

Economic Development of Japan



No.10 Postwar Recovery, 1945-49

Topics for Discussion

- ❑ What economic and social conditions did Japan face immediately after the war defeat in 1945? How difficult was the life in cities and villages?
- ❑ What were the objectives of the US military that occupied Japan during 1945-1952? What legacies did it leave for Japan's renaissance?
- ❑ How much policy freedom did the Japanese government have under US occupation?
- ❑ What democratization measures were adopted and how did they evolve over time? Were they effective in restoring democracy in Japan?
- ❑ What alternative strategies were debated for economic recovery, and which strategy was ultimately adopted? Was it really effective?

Postwar Reforms & Recovery Strategy

- ❑ Japan's war economy collapsed because of the lack of energy and raw materials. The US attacked and sank military and civilian ships, and Japan could not transport industrial materials from the occupied areas in Asia.
- ❑ Over three million Japanese lives were lost during the Pacific War, and 22 million more in the rest of Asia (estimates are uncertain). After the war defeat in 1945, industrial output collapsed to 30% of prewar level or 20% of wartime peak. There was a severe food shortage. Many urban residents lost housing.
- ❑ The US military occupied Japan from 1945 to 1952. It forced democratization and demilitarization on Japan. A new constitution was drafted under US guidance. Land reform, dismantling of zaibatsu and new labor laws were implemented. But some of these measures were partly reversed when the Cold War started. The US wanted to make Japan a reliable capitalist ally.
- ❑ Defeated Japan continued to use planning method to ignite output recovery. Government targeted production of coal and steel by resource mobilization in 1947-48, and the economy started to recover. Japan prioritized output recovery over stopping inflation.
- ❑ In 1949, Dodge Line stabilization ended the fiscal deficit and inflation, returning Japan to a basically (but not completely) market-oriented system.

Postwar Recovery 1945-1949

- ❑ The Japanese economy collapsed due to the lack of inputs. Inflation surged. Living standard plummeted. Food was in shortage and rationed. Black markets proliferated.
- ❑ The US occupied Japan from 1945 to 1952 and forced democratization and demilitarization (both of which were later partly reversed).
- ❑ Subsidies and US aid supported the war-torn economy.
- ❑ The Priority Production System, using planning method, contributed to output recovery (1947-48).
- ❑ Inflation was ended by Dodge Line stabilization (1949).



**Army General
Douglas MacArthur,
head of GHQ**



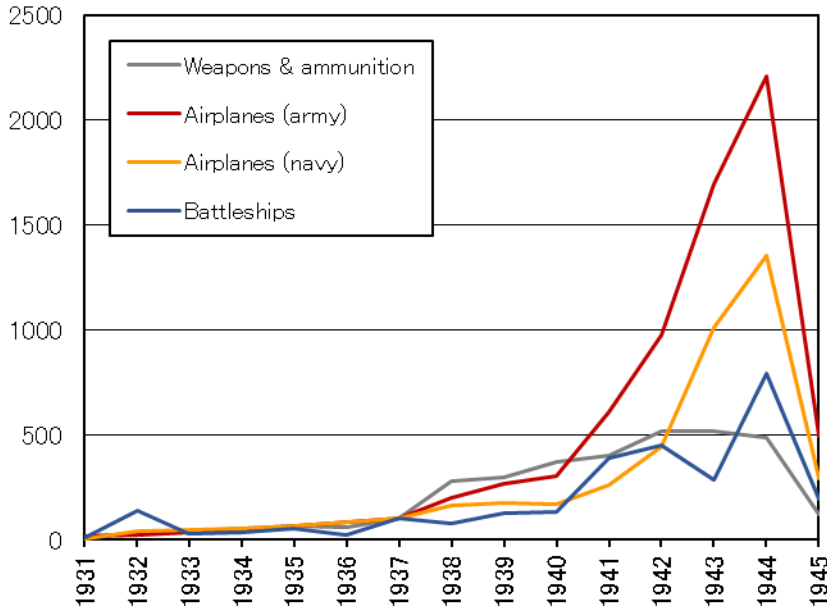
**GHQ building in Hibiya,
around 1950**

**American soldiers in
occupied Japan**



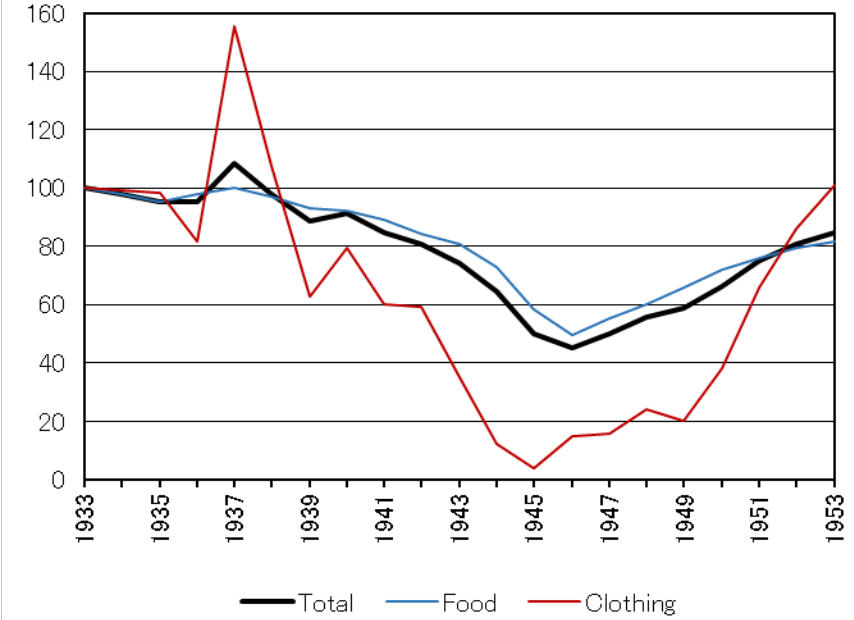
Military Production

(1937=100)



