What were the reasons for the growth of the global economy after WWII?

Objectives:
Students would be able to:
• Analyze the role of Europe and Japan's contribution to the growth of the global economy • Analyze the impact of MNCs and economic events in shaping the growth of the global economy

What role did Europe and Japan play?

At first economic recovery was slow in Western Europe and Japan due to the destruction of WW2 which incurred substantial human losses, damaged physical infrastructure and caused the physical and mental exhaustion of the people.

- In West Germany, the Allied powers initially implemented a policy to place greater emphasis on agriculture and reduce its industrial capacity, thus slowing economic recovery.
- Japan's recovery was fraught with greater problems and was much slower than Germany's. It lacked Germany's geographical advantage of being surrounded by rapidly recovering economies (the Western European countries), which provided the sales markets for Germany's recovery.

However, the recovery of Western Europe and Japan was expedited due to Marshall Aid from the USA, which provided the necessary physical and financial capital to jumpstart their devastated economies. Japan was given immense financial aid as USA wanted it to be the Far Eastern key political center of resistance to Communism.

- Recent scholarship has found the positive impact of the Marshall Plan not so much in the scale of material assistance, but rather in the political strings attached to it.
- Dollar aid enabled recipient nations to eliminate raw material shortages and invest in bottleneck industries, but only in exchange for trade liberalisation. The resources afforded by the counterpart funds allowed governments to finance public investment projects without the need to cut back on welfare spending, but they were compelled to reintroduce free markets and lift wartime controls and rationing, despite fierce opposition from labour unions.

Many domestic factors also contributed to the rapid recovery of Western Europe and Japan, such as the high rates of literacy and specialised education, their industrial-social discipline, a competent government, effective markets, home-grown technology and a long tradition of savings and capital creation.

- Their remarkable growth rate can be seen from their total share of world trade from the period between 1955-1971. The USA's share dropped from 16.7% to 11.7%, while Western Europe's increased from 30% to 41% and Japan's from 2.1% to 6.4%.
- By 1947, industrial production was back at pre-war levels in at least the victorious powers and the non-belligerent economies. Across Western Europe economic recovery was swift and dramatic. By 1952, production levels in the region exceeded pre-war levels.
- Japan was now seen as a Newly Industrialised Economies (NIE). It was at the forefront of booming Asian economies that came to be known as the "East Asian Tigers." Hong Kong, South Korea, Singapore and Taiwan were also eventually seen as similar rising economies.

Hwa Chong Institution (College): History Paper 1
Theme II: Understanding the Global Economy
How did the Development of the Global Economy Impact the World?

What impact did Europe and Japan have on the Global Economy?

The recovery of Western Europe and Japan helped to sustain the economic growth and development started by the USA. Moreover, they supported the USA's open-door policy and promoted trade through trading extensively with each other.

- In fact, their rapid industrial expansion significantly affected economic growth in many parts of the world in the 1960s and 70s, because their expansion generated an ever-growing demand for foreign products.
- Western Europe and Japan's economic rebound played a role in reducing the economic dominance of the USA, especially through their contribution to the international financial institutions like the International Monetary Fund (IMF) and the World Bank.

Countries	Post-1945 recovery and contribution to the GE
France	U.S. aid flows through the Marshall Plan and, combined with the national plan and worldwide prosperity, brings an economic boom and annual growth of 5 percent. France invests heavily in infrastructure and in 1957 plays an active role in setting up the European Economic Community (EEC), or Common Market, an expansion of the 1950 European Coal and Steel Community. By the 1980s, France had become a leading world economic power and the world's fourth-largest exporter of manufactured products. It became Europe's largest agricultural producer and exporter, accounting for more than 10 percent of world trade in such goods by the 1980s.[1]
Italy	Prewar industrial production levels were regained by 1948, and production for the Korean War (1950–53) provided further stimulus to growth. Until 1964, the country enjoyed an "economic miracle," with industrial growth rates of more than 8 percent per year. Its most prominent industries, still in the northwestern industrial triangle, produced fashionable clothing (especially shoes), typewriters, refrigerators, washing machines, furniture, plastics, artificial fibers, sewing machines, inexpensive motor scooters and cars.

Germany	Germany benefited enormously from the explosion of intracommunity trade that followed the gradual implementation of the customs union. Between 1958 and 1960 alone, trade between the six member countries grew by 50 percent. The 1960s was a decade of extraordinarily high and sustained rates of economic growth in Germany and throughout Western Europe. The 1960s epitomized a golden age in Germany's economic development. It was a decade of soaring growth rates, ample employment, and relatively low inflation. The German economy became the driving force within the Community. The West German revival was also aided by relatively good industrial relations. At a time when Germanys international competitors faced industrial militancy, with the British coal mining industry alone recording some 2400 strikes in 1954, industrial relations within the FRG remained positive. The simple idea of quick, amicable negotiations being established without much potential impact to a factories output. Such favorable relationships were helped by the aforementioned refugee

[1] https://www.questia.com/read/1G1-79211324/economic-policy-in-france-and-italy-since-the-war2

	workforce, who put downward pressure on wages, thus weakening the bargaining power of trade unions. The people of the FRG embraced consumption, as shown by its continued increase throughout the period of economic recovery, with advertisements and radio broadcasts urging people to spend. Between 1960-1975, West German consumption more than doubled that of Britain, emphasizing that there was high domestic demand for German goods, thus helping the continued expansion of firms and therefore economic recovery well into the 1960s.

Britain	Britain's desperate economic situation, however, forced the government to continue with rationing and controls throughout the late-1940s. The 1950s would be dominated, politically, by the Conservative Party. The 1950s was a time of full employment and rationing was phased out by 1954. The UK economy benefited from the period of rapid global economic growth, especially in Western Europe. In fact, in this period, UK growth lagged behind many of our Western European neighbours. The boom was helped by: - Recovery of Germany and Japan - Low global inflation - Increased free trade - Political stability - Technological improvements In the post-war period, the government controlled monetary policy and fiscal policy and had a willingness to cut interest rates during economic slowdowns. The benign global economic conditions helped give a low trade off between inflation and unemployment. However, UK's growth could have been higher if not for the following: - Uncompetitive industry - Poor industrial relations - Lack of vocational training

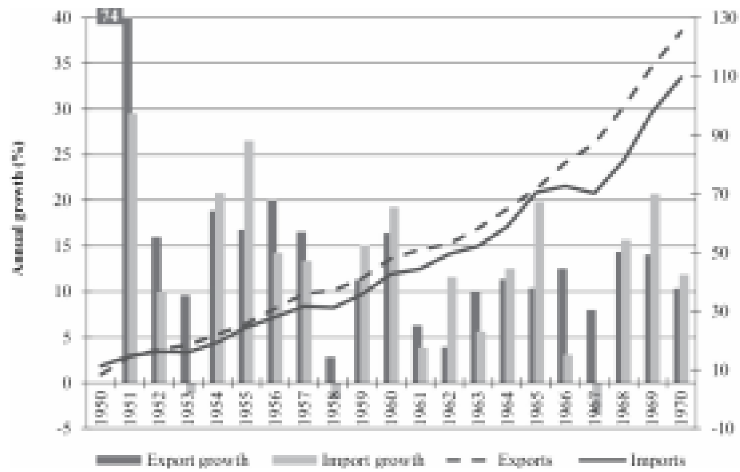
The convergence between France, West Germany and Italy can be traced back to certain advantages of the European economy.

