

**Japan's Economic Miracle:
Underlying Factors and Strategies for the Growth**

By Masahiro Takada

IR 163
Professor Wylie
March 23, 1999

Table of Contents

Abstract.....	3
Introduction.....	4-5
Impact of WWII.....	5
Major Problems.....	5-6
Occupation of Japan.....	6-10
From Reform to Recovery.....	10
The Dodge Plan in 1948.....	10-11
The Korean War Boom.....	11-12
Economic Miracle.....	12
Factors for Growth.....	12-14
Political Factors for Growth.....	14-16
The Road to Stable Growth.....	16
Conclusion.....	16
Endnote.....	17
Bibliography.....	18

Abstract

Japan's defeat in World War II enabled the Japanese people to start a new economy from a fresh start since everything they had built during the years were destroyed from the war. The U.S. Occupation of Japan set forth series of reform policies to reconstruct and recover the devastated nation and ultimately creating the opportunity to become the economic superpower. The three major reform policies implemented by the American forces were breakup of the zaibatsu, land reform, and labor democratization. These reform policies had a great impact in democratizing and modernizing the nation and affected the nation's ability to grow.

The recovery of the Japanese economy was achieved through the implementation of the Dodge Plan and the effect it had from the outbreak of the Korean War. The so called Korean War boom caused the economy to experience a rapid increase in production and marked the beginning of the economic miracle.

The ability of the Japanese people to imitate and apply the knowledge and skill learned from the Western countries is the single most important factor for Japan's amazing growth. Import of technologies and improved business condition were some of other factors for growth. Also, economic policies and strategies carried out by political characters greatly influenced and accelerated the economy.

Japan's Economic Miracle: Underlying Factors and Strategies for the Growth

Introduction

Japan's reconstruction of its nation to become the great economic power in less than forty years after the defeat of World War II has been a somewhat remarkable exception in modern economic history. Before the defeat in 1945, all of Japan's strength was spent on gaining power through war and, as a result, it led to destruction. A high proportion of the industrial and commercial buildings together with the equipment they contained had been destroyed, and much plant and machinery formerly used in production for the civilian market had been scrapped to provide metal for munitions.¹ Due to this concentration of power used in war, the surviving Japanese people from the war were left with chaos, starvation, and unemployment when returning to their country. With almost a quarter of its nation's housing accommodation destroyed, the Allied Occupation Forces came to rescue the devastated country. Although Japan was left with wastes and ruins of factories and infrastructures, Japan was able to reconstruct its economy from a fresh start by building on its prewar economic experience and gaining knowledge from the rest of the world.

To understand Japan's postwar economic growth, we must consider its economic development and history during the 1800s to early 1900s. At the starting point of modern economic growth when Japan became an open economy in the late 1800s, a huge gap existed between the Western Powers and Japan, due to Japan's historical isolation from the rest of the world. However, Japan was able to make the gap smaller by agricultural technology developed during the Tokugawa Period and also, the central government

during the Meiji Period carried out a series of modernization measures and it enabled Japan to import technologies and ideas from the Western countries easier. The heritage from the Tokugawa Period, together with the foundations for economic growth developed during the early Meiji Period, enabled Japan to propel the economy on the road to modern economic growth over a period of about twenty years starting from the mid-1880s.² By 1900, Japan was ready to expand its empire in a larger scale since Japan being heavily populated with small resources had to rely on trade to supply its basic needs it lacked. Until the defeat of World War II, Japan has clearly become to be one of the most powerful countries both economically and militarily and its basic factors for growth had been prepared. These remarkable achievements during the postwar period provided the basis and skills for the economic miracle after the destruction in 1945.

Impact of WWII.

Major Problems

With the defeat, the Japanese economy faced numerous problems. The most problematic issue was unemployment. When the military forces were disbanded, there were 7.6 million troops and cessation of military production and other military related jobs caused another 4 million people to go jobless. Also, about 1.5 million were forced to return to Japan from abroad and in total, approximately 13.1 million people were unemployed. However, large-scale unemployment never actually took place. This is because, in 1947, agriculture absorbed a labor force of 18 million, about 4 million more than before the war, but the problem of the low-income “underemployed” persisted long afterwards.³

The next concerns were the shortages of energy and food. The main sources of energy during that time was coal, but it's output dropped significantly right after the defeat. The biggest reason for its drop was that the Koreans and Chinese who had been subjected to forced labor in the coal mines were refusing to continue, and coal mining was in a state of virtual paralysis.⁴ Added to the shortage of energy, the output of nation's food supply, which is mostly rice, was also in shortage. With neither fuel nor food, people feared that they would starve to death during the winter of 1945-1946. For this reason, many jobless people worked in agriculture and coal production right after the defeat.

