and in the health, education, and training of people stimulates economic growth and can raise future standards of living.

- Content Standard 16: Role of Government and Market Failure. Students will understand that there is an economic role for government in a market economy whenever the benefits of a government policy outweigh its costs. Governments often provide for national defense, address environmental concerns, define and protect property rights, and attempt to make markets more competitive. Most government policies also have direct or indirect effects on people's incomes.
- Content Standard 18: Economic Fluctuations. Students will understand that fluctuations in a nation's overall levels of income, employment, and prices are determined by the interaction of spending and production decisions made by all households, firms, government agencies, and others in the economy. Recessions occur when overall levels of income and employment decline.
- Content Standard 20: Fiscal and Monetary Policy. Students will understand that federal government budgetary policy and the Federal Reserve System's monetary policy influence the overall levels of employment, output, and prices.

Reading Standards for Literacy in History/Social Studies (from the Common Core State Standards Initiative)

- Standard 1, Grades 9–10: Cite specific textual evidence to support analysis of primary and secondary sources, attending to such features as the date and origin of the information.
- Standard 2, Grades 11–12: Determine the central ideas or information of a primary or secondary source; provide an accurate summary that makes clear the relationships among the key details and ideas.
- Standard 3, Grades 9–10: Analyze in detail a series of events described in a text; determine whether earlier events caused later ones or simply preceded them.
- Standard 4, Grades 9–10: Determine the meaning of words and phrases as they are used in a text, including vocabulary describing political, social, or economic aspects of history/social science.
- Standard 7, Grades 11–12: Integrate and evaluate multiple sources of information presented in diverse formats and media (e.g., visually, quantitatively, as well as in words) in order to address a question or solve a problem.
- Standard 9, Grades 11–12: Integrate information from diverse sources, both primary and secondary, into a coherent understanding of an idea or event, noting discrepancies among sources.

Writing Standards for Literacy in History/Social Studies, Science, and Technical Subjects (from the Common Core State Standards Initiative)

- Standard 4, Grades 6–12: Produce clear and coherent writing in which the development, organization, and style are appropriate to task, purpose, and audience.
- Standard 9, Grades 6–12: Draw evidence from informational texts to support analysis, reflection, and research.

Materials

Handout 1, *Background of the 1990s Financial Crisis in Japan*, 30 copies

Handout 2, *Quiz: Background of the 1990s Financial Crisis in Japan*, 30 copies

Handout 3, *Economic Terms*, six copies

Handout 4, *Japan's Economic Growth and Rise of Tokyo*, 30 copies

Handout 5, *Video Lecture Questions*, 30 copies

Handout 6, *Assessment Activity*, 30 copies

Activity Cards, *Economic Terms*, 1–2 copies

Answer Key 1, *Quiz: Background of the 1990s Financial Crisis in Japan*

Answer Key 2, *Economic Terms*

Answer Key 3, *Japan's Economic Growth and Rise of Tokyo*

Answer Key 4, *Video Lecture Questions*

Video Lecture, "Japan's Modern Economy: A Pioneer at the Crossroads" (54 minutes), online at https://spice.fsi.stanford.edu/multimedia/japans-modern-economy

Equipment

Computer with Internet access and a Flash-enabled or HTML5-supported web browser

Computer projector and screen

Computer speakers

Butcher paper

Teacher Preparation

Instructions and materials are based on a class size of 30 students. Adjust accordingly for different class sizes.

1. Make the appropriate number of copies of handouts and activity cards.
2. View Video Lecture, "Japan's Modern Economy: A Pioneer at the Crossroads," and become familiar with the content of the handouts, activity cards, and answer keys.
3. Determine whether you will need to make additional copies of any of the activity cards. Cut out all the terms prior to Day One.
4. Prior to Day One of the lesson, distribute one copy of Handout 1, *Background of the 1990s Financial Crisis in Japan*, to each student to read for homework, and inform them that they will take a quiz on the information at the beginning of the next class meeting.

5. Prior to Day Two of the lesson, set up and test computer, projector, speakers, and streaming video lecture. Confirm that you are able to play the video lecture and project sound audibly to students.

Time

At least four 50-minute class periods

Procedures Before Day One

Distribute one copy of Handout 1, *Background of the 1990s Financial Crisis in Japan*, to each student to read for homework, and inform them that they will take a quiz on the information at the beginning of the next class period.

Day One

1. Distribute one copy of Handout 2, *Quiz: Background of the 1990s Financial Crisis in Japan*, to each student and instruct them to quietly respond to the prompts based on the information they read for homework.
2. Facilitate a class discussion, asking students to share what they know or think they know about the following:
   - Japan's economy after World War II until the early 1990s
   - Japan's economy from the 1990s until now (They should know quite a bit of information since they just read the handout on Japan's financial crisis.)
   - Challenges currently facing Japan's economy
3. Compile student answers on a sheet of butcher paper. Keep this sheet of responses for later; you will revisit it at the end of the lesson.
4. Inform students that there will be a number of terms pertaining to economics and to the Japanese economy in particular that they will need to familiarize themselves with to make the most of the lesson. Divide the class into six small groups and distribute one term from Activity Cards, *Economic Terms*, to each student.
5. Distribute one copy of Handout 3, *Economic Terms*, to each group. Review the directions with the class. Allow them time to complete as many answers as they can within their group. Then, instruct all groups to turn the handouts face down on their desks.
6. Inform students that they have 10–15 minutes to circulate through the room, taking turns reading their terms and definitions to each other. Students should take turns reading to each other and not talk at the same time. They should also share with as many other students as possible.
7. After 10–15 minutes, instruct groups to reconvene. Direct students to complete as much of Handout 3 as possible, using the economics terms they have just learned from each other.
8. Review the answers to Handout 3 using Answer Key 2, *Economic Terms*, as a guide.

