

## Chapter 3

### Economy

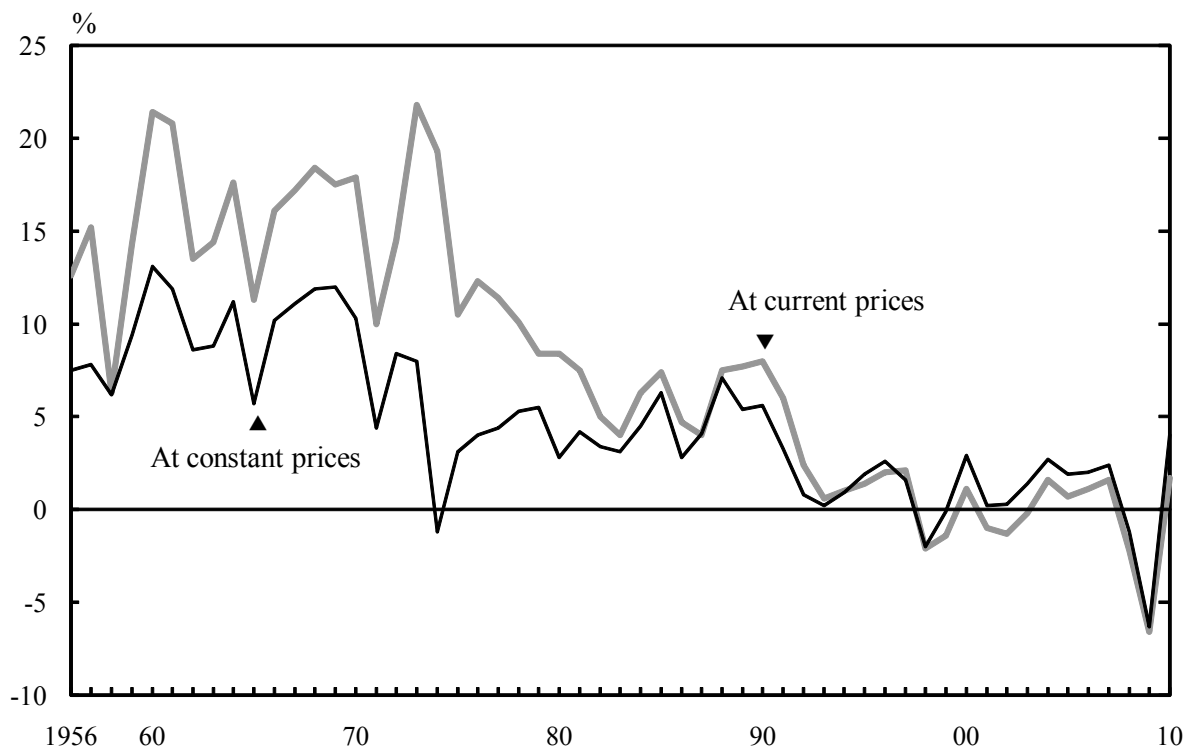


A bird's-eye view of Narihira, Sumida-ku, Tokyo. This area will be an integral part of Tokyo, a global city, as a safe, comfortable and environmentally-friendly tourist site where the long-established, traditional downtown Tokyo culture is blended with cutting-edge functions provided by "Tokyo Sky Tree®," which, in March 2011, attained 634 meters in height to become the world's tallest freestanding communications tower.

## 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. 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 1979, and the chain-linked method from 1980 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.