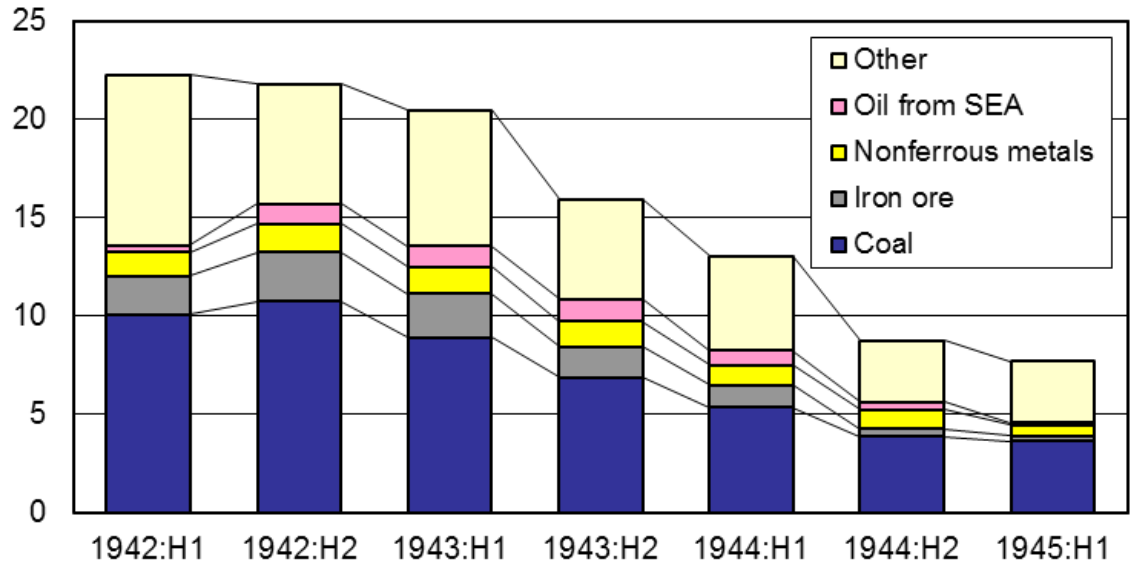
Consumer Goods Supply

(1933=100)



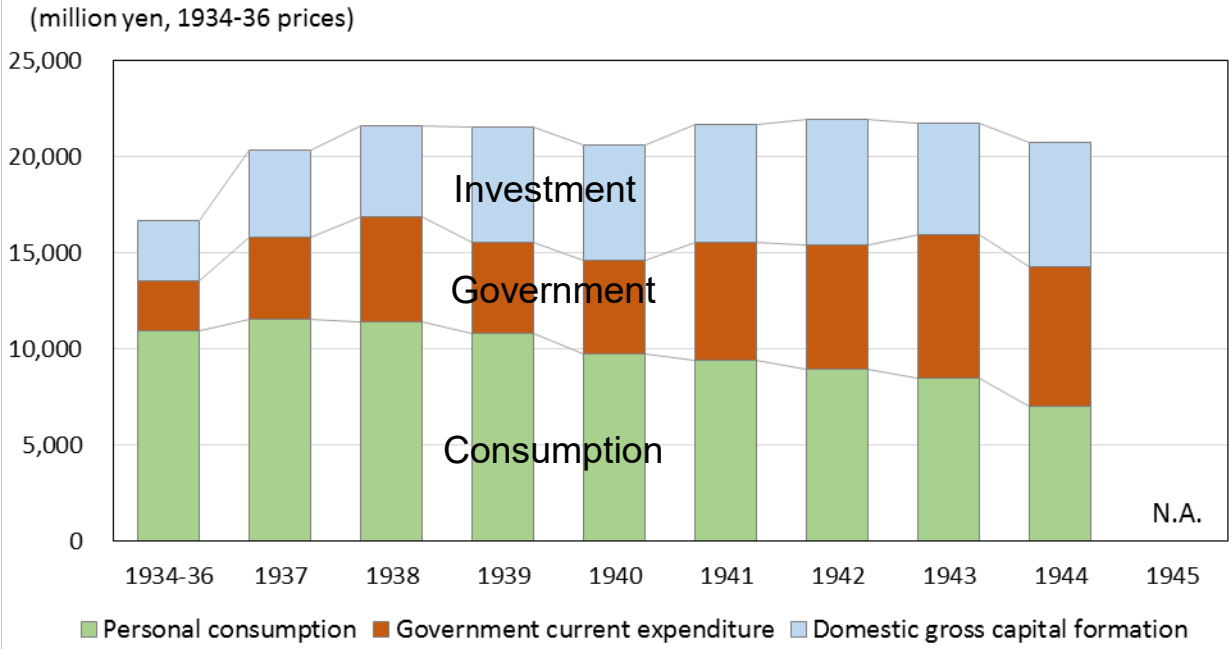
Maritime Transport during the Pacific War