9. Distribute one copy of Handout 4, *Japan's Economic Growth and Rise of Tokyo*, to each student. Instruct them to use the remainder of class to read the handout. For homework, they should finish reading the handout and respond to the prompts on a separate sheet of paper. Students should bring their written responses to the next class period.

Day Two

1. Instruct students to get out their copies of Handout 4, *Japan's Economic Growth and Rise of Tokyo*, and responses to the questions. Review the handout and the answers as a class, using Answer Key 3, *Japan's Economic Growth and Rise of Tokyo*, as a guide.
2. Explain to students that they will view a video lecture by Stanford professor emeritus, Daniel Okimoto, on Japan's economy. Distribute one copy Handout 5, *Video Lecture Questions*, to each student. Instruct students to respond to the questions while viewing the lecture.
3. Begin viewing Video Lecture, "Japan's Modern Economy: A Pioneer at the Crossroads," online at https://spice.fsi.stanford.edu/multimedia/japans-modern-economy. The lecture is 54 minutes in length so will require the remainder of class time as well as the beginning of the next class period.

Day Three

1. View the remainder of Video Lecture, "Japan's Modern Economy: A Pioneer at the Crossroads." Students should also complete Handout 5, *Video Lecture Questions*, while viewing the lecture.
2. Facilitate a class discussion about the lecture using Answer Key 4, *Video Lecture Questions*, as a guide. Students can make corrections or additions as needed.
3. Instruct students to review all the lesson materials as homework because they will complete an assessment activity during the next class period.

Day Four

1. Display the butcher paper used on Day One of the lesson. Distribute one copy of Handout 6, *Assessment Activity*, to each student and review the directions as a class. Allow students time to complete the activity. Collect handouts for assessment.
2. Facilitate a debriefing discussion of the lesson using the following questions.
   - How does the Japanese economy compare with the economic situation in your own country?
   - What were some surprising facts you learned about the Japanese economy?
   - What do you believe the Japanese government should do to resolve issues pertaining to its low fertility rate?
   - What do you believe the Japanese government should do to resolve issues pertaining to its economic issues?

Assessment

The following are suggestions for assessing student work in this lesson:

1. Handout 2, *Quiz: Background of the 1990s Financial Crisis in Japan*, using Answer Key 1, *Quiz: Background of the 1990s Financial Crisis in Japan*, as a guide.
2. Handout 3, *Economic Terms*, using Answer Key 2, *Economic Terms*, as a guide.
3. Handout 4, *Japan's Economic Growth and Rise of Tokyo*, using Answer Key 3, *Japan's Economic Growth and Rise of Tokyo*, as a guide.
4. Handout 5, *Video Lecture Questions*, using Answer Key 4, *Video Lecture Questions*, as a guide.
5. Handout 6, *Assessment Activity*, using the criteria outlined on the handout as a guide.
6. Student participation in group and class discussions, evaluating students' ability to
   - clearly state their opinions, questions, and/or answers;
   - provide thoughtful answers;
   - exhibit sensitivity toward different cultures and ideas;
   - respect and acknowledge other students' comments; and
   - ask relevant and insightful questions.

Background of the 1990s Financial Crisis in Japan

Japan and the United States—Economic Friction and Domestic Financial Excess

The United States faced a growing trade deficit with Japan in the 1970s, which made its relations with its Asian economic counterpart tense and uncertain. Japan had established a thriving powerhouse automobile industry that rivaled those of the United States and other industrialized countries in Europe. The activity of domestic investors outpaced Japan's efforts to develop a sound regulatory system to check bank lending and corporate borrowing practices. The U.S. auto industries in the meantime clamored for protection from their Japanese competitors. Thus, the U.S. urged Japan to slacken its exports. However, the trade imbalance between the United States and Japan grew steadily worse well into the mid-1980s.

Japanese exports exceeded its imports and the U.S. dollar kept rising against the yen. Consumers in the United States were spending more on imported goods (not only from Japan but from other countries to a lesser extent) than their foreign counterparts were spending on U.S. products. The appreciation of the dollar made U.S. products more expensive for other countries. The resulting trade imbalance created anxieties about declining profits among U.S. companies. U.S. protectionist trade tariffs threatened to close the doors to international trade. After a meeting was called by the G7 leaders (Plaza Accord in New York, in September 1985), two economic goals for international trade were announced: to push the dollar back down by intervening in the world foreign exchange markets, and to maintain it there by adjusting the macroeconomic policies of those seven countries. All hoped that making the dollar cheaper would lower the prices of U.S. goods, thus enabling consumers in other countries to purchase more U.S. products and thereby raise the level of U.S. exports.

tariff—a tax or duty to be paid on imports or exports

Group of Seven (G7)—the seven largest world economic powers: Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States

macroeconomics—the branch of economics that focuses on the behavior and welfare of a national or regional economy as a whole

bubble economy—a situation in which the prices of assets exceed their fundamental market values

By the end of 1985, the first goal was met, and the U.S. dollar fell by nearly 18 percent against the yen. Domestic investment in Japan continued to thrive, and from 1986 to 1990, Japan found itself in the midst of a domestic bubble economy. Its real estate and stock market prices skyrocketed to amazing levels.