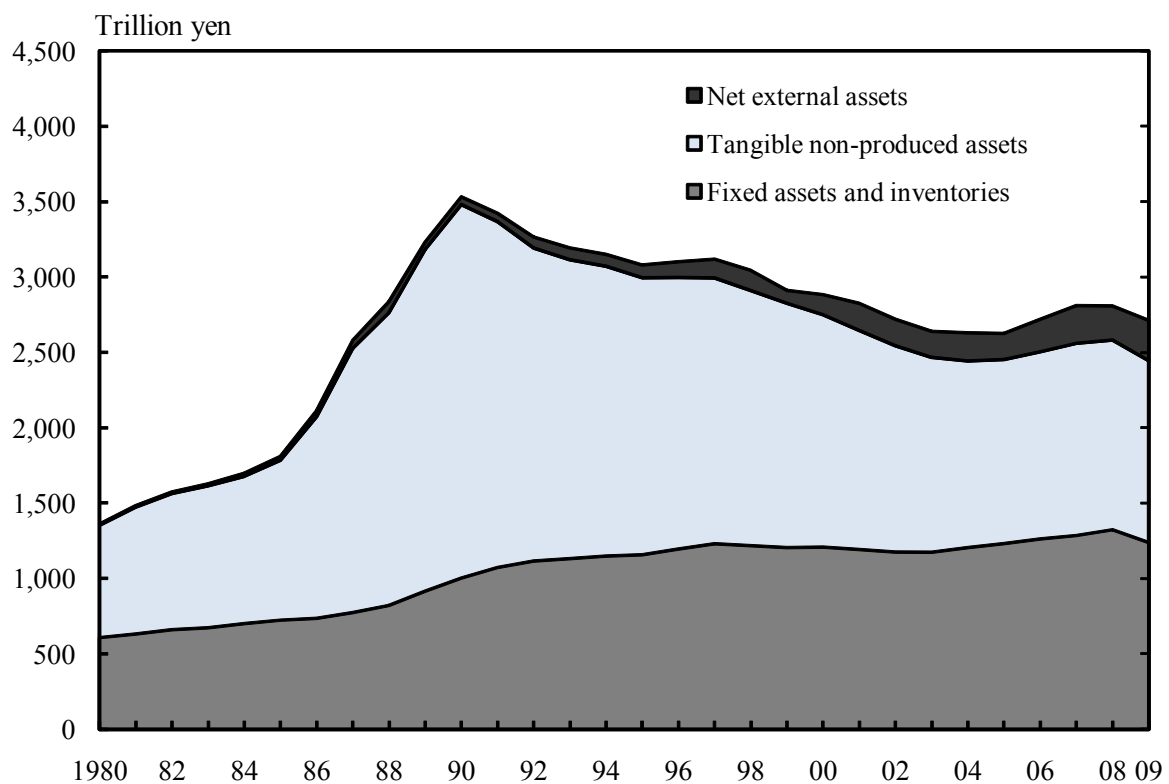
In October 1973, the fourth Middle East War led to the first oil crisis, triggering high inflation. Accordingly, Japan recorded negative economic growth in 1974 for the first time in the post-war period. Following the second oil crisis in 1978, efforts were made to change Japan's industrial structure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

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.

## 2. Bubble Economy and Its Collapse

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, 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 3.2**  
**National Wealth**



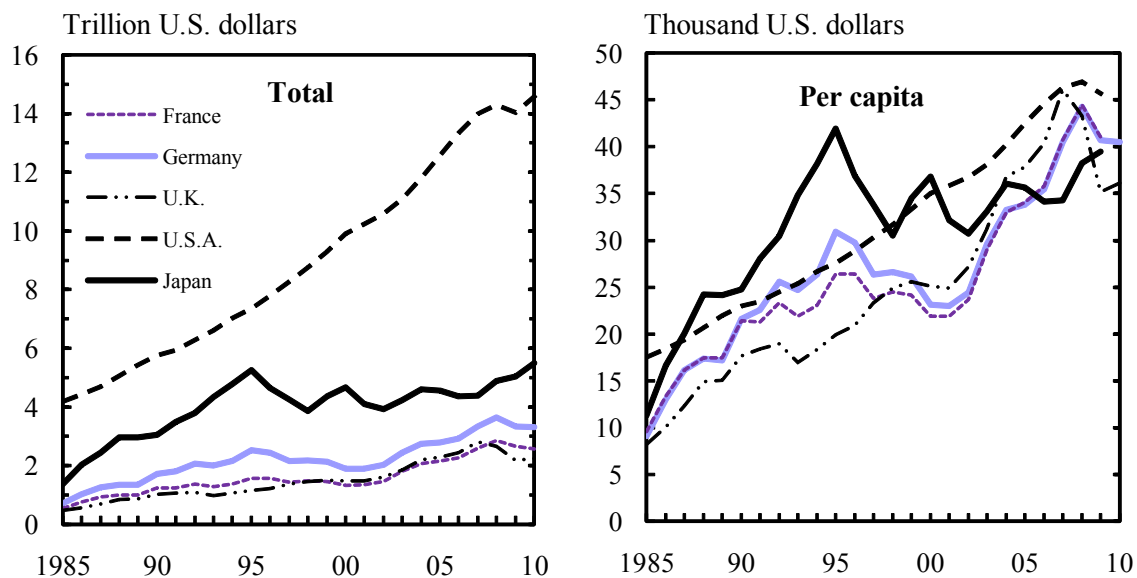
Source: Cabinet Office.

