

## Chapter 3

### Economy

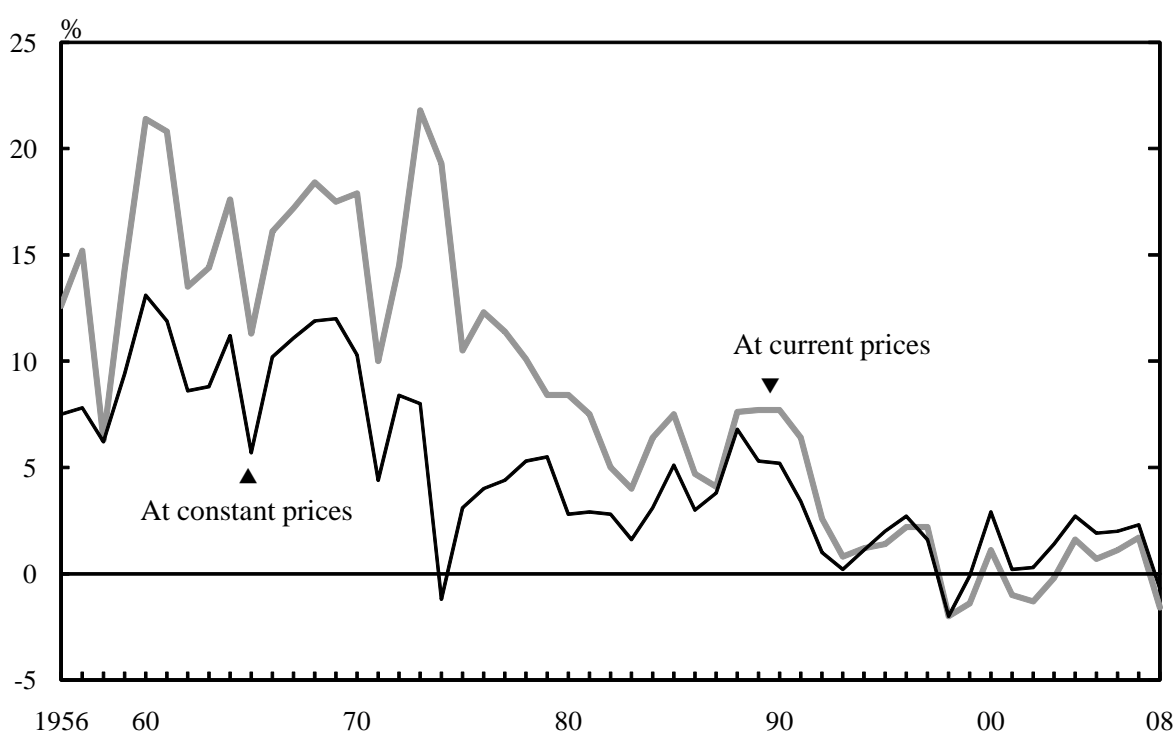


A view of the port of Nagasaki seen from Glover Garden, once a foreign settlement where *Meiji*-era residences still stand, including the former Glover house, the oldest wooden Western-style building in Japan. Marking its 150th anniversary since its opening, along with Hakodate and Yokohama, under the Japan-U.S. Treaty of Amity and Commerce, the port used to flourish as Japan's sole international port during the *Edo*-era isolation period. Now it serves as a gateway to Nagasaki, a popular tourist destination.

## 1. Economic Development

After World War II, Japan underwent a period of restoration followed by high economic growth, eventually becoming the economy with the second largest GDP in the world in 1967. Through two oil crises and a prolonged recession that began in the 1990s, Japan has since retained this position as the world's second largest economy. The following is a brief history of Japan's economic development.

**Figure 3.1**  
Economic Growth Rates <sup>1)</sup>



1) Data from 1955 to 1979 are based on the 1968 SNA. Data from 1980 onward are based on the 1993 SNA. Data was calculated using the fixed-based method from 1955 to 1993, and the chain-linked method from 1994 to the present date.

Source: Cabinet Office.