Million tons

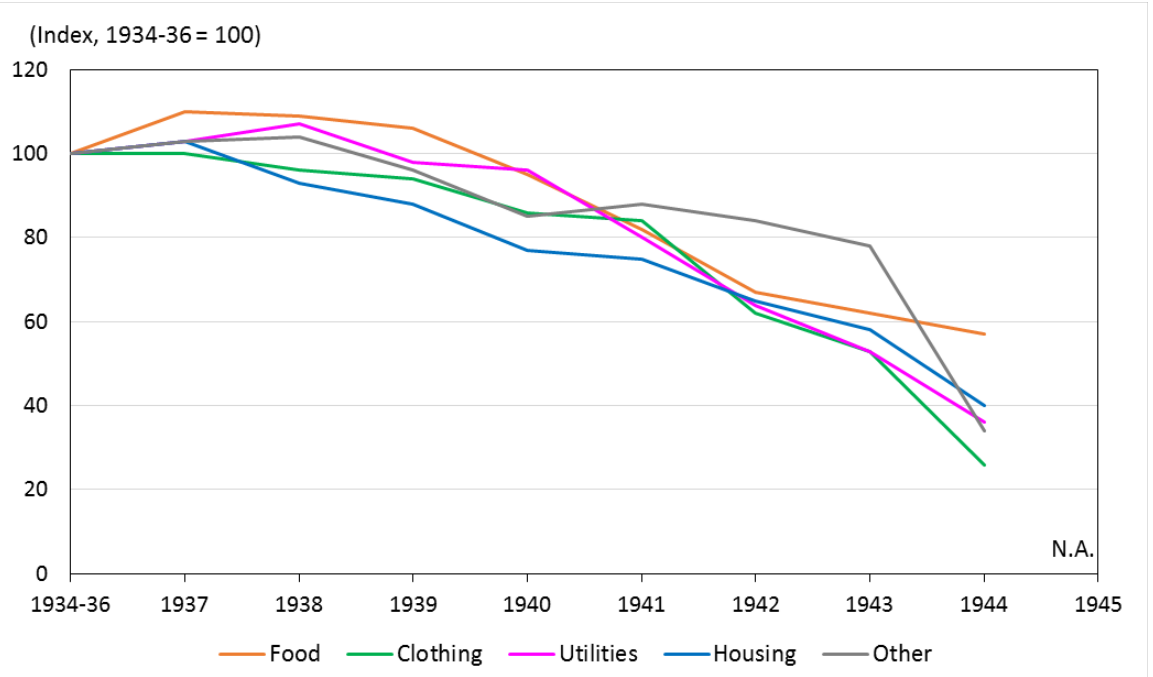


Estimated Real GNP & its Components

Government expenditure rose sharply while personal consumption was severely reduced during the war. Data for 1945-46, hardest years, are not available.

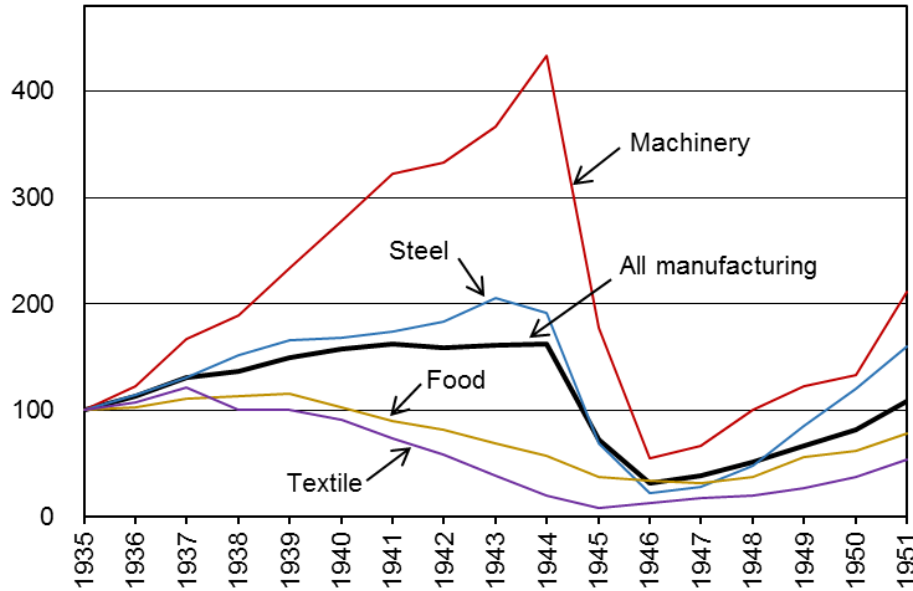


Real Consumption Expenditure



Source: Junko Watanabe, "Civil Industries during the War," K. Ishii, A. Hara & H. Takeda eds., *Economic History of Japan vol. 4: War and Postwar Periods*, University of Tokyo Press, 2007, pp.60-62.

(1935 = 100)

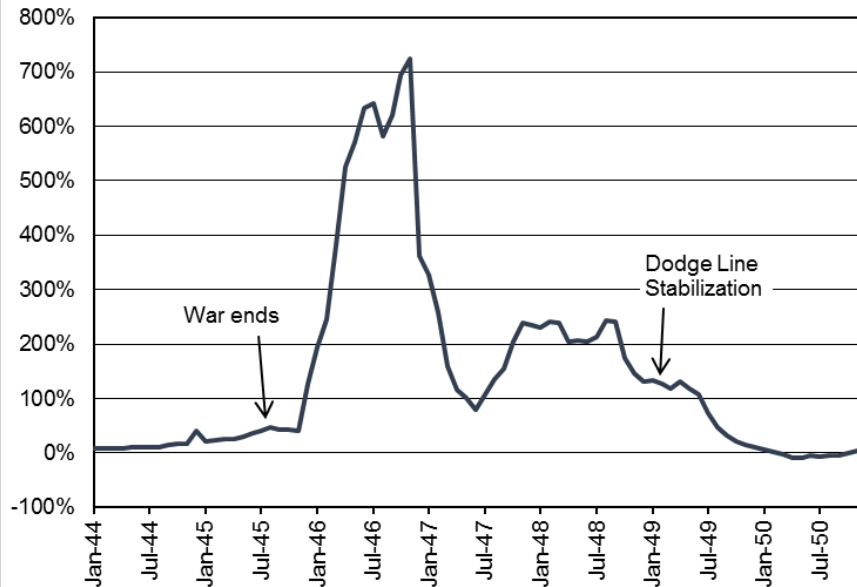


Industrial Production Index

Production collapsed in 1945, then hit the bottom in 1946. Recovery started in 1947 with the implementation of Priority Production System. Output output continued to grow even after Dodge Line of 1949 which imposed severe fiscal and monetary tightening. The Korean war demand (US procurement of military and civilian goods) starting in 1950 stimulated the Japanese economy.