Another major problem after the defeat was inflation. This problem arose primarily because large volume of funds for provisional military expenses had flowed into circulation: the salaries of the demobilized troops, payments for completed orders of military goods, advance payments, compensation for losses, and so on.⁵ This problem was resolved with the implementation of the Dodge Plan in 1949, which will be covered later in the paper.

Occupation of Japan

Since Japan was in need for help to reconstruct its economy, the Allied Powers, who comprised mostly of American forces occupied Japan. The Occupation of Japan took the form of indirect rule due to the existence of the Japanese government, but the reform policies set forth by the Allied Powers was more of a direct rule to Japan. General Douglas MacArthur as the Supreme Commander for the Allied Powers (SCAP) led the Occupation and the first step MacArthur took before implementing the reform policies were to establish economic demilitarization and to ensure that all production of military

materials had stopped and closed down. This led to the formation of the Constitution of 1947, where Japan gave up the right to use any military force forever and relied on the United States for their protection from outside forces. The decreased spending on military and defense forces are clearly one of the main reasons for Japan's economic miracle. In addition to the demilitarization, series of reform policies were set forth by the SCAP during the occupation, which was aimed to democratize the country. There were three major reforms set forth during the Occupation of Japan, and they are the breakup of the zaibatsu, land reform, and labor democratization.

The first reform, the breakup of the zaibatsu was carried out for the purpose of destroying Japan's military power both psychologically and institutionally.⁶ These zaibatsu are business conglomerates that were often treated preferably by the government through lower taxes and receiving huge funds for expansion of the company. Moreover, the concentration of industrial control promoted the continuation of a semi-feudal relationship between labor and management, held down wages, blocked the development of labor unions, obstructed the creation of firms by independent entrepreneurs, and hindered the rise of a middle class in Japan.⁷

The dissolution of the zaibatsu was implemented by breaking up the holding companies, which were the core of zaibatsu control, and to sell their stock to the public. The democratization policies concerning the industrial associations were able to achieve success by the creation of two laws, which were Anti-Monopoly Law and Decentralization Law. Anti-Monopoly Law was formed to prohibit all cartel activities and the Decentralization Law was created to force firms to reduce in size if any of the designated companies had market control. Although the existence of zaibatsu were

unfair to other small companies, its role in the development of modern economic growth during the prewar period was significant. For example, the zaibatsu introduced new industries into Japan and possessed the strength to put those industries to become successful in the new environment. Also, mass production of military materials during the war was made possible due to the existence and power held by the zaibatsu. With the breakup of the zaibatsu, competition within all industries became fierce and marked the beginning of the rapid postwar economic growth.

The next reform imposed by SCAP was land reform, in which land, occupied and farmed by the landlords were forced to sell their holdings of land. These lands were bought up by the government for redistribution to tenant farmers. The land reform was necessary to democratize the country, because, before the war, about two-thirds of all Japanese farmers rented all or part of the land they cultivated, and the land system was characterized by many factors of a feudalistic state. One characteristic of a feudalistic state of the land system was that, landlords who owned arable land were not usually farmers themselves, and to efficiently use the land they owned, they rented the land to tenant farmers and acquired some kind of benefit for the rent. Due to this problem, the democratization policy of SCAP had two major objectives, (1) to transfer land ownership to farmers who actually tilled the soil, and (2) to improve farm tenancy practices for those who continued as tenants.⁸ Before the beginning of the program, only 54 percent of the cultivated land was owner-operated, but by the beginning of 1950 this figure reached 90 percent.⁹ The abolishment of a feudalistic state and transfer of land ownership was accomplished at an amazing speed, because the nation as whole and even landlords were eager to modernize and bring Japan to recovery. With the introduction of this land

reform, landlords were no longer recognized as above the social class of that of the farmers or tenants and such a program was revolutionary to Japan.