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 1,363 trillion yen, 5.6 times GDP. It then increased, reaching 3,531 trillion yen, 8.0 times GDP, at the end of 1990, due to increasing land and stock prices. The subsequent collapse of the bubble economy resulted in Japan's national wealth dropping to 2,712 trillion yen by the end of 2009.

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.

**Figure 3.3**  
**Gross Domestic Product** (Current prices, converted into U.S. dollars)



Source: OECD.

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.

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.

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	2007	2008	2009	2010
Gross domestic product (GDP) .....	560,650.8	554,117.6	519,299.8	539,854.6
Domestic demand .....	533,984.0	526,473.6	501,406.3	512,178.1
Private demand .....	417,032.0	410,812.1	380,657.0	389,959.5
Private final consumption expenditure .....	309,857.0	307,629.7	301,663.6	307,218.1
Private Residential Investment .....	16,676.9	15,339.2	13,194.0	12,364.3
Private plant and equipment .....	87,258.4	86,063.7	71,686.8	73,189.1
Changes in inventories of private sector .....	3,818.5	2,528.0	-4,611.9	-1,448.1
Public demand .....	117,089.9	115,789.4	120,578.3	122,076.0
Government final consumption expenditure ....	96,655.3	97,094.4	99,996.1	102,236.9
Gross capital formation by public sector .....	20,264.7	18,529.2	20,463.8	19,764.4
Changes in inventories of public sector .....	250.1	338.4	196.1	225.7
Net exports of goods and services .....	26,202.1	27,352.0	15,516.1	26,600.1
Exports of goods and services .....	87,495.5	88,881.1	67,611.9	83,800.5
(less) Imports of goods and services .....	61,293.4	61,529.1	52,095.8	57,200.4
(Reference)				
Trading gains/losses .....	-18,774.5	-26,784.9	-14,094.5	-21,082.3
Gross domestic income .....	541,876.3	527,332.7	505,205.3	518,772.2
Net income from the rest of the world .....	18,207.6	17,567.5	13,825.5	13,587.2
Incomes from the rest of the world .....	27,794.6	25,945.5	19,896.4	19,171.6
(less) Incomes to the rest of the world .....	9,587.0	8,378.0	6,070.9	5,584.4
Gross national income (GNI) .....	560,083.8	544,900.2	519,030.8	532,359.4

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

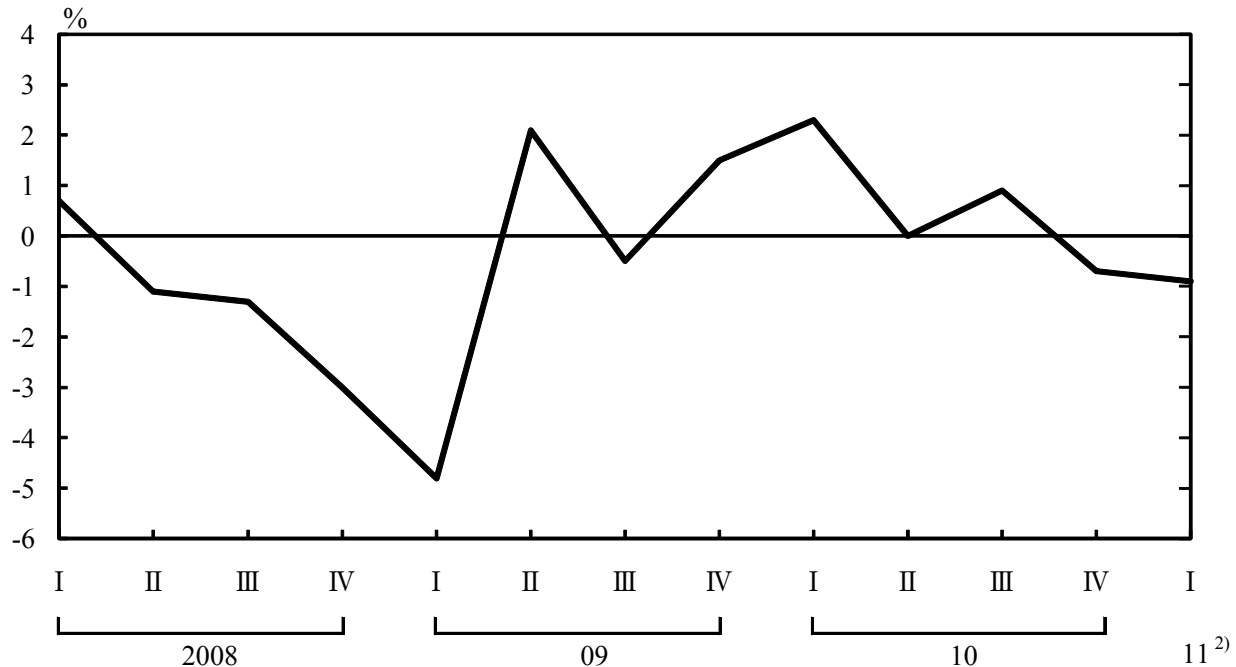
Source: Cabinet Office.