The Japanese Bubble and the Aftermath

In a bubble economy, investors overanticipate future returns from companies that promise positive growth rates and from increasing real estate values. There is a general expectation that growth rates will continue to climb upward. One might even say that investors get into a frenzy of buying up shares of stock and real estate. Demand soars as other investors join in the buying craze, hoping to acquire assets that will rapidly increase in value over time. Investment capital is made readily available through relaxed monetary policy, featuring low interest rates. Property developers who are anticipating huge profits from this optimistic

stock—a financial instrument that is a claim on the earnings and assets of a corporation market artificially raise the values of real estate. Only in a bubble market would one find people willing to pay such exorbitant prices for property, because they know that they can sell it at an even higher price. This causes a trend in which investors' optimistic expectations of future growth rates often exceed the actual rates of return for these "wonder" companies and stocks. Investors contribute to the expanding bubble, and prices continue to climb upward until fears of overvaluation set in. Realizing that expectations have exceeded actual values in the stock and property markets, investors pull their money out, prices take a drastic plunge, and the bubble finally bursts.

overvalue—to assign too high a value to

As Japan attempted to maintain its new exchange rate at a higher level, the U.S. dollar became cheaper and the yen appreciated further. Japan's exports started to weaken in the late 1980s. Its higher exchange rate made its products more expensive relative to those produced in other countries. In the meantime, Japan's Ministry of Finance lowered its interest rates. The general theory is that these extremely low interest rates caused Japan's bubble economy in the period between 1986 and 1990. In fact, from 1987 to 1989, interest rates fell to 2.5 percent. Lower interest rates led to increased borrowing. What followed was a period of overexuberant investing.

speculative—involving a high risk of loss

default risk—the chance that the borrower will be unable to make interest payments or pay off the original amount borrowed

diversified—holding a balanced variety of assets from different industries in order to spread out or minimize the risk of possible losses

financial intermediary—a financial institution such as bank, building society, insurance company, investment bank, or pension fund. A financial intermediary offers a service to help an individual or firm to save or borrow money.

insolvent—unable to pay debts owed

recession—a period of reduced economic activity that is less severe than a depression, and which is characterized as a period of drastic decline in economic output and employment, usually accompanied by falling prices

Banks failed to assess the risks associated with highly speculative accounts and to restrict lending practices. Large corporations raised money on the stock market and then placed it in banks where it earned additional interest. Since money could be made so easily in the stock and real estate markets, banks soon found themselves with fewer customers who needed to borrow. So banks, too, joined in the investment frenzy and lent out vast sums of money to real estate developers without protecting themselves against default risk. Because investor confidence was so high, many also neglected to ensure that their investments were diversified enough to compensate for any downturns in the market. The bubble became even bigger in the late 1980s as the banks contributed to the high prices of land and stocks in Japan.

Japan's bubble economy expanded further until the Bank of Japan (Japan's central bank) and the Ministry of Finance decided that the market was indeed overvalued. The Bank of Japan began to raise interest rates in May 1989. Japan's efforts to deflate its bubble soon led to an interest rate hike to six percent in the same year, which put a sudden halt to the frenzy of investment. Hence, the bubble popped in 1990 and Japan's stock markets crashed. The stock prices were 63 percent below 1989 values. Many banks and other financial intermediaries could not pay their depositors, and several real estate companies became insolvent as well.

After the Japanese stock market collapsed, the country fell into a recession from which it has yet to fully recover. Hundreds of billions of dollars in debt were the result of frenzied cheap borrowing. Despite the central bank's efforts to stimulate the economy by decreasing rates, the recession deepened. The main question was how to end the recession and energize the economy when interest rates were already so low. People were saving

stimulus package—a set of policies intended to increase economic activity

instead of spending, and so the Japanese economy contracted. In 1993, the Japanese government began to implement major stimulus packages and ease its taxes in order to pull the economy out of its recession. Japan's once-envied period of financial exuberance had subsided on a dour note.

Adapted from Isadora Lee, Selena Lai, Gregory Francis, and Rachel Brunette, "Background of the Crisis," in *Contagion in the East: A Look at the 1997–98 Asian Financial Crisis* (Stanford, CA: Stanford Program on International and Cross-Cultural Education, 2000), 17–18.

Quiz: Background of the 1990s Financial Crisis in Japan

1. What were two reasons behind the economic friction between the United States and Japan during the 1970s and 1980s?

2. From 1986 to 1990, Japan found itself in the midst of a domestic __________________. Its real estate and stock market prices skyrocketed to amazing levels.

3. Number the following events in order of their occurrence.

   __ Interest rates were raised.

   __ The Bank of Japan and Japan's Ministry of Finance decided that its real estate and stock markets were indeed overvalued.

   __ Japan entered into a two-decade-long recession.

   __ Investments declined suddenly.

   __ Japan's stock market crashed.

Economic Terms

Throughout the course of this lesson, you will need to be familiar with a number of terms associated with the Japanese economy. Each student will receive one term from the teacher. Once your teacher has instructed you to do so, you will read your term and listen to as many of your classmates' terms as you can before time is called. Once you have finished, your group will reconvene and try to complete as much of this handout as possible.

1. During the economic slowdown of the past two decades, the Japanese government did not want an increase in bankruptcies and unemployment, which would have been difficult to deal with in the short run. As a result, banks continued to loan money to these types of companies, resulting in an inefficient allocation of labor and capital. ________________

2. During the economic slowdown of the past two decades, the Japanese government did not want an increase in bankruptcies and unemployment, which would have been difficult to deal with in the short run. As a result, banks continued to issue these kinds of loans to companies that would not have been able to survive on their own, resulting in an inefficient allocation of labor and capital. ________________

3. This term describes the average number of children that would be born per woman if all women lived to the end of their childbearing years. ________________

4. Currently there is a distortion of capital flow from Asia into the United States. This imbalance is a ________________ and may not be sustainable for a long period of time.

5. The return paid on borrowed capital is _________________________.

6. The total market value of the goods and services produced in a country in a given year is ____________________.

7. Beginning in the early 1990s, Japan began experiencing a two-decade-long _____________. These decades are known as Japan's "Lost Decades."