Source: Management and Coordination Agency, *Historical Statistics of Japan, Vol. 2, 1988.*

(12-month change)



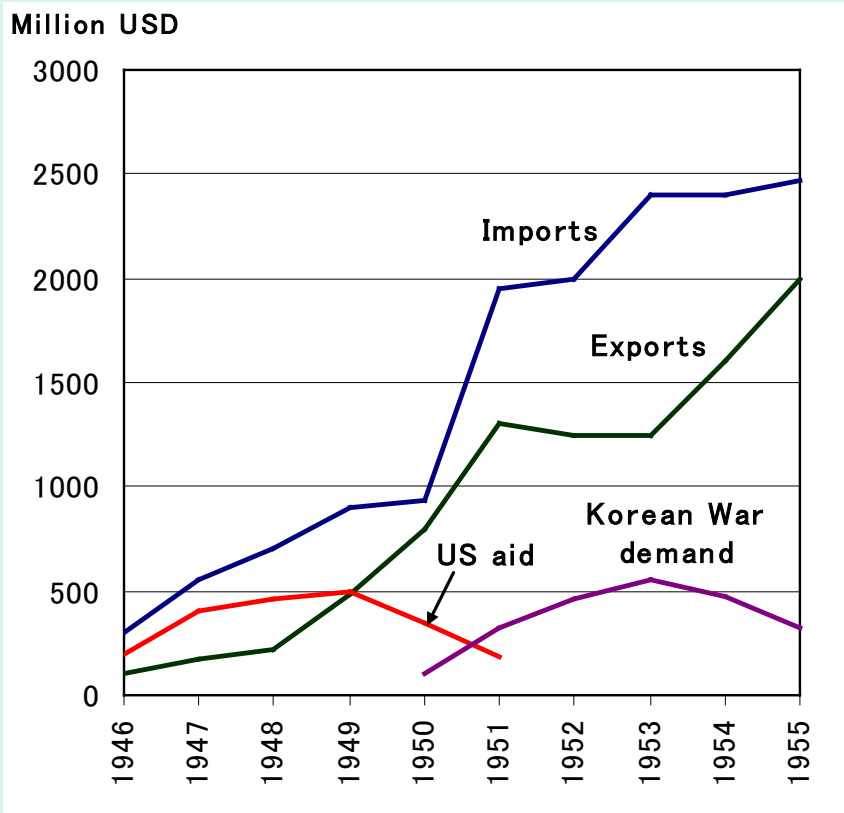
Tokyo Retail Price Inflation

Price control became largely ineffective after the war. Bank deposit blockade (real-value cancellation of people's bank savings) in 1946 did not produce lasting results. Triple-digit inflation was finally ended by Dodge Line, the Washington-imposed macroeconomic shock therapy in 1949.

Source: Management and Coordination Agency, *Historical Statistics of Japan, Vol. 4, 1988.*

Two Artificial Supports (Subsidies & US Aid) 竹馬經濟

US Aid and Korean War Boom



US food and medical assistance was provided until 1951. Then, US military procurement for the Korean War supported Japanese industries through increased demand.

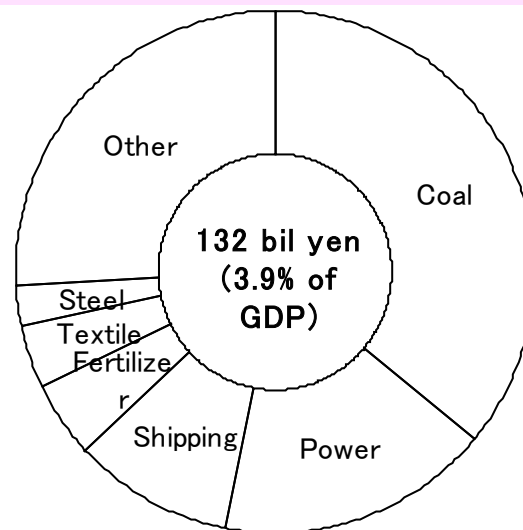
Price Gap Subsidies 価格差補給金



	Mil yen	% of GDP
1946	9,011	1.9%
1947	22,511	1.7%
1948	62,499	2.3%
1949	170,213	5.0%
1950	60,161	1.5%
1951	30,261	0.6%
1952	27,000	0.4%

Production subsidies were directed to coal, steel, copper, fertilizer as well as food to cover the difference between controlled sale prices and production costs.

Fukkin Loan Balance 復興金融公庫 (March 1949)



The Recovery Financial Fund (*fukkin*) loans were poured into priority industries, especially coal. The Ministry of Finance issued *fukkin* bonds which were immediately purchased by the Bank of Japan—this increased money supply. The pie chart shows the final *fukkin* balance prior to termination.

The Basic Problems of Japan's Economic Reconstruction (Sep. 1946)

(English edition: Special Survey Committee, Ministry of Foreign Affairs ed., *Postwar Reconstruction of the Japanese Economy*, compiled by Saburo Okita, University of Tokyo Press, 1992)

Long-term goals must be set for Japan's recovery and global industrial positioning.

Concrete real-sector strategies are needed to attain these goals, sector by sector.