Another major reform conducted by the Occupation forces was aimed for labor democratization. The major achievement from this reform was that it enabled the Japanese to form labor unions. The proportion of workers organized into labor unions rose rapidly, from zero in 1945 to nearly 60 percent in 1948-1949. This is an extraordinarily high rate in view of the fact that the international average is about 30 percent.¹⁰

The rapid creation of labor unions were caused in part by the breakup of the zaibatsu and poor working conditions with low wages in Japan, and in effect, formed The Trade Union Law. The enactment of The Trade Union Law in 1945 sets forth the basic right of workers in private industry to organize, to bargain collectively, and to strike; provides for democratic procedures in all union activities; establishes the labor relations commission; prohibits unfair labor practices on the part of employers.¹¹ Due to this newly formed law, the early improvements in real wages and working conditions were significant. In addition, the unions had compelled management to accept the lifetime employment system with restrictions of dismissing employees in return for promise of loyalty and priority to the company. The acceptance of this system by management was slow and caused numerous strikes to occur. However, fearing that the strike was going to be prolonged and ultimately drive the company into bankruptcy, the lifetime employment system was established and labor-management relations became entrenched. The improved working conditions and higher wages achieved by the labor unions expanded

the domestic consumption markets and affected greatly to the development of the economy.

From Reform to Recovery

The Dodge Plan in 1948

With the three major reforms introduced and put into effect, the Japanese economy was on its way to recovery. However, by early as summer 1947, the Cold War tensions had started to build up in East Asia and the United States revised its policies towards Japan for the purpose of accelerating its economic recovery. The Dodge Plan in 1948, conducted by a Detroit bank president Joseph Dodge was implemented for the solution of bringing back Japan to full strength and ultimately removing American aid from Japan to prepare for the Cold War. He introduced three basic policies to mainly resolve the serious problem of inflation and to establish stabilization in Japan. The first was a balanced budget. The second was the suspension of new loans from the Reconstruction Finance Bank. This measure was aimed at cutting off at their source the supplies of new currency, which were seen as the fundamental cause of inflation.¹² The third policy was reduction and abolition of subsidies.

The goal to accelerate the economy in such a short period of time with these three policies were almost impossible to achieve due to sudden adjustments, but with the start of the Korean War in 1950, the economy boomed. The reasons for the boom will be described in the next section of the paper. Although these policies left by Dodge caused problems, he has set the basis for recovery without American aid and the Occupation of Japan ended in 1951. The work accomplished by Dodge had eliminated the financial

problems in Japan and the Japanese were to achieve recovery through their own work by economizing and accumulating capital to be exposed to international competition

The Korean War Boom

The early period of the Dodge Plan caused Japan to enter into recession and labor unrest increased, and a full-scale depression was feared. However, with the outbreak of the Korean War soon afterwards, the economic condition and situation changed completely. From 1950, when the Korean War began, to 1951, the total amount of world trade increased by 34 percent and many countries including Japan experienced a significant boom of its economy. Japan's production increased by nearly 70 percent and as far as business firms were concerned, it provided a greater boost than anything else to its economic recovery, since many firms were with the burdens of reconstruction. What was more remarkable was that,

Foreign currency derived from U.S. Army and military personnel reached gigantic sums for those times: \$590 million in 1951 and over \$800 million both in 1952 and in 1953. Thus, Japan obtained a temporary dollar income that amounted to 60 to 70 percent of its exports and that is to say, Japan was enabled to import at the rate of about \$2 billion per year. To the Japanese economy, which had been doing its level best just to import something less than one billion dollars' worth of goods in 1949 and 1950, \$2 billion in imports meant that the key industries which depended on imports of raw materials could virtually double their scale of production and firms which were extremely anxious to expand production could obtain the imports needed to support a much larger scale of activity.¹³

In addition, the Korean War had increased the effect on plant and equipment investment and technological innovation. Since Japan was still behind the international competition, many industries imported technology mainly from the Western countries and expanded capacity. Due to these rapid increases in production and economy as a whole, full recovery and stabilization was obviously achieved well beyond the end of the war and Japan restored its independence with the signing of the Japanese-American Security Pact in 1952.