- Europe was an industrial and commercial powerhouse before WWII and its economic infrastructure already existed, and some of the technological knowledge, infrastructure and managerial/worker skills were still available.
- After the war, social and economic policies focused on recovery, catch-up and growth e.g. extensive job training programmes (Germany), high rates of savings, close ties between business and government facilitated recovery of key industries (France).

CASE STUDY: GERMANY

At the end of World War II, much of Germany was in ruins. Large parts of its infrastructure were attacked or bombed by the Allied Forces. The city of Dresden was completely destroyed. The population of Cologne had dropped from 750,000 to 32,000. The housing stock was reduced by 20%. Food production was half the level it was before the start of the war; industrial output was down by a third. Many of its men between the ages of 18 and 35, the demographic which could do the heavy lifting to literally rebuild the country, had been either killed or crippled.

But by 1989, Germany had the third-biggest economy in the world, trailing only Japan and the United States in GDP. The West German boom that began in 1950 was truly memorable. The growth rate of industrial production was 25.0 percent in 1950 and 18.1 percent in 1951. Growth continued at a high rate for most of the 1950s, despite occasional slowdowns. By 1960 industrial production had risen to two-and one-half times the level of 1950 and far beyond any that the Nazis had reached during the 1930s in all of Germany. GDP rose by two-thirds during the same decade. The number of persons employed rose from 13.8 million in 1950 to 19.8 million in 1960, and the unemployment rate fell from 10.3 percent to 1.2 percent.



hard currency to enable them to reduce trade barriers without risking insolvency. By encouraging **inter European trade**, through such mechanisms as the European Payments Union of 1950, the USA in effect guaranteed a fragile free trading order that benefited the West German economy.

Germany's rebirth was the European Recovery Program, better known as the Marshall Plan. Crafted by U.S. Secretary of State George Marshall, this act saw the United States giving $13 billion (around $115 billion in 2008 prices) to European nations affected by World War II, with a large chunk of this money going to Germany.

Evaluation: However, the success of the Marshall Plan has been debated by economic historians. Some have estimated that aid from the Marshall Plan contributed less than 5% to Germany's national income during this time period. Other countries that received substantial Marshall Plan aid exhibited lower growth than Germany. Moreover, while West Germany was receiving aid, it was also making reparations and restitution payments well in excess of $1 billion. Finally, and most important, the Allies charged the Germans DM7.2 billion annually ($2.4 billion) for their costs of occupying Germany.

That is just the outer shell of the Marshall Plan, the sweetener that was added to make a large political package containing bitter pills more palatable to the public in Paris and London. The financial core of the Marshall Plan was something much, bigger, an enormous sovereign debt relief programme.

Beyond Marshall Plan Aid

Germany's deficits during World War II were mostly robbery at gunpoint, usually at heavily distorted exchange rates. German internal wartime statistics suggest that when calculated at more realistic rates, transfers from Europe on clearing account were actually closer to 90% of Germany's 1938 GDP. To this adds Germany's official public debt, which internal wartime statistics put at some 300% of German 1938 GDP. Recipients of Marshall Aid were (politely) asked to sign a waiver that made U.S. Marshall Aid a first charge on Germany. No claims against Germany could be brought unless the Germans had fully repaid Marshall Aid. This meant that by 1947, all foreign claims on Germany were blocked, including the 90% of 1938 GDP in wartime clearing debt.

Labor also benefited in due course from the boom. Although wage demands and pay increases had been modest at first, wages and salaries rose over 80 percent between 1949 and 1955, catching up with growth. West German social programs were given a considerable boost in 1957, just before a national election, when the government decided to initiate a number of social programs and to expand others.

Until the economic effects of unification became apparent in 1991 and 1992, Germany had an enviable record of generally sustained growth, high employment, and low inflation. Germany's ability to bear the heavy burden of unification is testimony to the country's resilient economy and robust currency. Germany's ascent became known throughout the world as the German Economic Miracle. In Germany, it was dubbed the *Wirtschaftswunder*.

Role of the US

The Marshall Plan originated primarily in the realization that the Western European economies lacked the

Currency reform in 1948—the U.S. Army put an occupation currency into circulation, and gave it the neutral name of Deutsche Mark, as no emitting authority existed yet—wiped out domestic public debt, the largest part of the 300% of 1938 GDP mentioned above.

But given that Germany's debt was blocked, the countries of Europe would not trade with post-war Germany except on a barter basis. Also, to mitigate this, Europe was temporarily taken out of the Bretton Woods currency system and put together in a multilateral trade and clearing agreement dubbed the European Payments Union. Trade credit within this clearing system was underwritten by, again, the Marshall Plan.

In 1953, the London Agreement on German Debt perpetuated these arrangements, and thus waterproofed them for the days when Marshall Aid would be repaid, and the European Payments Union would be dissolved. German pre-1933 debt was to be repaid at much reduced interest rates, while settlement of post-1933 debts was postponed to a reparations conference to be held after a future German unification. No such conference has been held after the reunification of 1990. The German position is that these debts have ceased to exist.

Let's recap. The Marshall Plan had an outer shell, the European Recovery Programme, and an inner core, the economic reconstruction of Europe on the basis of debt forgiveness to and trade integration with Germany. The effects of its implementation were huge. While Western Europe in the 1950s struggled with debt/GDP ratios close to 200%, the new West German state enjoyed debt/ GDP ratios of less than 20%. This and its forced re-entry into Europe's markets was Germany's true benefit from the Marshall Plan, not just the 2-4% pump priming effect of Marshall Aid. As a long-term effect, Germany effortlessly embarked on a policy of macroeconomic orthodoxy that it has seen no reason to deviate from ever since.

West Germany's growth continued over the years. By 1958, its industrial production was four times higher than it was just one decade earlier.

A vast amount of money was invested in the rebuilding of industry, with the coal industry alone receiving 40% of these funds. 20% in electricity in 1949-51 and 15% in iron and steel in 1950-51. The concept was simple enough, companies that were provided such funds, were obliged to repay these "loans" to their government, so that these same funds could be used to assist other businesses and industries.

