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KC3014 Contemporary Japanese Economy

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The most important factor affecting Japan's low productivity/growth rate, is the decreasing real wage in Japan. Factors like the working environment and industrial structure have shown improvement, but not enough to affect Japan's low productivity like the real wage has with its decrease. As it stands currently, Japan's employment system makes this difficult to remedy. Since an employee's wages are based on their seniority and it's difficult to lay off employees, companies lack the flexibility to adjust wages for a rapidly changing economic environment.

By increasing price in tandem with wage (increasing inflation) tax revenue increases. Consequently, it becomes easier to pay off debt without affecting standard of living and the amount of past debt. To avoid deflation, Japan should aim for 2% inflation rate, since Japan's potential growth rate is also 2%. Additionally, money should decrease moderately to motivate them to use it. With deflation, people are more inclined to save as they wait for the value of money to increase. On the other hand, if money decreases in value too quickly because of inflation, then people won't be motivated to earn it. Thus, the best option is to moderately decrease the value to maintain its value. Another benefit is that inflation motivates individuals to invest, since these investments can make money for them, as opposed to just holding it while it loses value. This propels further inflation and economic investments. Unfortunately, in Japan's case, since it's difficult to increase real wage due to the rigid employment system, the inflation just has a negative effect on the economy.

As a result of the Vietnam War in the 1960s, the U.S. had expanded fiscal spending and facility investment which caused high inflation. Moreover, with the additional imports and decreasing trade surplus, the amount of dollar circulating started exceeding the amount of gold that the U.S. possessed. To stop the dollar-gold standard from collapsing, President Nixon suspended dollar-gold convertibility in 1971 to avoid default and help U.S. goods recover value. Since the dollar's value was being doubted, a lot of selling dollars and buying yen occurred in the foreign exchange market. This is because they believed the value of the dollar would continue to decrease while the yen's value would increase. The Bank of Japan attempted to combat this by doing the opposite (selling yen and buying dollars). They were the only ones attempting to do this, so they were losing money which caused them to give up on their attempt after a few months.

The Smithsonian Agreement was the agreement to rebuild the dollar-gold standard. They planned to do this by devaluing the dollar and adjusting the exchange rate between the dollar and other currencies. The devaluation wasn't nearly enough to restore the standard, and by February 1973 with a series of speculative attacks, the fixed exchange rate system was dropped. Currently, all major countries follow the float system as a result.

In the aftermath, money printing increased and so did inflation. Japan's leaders thought the appreciation of yen would reduce exports and increase imports, so they increased public works. The development of transportation networks like highways shinkansen lines to decentralize industry, pollution and reduce the wealth gap between urban and rural areas. Since more areas were easily accessible to this, land was being bought up (resulting in increased land prices). They also wanted to avoid a recession, so they stimulated the domestic market by lowering the discount rate. Lastly, another factor contributing to inflation was the oil crisis in 1973 where middle eastern countries placed an oil embargo against countries supporting Israel, causing oil supply to decrease and oil price to increase (price level increase).

To stabilize the rapid inflation, they stopped their expansionary fiscal policy and raised the discount rate (aggregate demand-control policy). Oil demand was still high as all countries used oil to function and time was needed to develop alternatives and find new oil fields. Because of these actions, Japan experienced stagflation. In 1978, there was a second oil crisis which tripled oil prices which put Japan in high inflation again. This wasn't as bad as the first oil crisis, as they had already prepared alternative energy sources and quickly implemented anti-inflation measures.

The U.S. also underwent high inflation due to the oil crisis and expansionary fiscal policy. The U.S. also underwent stagflation. Reagan's administration reduced tax to increase supply expecting increased tax revenue (but didn't end up going there). The federal reserve also increased interest rate to subdue the inflation rate. These actions caused short term economic downturn and larger fiscal deficit. This caused trade friction between the U.S. and Japan. This resulted in protectionism, where U.S. lobbyists wanted to protect U.S. manufacturers from Japanese companies "invading". The Plaza Accord was intended to prevent protectionism. Thus, it was agreed to raise the value of yen, coordinate currency intervention together. In response to the Plaza Accord, yen buying increased rapidly. Wanting to avoid a recession, Japan lowered interest rates and created a fanned bubble.

With this bubble, land prices skyrocketed and stimulated the bubble further (with help from private banks loaning large amounts of money with land as collateral). Eventually, the bubble burst because the government reacted too strongly with their policies. The burst resulted in plummeting land prices, and borrowers bankrupted rapidly. The subsequent recession was caused by the bank too slowly cleaning up bad loans. The Koizumi Reform in 2001 enacted reduced bad debts, more privatized government companies (postal service) Lastly, Abenomics started in 2009. Abenomics aimed for expansionary monetary and fiscal policy and structural reform. This was intended to induce 2% inflation and Higher GDP growth rate.