- ❑ Toward the end of the war, young engineers Okita Saburo and Goto Yonosuke knew that Japan would lose, and decided to organize study meetings to discuss postwar recovery strategies.
- ❑ The first meeting was held on August 16, 1945, one day after Japan's defeat. The topic was the impact of the Bretton Woods Agreement of 1944 which created the IMF and the World Bank.
- ❑ Various topics were discussed every week with the attendance of prominent officials and academics. Okita and Goto served as the secretariat. The study group began informally but was later officially recognized as the Special Survey Committee of the Ministry of Foreign Affairs.

Excerpts from the 1946 Report

(The two page numbers refer to Japanese original and English translation, respectively)

“In capitalistic free competition many Japanese industries will be overwhelmed by gigantic modern foreign industries, and Japan’s industrial structure will thus be deformed. This will make it necessary to **adopt State policies that will keep at least basic industries intact.**” (p.81/p.85)

“A national posture will have to be assumed in which all the people do not seek an affluent consumer life but are **content with minimum standards of living, consume conservatively, and increase savings**—thereby contriving to recover economic power and not seeking financial assistance from the outside world for consumption purposes.” (p.85/p.88)

“**A comprehensive and specific year-to-year reconstruction program** will have to be formulated in order to revive the Japanese economy from the extreme destitution in which it finds itself now. The waste of economic power that would result from **allowing laissez-faire play to market forces will not be permitted** in order that all the meager economic power remaining may be concentrated in a direction toward reproduction on an enlarged scale and that the process of reconstruction may be expedited.” (p.92/p.94)

Japan's Advice on African Development

A More Recent Example of the Japanese Approach

Source: Japan International Cooperation Agency and Japan Bank for International Cooperation, *Report of the Stocktaking Work on the Economic Development in Africa and the Asian Growth Experience* (May 2008), pp.14-15.

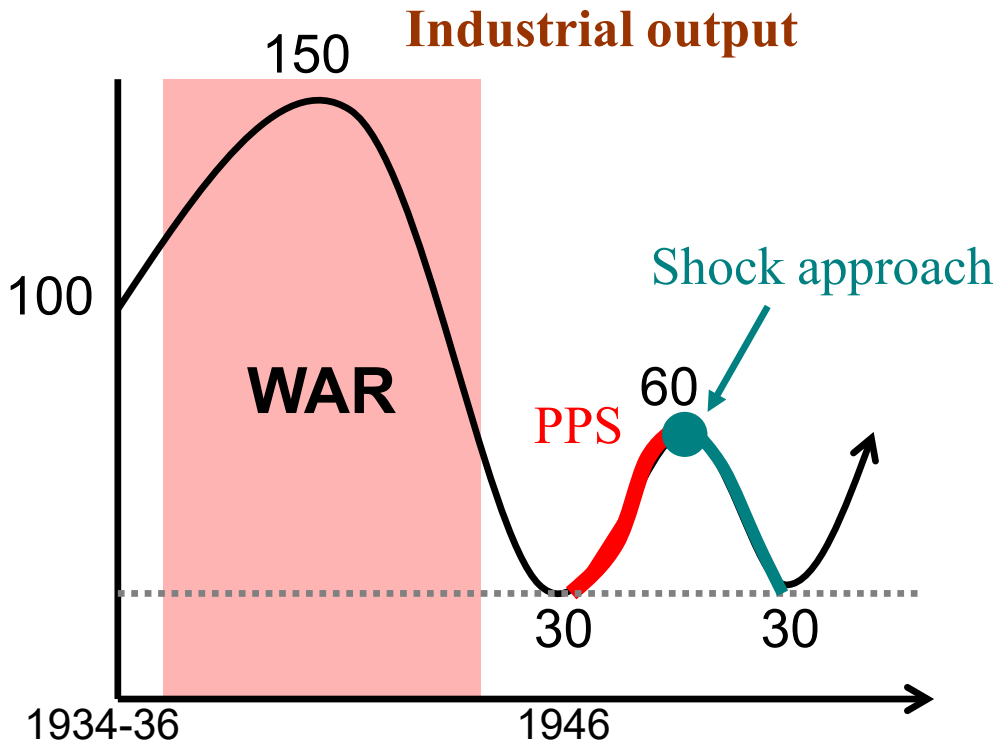
Establish “Industrialization Strategy” as a process, not just a document, in the following sequence.

1. Identify the desired vision, economic structure, and positioning in the global value chain.
2. Through public-private dialogue, discover growth-leading industries for future.
3. Identify their constraints (infrastructure, human resource, etc.)
4. Devise measures to remove constraints and promote targeted industries.

Proposed measures must be consistent with the country's institutional capability and executed under discipline and competition.

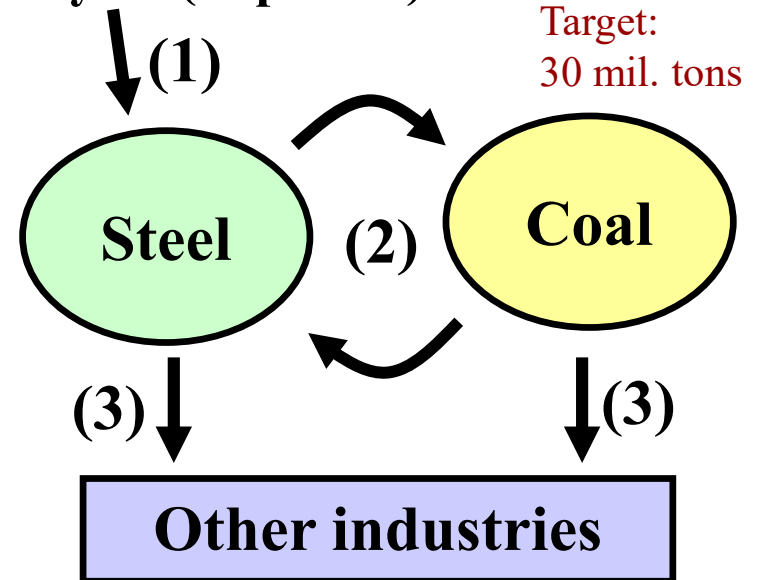
Conditional Shock Approach (中間安定論)

- Debate emerged between a shock therapy vs. gradualism in stopping inflation.
- The idea of recovering output first, then stop inflation by bold measures, was proposed separately by Professor Arisawa Hiromi of Tokyo University and the Ministry of Commerce and Industry.
- Professor Arisawa argued that (i) minimum living standard must be ensured even after the shock therapy; and (ii) coal & steel production should be jump-started by planning method and mutual interaction.