### 3. Recent Economic Trends

At the start of 2008, the Japanese economy was faced with a standstill in its path to recovery as private consumption and investments in plant and equipment fell flat and so did production. 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. As signs of recovery began to appear in the economy in April 2009, the government decided to define, tentatively, March 2009 to be the trough of the economic cycle. In November 2009, the government also

summed up price movements to conclude that they were "in a state of moderate deflation."

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



1) Data based on the 1993 SNA, calculated using the chain-linked method. Growth rates calculated using seasonally adjusted figures, based on constant prices in 2000. 2) Some regions are excluded from the survey because of the impact of the earthquake.

Source: Cabinet Office.

In 2010, the economy was picking up steadily, thanks to the driving force created by foreign demand and an economic package. However, not only was Japan faced with supply chain disruptions and power shortages resulting from the tsunami damage and nuclear plant accidents caused by the Great East Japan Earthquake on March 11, 2011, but it also found itself falling into an economic slump and a worsening fiscal position. As of June 2011, the economy still remains in a grave condition due to the impact of the earthquake but, recently, some upward signs have been seen. On a year-on-year comparison, the overall index of consumer prices (with 2005 as the base year=100) had remained unchanged from December 2010 until March 2011, but it was up 0.3 percent from the previous year in April and May 2011. Meanwhile, the average unemployment rate (a seasonally adjusted figure) was 5.1 percent in 2010, thus remaining in the 5.0-percent range for the second consecutive year. It then shifted to 4.5 percent in May 2011, down 0.2 percentage points from the previous month (excluding Iwate, Miyagi and Fukushima prefectures).

## 4. 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 1.5 percent, 26.8 percent, and 71.7 percent, respectively.

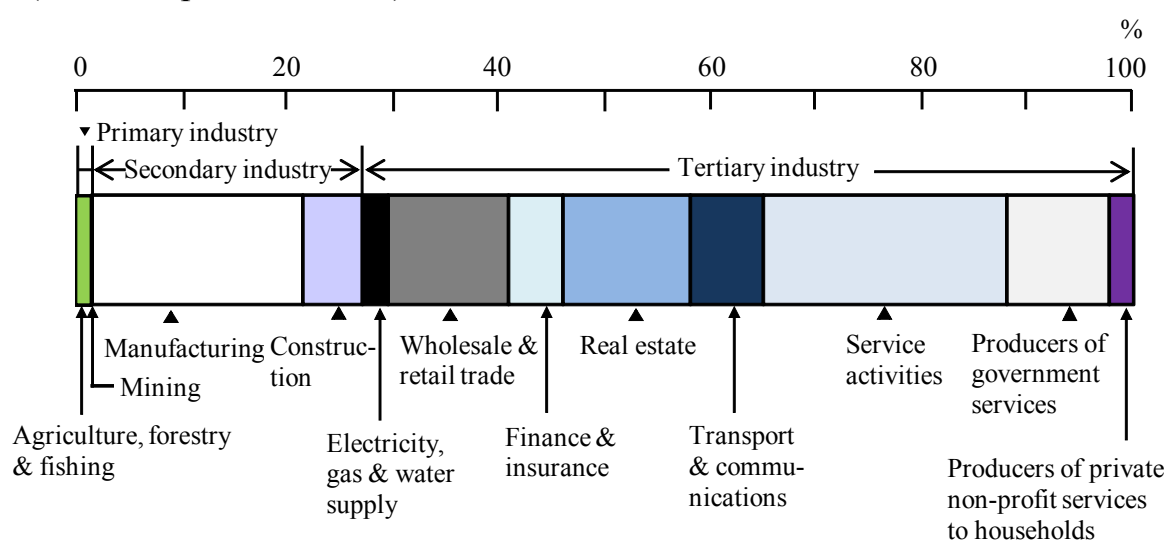
**Table 3.2**  
**Changes in Industrial Structure**

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	# 36.2	# 60.3
1985	9.3	33.1	57.3	3.0	34.9	62.0
1990	7.1	33.3	59.0	2.4	35.4	62.2
1995	6.0	31.6	61.8	1.8	30.4	67.8
2000	# 5.1	# 29.2	# 64.5	1.7	28.5	69.8
2005	4.8	26.1	67.2	1.5	26.8	71.7

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.