8. The situation in which the prices of assets exceed their fundamental market values describes what kind of economy? ________________

9. When revenues made from selling exports exceed the amount spent on imports, a country has a ___________________.

10. In 2011, 55 percent of Japan's total tax revenues was spent on _________________.

11. The ________________ is a term used to describe how Japan followed economic policies and practices that isolated it from the rest of the world.

12. Since 2011, Japan's national __________ has been more than twice its GDP, with an upward trajectory. In 2015, it was nearly 230 percent of its GDP.

13. Although Japan's economy has been having problems for more than two decades, Japan has substantial ____________, such as manufacturing know-how, infrastructure, and massive household and corporate savings equaling $12 trillion, that could help in its economic recovery.

14. The rate of one country's currency paid for another country's currency is its ______________________.

15. The __________________ is the difference between a household's disposable income (mainly wages received, or revenue of the self-employed and net property income) and its consumption (expenditures on goods and services).

16. To compute a country's _____________________, the value of its imports is subtracted from the value of its exports.

17. Japan's postwar economy was built on the notion of openness and _________________.

18. An _______________ is a good or service sold in one country that is produced in a foreign country.

19. An _______________ is any good or service sold from one country to another.

20. The ______________________ is the most commonly used measure of inequality in a country.

21. ________________________ is investment in stocks, property, or other ventures in the hope of gain but with the risk of loss.

22. _____________________ is a decrease in the overall price level.

Japan's Economic Growth and Rise of Tokyo

by Dr. Mariko Yoshihara Yang

Westernization—a process whereby societies come under or adopt Western culture

megalopolis—a chain of roughly adjacent metropolitan areas

trajectory—a path, progression

Meiji era—the period when Japan was ruled by the Emperor Meiji, marked by the modernization and Westernization of the country

industrialization—the development of manufacturing industry from a predominantly agrarian society

firebombing raids—massive air raids carried out by the U.S. military towards the end of World War II in which hundreds of firebombs were dropped on Tokyo and other Japanese cities

gross national product (GNP)—the total value of all goods and services produced within a country in a year, including net income from investments in other countries

per capita income—income per person; the mean income of the people in an economic unit such as a country or city

shantytown—a deprived area on the outskirts of a town consisting of large numbers of crude dwellings

Organisation for Economic Co-operation and Development (OECD)—an international organization of countries that accept the principles of representative democracy and a free market economy

The massive Westernization that started at the end of the 19th century brought a transformational change to Japan. The domestic industry went through a major evolution, shifting its concentration from agriculture (45.2 percent in 1885 to 18.8 percent in 1950 and to 1.3 percent in 2011) to service industry (22.2 percent in 1906 to 30.7 percent in 1940 and to 62.2 percent in 2011). During this period, Japan emerged as an economic giant, and its capital, Tokyo, became the world's largest megalopolis. Today, in an area that accounts for only 0.6 percent of the national land, Tokyo hosts approximately 10 percent of Japan's 128 million inhabitants and generates about 20 percent of the nation's economic activity. Tracing the footsteps of Tokyo's postwar trajectory unveils the transformation of the Japanese economy.

Road to Tokyo: Brief History

From an obscure fishing village in the 15th century, Tokyo grew to become one of the largest cities in the world by the end of the 1860s. The aggressive adoption of Western technology and urban planning during the Meiji era further transformed the city into a centerpiece of Japan's industrialization by the first decade of the 20th century. Japan expanded its economic and military capability through the 1930s and entered World War II (1939–45), which brought a devastating defeat to the rising Asian power. What was most remarkable was the rapid pace at which Tokyo achieved economic recovery and growth. The wartime firebombing raids destroyed the city's infrastructure and industrial bases, completely shattering the lives of its seven million dwellers. The landscape of the city was diminished into ashes and rubble. Few would have predicted that the city would rejuvenate itself out of the wreckage into a mecca of futuristic office towers in less than three decades. Following Japan's defeat in the war and its restoration under U.S. support, Japan's economy continued to grow. In 1961, the Japanese government launched a massive plan to double the country's GNP and per capita income simultaneously by the end of the decade. Tokyo accelerated its effort to revamp its social and industrial infrastructure. The shantytowns in central Tokyo were replaced by modern office buildings. By the time Japan became a member of the OECD and won the right to host the Tokyo Olympics in 1964, the nation regained its presence in the global economic arena as a confident and competitive participant. Japan's economic and industrial growth through the 1970s has often been described as "miraculous" as its rate and scope of development were unprecedented.

Explaining Postwar Economic Growth

Who should receive credit for Japan's economic miracle and Tokyo's rejuvenation? Competing arguments exist. The **neoclassical view** stresses that the government provided the stable market fundamentals such as investment in human capital but did nothing extraordinary to manipulate the market. The **revisionist view** argues that the government intervened with extensive industrial policy, which boosted Japan's industries and generated high growth. Yet, an alternative view portrays Japan as utilizing **strategic capitalism** where the government played an effective but limited role ensuring adequate investments in key sectors while providing a competitive climate. Regardless of the varying perspectives, several favorable pre-conditions did exist. The hostility between the Western capitalist and Eastern communist nations brought a significant shift in U.S. policy priority toward Japan. Japan's well-developed industrial conglomerates (*zaibatsu*) were allowed to reconsolidate and orchestrate investments in strategic areas. Sophisticated political and financial institutions from the Meiji era produced elite technocrats who were retrained to administer long-term planning. The prewar compulsory education and the resultant high literacy rates provided a skilled work force. Furthermore, the robust savings rate supplied a stable flow of capital for growth. Last but not the least, U.S. nuclear protection allowed Japan to focus on stabilizing the domestic economy.