Post-war Germany had been forced to dismantle a great deal of its major factories and industries, according to guidelines enforced by the Allied Control Council. Figures for car production alone had been set to levels that represented only 10% of pre-war numbers. With the introduction by the Western Allies of the German "Mark" as the new official currency, on June 21, 1948, a new economic era was signaled within Europe and especially Germany. The Petersburg Agreement, signed in November 1949, increased these production figures for Germany dramatically.

Therefore, Germany in particular was keen on maintaining this concept, even after the Marshall Plan had officially terminated, so that this process continues today. The KfW Banks (Kreditanstalt für Wiederaufbau) headquartered in Frankfurt, has since 1948, administrated these funds. Under the leadership of Dr. Hermann-Josef Abs and Dr. Otto Schniewind, the KfW Bank continued to work "miracles", during the "Wirtschaft Wunder" years, playing an important role in getting the German economy going. By 1950, 12% of their loans were used for housing construction. With the unification of Germany, the KfW

helped pay, between 1990 and 1997, for the modernisation of 3.2 million apartments in the former East Germany, nearly one half of all existing housing structures in the new States.

This institution has an annual revenue of 70 billion Euro. The KfW is Europe's largest promotional bank, promoting the legacy of the Marshall Plan in third world countries today, in much the same way, with a new primary emphasis on microfinance; the loaning of small amounts to impoverished third world individuals, to start a small business.

Role of the West German Government

Volker Hentschel (an academic) argues that importance of the physical reconstruction that took place from 1945 – 1948, particularly the impact of the modernizing of the transportation network, and the effects of the Marshall Plan. While critical of Erhard, he acknowledges that the policies in place mattered in influencing the rate of growth.

Erhard began to formulate a multi-pronged effort to bring West Germany's economy back to life. First, he played a large role in formulating a new currency issued by the Allies to replace the worthless remnant of the past. This plan would reduce the amount of currency available to the public by a staggering 93%, a decision that would reduce the little wealth that German individuals and companies held. The basic idea was to substitute a much smaller number of deutsche marks (DM), the new legal currency, for Reichsmarks. The money supply would thus contract substantially so that even at the controlled prices, now stated in deutsche marks, there would be fewer shortages.

In addition, **large tax cuts** were also instituted in an attempt to spur spending and investment. The corporate income tax rate, which had ranged from 35 percent to 65 percent, was made a flat 50 percent. Although the top rate on individual income remained at 95 percent, it applied only to income above the level of DM250,000 annually. In 1946, by contrast, the Allies had taxed all income above 60,000 Reichsmarks (which translated into about DM6,000) at 95 percent. For the median-income German in 1950, with an annual income of a little less than DM2,400, the marginal tax rate was 18 percent. That same person, had he earned the Reichsmark equivalent in 1948, would have been in an 85 percent tax bracket.

Almost overnight, West Germany came to life. Shops immediately became stocked with goods as people realized that the new currency had value. Bartering ceased quickly; the black market ended.

As the commercial marketplace took hold, and as people once again had an incentive to work, West Germany's **famed sense of industriousness** also returned. In May of 1948, Germans missed approximately 9.5 hours of work a week, spending their time desperately looking for food and other necessities. But in October, just weeks after the new currency was introduced and price controls were lifted, that number was down to 4.2 hours per week. In June, the nation's industrial production was about half of its level in 1936. By the end of the year, it was close to 80%. By 1958 industrial production was more than four times its annual rate for the six months in 1948 preceding currency reform. Industrial production per capita was more than three times as high. East Germany's communist economy, by contrast, stagnated.

Cartels were also broken up, with a push for investments in export sectors. The government signaled its unwillingness to maintain aggregate demand at home at a level sufficient to ensure full utilization of

capacity: firms were forced to enter or reenter export markets. Wallich commented in 1955: 'German businessmen, having so long been cut off from the outside world, would not willingly seek new markets abroad if selling was made easy for them at home.' (p.83). Their task was made easier when the Korean War boom generated rapidly growing demand for investment goods in which Germany, unique in Europe, had spare capacity. The Germans had to reenter international markets in the early 1950s, but they were not starting from scratch: 80% of exported branded articles in 1952/3 were sold using trade-marks valid world-wide before the war.

In 1957 West Germany gained a new central bank, the Deutsche Bundesbank, generally called simply the Bundesbank, which succeeded the Bank Deutscher Länder and was given much more authority over monetary policy. That year also saw the establishment of the Bundeskartellamt (Federal Cartel Office), designed to prevent the return of German monopolies and cartels. Six years later, in 1963, the Bundestag, the lower house of Germany's parliament, at Erhard's urging established the Council of Economic Experts to provide objective evaluations on which to base German economic policy.

Role of Economic Restructuring and Labour Boost Economic Growth?

Reserves of underemployed labour have long been identified as a source of exceptional growth in the golden age. The one-off boost to growth from the reallocation of labour to more productive uses appears particularly relevant for West Germany in the years up to 1961. West Germany, like a number of other Continental

European economies, benefited from a pool of labour in agriculture which could be drawn into industry without putting upward pressure on wages. In addition, there was a steady inflow of well trained and mobile German immigrants from East Germany and elsewhere in Europe.

A total of 3.6 million refugees from East Germany entered West Germany between 1950 and 1962 (adding to the 2.5m who entered between 1946 and 1950). On average this labour pool was well trained and highly mobile. Abelshauser argues that the inflow of trained labour permitted West Germany to devote a smaller proportion of GDP to training and education in the 1950s than was the case in the Weimar Republic without negative consequences for growth (1925: 2.8%; 1951: 2.4%; 1962: 2.7%; 1968: 3.0%)

Surplus labour contributed to the weakening of the economic strength of the trade unions relative to that of employers in the immediate post-war period. The unions were accorded a diminished role in economic policy making from 1947, in parallel with the rehabilitation of business. The shift in the balance of power toward business was symbolized by the loss of union financial resources in the currency reform and confirmed in the stabilization episode of 1949 in which rationalization and labour shedding took place. The growing cohesion of the business associations was further marked by the passing of the Works Constitution Act in 1952 which weakened the position of the unions at plant level.

The economic weakness of labour reflected high unemployment and the economic insecurity of employees. The pool of unemployment in this period included the highly skilled and motivated refugees who can be thought of as good substitutes for the existing labour force and hence as a genuine excess supply of labour dampening union wage bargaining power. Trade union membership density fell from a peak of 36% in 1951 to 32% in 1955. It is union economic weakness in this period more than a conversion to 'the politics of productivity' which accounts for wage moderation. Wage claims were made to look even more moderate ex post by the unexpectedly rapid growth of productivity.

European integration, had devised the plan to pool production of coal and steel under a single supranational authority. At that time, coal and steel were the essential ingredients of economic reconstruction and future prosperity. Thus, Schuman's short, simple statement outlined a strategy to reconcile German economic recovery and French national security in the context of European integration. The Schuman Declaration resulted first in the European Coal and Steel Community (1952), and later in the European Atomic Energy Community (1958) and the European Economic Community (1958). Today, these three communities are known collectively as the European Community.