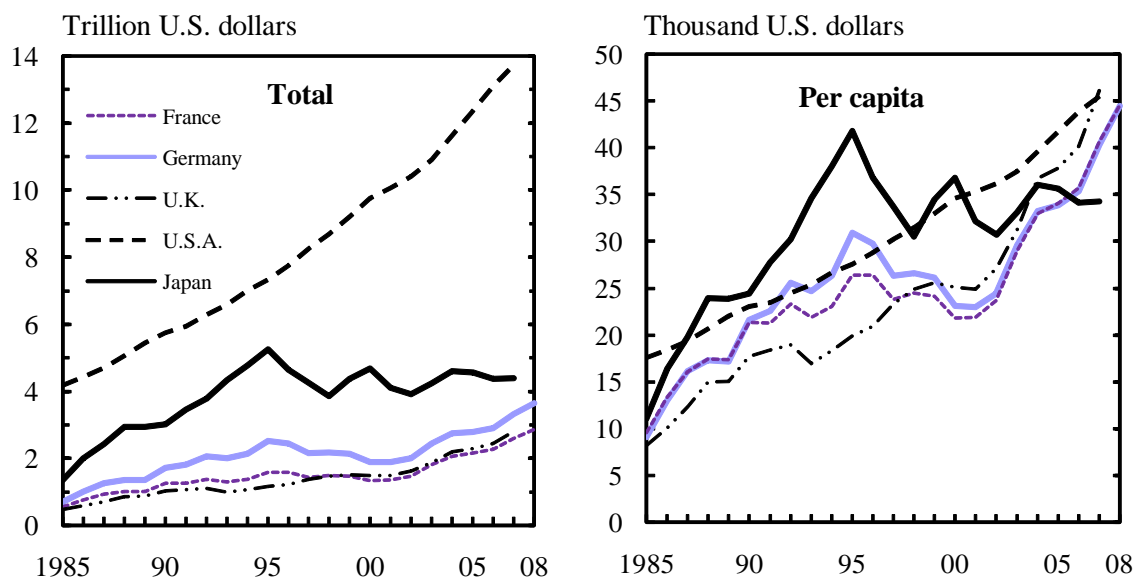
During the 1960s, Japan's economy grew at a rapid pace of over 10 percent per annum. This rapid economic growth was supported by: (i) expansion of private investments in plant and equipment, backed by a high rate of personal savings; (ii) a large shift in the working population from primary to secondary industries, and abundant supply of high-quality labor; and (iii) an increase in productivity brought about by adopting and improving foreign technologies.

From the late 1960s until the first half of the 1970s, new social problems emerged that reflected warps left by high economic growth. As a result, steps to tackle environmental pollution, urban issues and social security problems became the central targets of administrators, and countermeasures were taken accordingly.

In the 1970s, the sharp increase of Japan's exports of industrial products to the U.S.A. and Europe began to cause international friction. In 1971, the U.S.A. announced it would end the convertibility of the dollar into gold. In December 1971, Japan revalued the yen from 360 yen against the U.S. dollar, which had been maintained for 22 years, to 308 yen. In February 1973, Japan adopted a floating exchange-rate system.

In October 1973, the fourth Middle East War led to the first oil crisis, triggering high inflation. Accordingly, Japan recorded negative economic growth in 1974 for the first time in the post-war period. Following the second oil crisis in 1978, efforts were made to change Japan's industrial structure from "energy-dependent" to "energy-saving," enabling Japan to successfully overcome inflation.