Dual Political Economy

Both scholarly works and journalistic accounts have pointed to a persistent coexistence of the highly competitive export-oriented industrial sector and the grossly inefficient domestic sector in postwar Japan. This dichotomy is often characterized as "first-rate economy and third-rate politics." Underlying dynamics behind the dual economy was the political bargaining between the elite bureaucrats and the ruling Liberal Democratic Party (LDP). On one hand, the export-oriented sectors such as auto, electronics, and semiconductors were guided by elite government officials to nurture global competitiveness and shielded from general political influence. On the other hand, domestic sectors such as agriculture, construction, and small-scale retail remained heavily politicized as central to the LDP's core constituencies and, therefore, protected from foreign competition. Excess capital as a result of Japan's export surpluses and highly appreciated currency, combined with financial deregulation, led to aggressive speculative activities. From 1985 to 1989, Japan's Nikkei index tripled and accounted for more than one-third of the world's stock market capitalization. Real estate prices experienced a similar hike where the ground under Tokyo's Imperial Palace was arguably more expensive than the value of all real estate in California. Tokyo was a hustling and bustling metropolis of booms and trends as its residents experienced an asset price bubble and extravagance unparalleled in modern industrial nations.

neoclassical economics—an approach to economics that relates supply and demand to an individual's rationality and his or her ability to maximize utility or profit. Neoclassical economics increased the use of mathematical equations in the study of various aspects of the economy.

revisionist—advocacy of the revision of an accepted, usually long-standing view, theory, or doctrine, especially a revision of historical events and movements

capitalism—an economic and political system in which a country's trade and industry are controlled by private owners for profit, rather than by the state

conglomerate—the combination of two or more corporations engaged in entirely different businesses that fall under one corporate group, usually involving a parent company and many subsidiaries

technocrat—someone who advocates technology

savings rate—refers to the percentage of gross domestic product (GDP) savings by households in a country. It indicates the financial state and growth of a country, as household saving is the main source of government borrowing to fund public services.

dichotomy—a division or contrast between two things that are or are represented as being opposed or entirely different

Liberal Democratic Party (LDP)—a conservative political party and Japan's largest political party, which has held power almost continuously since its formation in 1955. The party has generally worked closely with business interests and followed a pro-U.S. foreign policy.

politicize—to cause (an activity or event) to become political in character

constituency—a group of people served by an organization

financial deregulation—the process of removing government rules controlling the way that banks and other financial organizations operate

Nikkei index—short for Japan's Nikkei 225 Stock Average, the leading and most-respected index of Japanese stocks; a price-weighted index comprised of Japan's top 225 blue-chip companies traded on the Tokyo Stock Exchange; similar to the Dow Jones Industrial Average Index in the United States

capitalization—the number of outstanding shares multiplied by share price

metropolis—a very large and densely populated industrial and commercial city

ethnic homogeneity—refers to a population comprised of people with a similar ethnic background

Burst of Bubble and Signs of Resilience

The soaring Nikkei stock average finished at an all-time high on the last day of trading in 1989, only to be followed by decades of slow growth and stagnation. While there is no consensus as to what caused the financial missteps, many started to scrutinize attributes such as ethnic homogeneity that were once believed to be the engine behind Japan's economic growth and social stability. Many observers believe, however, that Japan's economy today is more transparent and healthier than ever due to the recent structural reform. It is true that Japan is still saddled with the highest debt burden in the industrialized world and a shrinking workforce due to its aging population. However, the catastrophic earthquake, tsunami, and nuclear meltdown in 2011 brought an outpour of international support and revealed a unified home front, paradoxically boosting the national psyche and reassuring the nation of its resilience. With the 2020 Olympic Games on the horizon, concerted efforts are under way to demonstrate to the world once again Japan's innovative capacity and economic vigor.

Assignment

Respond to the following prompts on a separate sheet of paper.

1. List six factors that contributed to Tokyo's rapid economic recovery and growth after World War II.
2. The handout mentioned that ethnic homogeneity has been partly blamed for Japan's two-decade economic recession. Why could ethnic homogeneity be a disadvantage to a country's economic prospects?
3. Explain why Japan's shrinking work force and aging population are a major challenge to its economic future.

Video Lecture Questions

1. Name three factors that were instrumental in Japan's industrialization and economic success.
   •
   •
   •

2. After World War II, Japan developed a new paradigm of industrial development which Professor Okimoto refers to as the SEID model. What does SEID stand for?
   S:

   E:

   I and D:

3. Arrange the following developments in order (1–5) to explain the effects of Japan's export-oriented economy.
   __ Decreased value of dollar reserves
   __ Current account surplus
   __ Exporting more than it imported
   __ Increased amount of foreign currency reserves
   __ Yen appreciation

4. How was the household instrumental in financing Japan's industrial development?

5. Although the SEID model placed priority on producer groups (corporations) and the state, how did individual Japanese consumers also benefit?

6. In the early 1990s, Japan entered into two "Lost Decades" of stagnant economic growth. Describe three characteristics of these two decades.
   -
   -
   -

7. When discussing Japan's high level of debt, Professor Okimoto emphasizes that high debt levels are a generic problem in all industrial economies. Why is this so?

8. Why is Japan's debt not as worrisome for Japanese leaders as the United States' debt is to U.S. leaders?

9. What is "debt servicing," and what percentage of Japan's total tax revenues in 2011 was spent on it?

10. List and describe three factors behind Japan's economic slowdown.
    -
    -
    -

11. What is the Galapagos Effect?

12. Compare the differences between Japan's population in 2012 and its population in 1945–50.

    1945–50: ________________ 2012: ________________

    % of population 65+ years: _________ % of population 65+ years: ________

    Note: As of July 2015, Japan's population 65 years and over was estimated to be 26.6 percent.

13. How many children per couple are necessary for a country to maintain its population?

14. In the year 2100, if current fertility rates continue, Japan's population will be approximately __________ million, about __________ of its current population and the same as its population in 19______.