The **Schuman Declaration** created the climate in which West Germany's economic miracle flourished. That evocative phrase describes Germany's extraordinary recuperation from the devastation of 1945. Weakened by hunger and shocked by the trauma of defeat and occupation, Germans toiled tirelessly to clear rubble, remove wreckage, reopen roads and railways, and rebuild houses, schools, and hospitals. Despite the terrible extent of wartime destruction, a surprising amount of industrial capacity remained relatively intact, ready to be restored. Having gradually regained their strength and self-esteem, by the early 1950s Germans were ready to launch their country on the road to full economic recovery. The European Coal and Steel Community gave them the ability to do so; prevailing cheap labor and the economic effects of the Korean War also helped to fuel the boom.

In 1961, labour supply conditions in Germany changed sharply with the building of the Berlin Wall which ended the inflow of labour from the East. Between 1950 and 1961, the labour force grew by 1.5% p.a.; from 1961 until 1973, it grew by only 0.4% p.a. Even more striking is the slowdown in non-agricultural employment growth from 2.5% (1955-61) to 0.4% after 1961.

However, the tightening of the labour market did not result in the full utilization by the unions of their increased bargaining power. First, there was a parallel increase in the level of organization and cohesion of the employers' associations and second, the unions chose to exercise bargaining restraint. In the early 1960s, the attempt by the engineering union, IG Metall, to make use of the tension in the labour market by supporting decentralized wage negotiations was defeated by the concerted action of the employers. Subsequently, although the underlying balance of factor availability was operating to shift the factor distribution of income in labour's favour, the unions refrained from pushing their advantage – apparently recognizing the benefits for their membership of protecting competitiveness and investment.

Impact of Regionalism

Jean Monnet, a brilliant French official with a lifelong commitment to Franco-German reconciliation and

With an initial membership of France, Germany, Belgium, the Netherlands, Luxembourg, and Italy, the **European Coal and Steel Community** included a supranational High Authority, the institutional depository of shared national sovereignty over the coal and steel sectors. The High Authority was responsible for formulating a common market in coal and steel, and for such related issues as pricing, wages, investment, and competition. As Monnet saw it, the ECSC's purpose was not "to substitute the High Authority for private enterprise, but to make possible real competition throughout a vast market, from which producers, workers and consumers would all gain." The role of exports in fueling West German prosperity during the 1950s underscores the Western European regional context within which West German reconstruction took place. Nevertheless, as most other studies of the Marshall Plan and Western European economic history have noted, West Germany was the engine of Western

European economic growth.

As an emerging industrial giant, Germany benefited enormously from the explosion of intracommunity trade that followed the gradual implementation of the customs union. Between 1958 and 1960 alone, trade between the six member countries grew by 50 percent. The 1960s was a decade of extraordinarily high and sustained rates of economic growth in Germany and throughout Western Europe. Mirroring a similar development in the 1980s, following the launch of the European Community's single market program, economic growth was as much a result of "the increased activity of businessmen [as of] the actual reduction of tariffs. As soon as managers were convinced that the common market was going to be established, they started to behave in many ways as if it was already in existence"

In the 1960s, Germany, more than any other Community country, enjoyed rapid economic development, a healthy balance of payments, and stable prices. Only twenty years after the end of the war, Germany's economy had developed remarkably. A strong work ethic, harmonious labor relations, good management, sound investment, growing domestic and international demand, and a reputation for product reliability and durability characterized the manufacturing sector. Machine tools, cars, household appliances, chemicals, and pharmaceuticals were the leading industries.

The 1960s epitomized a golden age in Germany's economic development. It was a decade of soaring growth rates, ample employment, and relatively low inflation. The German economy became the driving force within the Community.

How did West Germany achieve a Balance of Trade surplus?

For Germany, the issue of the role of demand is less muddied by the simultaneity problem since until 1968 the government steadfastly refused to undertake a commitment to maintain domestic demand. In the golden age, Germany benefited from demand buoyancy as an external effect of the strong growth of its markets, especially in Europe. Modernization of the French and Italian economies called for new capital equipment and this was supplied by Germany. The formation of the European Community contributed to the creation of favourable expectations especially in Italy as the threat of increased competition acted to boost investment. When demand slackened at home, high capacity utilization in German industry was maintained because of export growth. This was assisted by the very long periods of fixed exchange rates combined with restrained wage behavior during which German competitiveness was maintained (until 1969).

Detailed analysis of German export behaviour in the 1950s and 1960s confirms that once markets had been reentered, Germany benefitted from the strong growth of its markets (commodity and area composition) rather than from the growth of market share (Maizels 1963, Batchelor et al. 1980).

Limitations

In the early 1970s, however, the global economic bubble burst. Fiscal and monetary strains in the United States and Europe caused the postwar system of fixed exchange rates to collapse. President Richard Nixon's suspension in August 1971 of dollar convertibility compounded the prevailing sense of uncertainty and apprehension. The 1973 war in the Middle East and subsequent oil embargo produced sluggish growth and spiraling inflation and sent Western Europe into a recession. A robust economy and resilient currency helped Germany weather the storm, but the country's rate of economic growth declined while unemployment and inflation increased.

CASE STUDY: JAPAN

By the 1970s, Japan had become the second largest capitalist economy in the world after the USA. The years 1972-1989 saw Japan become a major player in international politics due to its economic power. It was also a model of how to achieve prosperity and provided inspiration to the newly industrializing states in Asia. For a region that lay in ruins in 1945, this was a remarkable change in fortunes. To understand the 'economic miracle' of Japan, it is necessary to look at the political environment within the region, and not only the economic factors. The relationship Japan had with the Cold War cannot be separated when looking at her growth especially in the context of East Asia. Indeed, it can be argued that the 'economic miracle' in East Asia would not have happened outside the Cold War environment.

The graph above compares changes in real per capita gross domestic product in Japan, the United States, and Britain between 1870 and 2008. The values used are the natural logs of each country's per capita GDP in 1990 US dollar purchasing-power equivalents. Japan's per capita GDP in 1945, the year of its surrender in World War II, was $1,346 in 1990 US dollars—a mere 11% of the US figure for the same year and just 47% of the per capita income Japan itself achieved in 1940, the year before its entry into World War II.