**Figure 3.2**  
**Gross Domestic Product** (Current prices, converted into U.S. dollars)

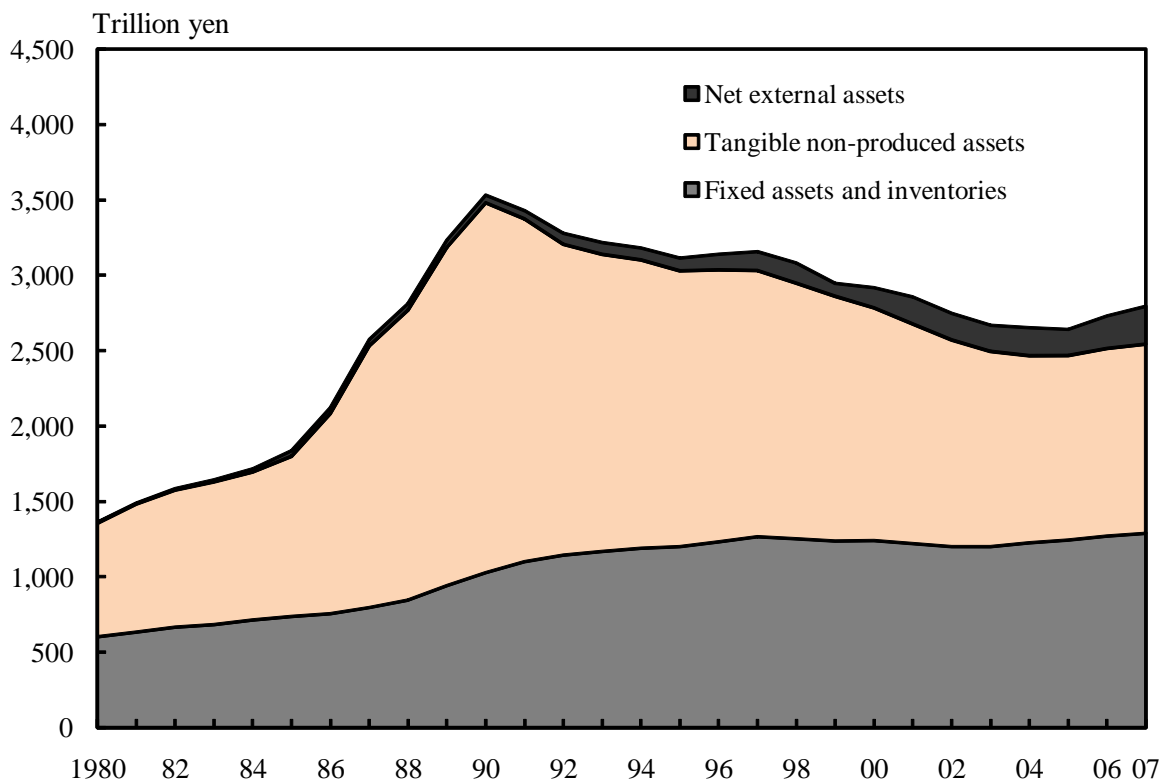


Source: OECD.

In the 1980s, the trade imbalance with advanced industrial countries expanded because of the yen's appreciation. As part of administrative and financial reforms, Japan National Railways and Nippon Telegraph and Telephone Public Corporation were privatized. As a result, domestic demand-led economic growth was achieved.

At the end of the 1980s, Japan's economy enjoyed favorable conditions, with stable wholesale prices and a low unemployment rate. Corporate profits were at their highest level in history, and corporate failures were at their lowest level in several years, while investments in plant and equipment for manufacturing products, such as semiconductors, were very active. Stock and land prices continued to rise rapidly, and large-scale urban developments and resort facility developments in rural areas progressed at a very fast pace. However, excessive funds flowed into the stock and real estate markets, causing abnormal increases in capital asset values (forming an economic bubble).

**Figure 3.3**  
**National Wealth**



Source: Cabinet Office.

The change of Japan's net worth (national wealth) has reflected the status of its economy well. At the end of 1980, Japan's national wealth stood at 1,360 trillion yen, 5.6 times GDP. It then increased, reaching 3,533 trillion yen, 8.0 times GDP, at the end of 1990, due to increasing land and stock prices. With the collapse of the bubble economy, Japan's national wealth has since shifted into decline, dropping to 2,794 trillion yen at the end of 2007.

At the beginning of 1990, stock prices plummeted, followed by sharp declines in land prices. This marked the start of major economic recession (collapse of the bubble economy). Japan's financial and economic systems, which were excessively dependent on land, consequently approached collapse.

Massive bad debts were created in financial institutions' loan portfolios, as corporate borrowers suffered serious losses due to declining land prices. As a result, shareholders' equity in financial institutions shrank. In 1997, large banks began to fail. In 1998 and 1999, the government injected public money into the banking sector to stabilize the financial system.

Due to reluctance on the part of financial institutions to grant loans under efforts to improve their capital-to-asset ratio, the number of corporate bankruptcies in fiscal 2001 rose to the second highest level posted in the post-war period, following the record high registered in fiscal 1984. Furthermore, troubled by cash flow problems and lack of demand, companies were forced to cut employment and investments in plant and equipment.

The Japanese economy began to make a moderate recovery in April 1999. This, however, was only a temporary phenomenon, as investments in plant and equipment were weak and the economy was too dependent on foreign demand and information and communication technologies. With the global decline in IT demand from mid-2000, Japan's exports to Asia dropped, necessitating adjustments of excess inventory and production facilities. In line with this, the Japanese economy again entered into an economic downturn in 2001.