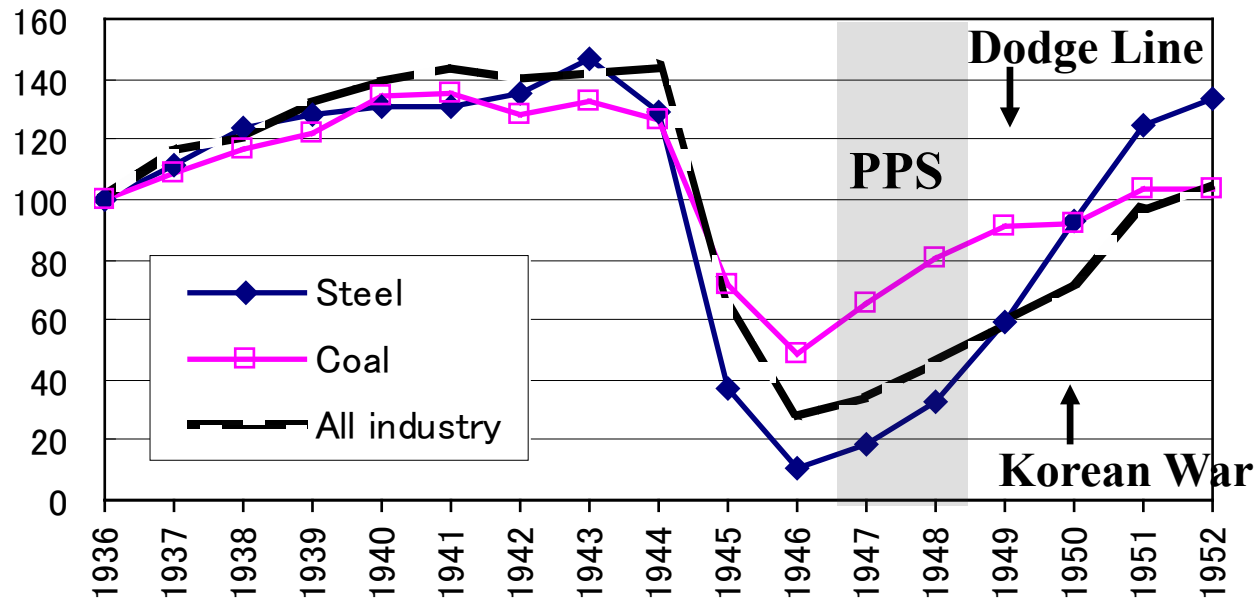
Priority Production System

Heavy oil (imported)



Priority Production System (傾斜生産方式)

(1936 = 100)



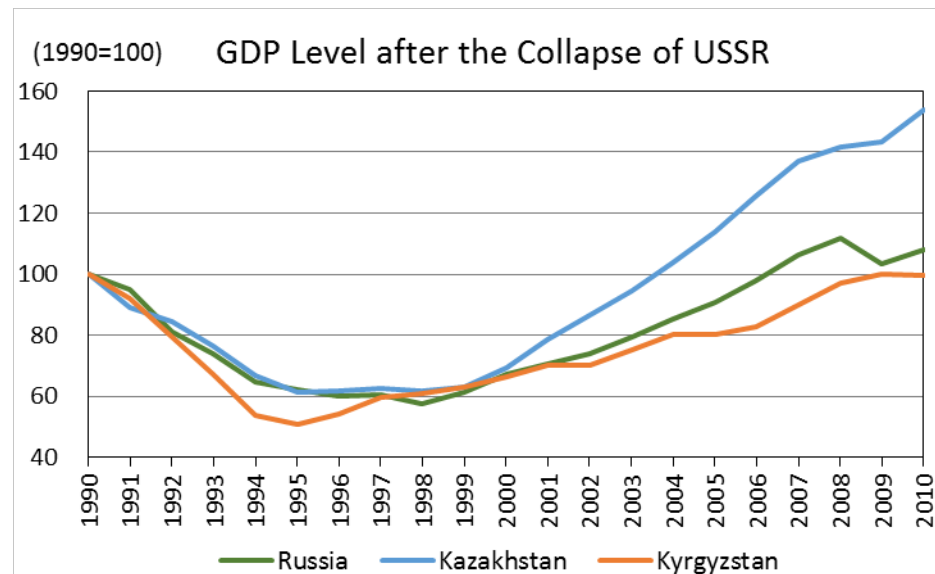
**Industrial
Production
Index**

Source: *Historical Statistics of Japan*, vol.2, 1988.

- ❑ PPS was conducted by carefully estimating coal mine capacity as well as energy demand, concentrating limited resources on coal mining, and publicly announcing daily production. A dedicated radio program sent heartfelt messages from all over Japan to coal miners.
- ❑ In 1947 and 1948, output targets were mostly met and industrial production turned around for recovery. Prof. Arisawa wanted to continue PPS into 1949, but Washington ordered disinflation.