15. What must change for Japan to maintain or increase its current population?

16. What have been some positive and negative aspects of the SEID model?
    Positive:

    Negative:

17. List two of Japan's assets and describe them.
    -
    -

18. What does Professor Okimoto believe will be required for Japan to spring out of its economic stagnation?

Assessment Activity

Recall the discussion from the beginning of the lesson, and reflect on what you have learned since then, including:

- What you thought you knew and how that might differ from what you know now
- Any new information that surprised you and why
- Additional opinions about the subject

Write your reflections in the spaces below, according to topic. Make sure to write clearly and use complete sentences.

1. The Japanese economy after World War II until the early 1990s

2. The Japanese economy from the early 1990s until now

3. Challenges facing the Japanese economy

Economic Terms

Note to Teacher:

There are 22 terms listed below that students will need to learn. If there are more than 22 students, make additional copies of any of the terms until you have the desired number. Cut out the cards and distribute one to each student.

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zombie company—a failing company that continues to operate with government support but cannot stand on its own

During the economic slowdown of the past two decades, the Japanese government did not want an increase in bankruptcies and unemployment, which would have been difficult to deal with in the short run. As a result, banks continued to loan money to "zombie companies," resulting in an inefficient allocation of labor and capital.

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zombie loan—a government loan made to a failing company that can only continue to operate with assistance; it cannot stand on its own

During the economic slowdown of the past two decades, the Japanese government did not want an increase in bankruptcies and unemployment, which would have been difficult to deal with in the short run. As a result, banks continued to issue "zombie loans" to companies that would not have been able to survive on their own, resulting in an inefficient allocation of labor and capital.

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fertility rate—the average number of children that would be born per woman if all women lived to the end of their childbearing years. A rate of approximately 2.1 children per woman is considered the replacement rate for a population, resulting in relative stability in terms of total numbers.

Japan's fertility rate is currently 1.4 (2015 estimate).[1]

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global macro imbalance—the distortion of capital flow from one country to another. For instance, there is currently a distortion of capital flow from Asia into the United States. This imbalance may not be sustainable for a long period of time.

interest—the return paid on borrowed capital

Low interest rates can lead to an increase in purchasing since paying back the borrowed money would be cheaper than it would be when interest rates are high. In fact, from 1987 to 1989, Japan's interest rates fell to 2.5 percent. The lower interest rates led to increased borrowing. What followed was a period of overexuberant investing.

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gross domestic product (GDP)—the total market value of the goods and services produced in a country in a given year

Japan's estimated GDP as of 2015 is approximately $4.658 trillion (in U.S. dollars)[2]

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recession—a period of reduced economic activity that is less severe than a depression, and which is characterized as a period of drastic decline in economic output and employment, usually accompanied by falling prices

Beginning in the early 1990s, Japan began experiencing a two-decade-long recession. These decades are known as Japan's "Lost Decades."

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bubble economy—a situation in which the prices of assets exceed their fundamental market values

For instance, at the height of Japan's real estate bubble in the 1980s, the property on which the Imperial Palace is located was equal to the value of all the real estate in the entire state of California.

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current-account surplus—a situation in which the revenues made from selling exports exceed the amount spent on imports

Japan's focus on exports led to a current account surplus.

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debt servicing—the payment of interest on a debt

In 2011, 55 percent of Japan's total tax revenues was spent on debt servicing.

Galapagos Effect—a term used to describe how Japan followed economic policies and practices that isolated Japan from the rest of the world. The term is a reference to a similar phenomenon observed in the Galápagos Islands, and described by Darwin, where plants and animals evolved endemically and in genetic isolation from other locations.

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debt—money that is owed to a lender

Since 2011, Japan's national debt has been more than twice its GDP, with an upward trajectory. In 2015, it reached nearly 230 percent of its GDP, at $11 trillion (in U.S. dollars).[3]

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asset—capital that can be converted into currency to cover liability

Although Japan's economy has been having problems for more than two decades, Japan has substantial assets, such as manufacturing know-how, infrastructure, and massive liquid assets (household and corporate savings equaling $12 trillion), which could help in Japan's economic recovery.

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currency exchange rate—the rate of one country's currency paid for another country's currency. For instance, with an exchange rate of U.S. $1=100 yen, one would get 100 yen for each dollar exchanged.

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household savings rate—the difference between a household's disposable income (mainly wages received, or revenue of the self-employed and net property income) and its consumption (expenditures on goods and services)

During the 1970s and 1980s, the average Japanese household was saving 18–25 percent of its disposable income. As a result, banks had a large amount of money that they were able to lend to corporations. Those corporations then invested in new facilities and expanded businesses. As of 2009, the household savings rate was only 2.2 percent, and in 2015, it dipped below zero.[4]

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balance of trade—the difference between the value of a country's exports and the value of its imports. To compute a country's balance of trade, the value of its imports is subtracted from the value of its exports. A negative result indicates a trade deficit. A positive result indicates a trade surplus.

free trade—trade between countries, free from governmental restrictions or duties

Japan's postwar economy was built on the notion of openness and free trade.

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import—a good or service sold in one country that is produced in a foreign country

Japan's imports consist mainly of machinery and equipment, fuels, foodstuffs, chemicals, textiles, and raw materials.[5]

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export—any good or service sold from one country to another

Japan is a highly export-oriented economy. Its exports consist mainly of motor vehicles, iron and steel products, semiconductors, auto parts, power generating machinery, and plastic materials.[6]

Gini coefficient of inequality—the most commonly used measure of inequality. The coefficient varies between 0, which reflects complete equality, and 1, which indicates complete inequality (one person has all the income or consumption, and all others have none).