1. Role of the USA

1.1 US Occupation of Japan

On 2 September 1945, Japan signed the official document of surrender ending the Pacific War led by General MacArthur, the Supreme Commander Allied Powers (SCAP). For the next seven years, the USA occupied Japan and set out on a massive campaign of reform designed to remove all vestiges of militarism and feudalism so that she could never be a threat to international order. It decided to keep a Japanese government as well as allowing the Emperor to stay on his throne. The rationale behind this was so that American influence would still prevail in Japan even after the seven years was up. The revolutionary political and economic changes imposed by the USA during its occupation were vital in creating Japan into an economic power. The US occupation can be divided into 2 eras:

1.1.1 <u>1945-1947: The 'Liberal' Phase</u>

SCAP concentrated on establishing democracy and pluralism so it encouraged the growth of the labour Movement, enfranchised women and engaged in extensive agricultural reform policy to eradicate tenancy, which was seen to have contributed to the rise of ultra-nationalism in the 1930s. Many of those associated with militarism were either put on trial-or purged from public life. This affected former army and navy personnel and some right-wing politicians, this was not applied to the royal family or the industrialists needed to run the country. In 1947, a new constitution was proclaimed, and this vested all political authority in the Prime Minister and the Diet, and the Emperor was a mere symbol. In Article 9, it declared that Japan renounced the right to go to war and to possess armed forces.

- The first step MacArthur took before implementing the reform policies were to establish economic demilitarization and to ensure that all production of military 7 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.

1.1.2 <u>1948-1951: The 'Reverse' Course</u>

The liberal phase ran its course by 1948 for USA began to change track and stress instead on the need for economic recovery and eventual rearmament. This transformation was caused by a number of concerns such as the need to re-establish Japan as a key player in the world economy, and the fear that continued economic dislocation would encourage the growth of communism. In order to create a stronger economy, SCAP introduced in 1949 a policy of financial austerity, designed to curb government expenditure, inflation and encourage the growth of the export sector by giving it preferential access to raw materials and foreign currency earnings. USA also pegged the yen at the competitive exchange rate of 360 (yen) to $1.

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- 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.
- 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.

End of US Occupation

By 1951 Washington brought the occupation to an end and a peace treaty was signed at an international conference in San Francisco (Treaty of San Francisco), which stated that Japan would gain her full sovereignty in April 1952. It was a deliberate lenient document and stated that Japanese control over her empire had formally ended and should pay reparations. One of the few punitive measures was that it would not regain control over Ryukyu Islands, which remained indefinitely under US control. The settlement did not end Japan's state of war with the Soviet Union and India refused to sign the treaty and the Chinese were not invited to attend the conference.

1.1.3 Security Treaty 1951

This was a security pact between Japan and USA. In the 1940s US was content to see Japan as a neutral, demilitarized state with a constitution. By 1951, policy-makers changed their mind with the 1951 Korean War as US believed that if Japan were allowed to become a sovereign state, it had to rearm and join the Western alliance. On the contrary, Yoshida, while desperate to win Japan's independence, loathed rearming as he feared that military expenditure would direct scarce economic resources away from domestic growth and politically and socially it was too early to revive such elements that had plunged Japan into the Pacific War. He sought to place Japan under US protection but to avoid reconstruction of the armed forces.

Prime Minister Yoshida Shigeru signs the bilateral security treaty with the United States on September 8, 1951. Secretary of State Dean Acheson (right) and special ambassador John Foster Dulles stand directly behind him. The Japanese official on the left is Ikeda Hayato, who served as prime minister from 1960 to 1964.

Two aspects of these agreements are notable. First is the timing. Japan was still occupied and under U.S. control when the treaties were signed, and the Cold War was at fever pitch. The Soviet Union tested its first atomic bomb on August 29, 1949, triggering the nuclear arms race. The victorious Communists proclaimed the People's Republic of China on October 1 of that same year, and a Sino-Soviet Treaty of Friendship and Alliance was concluded on February 14, 1950. On June 25, 1950, war erupted on the divided Korean Peninsula, drawing in U.S.- led United Nations forces immediately. Four months later, in

late October, Chinese forces entered the war to counter what China's leaders perceived to be a U.S. threat to advance through North Korea up to-and possibly across-the border with China.

Equally significant but less well remembered, the San Francisco settlement was a "separate peace." The omissions from the list of nations that signed the peace treaty were striking. Neither Communist China nor the Chinese Nationalist regime that had fled to Taiwan were invited to the peace conference, despite the fact that China had borne the brunt of Japanese aggression and occupation beginning a full decade before Pearl Harbor and the U.S. entry into the war. Both South and North Korea were excluded, although the Korean people had suffered grievously under Japanese colonial rule and oppressive wartime recruitment policies between 1910 and 1945. The Soviet Union attended the peace conference but refused to sign the treaty on several grounds, including the exclusion of the PRC and Washington's transparent plans to integrate Japan militarily into its Cold War policies.

Viewed from the perspective of the separate peace, the San Francisco settlement thus laid the groundwork for an exclusionary system that detached Japan from its closest neighbors. Japan, liberated from the burden of paying for its own defence, was able to concentrate on generating economic growth under an American security umbrella. Yoshida's refusal to agree to full rearmament cost Japan in the short term as the US were unable to rely on Japan to protect themselves, decided to use the Security Treaty to turn its bases in Japan into a bastion-for the defence of East Asia even if this compromised Japan's sovereignty. US -won the right to use these bases for regional defence without having to consult the Japanese government and in 1952, the US was given extraterritorial rights. Japan also lost diplomatic freedom of movement as US made it clear it would not ratify the peace treaty unless Japan opened relations with Taiwan. This was a bitter blow for Japan which traditionally had close commercial ties with mainland China.

1.2 Aid to Japan/Access to US markets

Japan's economic revival was being sponsored by USA in order to assist with the stabilization of Asia and to forestall the growth of communism Japan while strategically and politically being locked into the Western alliance system as a distinctly unequal partner. The USA pumped in $2.2 billion of humanitarian and development aid over the next 7 years and contributed tens of billions of dollars through procurement policies of its military forces based in Japan and the region.

The USA assumed almost exclusive responsibility for Japan's future after 1945, imposing an army of occupation under MacArthur and fashioning the Treaty of San Francisco (where Japan was to gain sovereignty in 1952). For the next 7 years the USA occupied Japan and set out on a massive campaign of reform designed to remove all vestiges of militarism and feudalism so that Japan could never threaten international order. In 1948, USA stressed the need for economic recovery and eventual rearmament as USA concerns included the need to re-establish Japan as a key player in the world economy and to discourage the growth of communism brought about by economic dislocation.

One vital reason for the rapid growth of Japan was due to the Cold War where the USA was prepared to go to great lengths to nurture and sponsor its development within the Bretton Woods system. During the 1950s, Washington continued to adhere to the view that Japanese economic growth was the sure way to undermine the appeal of the Left within Japanese politics. Added to this was the belief that a strong Japanese economy would have a beneficial effect on Asia. This meant that it was very much in American interests to ensure that the Japanese economy remained healthy.