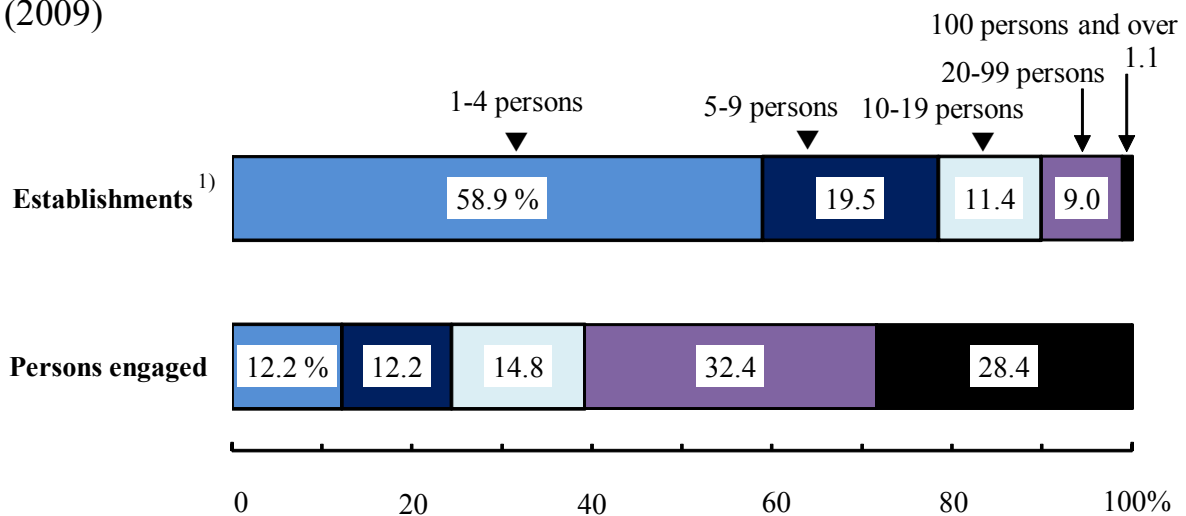
**Figure 3.5**  
**Gross Domestic Product by Type of Economic Activity (2009)**  
(Constant prices in 2000)



Source: Cabinet Office.

According to the 2009 Economic Census, there were 6.04 million establishments (establishments whose operation details are unknown were excluded) in Japan, at which a total of 62.86 million persons were employed. The average number of persons engaged per establishment was 10.4. Small-scale establishments employing fewer than 10 persons accounted for 78.4 percent of the total.

**Figure 3.6**  
**Shares of Establishments and Persons Engaged by Scale of Operation**  
 (2009)



1) Excluding dispatched employees.  
 Source: Statistics Bureau, MIC.

Going by the major groupings of the Japan Standard Industrial Classification, establishments were the most numerous in the "Wholesale and retail trade" category, numbering 1.56 million, followed by "Accommodations, eating and drinking services" and "Construction." In terms of the number of persons engaged, establishments in the "Wholesale and retail trade" ranked first as they employed 12.70 million persons, followed by "Manufacturing" and "Medical, health care and welfare."

**Table 3.3**  
**Number of Establishments and Persons Engaged (2009)**

	Number of establishments	Persons engaged
Total .....	6,043,300	62,860,514
<b>By industry</b>		
Primary industry		
Agriculture and forestry .....	29,917	339,315
Fisheries .....	3,994	48,347
Secondary industry		
Mining and quarrying of stone and gravel .....	2,921	30,710
Construction .....	583,616	4,320,444
Manufacturing .....	536,773	9,827,416
Tertiary industry		
Electricity, gas, heat supply and water .....	8,897	302,327
Information and communications .....	77,996	1,724,978
Transport and postal activities .....	148,559	3,611,602
Wholesale and retail trade .....	1,555,486	12,696,990
Finance and insurance .....	91,982	1,588,681
Real estate and goods rental and leasing .....	408,691	1,551,345
Scientific research, professional and technical services .....	244,174	1,897,680
Accommodations, eating and drinking services .....	781,265	5,736,967
Living-related and personal services and amusement services .....	514,589	2,750,705
Education, learning support .....	225,434	3,086,902
Medical, health care and welfare .....	374,737	6,386,056
Compound services .....	38,617	406,970
Services, n.e.c. ....	375,082	4,684,389
Government, n.e.c. ....	40,570	1,868,690
<b>By type of legal organizations</b>		
Privately owned .....	5,886,193	58,442,129
Individual proprietorship .....	2,465,870	7,068,207
Corporations .....	3,390,072	51,242,997
Companies .....	3,004,319	44,115,283
Unincorporated organizations .....	30,251	130,925
National and local governments .....	157,107	4,418,385