During the 1980s, 90–92 percent of survey respondents in Japan felt that they were "middle class," indicating a high degree of equality in Japan at the time.

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speculation—investment in stocks, property, or other ventures in the hope of gain but with the risk of loss

During the late 1980s, many Japanese investors speculated in stock and real estate.

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deflation—a decrease in the overall price level

Deflation is one of the aspects of Japan's "Lost Decades," i.e., the two decades of stagnant economic growth it has been experiencing since the early 1990s.

Quiz: Background of the 1990s Financial Crisis in Japan

1. What were two reasons behind the economic friction between the United States and Japan during the 1970s and 1980s?
   - *There was a trade imbalance between Japan and the United States. (Japan exported more goods to the United States than it imported.)*
   - *Japan's thriving auto industry led U.S. auto industries to push the U.S. government for protection from their Japanese competitors.*

2. From 1986 to 1990, Japan found itself in the midst of a domestic *bubble economy*. Its real estate and stock market prices skyrocketed to amazing levels.

3. Number the following events in order of their occurrence.

   2 Interest rates were raised.

   1 The Bank of Japan and Japan's Ministry of Finance decided that its real estate and stock markets were indeed overvalued.

   5 Japan entered into a two-decade-long recession.

   3 Investments declined suddenly.

   4 Japan's stock market crashed.

Economic Terms

1. During the economic slowdown of the past two decades, the Japanese government did not want an increase in bankruptcies and unemployment, which would have been difficult to deal with in the short run. As a result, banks continued to loan money to these types of companies resulting in an inefficient allocation of labor and capital. *zombie company*

2. During the economic slowdown of the past two decades, the Japanese government did not want an increase in bankruptcies and unemployment, which would have been difficult to deal with in the short run. As a result, banks continued to issue these kinds of loans to companies that would not have been able to survive on their own, resulting in an inefficient allocation of labor and capital. *zombie loan*

3. This term describes the average number of children that would be born per woman if all women lived to the end of their childbearing years. *fertility rate*

4. Currently there is a distortion of capital flow from Asia into the United States. This imbalance is a *global macro imbalance* and may not be sustainable for a long period of time.

5. The return paid on borrowed capital is *interest*.

6. The total market value of the goods and services produced in a country in a given year is *gross domestic product (GDP).*

7. Beginning in the early 1990s, Japan began experiencing a two-decade-long *recession*. These decades are known as Japan's "Lost Decades."

8. The situation in which the prices of assets exceed their fundamental market values describes what kind of economy? *bubble economy*

9. When revenues made from selling exports exceed the amount spent on imports, a country has a *current account surplus*.

10. In 2011, 55 percent of Japan's total tax revenues was spent on *debt servicing*.

11. The *Galapagos Effect* is a term used to describe how Japan followed economic policies and practices that isolated it from the rest of the world.

12. Since 2011, Japan's national *debt* has been more than twice its GDP, with an upward trajectory. In 2015, it was nearly 230 percent of its GDP.

13. Although Japan's economy has been having problems for more than two decades, Japan has substantial *assets*, such as manufacturing know-how, infrastructure, and massive household and corporate savings equaling $12 trillion, that could help in its economic recovery.

14. The rate of one country's currency paid for another country's currency is its *currency exchange rate*.

15. The *household savings rate* is the difference between a household's disposable income (mainly wages received, or revenue of the self-employed and net property income) and its consumption (expenditures on goods and services).

16. To compute a country's *balance of trade*, the value of its imports is subtracted from the value of its exports.

17. Japan's postwar economy was built on the notion of openness and *free trade*.

18. An *import* is a good or service sold in one country that is produced in a foreign country.

19. An *export* is any good or service sold from one country to another.

20. The *Gini coefficient of inequality* is the most commonly used measure of inequality in a country.

21. *Speculation* is investment in stocks, property, or other ventures in the hope of gain but with the risk of loss.

22. *Deflation* is a decrease in the overall price level.

Japan's Economic Growth and Rise of Tokyo

1. List six factors that contributed to Tokyo's rapid economic recovery and growth after World War II.

   Some possible answers include:

   - *U.S. policy toward Japan as an ally against Eastern communist nations*
   - *The strategic investments of the* zaibatsu
   - *Political and financial institutions from the Meiji era*
   - *High literacy rates and a skilled work force*
   - *A stable flow of capital from the high national savings rate*
   - *Nuclear protection from the United States that allowed Japan to focus on rebuilding and stabilizing the economy*

2. The handout mentioned that ethnic homogeneity has been one factor blamed for Japan's two-decade economic recession. Why could ethnic homogeneity be a disadvantage to Japan's economy?

   Student responses will vary, but students might mention that Japan's economy needs a strong work force in order to grow and that it can be strengthened by increasing immigration and sharing technology and expertise with skilled foreign workers and foreign corporations. They might also mention that an unskilled work force is important to the economy by providing manual and domestic labor, which many young Japanese people are not interested in doing, etc.

3. Explain why Japan's shrinking work force and aging population are a major challenge to its economic future.

   With a rapidly aging population, there is not a large enough work force of young people to help stabilize or grow the economy and support the costs of the elderly, such as pensions and medical care.