1.2.1 Means of American Aid

1. In 1949, SCAP introduced a policy of financial austerity designed to curb government expenditure, reduce inflation and encourage the growth of exports by giving it preferential access to raw materials and foreign currency earnings.
2. USA maintained its procurements for the American military throughout the decade which contributed greatly to Japan's economy.
3. USA eased Japan's path into the world economy by sponsoring its entry into the General Agreement on Tariffs and Trade (GATT) organization in 1955.
4. Washington also tolerated *Japan's* use of protectionist restrictions such as high tariffs and limits on foreign direct investment, to defend its growing heavy industry sector while opening its own markets widely to Japanese goods.
5. Noting also that Japan was denied access to the China market and that Southeast Asia was not sufficient to soak up Japan's exports, the Eisenhower administration in 1955 allowed Japanese access to the American domestic market.
6. The USA therefore gave consent to the protectionist policies pursued by MITI (Ministry of International Trade and Industry) and helped provide an international trading environment for Japanese exports. (MITI was created by USA to launch industrial and technology policies that fueled Japan's economic growth)
7. This policy continued in the 1960s, but the Kennedy administration lowered the American trade barriers as it believed this would assist in the stabilization of Japanese politics. As a result, Japanese automobiles and motorcycles began to enter the American market for the first time and in 1965 USA suffered its first trade deficit with Japan.
8. The USA intended to plant genuine democracy in Japan and to demilitarize the country. Efforts to break up the zaibatsu (huge industrial combines whose businessmen, like the militarists, had often disrupted Japanese political life before 1939) were less successful. By the early 1950s, the zaibatsu had recovered, and the army too made a comeback when the USA grew worried at the growth of communism in Asia.
9. Japan continued to benefit commercially from the Cold War tensions in the region. As Sino American tensions escalated in the mid-1960s and the situation in South Vietnam began to worsen, the USA was keen to use Japan's growing economic power to stabilize the region. In 1965 the USA brokered the opening of diplomatic relations between Japan and South Korea which beforehand had proved impossible due to the lingering animosity between the two countries. This move, which was part to strengthen the Korean economy and reducing the reliance on the USA, opened a new market for Japanese goods and investment.
10. With the Vietnam War reaching its peak, USA encouraged Japan to expand its trade links with Southeast Asia. In 1966, Japan extended credits to Thailand and Malaysia and helped with the restructuring of Indonesia's debt burden and became one of the largest contributors to the newly established Asian Development Bank.
11. The USA scrapped Japan's totalitarian political system and replaced it with a democratic constitution.
12. USA advocated major reforms through land, labour and industrial reforms thus allowing conservatives to establish political power which they have used to dominate politics.
13. USA forced Japan to set the yen at a rate whereby all of Japan's major industries could export successfully.
14. Although USA's defense burden was 6-7% of GNP, she allowed Japan to keep their defense spending at 1% which means Japan had 5% more to invest in productive consumer industries.

15. In addition to points 2, 5 and 7 above, USA also granted Japan the 'most favoured nation status' which granted her all trade advantages, such as low tariffs. In essence it was to promote free trade. USA had helped Japan greatly to economic recovery. i.e. during the Korean War, the Japanese economy was aided by USA's need for trucks, clothing, bedding and other goods for its armed forces. It allowed Japanese goods to flood the American markets which, boosted Japanese economy tremendously. In fact, Toyota was saved from imminent bankruptcy by American procurements.

2. Favorable International Environment; Impact of the Cold War (Korean War Boom)

For many of the industrialized nations the period between the Korean War and the first oil shock of 1973 was one of steady progress because of the stability provided by the American-dominated Bretton Woods financial and trading system.

- 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.
- 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.
- 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.

Its fixed exchange rate and steady reduction of protective tariffs helped in the stimulation and growth of the world economy. The expansion of international trade in this period was advantageous to a state that had orientated itself towards exports.

It is also important to note that the stability of the capitalist economies at this time was underpinned by the low cost of the major new energy source for industry - oil. Japan was particularly well placed to take advantage of the shift towards oil for much of its industrial plant was new, replacing factories that had been destroyed during the war. Furthermore, as the world's most cost-effective shipbuilder, Japan was able to benefit from the ever-growing demand for ocean-going oil tankers.

2.1 Internal Factors

Close government-industry cooperation, a strong work ethic, mastery of high technology, and a comparatively small defense allocation have helped Japan become the second largest economy in the world, after the United States, at around US$4.5 trillion in terms of nominal GDP and third after the United States and China in terms of purchasing power parity. Banking, insurance, real estate, retailing, transportation and telecommunications are all major industries.

Japan has a large industrial capacity and is home to some of the largest and most technologically advanced producers of motor vehicles, electronic equipment, machine tools, steel and nonferrous metals, ships, chemicals, textiles and processed foods. It is home to leading multinational corporations and commercial brands in technology and machinery. Construction has long been one of Japan's largest industries, with the help of multi-billion-dollar government contracts in the civil sector. Distinguishing characteristics of the Japanese economy have included the cooperation of manufacturers, suppliers, distributors and banks in closely-knit groups called keiretsu and the guarantee of lifetime employment in big corporations.

2.2 Role of the Japanese Government

2.2.1 Political Stability

The 1951 Security Treaty saw to divisions within the Japanese government as those on the Left were opposed to the security ties with America with the communists favouring an alignment with the Soviets. The moderate socialists felt that Japan should adopt a more pacifist position. The conservatives were also divided, with those favouring concentration on economic growth while maintaining a low security position. Another group favoured rearmament and more equality with USA. In 1955, the socialists put their differences aside and merged to form the JSP (Japanese Socialist Party) which let to alarmed Right wing politicians and business community to merge and form one organization, the Liberal Democratic Party (LDP).

Japanese politics saw internalization of the Cold War between the Left and Right, but the merges also saw to the Japanese overcoming the instability of the previous years and set the dominance of the LDP for years until 1993. In 1960, a new LDP Prime Minister, Hayato Ikeda, a protégé of Yoshida, saw to Japan taking a new political course. The previous Prime Minister, Kishi had almost brought Japan to the brink of a political abyss through his obsession with the security issue and undemocratic tendencies. Thus, Ikeda played down national defence and created an atmosphere of consensus by rebuilding dialogue with the JSP and introduced a policy whose central theme was that by the end of the 1960s, Japan should have doubled its national income.

Ikeda's 'income doubling' concept was a vital turning point in Japan's history for in accepting Japan's discomfort with its expansionist past, therefore, downplaying defence and instead emphasizing economic growth. He would later be responsible for setting the policy parameters for Japanese politics for the next 30 years. Thus 1960 was an important year in the structure of Japanese politics as it created modern Japan by the policies that were made that year. Japan was able to achieve rapid growth due largely to the way which the government acted to create an economic environment that stimulated growth.