Big Bang vs. Recovery First

- ❑ In Japan, policy response to a severe economic crisis often prioritized output recovery before stopping inflation. Real-sector goals are first set, then concrete policies for targeted industries are designed and implemented. *The Basic Problems of Japanese Economic Reconstruction* (MoFA, 1946) and the Priority Production System epitomized this approach.
- ❑ This is in sharp contrast to the advice of the IMF, World Bank and Western donors, especially in the 1980s-90s, which (i) regards attaining macro stability as the pre-condition for recovery, (ii) tries to improve institutions and business climate *generally* without targeting specific sectors; and (iii) trusts the power of free market in generating growth.
- ❑ Japan usually takes a more balanced (gradual) approach to liberalization, privatization and global integration in assisting developing countries. Attaining free market without building industrial competitiveness is considered unwise.



Dodge Line Stabilization & Shoup Tax Reform (1949)



Joseph Dodge



Prof. Shoup

- ❑ Washington sent Joseph Dodge, a US banker with strong belief in free market and sound budget, to end inflation (he was first sent to Germany to stop inflation there, then dispatched to Japan).
- ❑ “Super-balanced (i.e., surplus) Budget” was imposed by cutting expenditure, ending subsidies (including fuckin loans) and raising utility charges. The fiscal deficit, which rose from 92.3 to 141.9 billion yen in 1946-48, suddenly turned to a surplus of 156.9 billion yen in 1949.
- ❑ The exchange rate was unified and fixed at \$1=360 yen.
- ❑ It was feared that Dodge Line measures would plunge the Japanese economy to another depression. This did not happen because the Korean War (1950-53) increased US demand for Japanese goods.
- ❑ Professor Carl Shoup was also sent to Japan for tax reform. A direct tax-based system (personal and corporate income taxes) was introduced, the local tax base was strengthened, and tax collection was rationalized.

Democratization

Under US occupation, the Japanese government was permitted to exist, but had to follow GHQ orders. In reality, the Japanese government often argued, proposed and negotiated with GHQ instead of passively taking orders. Some of the reform actions (esp. land reform) were previously studied (but not executed) by the Japanese government.

Here are the US-imposed actions:

- ❑ Demilitarization
- ❑ New Constitution based on human rights and pacifism (1947)
- ❑ Tokyo Military Tribunal (1946-48)—execution and imprisonment of war criminals (Emperor was not tried)
- ❑ Breaking up of *zaibatsu* (1946); later remerged as *keiretsu* (with no holding company)
- ❑ New labor laws to protect workers' rights (1945-47)
- ❑ Land reform (1946-)
- ❑ Women's suffrage (1945)

New Constitution

Promulgated Nov. 3, 1946; Enforced May 3, 1947

Initial Japanese drafts, maintaining emperor's sovereignty, were rejected by GHQ. Instead, the American draft served as the base.

- ❑ Natural law—social contract among people (preface).
- ❑ Sovereignty resides with the people.
- ❑ Emperor is the symbol of the state and people's unity (without political power).
- ❑ Basic human rights—not just freedom, but also guarantee of minimum living standards.
- ❑ Pacifism (Article 9—see below).
- ❑ Balance of power among legislature, executive and judiciary.



Article 9 Controversy

Full text of Article 9:

- 1) Aspiring sincerely to an international peace based on justice and order, the Japanese people forever renounce war as a sovereign right of the nation and the threat or use of force as means of settling international disputes.
- 2) In order to accomplish the aim of the preceding paragraph, land, sea, and air forces, as well as other war potential, will never be maintained. The right of belligerency of the state will not be recognized.

- ❑ Renunciation of war
- ❑ No possession of military forces
- ❑ Denial of the state's right of belligerency

Nevertheless, Self-Defense Force (SDF) was created in 1954.

Interpretation of LDP Government (until 2009):

- Invasion is prohibited but self-defense is permitted.
- SDF is a minimal power and not military forces

PM Abe's Second Government (2014-2020)

➔ Tried to revise constitution to explicitly legitimize SDF

- ❑ “Recently, security situations surrounding Japan have changed significantly for worse.” (North Korea and China)
- ❑ The Right of Collective Self-defense should be permitted (SDF to assist US forces under enemy attack) in addition to self-defense (Cabinet Decision, July 2014).
- ❑ In July 2015, parliament passed a bundle of laws to allow SDF to go abroad (previously, ad hoc laws were created for individual operations in Cambodia, Iraq, etc.) ➔ Applied to S. Sudan PKO
- ❑ LDP under PM Abe (with other parties) secured 2/3 of Lower House and 1/2 of Upper House.
- ❑ In 2017, PM Abe openly stated his intention to amend the constitution (add one paragraph legalizing SDF to Article 9). But political and popular support did not gather, and his plan did not go to the parliament.

Land Reform, 1946-50



- ❑ GHQ ordered land reform (“landlords are evil”). The 1945 draft plan, redistributing only 11% of farmland, was rejected by GHQ. The 1946 plan, redistributing all land above 1 ha (in Hokkaido, above 4 ha) to actual cultivators, was implemented.
- ❑ A land reform committee was established in each village. 415,000 officials and volunteers were mobilized nationwide. High unemployment of qualified persons at that time made this possible.
- ❑ Six million families were involved, of which two million were losers. 80-90% of absentee landlord holdings and 70-80% of resident landlord holdings were transferred. Owned land rose from 54% in 1941 to 91% in 1955. Japanese agriculture was returned to small family farming.
- ❑ Land transfer prices and rents were set low to the benefit of former tenants. High inflation quickly eroded the real value of any land purchase.

Land Reform: Reasons for Success

- Forced reform under US occupation.
- Existence of accurate database for land title and actual cultivators.
- Preparation by reform-minded agricultural officials even before WW2.
- Availability of a large number of unemployed but educated staff.