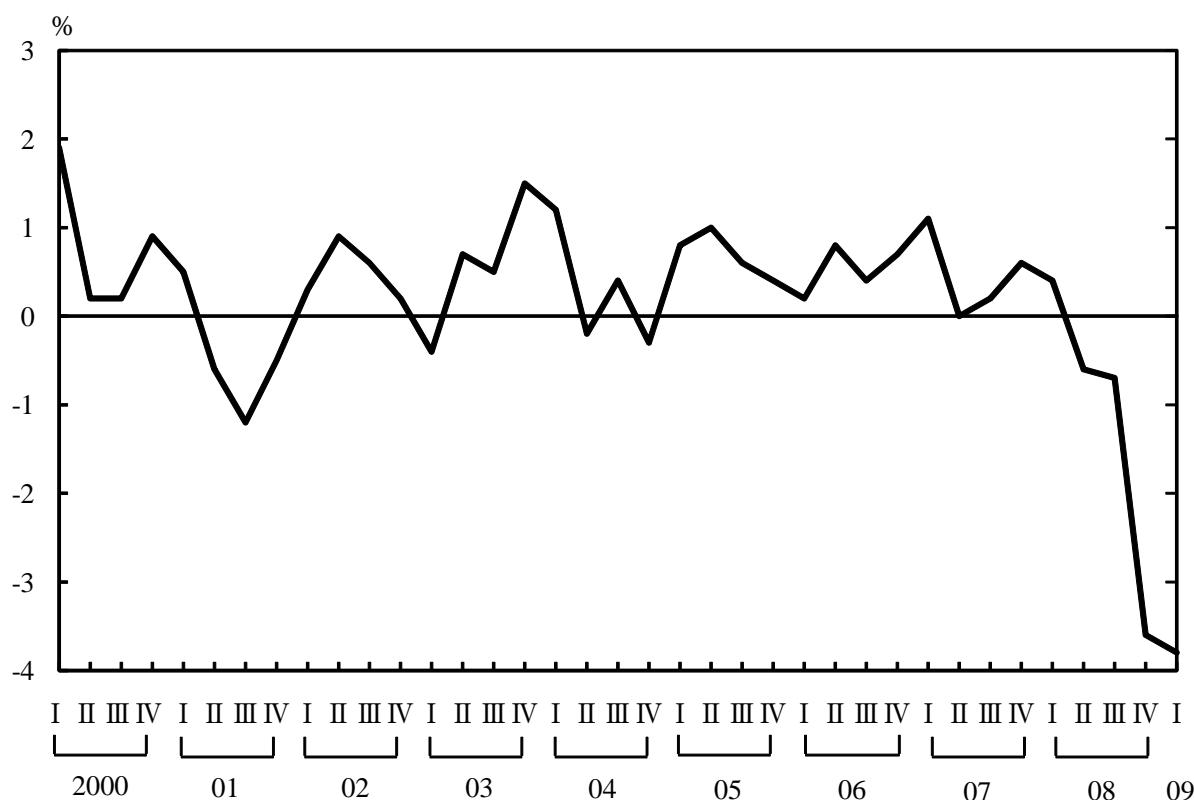
Following the simultaneous terrorist attacks in the U.S.A. in September 2001, further slowdown of the world economy became a matter of serious concern, resulting in greater uncertainty over the outlook for the Japanese economy. There were several reasons for the long-running stagnation of

the Japanese economy. One major reason was that the huge bad debts of Japanese banks had yet to be cleaned up. Lengthy economic recessions aggravated bad debt conditions, which hindered Japan's economic growth. Another reason was that the economic structure of Japan made it impossible to deal flexibly with changes in the economic environment.

## 2. Recent Economic Trends

The Japanese economy maintained a long-lasting recovery since the beginning of 2002. However, the path has not been flat, given the two "soft patches (temporary softening in the market)" in the past and impairment in some parts of the economy.

**Figure 3.4**  
Economic Growth Rates (Quarterly changes) <sup>1)</sup>



1) Data based on the 1993 SNA, calculated using the chain-linking method. Growth rates calculated using seasonally adjusted figures, based on constant prices in 2000.

Source: Cabinet Office.