2.2.2 State Corporate Relations

The government, particularly MITI, charted a course for the economy and coordinated its industrial growth. Government and industrial firms engaged in long term planning and both made use of consensus decision-making. The MITI bureaucracy, with its ties to political and business leaders, also steered a steady course, thereby providing policy continuity.

- It guided industrial development not only by targeting specific industries for growth but also by designating declining industries to be scaled down or dismantled. It also targeted foreign markets on which the Japanese would concentrate their attack. In sum, the Japanese government fostered a national consensus on the priority of economic growth and established industrial and trade policies.

The Ministry of Finance (MOF) and Ministry of Trade and Industry (MITI) shared the creation and implementation of policies designed to systematically target and develops strategic industries and technologies within the context of a five-year plan. Other ministries such as those of Construction, Transportation, Posts and Telecommunications, Education, Justice and so on have their own industries that they nurture. Each industry is organized into an industrial association and cooperates in both writing and implementing government policies through cartels, the diffusion of technology, import barriers and export promotion.

2.2.3 Promotion of Foreign Trade

Ikeda's decision to concentrate on economic growth had a solid foundation, for the Japanese economy begun to expand markedly from mid 1950s onwards. This period saw to the increase in the productivity of heavy industry with a substantial rise in steel production and Japan becoming the world's largest shipbuilder.

Iron and steel had been a leading industry in Japan and had been considered critical to economic growth by the Japanese government in the 1950s. The sector was offered loans at favourable rates. It led to rapid modernization and the expansion of the domestic industry. By 1970, iron and steel were the leading exports from Japan, accounting for over US$2.8 billion, or 14.7%, of total exports. This export share peaked in 1974, at 19%. Due to the domestic industry's strength and import barriers, imports of iron and steel represented a minimal US$276 million in 1974. A vital element to this growth was due to the efforts of the Ministry of International Trade and Industry (MITI), which utilized methods that had previously been used during wartime to direct national resources to stimulate growth in sectors like steel production and shipbuilding.

Japan dominated world shipbuilding till the late 1980s, filling more than half of all orders worldwide. Its closest competitors were South Korea and Spain, with 9% and 5.2% of the market, respectively. Japan's shipyards replaced their West European competitors as world leaders in production through advanced design, fast delivery, and low production costs. For example, the MITI used its control over the distribution of imported raw materials and foreign currency earnings to favour these sectors that were seen as vital to future economic growth and used tariffs and other mechanisms to protect Japanese companies.

The government also worked to diffuse good practices such as quality control and lifetime employment system and encouraged companies to disseminate technology and patents. It also worked closely with the

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Ministry of Finance and the Bank of Japan to ensure that the public and private capitals were made widely available to the key industrial sectors. In the case of Japan, it can be seen that the state played a direct role in planning the development of a capitalist economy.

Case Study 1: Motor vehicles industry

The motor vehicle industry is one of the most successful industries in Japan, with large world shares in automobile, electrical machineries, parts and engine manufacturing. Japan is home to six out of top 10 largest vehicle manufacturers in the world. For example, it is home to multinational companies such as Toyota, Honda, Nissan, Suzuki and Mazda. Some of these companies cross over to different sectors such as electronics to produce electronic equipment as some of them being a part of keiretsu. Japan's automobiles are generally known for their quality, durability, fuel efficiency and more features with relatively cheaper price than their competitors.

2.2.4 Export-Oriented Industrialization

Ikeda also stressed on the importance of exports by working to stimulate its growth. This led to a huge increase in Japan's trade with both developed and the developing nations. Japan developed superior mechanisms for marketing its products abroad. Japanese comprehensive trading companies set up branch offices all around the world collecting data, conducting thorough market research and in numerous other ways facilitating Japanese trade. They also worked with MITI to arrange the most advantageous trade agreements, secure long-term supply of vital raw materials and direct Japanese investment abroad.

Although Japan was vulnerable because of its lack of natural resources, it made itself much less so by becoming indispensable to resource-supplying nations, both as a reliable buyer and as a supplier of technology and capital. Other nations had nothing comparable to Japan's comprehensive trading companies for conducting a large volume of foreign trade. Ikeda's ambitions for Japan were met beyond anyone's expectations, for in the 1960s the economy grew at an average rate of 10.4% per annum, overtaking those of France, Britain and West Germany. Of Japan's $387.965 billion exports, 96% were manufactured goods compared to USA's 65% of exports during the same period.

Case Study 2: The electronics industry

The Japanese consumer electronics industry is one of the largest and most powerful industries in the world. It is one of the most prolific exporters and manufacturers of electronic products in the world as evidenced by the number of companies it has relative to other countries that distributes many high technology products and inventions. For instance Japan is home to some of the best known and largest electronics manufacturers such as Sony, Casio, Hitachi, Toshiba, NEC, TDK, JVC, Panasonic, Roland, Fujitsu, Canon, Sharp, Fujifilm, Rohm, Plextor, Korg, Pioneer, Kyocera, Konica Minolta, Maxell, Mitsubishi, Technics, Ricoh, Pentax, Olympus, Nintendo, Sanyo, Epson, Nikon, Yamaha, Seiko, Citizen Watch, Kenwood and more.

Japan is a leading nation in consumer electronics and arguably the largest electronics manufacturer in the world today. In 1991, 46.7 percent of colour televisions and 87.3 percent of videocassette recorders produced in Japan were exported. The export shares of some products were too small to show separately in summary trade data, but audio tape recorders represented 2.9% of total Japanese exports in 1988,

videocassette recorders 2.3 percent, radio receivers 0.8 percent, and television receivers 0.7 percent, totaling 6.7 percent. These industries built Japan's success in developing commercial applications for the transistor in the 1950s and generations of semiconductor devices of the 1970s and 1980s. Output came from large, integrated electronics firms manufacturing semiconductor devices, consumer electronics, and computers. The companies' international success came from continually pushing miniaturization and driving down manufacturing costs through production innovations. Japan is arguably the largest electronics manufacturer in the world today.

2.2.5 Japanese Protectionist Policies

Japan's overseas investment in the consumer electronics industry was motivated by protectionism and labour costs, which was the main reason for Japanese colour television plant establishment in the United States. After three years of voluntary export restraints, seven Japanese firms located plants in the United States by 1980. Japanese firms retained production of the most technologically-advanced products, while shifting production of less-advanced products to developing countries, such as Taiwan. Moving production caused Japan's export of colour televisions to fall during the 1980s, from 2 percent of total exports in 1970 to only 0.7 percent in 1988.

Under the protection of tariffs on foreign goods, Japan was able to make progress in import substitution, for example, building up its automobile and electronic industries. Trade and investment barriers restricted imported automobiles to an insignificant share of the market in the 1950s, and as barriers were finally lowered, strong control over the distribution networks made penetration difficult. Foreign penetration of the automotive market in Japan has been less successful. Imports of foreign automobiles were very low during the forty years prior to 1985, never exceeding 60,000 units annually, or 1% of the domestic market.

