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THE ECONOMY OF JAPAN

Alexandra Zoltai

Abstract

Japan is one of the largest and most developed economies in the world, with a well-educated and hard-working workforce, and its population makes it one of the largest consumer markets in the world in terms of size and standard of living. Its post-World War II economic growth was unprecedented. Japan was the second largest economy in the world from 1968 until 2010, but the emerging China has overtaken. This briefing looks at the question of whether the revival of the Japanese economy will be successful and the country will preserve its outstanding ranking in the world economy.

Keywords: Japan, economy, GDP, COVID-19,

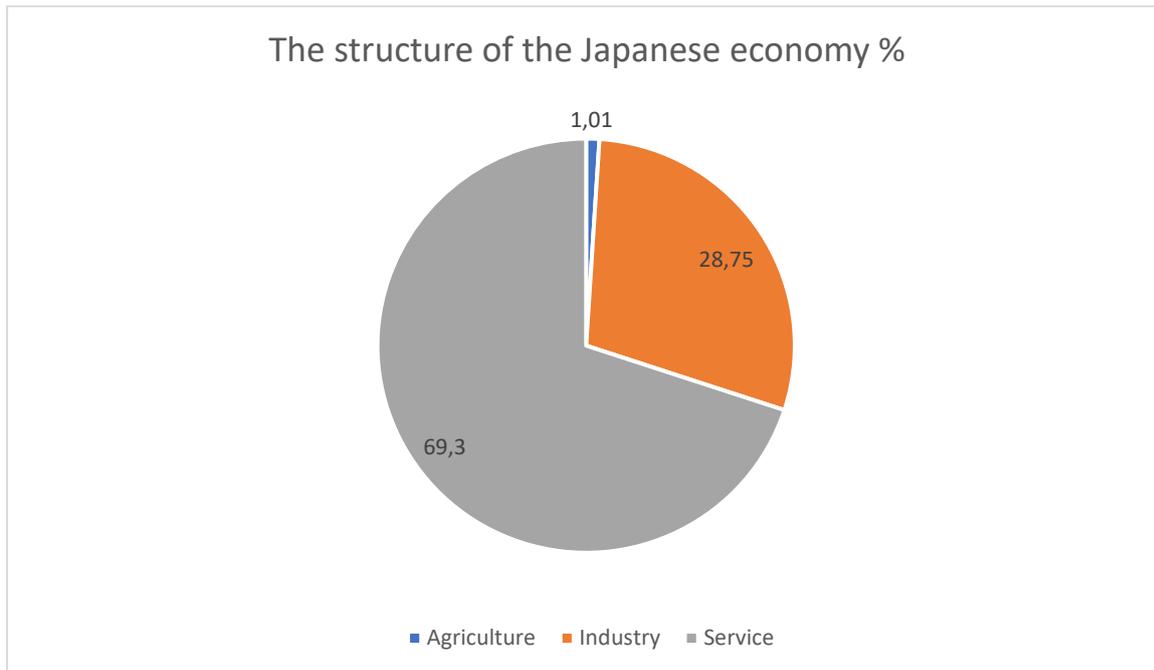
Early years

Japan is one of the largest and most developed economies in the world. From 1968 to 2010, - when it was overtaken by China -, it was the second largest in the world (behind the United States). With the country's unprecedented post- World War II economic boom, Japan was one of the first Asian countries to climb the value chain with cheap textiles, advanced manufacturing and services - which today account for much of Japan's GDP and employment, while primary industries, including agriculture, account for only 1 percent of the country's GDP. An important growth factor for the country has been the "backwardness" of the Japanese economy relative to the world's advanced industrialized countries. Because of this backwardness, the country was able to benefit greatly from technologies imported from more developed countries. "Technology" in this context included not only technical know-how directly related to production, but also social and economic systems and institutions. The use of advanced technologies meant a great opportunity for rapid growth for Japan, and from the 1960s to the 1980s, Japan achieved one of the highest economic growth rates in the world.

Japan's growth was driven by the following factors:

- A high rate of investment in production equipment and facilities;
- application of advanced industrial techniques;
- high quality of education;
- a good labor-management ratio;
- easy access to leading technologies and significant investment in research and development;
- the important role of the state in economic development;
- increasing integration with world trade.