The first soft patch was caused by slower export growth following economic slowdowns in the U.S.A. and the Asian region, both Japan's major export destinations, since late 2002. The second soft patch resulted from slower export growth owing to a surplus inventory of information-related producer goods in Japan as demand for IT-related goods declined worldwide since late 2004. During the phase of Japan's economic recovery from the beginning of 2002, there was a common trend where exports were showing signs of steady growth, reflecting a brisk recovery of the world economy, but then a soft patch set in and pushed exports down, resulting in sluggish growth in both production and personal spending. As exports picked up, the economy broke away from this slower period.

**Table 3.1****Gross Domestic Product** (Expenditure approach) <sup>1)</sup>

	(Billion yen)			
Item	2005	2006	2007	2008
Gross domestic product (GDP) .....	536,762.2	547,709.3	560,517.5	556,501.6
Domestic demand .....	520,972.2	527,314.3	533,748.4	528,971.5
Private demand .....	402,636.0	410,085.0	416,384.8	412,294.2
Private final consumption expenditure .....	300,390.3	304,965.6	307,023.7	308,738.0
Private Residential Investment .....	18,354.6	18,454.1	16,672.2	15,397.0
Private plant and equipment .....	83,087.2	85,013.3	89,838.3	86,249.9
Changes in inventories of private sector .....	1,191.8	2,091.5	3,530.6	2,660.9
Public demand .....	118,403.0	117,337.3	117,493.9	116,799.3
Government final consumption expenditure ..	94,843.4	95,203.4	97,051.6	97,845.2
Gross capital formation by public sector .....	23,203.6	21,880.5	20,273.5	18,878.9
Changes in inventories of public sector .....	311.5	252.0	252.2	250.2
Net exports of goods and services .....	15,721.1	20,392.4	26,281.5	27,263.1
Exports of goods and services .....	73,584.3	80,699.5	87,490.9	89,047.6
(less) Imports of goods and services .....	57,863.2	60,307.1	61,209.4	61,784.6
(Reference)				
Trading gains/losses .....	-9,024.8	-14,706.6	-18,858.0	-26,704.2
Gross domestic income .....	527,737.4	533,002.8	541,659.5	529,797.4
Net income from the rest of the world .....	12,501.9	15,221.5	18,189.0	17,545.6
Incomes from the rest of the world .....	18,562.1	22,923.8	27,766.5	25,911.0
(less) Incomes to the rest of the world .....	6,060.2	7,702.3	9,577.5	8,365.5
Gross national income (GNI) .....	540,239.3	548,224.3	559,848.5	547,343.0

1) Constant prices in 2000; by chain-linking method.

Source: Cabinet Office.

However, with the start of 2008, private consumption and investments in plant and equipment fell flat and so did production, bringing the economic recovery to a standstill. This occurred against the backdrop of soaring crude oil and raw material prices and repercussions from the subprime mortgage loan problems that, since mid-2007, rapidly clouded future prospects for the world economy further. Moreover, after the failure of a major American investment bank in September 2008, the situation worsened and even developed into a global financial crisis. Stock prices plummeted in Japan as well, which, combined with the sharp appreciation of the yen, further undermined business and household confidence.

The Consumer prices showed a downward trend again, with the overall index (with 2005 as the base year = 100) shifting below the previous year's level since February 2009. Employment conditions are also increasingly harsh, as seen in an example of the unemployment rate (a seasonally adjusted figure) which rose to the 5 percent range, up over 1 percentage point in four months from January to May 2009. The economy is still in trouble overall, though it appears to have overcome some weaknesses.

### **3. Industrial Structure**

Japan's industrial structure has undergone a major transformation in the half-century since the end of World War II. Looking at changes in the industrial structure in terms of industry share of employed persons and GDP over time, we see those in the primary industry in particular have fallen dramatically since 1970, when Japan experienced a long-standing rapid economic growth. During the 1980s, the secondary industry's share of employed persons and GDP also began to decline gradually. On the other hand, the tertiary industry's shares of both employed persons and GDP have risen consistently.

In 1970, the primary industry accounted for 19.3 percent of employed persons, the secondary industry for 34.0 percent, and the tertiary industry for 46.6 percent. In 2005, the corresponding shares of these three sectors were 4.8 percent, 26.1 percent and 67.2 percent, respectively.

As for GDP by type of economic activity, in 1970, the primary, secondary and tertiary industries accounted for 5.9 percent, 43.1 percent and 50.9 percent, respectively. In 2005, these figures for the primary, secondary and

tertiary industries were 1.4 percent, 26.4 percent, and 72.2 percent, respectively.