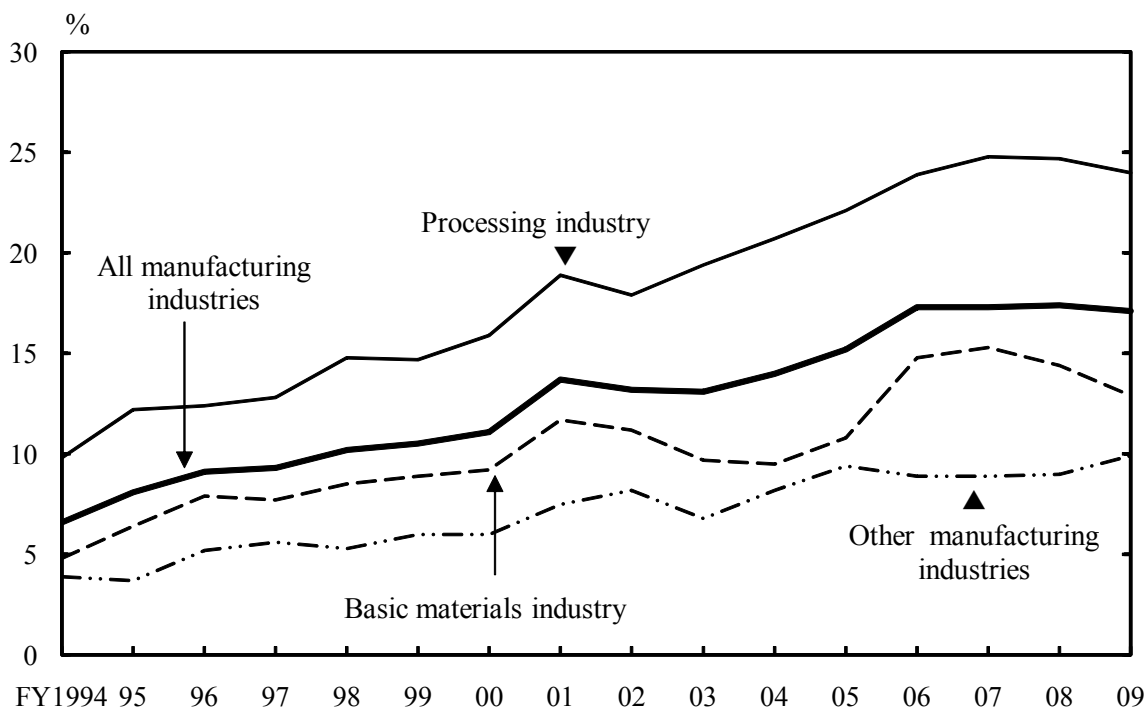
Source: Statistics Bureau, MIC.

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 percentage of companies in the manufacturing sector that have overseas production sites was 67.1 percent in fiscal 2009, thus remaining at the fiscal 2007 level. In terms of sales proceeds, overseas production accounted for 17.2 percent in fiscal 2009 and increased by 0.2 percentage points from the previous fiscal year (the first increase in two years). By category, the percentage of overseas production was the highest in transport equipment, which was 39.3 percent, followed by 26.1 percent in information and communication electronics equipment. Of total overseas production output in the manufacturing sector, exports bound for Japan constituted 22.6 percent.

As a reason for setting up production bases overseas, many Japanese companies in the manufacturing sector cite their intention to cater to local demand for products. Other areas increasingly drawing the attention of Japanese manufacturing companies as potential operation locations are China, as well as India and Vietnam. China in particular is gaining significance not only as a potential production site and export market, but also as a competitor in the global market.

**Figure 3.7**  
**Ratio of Overseas Production in the Manufacturing Sector**  
 (Monetary basis)



Source: Cabinet Office.