Remaining Problem: Inefficiency

- ❑ The land reform was very successful from the viewpoint of equity and removing landed parasites. Politically, it was a great reform.
- ❑ But the average size of land per family remained small and even declined after the reform (1.09ha in 1941, 0.99ha in 1955), which was too small for efficiency. There is no evidence that owned land became more productive than tenanted land.
- ❑ Lavish farm subsidies and trade protection were subsequently provided to Japanese agriculture but they failed to raise productivity.

Rural Life Quality Improvement Movement

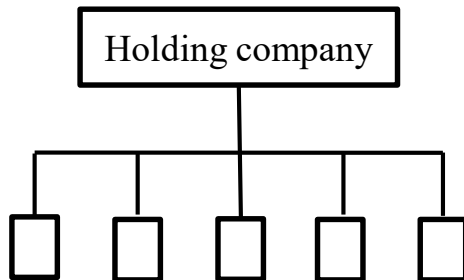
M. Mizuno and H. Sato, eds, *Development in Rural Society: Rethinking Rural Development*, IDE-JETRO, 2008, in Japanese.

- ❑ In 1948, GHQ ordered the Ministry of Agriculture to initiate nationwide “Life Improvement and Dissemination Movement.”
- ❑ Many local governments (Yamaguchi, Kagoshima, etc.) also launched similar programs with enthusiasm.
- ❑ The movement combined top-down official directives with grass-root village activities organized by life improvement dissemination staff (village housewives).
- ❑ Daily life improvement over cooking, nutrition, meals, clothing, bedding, cleaning, washing, child raising, public morals, frugal weddings and funerals, superstition, feudal habits, etc.
- ❑ Staff were trained in Tokyo and major cities; universities and research institutions provided information and techniques.
- ❑ Similarly, “New Life Improvement,” “Life without Mosquitoes and Flies Movement,” etc. were conducted up to the 1950s and 1960s.

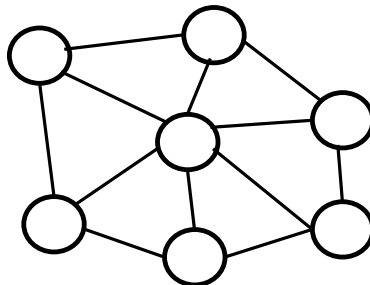
From Zaibatsu to Keiretsu

- ❑ The US regarded zaibatsu as the economic source of war and ordered their dissolution and transfer of financial assets to a special committee. In 1946-47, targeted zaibatsu were designated in five batches. The first batch included Mitsui, Mitsubishi, Sumitomo, Yasuda and Fuji.
- ❑ The anti-monopoly law prohibited *holding (parent) companies* (they were legalized again in 1997).
- ❑ Disbanded firms later re-formed as *keiretsu* (Type I). These were groups of friendly firms loosely linked through (i) a core bank; (ii) mutual share holding; and (iii) weekly lunch meetings of CEOs.
- ❑ There was also another type of *keiretsu* led by a giant assembler (such as Toyota and Nissan) with pyramidal subcontracting relationship.

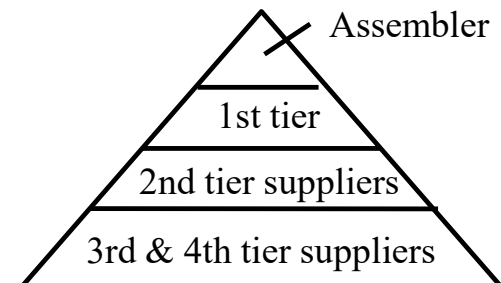
Zaibatsu



Keiretsu Type I



Keiretsu Type II



Three Labor Laws

In 1945-47, a series of laws including the Labor Union Act, the Labor Relations Adjustment Act and the Labor Standards Act were enacted.

Their features were as follows:

- ❑ Basic rules and criteria for labor contracts are enforced.
- ❑ Support creation of trade unions and negotiation between management and labor.
- ❑ Procedure for dispute settlement in collective bargaining.
- ❑ Prohibition of strikes by public servants.
- ❑ Prevention of exploitation by private labor brokers.
- ❑ State provision of labor matching service and unemployment benefits.

Economic Reforms in Postwar Japan

A book edited by Yutaka Kosai & Juro Teranishi, University of Tokyo Press, 1993

The main points advanced by the editors are as follows.

- ❑ During the postwar recovery, radical reforms were possible because of (i) US occupation; (ii) wartime control that weakened the reform opposition groups (zaibatsu and landlords); (iii) general distrust of the market mechanism; and (iv) foreign aid and the Korean War boom which provided economic resources.
- ❑ Labor, land and zaibatsu reforms altered power relations and wealth distribution and brought equity, but they did not improve efficiency.
- ❑ From the mid- to late twentieth century, Japan experienced three waves of deregulation:
 1. Reforms by planning method under US occupation, 1945-50
 2. Global trade re-integration, 1950s to mid-1970s
 3. Financial deregulation and privatization of state enterprises, 1980s

Note: prolonged reform period can be interpreted as the result of strong resistance or the fact that a market economy needs time to grow, or both.

Additional Topics for Discussion

- ❑ How do you evaluate Japan's economic recovery strategy during 1945-49? Was it excellent, sensible or disastrous? Please assess (i) concern over output vs. inflation; (ii) use of planning and the (slow) timing of reverting to market; (iii) US occupation policy as a constraint and/or push factor; and (iv) comparison with typical IMF advice to crisis countries.
- ❑ Assess the land reform, disbanding zaibatsu and the new labor laws as shapers of the postwar Japanese economic model. Were they critically important or not so important in changing Japan's fundamental mindset and systems?
- ❑ Was Japan's postwar economic system inherited from the war years, or was it created mostly after WW2? Was there a systemic continuity or break before and after the war?