Video Lecture Questions

1. Name three factors that were instrumental in Japan's industrialization and economic success.

   Student answers may include the following:

   - *Strong national motivation: In the mid-19th century, Japan faced a national security crisis. The incentive to industrialize was great because the Japanese knew they needed to do so in order to forestall colonization by Western powers.*
   - *Latecomer status: Having to catch up with countries such as the United Kingdom, the United States, and Germany meant that Japan had a blueprint of experiences that it could follow.*
   - *The state: Only the state had the power, authority, and resources to mobilize large amounts of money when Japan began to industrialize. The state led development in a top-down fashion by developing and helping to implement strategy.*
   - *People: In Japan's industrialization, the people contributed their energy, power, and ability in a bottom-up fashion. By the mid-19th century, male literacy was substantial. After WWII, literacy was universal. The Japanese people—energetic, ambitious, industrious, and committed to work—were instrumental in Japan's industrialization.*
   - *Culture: In Japan, there was a culture of hard work and frugality (similar to the Protestant work ethic).*
   - *Japan's postwar economy was built on the notion of openness and free trade.*
   - *Japan was accepted into international systems in the 1960s.*
   - *Japan enjoyed political mobilizability—single-party rule by the Liberal Democratic Party (LDP) resulted in a strong bureaucratic administration.*

2. After World War II, Japan developed a new paradigm of industrial development which Professor Okimoto refers to as the SEID model. What does SEID stand for?

   S: State-led

   E: Export-oriented

   I and D: Investment-driven

3. Arrange the following developments in order (1–5) to explain the effects of Japan's export-oriented economy.

   _5_ Decreased value of dollar reserves

   _2_ Current account surplus

   _1_ Exporting more than it imported

   _3_ Increased amount of foreign currency reserves

   _4_ Yen appreciation

4. How was the household instrumental in financing Japan's industrial development?

   The average Japanese household was extremely frugal and saved an average of 18–25 percent of its disposable income in banks or postal savings accounts during the mid-1970s and 1980s. As a result, banks had a large amount of money that they were able to lend to corporations, which in turn invested in new facilities and to expand businesses. Large amounts of capital in postal savings accounts allowed the government to recycle money into supplemental budgets and invest in transportation, *energy, telecommunications, and infrastructure. In addition, the Japanese household provided taxes to the government which helped finance industrialization as well.*

5. Although the SEID model placed priority on producer groups (corporations) and the state, how did individual Japanese consumers also benefit?

   Individuals benefited by having an increased amount of disposable income and higher wages. The SEID model also resulted in a high degree of equality throughout Japan.

6. In the early 1990s, Japan entered into two "Lost Decades" of stagnant economic growth. Describe three characteristics of these two decades.

   Student answers may include the following:

   - *The economy only grew 1–2 percent per year (as opposed to 8–9 percent from 1961 to 1972).*
   - *Drop in asset values (real estate and stock market)*
   - *Deflation*
   - *U.S. and Chinese economies continued to grow, leading to an increasing gap between Japan and the United States, and China eventually overtaking Japan.*
   - *High level of national debt (almost 200 percent of GDP)*

7. When discussing Japan's high level of debt, Professor Okimoto emphasizes that high debt levels are a generic problem in all industrial economies. Why is this so?

   In almost all industrial economies, people expect and demand government services yet are unwilling to pay for the cost of these services.

8. Why is Japan's debt not as worrisome for Japanese leaders as the United States' debt is to U.S. leaders?

   Only 5–6 percent of Japan's debt is held by foreign entities, whereas over half of U.S. debt is held by foreign entities.

9. What is "debt servicing," and what percentage of Japan's total tax revenues in 2011 was spent on it?

   "Debt servicing" is the payment of interest on a debt. Fifty-five percent of Japan's total tax revenues was spent on debt servicing in 2011.

10. List and describe three factors behind Japan's economic slowdown.

    Student answers may include the following:

    - *Lack of political leadership/policy mistakes: The Ministry of Finance, Bank of Japan, and LDP allowed a massive speculative real estate "bubble" to grow and then burst. Once the bubble popped, the government did not deal with the results (banking crisis, nonperforming loans) effectively. The government did not implement the reforms necessary to kick-start the economy (or if it did, the reforms were often reversed).*
    - *SEID model allowed "zombie companies" and "zombie loans" to continue because the government did not want an increase in bankruptcies and unemployment, which would have been difficult*

to deal with in the short run. As a result, banks continued to roll over bad loans and companies continued to operate, resulting in an inefficient allocation of labor and capital.

- *The private sector became big, clumsy, and risk-averse. Many companies failed to adapt to Japan's economic stagnation.*

11. What is the Galapagos Effect?

    The Galapagos Effect is a term used to describe how Japan followed policies and practices that isolated Japan from the rest of the world.

12. Compare the differences between Japan's population in 2012 and its population in 1945–50.

    1945–50: *one of the youngest* 2012: *one of the oldest*

    % of population 65+ years: *5 percent* % of population 65+ years: *25 percent*

    Note: As of July 2015, Japan's population 65 years and over was estimated to be 26.6 percent.

13. How many children per couple are necessary for a country to maintain its population?

    2.2 children/couple

14. In the year 2100, if current fertility rates continue, Japan's population will be approximately *64* million, about *half* of its current population and the same as its population in 19*30.*

15. What must change for Japan to maintain or increase its current population?

    The fertility rate must increase or Japan must change its immigration policy.

16. What have been some positive and negative aspects of the SEID model?

    - *Positive: The SEID model contributed to the rise of industrial Asia, which in turn had a positive impact on world economic growth rates. It allowed for a global division of labor (greater labor efficiency and productivity as well as lower costs of production resulting in lower prices). It represented the triumph of capitalism over communism.*
    - *Negative: The SEID model has resulted in a global macro imbalance, i.e., the distortion of capital flow from Asia into the United States (Asian exports flooding markets with not enough demand in Asian markets). This imbalance may not be sustainable for a long period of time.*

17. List two of Japan's assets and describe them.

    - *Manufacturing know-how, infrastructure, massive liquid assets (household and corporate savings equaling $12 trillion)*
    - *Potential high-growth sectors such as tourism, health care, and global infrastructure such as transportation, energy, and telecommunications*

18. What does Professor Okimoto believe will be required for Japan to spring out of its economic stagnation?

    Bold leadership

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