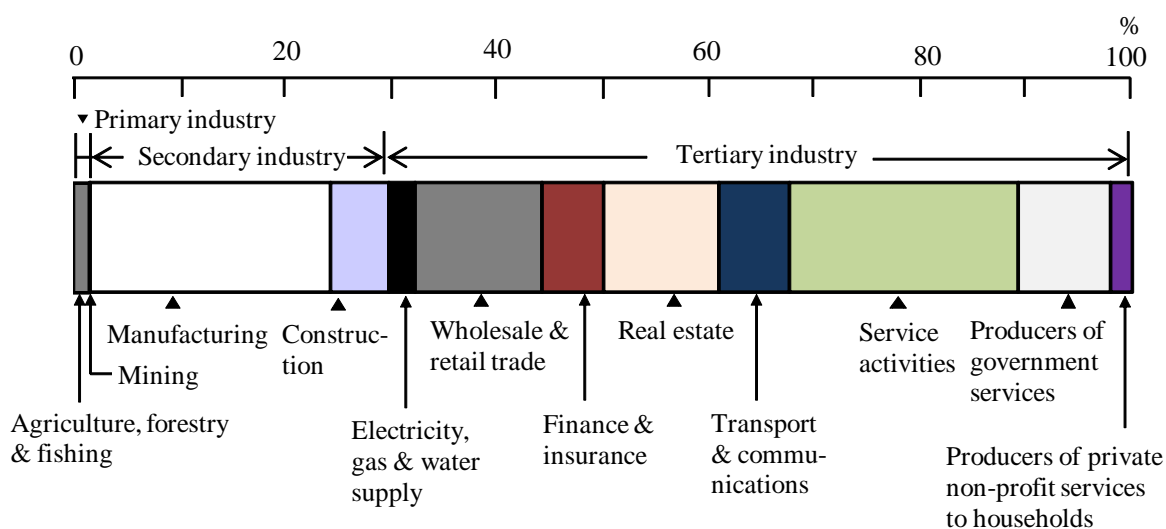
**Table 3.2**  
**Changes in Industrial Structure**

Year	Employed persons <sup>1)</sup>			Gross domestic product (GDP) <sup>2)</sup>		
	Primary industry	Secondary industry	Tertiary industry	Primary industry	Secondary industry	Tertiary industry
1950	48.5	21.8	29.6	-	-	-
1955	41.1	23.4	35.5	19.2	33.7	47.0
1960	32.7	29.1	38.2	12.8	40.8	46.4
1965	24.7	31.5	43.7	9.5	40.1	50.3
1970	19.3	34.0	46.6	5.9	43.1	50.9
1975	13.8	34.1	51.8	5.3	38.8	55.9
1980	10.9	33.6	55.4	# 3.5	# 36.5	# 60.0
1985	9.3	33.1	57.3	3.1	35.1	61.8
1990	7.1	33.3	59.0	2.4	35.7	61.8
1995	6.0	31.6	61.8	1.8	30.3	67.9
2000	# 5.1	# 29.2	# 64.5	1.7	28.5	69.8
2005	4.8	26.1	67.2	1.4	26.4	72.2

1) Due to the revision of the Japan Standard Industrial Classification, the figures from 2000 onward are not strictly consistent with those for 1995 or earlier. 2) Data from 1955 to 1979 are based on the 1968 SNA. Data from 1980 onward are based on the 1993 SNA.

Source: Statistics Bureau, MIC; Cabinet Office.