Economic Miracle

Factors for Growth

The rapid economic growth in Japan from the beginning of the 1950s to the early 1970s did not only result from special government policies and revolutionary events, but were also achieved by the cumulative effort and hard work by the people. The unique characteristic and ability of the Japanese people to imitate and improve the skills learned, and then applying them to their own system was the most important factor for their successes.

One of the factors that the Japanese made use of their unique characteristic to expand the economy was to improve and make practical use of technologies and technological know-how's imported from foreign countries. The Japanese were among the best at doing such a thing and often asserted that Japan has produced very little technology of its own. However, Japan has created new technology, such as the low-cost mass production systems, by combining numerous technologies imported from abroad. The most important point to recognize about Japan's import of technology was that it was translated into industrial strength only because it was combined with domestic

innovation.¹⁴ Technological improvements in Japan contributed greatly to its economic growth, because improvements of technologies in one industry influenced the growth of many other industries. For example, Japan's steel industry successfully improved the quality of the special steel used in automobiles and as a result of technological progress in the casing of parts, the automobile industry, too, grew into an industry to be able to compete in international markets for the first time. Similar progress occurred in the shipbuilding industry also, and numerous industries were growing almost at a proportionate rate. As you can see, the improvements and modifications of technologies stimulated industries to develop an even more productive ways to grow and this trend led the Japanese economy to compete in the international markets.

Changing business conditions had also led to the amazing economic growth in Japan. The dissolution of the zaibatsu was the primary event that enabled Japanese firms to become more flexible and to go through a change process. The first change was that there was a complete change of managers and eliminated the trend of owner-managers. The firms were conducted by hired, professional managers instead of managers who gained their position from inheritance before the zaibatsu dissolution. Due to these managers, better working conditions within firms were achieved and enabled both domestic and international competition. The reasons for their successes lay wholly in the fact that the forte of these professional managers was "aggressiveness" rather than "soundness" in a changed environment where, for one thing, competition had intensified.¹⁵ Another changing business condition was the stability of labor-management relations. As described before, the unity between labor and management was established from the active role taken by the union and the acceptance of the lifetime

employment system. The company unions demonstrated their loyalty in return for the favorable system and made the management of employees easier.

Political Factors for Growth

Although rapid economic growth was produced primarily by the efforts of the Japanese people, this is not to say that the economic policies and planning had no role in the process. The policies and strategies were set forth carefully by the policy-making authorities to protect and sustain the growth, and therefore the Japanese political system had a major role in its development as well.

There are two major policies that led to Japan's rapid growth. The first policy was the Yoshida Doctrine, in which shaped the postwar economy in Japan to recovery. Prime Minister Yoshida Shigeru developed this policy during the early period of the Korean War, and he is often called on as the father of modern Japanese economy. The policy was aimed to set economic reconstruction and development as the nation's immediate goals while saving on military expenses by leaving defense to the U.S. army. This significant reduction on military spending has allowed Japan to put all its strength and money solely on reconstructing the economy and it was very influential to the rapid recovery after the defeat. Also, this policy advocates a pacifistic, nonmilitary role for Japan and forms the core of its contemporary diplomatic identity.¹⁶ In addition to the Yoshida Doctrine, Ikeda, who is seen to be the most important figure in Japan's rapid growth, implemented the Income Doubling Plan in 1960. As the name of the plan implies, it was aimed to double the income earned by the Japanese workers and set a high living standard from the period of 1961 to 1970 by greatly increasing the amount of investments made by the central government to both private and public firms. To

successfully achieve the objective of the plan, it was also aimed to increase the amount of foreign trade with other countries. However, due to such a heavy industrialization during the plan, major problem of pollution came to an issue and it had to be dealt with in the proceeding few years afterwards. Although few problems arose from heavy industrialization, this plan has contributed greatly to the later half of Japan's rapid growth with an average growth rate of 10.8 percent in the late 1960s and drove the economy to become the second largest in the world by the year 1968.