In Japan, manufacturing has been the engine of economic growth and has also been recognized internationally. To date, Japan is a world leader in the manufacture of electrical and electronic equipment, automobiles, boats, machine tools, optical and precision equipment, machinery, and chemicals. In recent years, however, China and South Korea left behind in a number of areas, transforming the Japanese economy and service sector, including financial services, which now play a key role in the country's economy and account for nearly 70 percent of GDP. Financial services are also worth highlighting, as the Tokyo Stock Exchange is one of the most important financial centers in the world.



Source: Statista, 2019 <https://www.statista.com/statistics/270093/distribution-of-gross-domestic-product-gdp-across-economic-sectors-in-japan/>

In 2020, Japan was the third largest economy in the world in terms of GDP (USD), the fourth largest in terms of exports, and the fifth largest in terms of imports, 25th in terms of GDP per capita (USD), and the number one most complex economy in terms of the Economic Complexity Index¹ (ECI). International trade is a significant contributor to the Japanese economy, with exports accounting for about 16% of GDP. The main export goods are vehicles, machinery, and manufactured goods. In 2020, Japan's main export destinations were China (21.3%), the United States (18%), and South Korea (6.88%). Since Japan has few natural resources, the contribution of agriculture to GDP is small, so Japan mainly imports mineral fuels, machinery, and food. In 2020, the leading suppliers of these goods were China (26.1%), the United States (10.9%), and Australia (5.47%). Recent trends in Japanese trade and foreign investment show increasing linkages with China, which has already surpassed the United States to become Japan's largest trading partner.

The Changing Japanese Economy and the Impact of COVID-19

Recent economic reforms and further trade liberalization aimed at making the economy more open and resilient will be important for the Japanese economy to compete with other emerging economies and cope with external and internal challenges. In December 2012, after the Japanese elections, Prime Minister Abe Shinzo announced a reform package called "Abenomics," which included fiscal and monetary expansion and the adoption of structural reforms to liberalize the Japanese economy. Economic policies under Abenomics helped ease financial conditions, combat deflation, and increase labor force participation, but fell short of the deep reforms needed to boost productivity and achieve inclusive and sustainable growth. Although Abenomics has driven up stock prices and generated high corporate profits, the wages of low-wage workers and the growth of small businesses have been slow. Abenomics would have aimed to revive the Japanese economy, but nine years and several prime ministers later, growth has remained slow as wealth inequality within society widened.

Kishidanomics aims to change this - that is, to seek a more equitable distribution of the common good across the strata of society. The current prime minister, Fumio Kishida, sees an opportunity to give fairness a greater role in his economic policy. His program has become known as 'new capitalism' and includes tax breaks - and in some cases tax penalties - for companies depending on whether they raise or lower wages. Japan's newly elected prime minister has developed populist economic policies aimed at supporting potential growth sectors and encouraging companies to raise wages, which have long been stagnant. The planned measures appear promising, but they also imply a greater role for the state in an economy where the prevailing view has been that successful economic policy requires less rather than more government intervention. The additional tax package announced in November 2021 will support the health care system as well as affected workers and businesses. As the economy normalizes, fiscal policy can facilitate the redistribution of resources. To achieve this, the Bank of Japan should maintain monetary accommodation while continuing to support the balance sheets of smaller companies until pandemic uncertainty subsides.

Summary

The imposition of several states of emergency and their extension to almost the entire country has hindered the recovery of the economy from the difficulties caused by COVID -19. However, the significant progress in vaccination and the decline in the infection rate already provide the opportunity to increase consumption more and boost investment by restoring supply chains. As a result of the new government's economic policy package, economic growth is expected to reach 3.4% in 2022 and 1.1% in 2023. With recovery from the epidemic still ongoing, policy support remains important, especially for the hardest-hit households and businesses. Budget support can improve prosperity and prospects in the longer term, for example by strengthening the health system and investing in human resources, technology, and infrastructure. Accordingly, the new economic package will boost the economy in the short term and also support longer-term growth. Japan is expected to embark on its digital and green transformation, which could further support the economic



recovery from the epidemic while providing a boost. However, the positive outlook could be affected by uncertainties such as the Russia-Ukraine conflict. However, the rapid aging of Japan's population is also an issue to be addressed, as this is expected to reduce labor and tax revenues while increasing demands on health and social spending.

With appropriate economic policies the outlook for the Japanese economy is good, but it is important that policymakers respond to the individual challenges in time.

¹ This can be used to assess the current status of a country's productive knowledge. Individual countries can improve their position by, for example, increasing the number and complexity of successfully exported products.