**Figure 3.5**  
**Gross Domestic Product by Type of Economic Activity (2007)**  
(Constant prices in 2000)

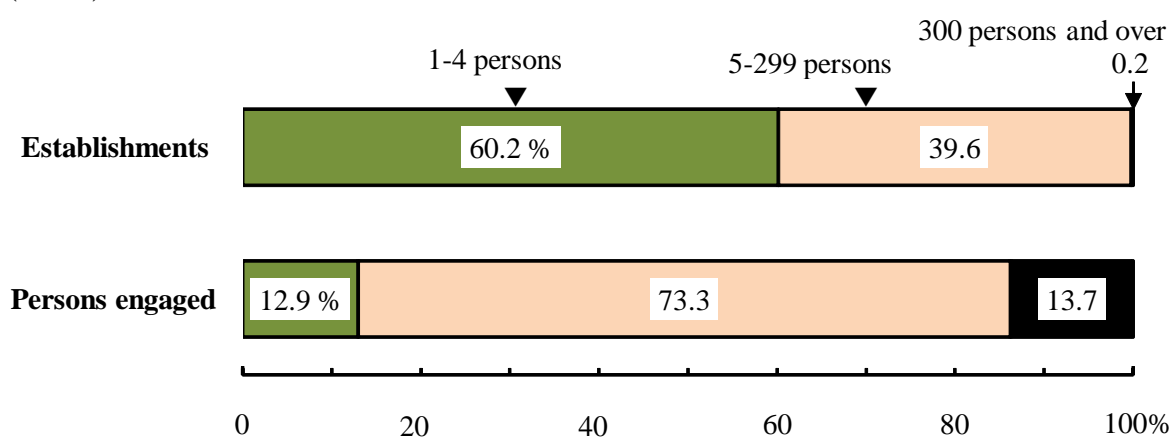


Source: Cabinet Office.

Next, let us examine changes in industrial structure using the "Establishment and Enterprise Census." This census covers every business establishment located in Japan, including those of the national and local governments (excluding unincorporated establishments in agriculture, forestry and fisheries). In 2006, there were 5.91 million establishments in Japan, at which a total of 58.63 million persons were employed. The average number of persons engaged per establishment was 9.9 persons. Large-scale establishments employing 300 or more persons accounted for 0.2 percent of the total.

A comparison of the numbers of establishments and persons engaged in the tertiary industry between 2001 and 2006 showed a great increase in "medical, health care and welfare," and a substantial decrease in "finance and insurance" and "wholesale and retail trade."

**Figure 3.6**  
**Shares of Establishments and Persons Engaged by Scale of Operation**  
 (2006)



Source: Statistics Bureau, MIC.

**Table 3.3**  
**Number of Establishments and Persons Engaged**

	Number of establishments (1,000)		Persons engaged (1,000)	
	2001	2006	2001	2006
Total .....	6,350	5,911	60,158	58,634
<b>By industry</b>				
Primary industry				
Agriculture, forestry and fisheries .....	22	22	251	248
Secondary industry				
Mining .....	4	3	47	34
Construction .....	607	549	4,944	4,144
Manufacturing .....	643	548	10,956	9,922
Tertiary industry				
Electricity, gas, heat supply and water .....	10	9	324	283
Information and communications .....	60	59	1,466	1,593
Transport .....	139	131	2,975	2,914
Wholesale and retail trade .....	1,807	1,605	13,316	12,401
Finance and insurance .....	97	84	1,638	1,429
Real estate .....	329	320	1,003	1,015
Eating and drinking places, accommodations ...	870	788	5,117	4,875
Medical, health care and welfare .....	298	351	4,529	5,588
Education, learning support .....	232	232	2,813	2,940
Compound services .....	54	49	753	707
Services, n.e.c. ....	1,133	1,119	8,149	8,690
Government, n.e.c. ....	46	42	1,877	1,852
<b>By type of legal organizations</b>				
Privately owned .....	6,138	5,723	54,912	54,184
Sole proprietorships .....	3,132	2,735	9,006	7,559
Corporations .....	2,972	2,955	45,761	46,495
Companies .....	2,665	2,605	40,620	39,963
Unincorporated organizations .....	35	32	145	130
National and local governments .....	212	188	5,245	4,450
<b>By number of persons engaged</b>				
1 - 4 persons .....	3,867	3,538	8,422	7,588
5 - 9 persons .....	1,214	1,124	7,896	7,327
10 - 29 persons .....	911	883	14,642	14,256
30 - 99 persons .....	274	273	13,434	13,421
100 - 299 persons .....	50	50	7,974	7,994
300 and over .....	12	12	7,789	8,050
Dispatched or subcontracted employees only .....	21	30	...	...

Source: Statistics Bureau, MIC.