In addition to policies and economic planning set forth by leaders of the country, another political factor that greatly influenced the growth was the role taken by the Ministry of International Trade and Industry (MITI). MITI, which was regarded as the most powerful government organization during the time of rapid expansion, was mostly responsible for the industrial growth in Japan. The Ministry's approach was one of providing encouragement and guidance to the initiatives of private business: creating a suitable un-level playing field which would give that critical advantage to industries identified by government as having potential for long-term success.¹⁷ The main targets that MITI focused for growth were in the industries of steel, shipbuilding, chemicals, and machinery. These industries were thought of as having large and rapidly growing world markets and that expanding these industries were the key to entering into the international markets and helping the economy to grow quicker. Large amount of financial aid and assistance was given to the companies MITI thought were important for economic growth of the country and it was somewhat unfair to the companies who were not receiving help. Another role that MITI had to explain its importance was that they had distributed new technologies to companies to promote even growth within industries. Therefore, the

guidance and distribution of technologies that MITI gave to specific companies had definitely helped Japan to industrialize as a whole and their role in the growth was essential.

The Road to Stable Growth

The oil crisis in 1973 had an enormous effect on the growing Japanese economy, since Japan had depended on the supply of oil for driving its economic growth. Inflation soared in the economy and unemployment problem arose, causing Japan to go into a recession for a short period of time. However, the Japanese government managed to keep economy under control by its tight money policies and again achieved successful recovery. The economy after the oil crisis stabilized due to government's quick response and high technological level already achieved. The key to recovery was the boom in exports of cars, electronics, and other products, which grew far more rapidly than imports. By 1977 Japan's burgeoning trade surplus had become a global issue.¹⁸

Conclusion

The most important factor that enabled Japan's amazing economic growth, which was somewhat an exception to modern economic history was the ability of the people itself to successfully combine all the knowledge and skills gained from foreign countries, and then improving those skills to fit their own system. The economic miracle did not occur simply from the reform policies implemented during the occupation of the American forces, but the basic factors for growth had already been prepared way beyond the start of WWII. The factors for the growth are unique and dependent upon each policies and strategies developed during the course of expansion.

Endnotes

¹ Allen, p.15.

² Minami, p.416.

³ Nakamura, p.21.

⁴ Ozaki, p. 47.

⁵ Ozaki, p. 52.

⁶ Noguchi, www.japanecho.com/docs/24S110.html.

⁷ Nakamura, p.26.

⁸ Yamamura, p.18.

⁹ Allen, p.85.

¹⁰ Nakamura, p. 31.

¹¹ Suzuki, p.163.

¹² Gluck, www.isslu.tokyo.ac.jp

¹³ Cohen, p.49.

¹⁴ Smith, p.169.

¹⁵ Fujii, p.18.

¹⁶ Borthwick, p.250.

¹⁷ Suzuki, p.179.

¹⁸ Borthwick, p.248.

Bibliography

1. Allen, G.C., Japan's Economic Expansion, Oxford University Press, Amen House, London, 1965.
2. Borthwick, Mark, "Miracle by Design: The Postwar Resurgence of Japan", Pacific Century. The Emergence of Modern Pacific Asia, 2nd edition, Westview Press, 1998; pp.241-270.
3. Cohen, Jerome B., Japan's Postwar Economy, Indiana University Press, New York, 1958.
4. Fujii, Hidehiko, "The Japanese Economy After the General Economic Measures", JapanResearch Quarterly, Spring 1994.
5. Gluck, Carol, "Paradigms Lost: History in the Post-Postwar Era", www.iss.u-tokyo.ac.jp/Newsletter/SSJI/
6. Minami, Ryoshin, The Economic Development of Japan: A Quantitative Study, St. Martin's Press, New York, 1986.
7. Nakamura, Takafusa, The Postwar Japanese Economy: Its Development and Structure, University of Tokyo Press, 1981.
8. Noguchi, Yukio, "The Persistence of the 1940 Setup", www.japonecho.com/docs/24S110.html, 1997.
10. Ozaki, Robert S., Postwar Economic Growth in Japan, University of California Press, Los Angeles, 1966,
11. Smith, Thomas C. Sources of Japanese Industrialization, University of California Press, Los Angeles, 1988.
12. Suzuki, Tessa Morris, "The Making of a Technological Superpower, since 1945", The Technological Transformation of Japan, Cambridge University Press, 1994, pp. 161-230.
13. Yamamura, Kozo, Economic Policy in Postwar Japan: Growth versus Economic Democracy, University of California Press, Los Angeles, 1967.