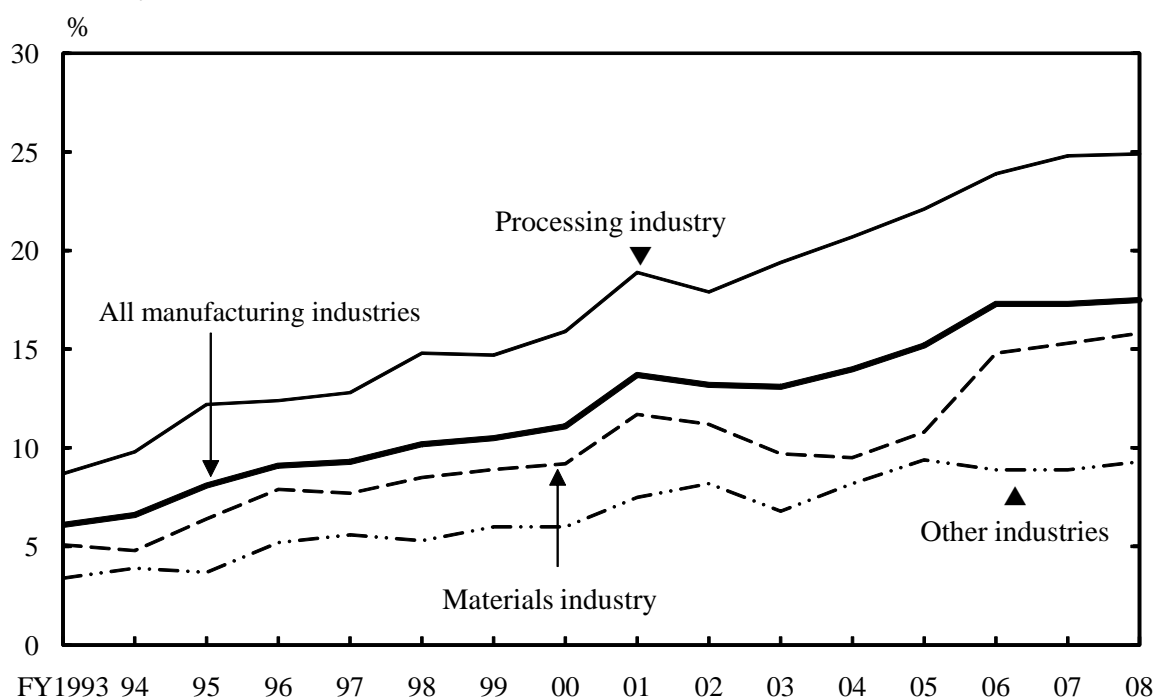
One of the main reasons for the accelerated shift to a service-oriented economy was the advancement of information technology, alongside which supporting industries that deliver software and information have grown. Another reason was changes in consumer demand. From the late 1970s in particular, incomes have risen, leisure time has increased, and more couples have double incomes. Affected by these changes, consumer lifestyles have largely changed, and demand for services has risen.

On the other hand, Japan's domestic manufacturing industry has continued to shrink amidst ongoing economic globalization. Imports of textiles and consumer durable goods have increased at a rapid pace in recent years, and the share of imports from China, among other sources, has risen. Furthermore, Japanese companies have begun manufacturing products in China and other Asian countries, and increased imports of these products into Japan have elicited the effect of pushing down the prices of finished products.

The ratio of companies in the manufacturing sector which have overseas production sites has been on an uptrend since the 1990s. It was 67.3 percent in fiscal 2007 but is expected to somewhat decline in and after fiscal 2008. In terms of output, overseas production accounted for 17.3 percent in fiscal 2007 and is expected to somewhat rise in the future. A category-by-category comparison showed that the ratio was high in the manufacture of textiles, electrical machinery, transportation equipment, etc. Of total overseas production output in the manufacturing sector, exports bound for Japan constituted around 25 percent.

As for the reasons that Japanese companies in the manufacturing sector set up production bases overseas, the one most frequently stated in the materials industry (textiles, pulp and paper, chemicals, iron and steel, etc.) was to cater to local product demand. Meanwhile, those in the processing industry (machinery, electrical equipment, transport equipment, etc.) often refer to the advantage of being able to secure good and cheap labor. In particular, increasing importance is attached to China as an export market, production base location and market competitor. Other areas increasingly drawing the attention of Japanese manufacturing companies as potential operation locations are Thailand (as the established hub in Southeast Asia), as well as India, Vietnam and Russia.

**Figure 3.7**  
**Ratio of Overseas Production in the Manufacturing Sector** <sup>1)</sup>  
 (Monetary basis)



1) Figures for FY2008 are estimates.  
 Source: Cabinet Office.