Obtaining foreign technology has been a vital component of Japan's rise into an economic power. The 1949 Foreign Exchange Control Law and 1950 Foreign Investment Law gave Tokyo enormous powers to restrict foreign trade and investments. Unable to import or invest in Japan because of government restrictions, foreign firms simply licensed their advanced technology to their Japanese rivals as the only way to make money. Between 1950 and 1980, the Japanese spent $10 billion for buying or licensing 30,000 foreign technologies. Japanese firms used this technology to modernize their factories and mass-produce inexpensive products which were sold and often dumped at below production costs around the world to capture a large share of the market and drive their rivals out of business.

The importance of industrial policies diminished as Japan's economy grew more complex and powerful. Although MITI and other ministries still continue to target industries and technologies for development, Tokyo has dismantled more blatant trade and investment barriers and tariffs are lower now than those of USA. Japan's markets remain guarded by arrays of non-tariff barriers.

2.2.6 Japanese use of advanced technology

The Japanese aggressively sought new technology in quest of industrial rationalization and greater productivity. The Japanese were swifter than their foreign competitors to modernize their steel plants with the most recent, efficient and cost-saving technology. When the oxygen-burning type of steel furnace was developed in Austria in the early 1960s, the Japanese quickly purchased the patents and invested a vast amount of capital to rapidly convert their plants to the new technology.

They also adopted the new continuous casting process at about the same time and the result was that within a decade, they had operation in the world's most efficient and cost-competitive plants. This explains why the Japanese were able to compete with the US made steel even though they had to import their iron ore and ship their finished steel across the Pacific Ocean. Japan swiftly gained the lead over the rest of the world in robotics and the automation production line. Data show that by the late 1980s Japan had twice as many industrial robots in operation than the rest of the world combined.

2.2.7 Undervalued Yen

Also vital to Japan's development was an undervalued yen. Originally set at 360 yen to a dollar in 1949, the yen became increasingly undervalued as Japan's economy expanded over the next 22 years. The yen remained undervalued even after Nixon forced the yen's revaluation to 308 to a dollar in 1971. Tokyo used a variety of means to maintain an undervalued yen. The Bank of Japan intervened in global currency markets to buy dollars and sell yen. The Finance Ministry continued to restrict foreign investments in Japan while allowing Japanese overseas investments. Similarly, it restricted the use of the yen in trade, all in an attempt limit demand for yen that would raise its value.

2.2.8 Power of the Keiretsu

The dynamic core of Japan's economy is its six major industrial groups (keiretsu) whose combined economic activity accounts for 25% of GNP. Each keiretsu has a range of interrelated manufacturing firms in steel, petrochemicals, microelectronics, automobiles, mining, metal forging, shipbuilding, aerospace and so on. These firms are largely financed by the keiretsu bank, trading firm and insurance company. Each corporation within the keiretsu either wholly or partially owns scores of smaller subcontracting and distributing firms. About 70% of each keiretsu stock is owned by other keiretsu members, therefore the big six own part of each other. Washington and Brussels have long complained that the keiretsu discriminates against foreign firms and violate antitrust laws. But Tokyo refuses to break up such vital sources of Japan's power.

3. Socio-economic reasons

3.1 Macroeconomic policies

Tokyo traditionally encouraged high savings by limiting such government benefits as welfare, education and social security and keeping consumer prices high and credit limited. Consumers thus had to save a huge percentage of their income not only to educate their children and survive after retirement but also without access to credit, to pay for an automobile or home. This also encouraged the Japanese to be frugal as well. Tokyo further limited the investment opportunities for savers by providing mostly bank or post

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office savings accounts that paid low interest rates. Tokyo then channeled these vast savings into cheap loans for strategic industries.

The Post Savings Bank assets alone in 1998 were \$2.1 trillion or 40% of all Japan's banking assets and four times larger than the world's largest commercial bank. These industries in turn invested the money into the most advanced production techniques and technologies.

3.1 High savings and a sound banking system

The high rate of personal savings by the Japanese and Japan's financial and banking practices were beneficial to capital formation for economic growth. Japanese workers saved a remarkable 18% of their salaries compared to about 6% of US workers. The banks then invested the surplus capital in industry and commerce.

Although Japanese firms were financed by selling stock, a great portion of their capital came from banks, which unlike stockholders, did not insist on quarterly profits. Instead, the banks financed long term business enterprises which at times operated in the red several years before they began to turn a profit. The ready availability of capital made possible continuous plant modernization.

Japan is home to the world's largest bank, the Mitsubishi UFJ Financial Group, which has roughly US\$1.7 trillion in assets; the world's largest postal savings system; and the largest holder of personal savings, Japan Post, holding personal savings valued at around US\$3.3 trillion.

3.2 Intangible traits: Positive work culture

Some factors were intangible factors unique to Japan or to East Asian countries that contributed to economic growth. The Japanese were served well by historically conditioned cultural traits, such as acceptance of authority, paternalism, a desire for harmony, loyalty to superiors, discipline and a sense of duty and sincerity. Group consciousness prevailed over individualism. Without these traits, Japan's labour management system would hardly have been possible. Additionally, there were certain historical circumstances that benefited Japan such as the timing of its industrial development during a period of global economic expansion.

It may also be argued that Japan thrived on its own deprivation. Japan's dearth of raw materials, for example, necessitated hard work to attain, conserve, and use them efficiently. By necessity, the Japanese came to excel in industry and foreign commerce. On average, employees worked a forty-six-hour week in 1987; employees of most large corporations worked a modified five-day week with two Saturdays a month, while those in most small firms worked as much as six days each week.

In 1986 the average employee in manufacturing and production industries worked 2,150 hours in Japan, compared with 1,924 hours in the United States and 1,643 in France. The average Japanese worker is entitled to fifteen days of paid vacation a year but actually took only seven days. The conscientious working culture coupled with high savings and an attractive employment system all combined to contribute to Japan's economic growth.

3.3 Employment system

The labour-management system in Japan stressed mutual harmony between the workers and management rather than confrontation. Japan's "lifetime employment" system, with its built-in rewards for worker seniority, provided job security to the workers who in turn developed strong identity with and dedication to their firms. The companies in turn were able to count on the services of a well-trained and loyal work force. Generally, management treated its work force as an investment.

Worker morale and motivation were increased by various management programmes, such as a generous bonus system, educational benefits, housing, insurance and recreational facilities. This has resulted in greater worker loyalty and productivity. There were labour unions in Japan, but they were organized locally (as opposed to national trade unions) and their relations with the management tended to be cooperative rather than confrontational. Worker participation in management decision-making and in quality-control circles also contributed significantly to the mutual benefit of employer and employee.

3.4 Lifetime employment as a sense of security

Lifetime employment or Permanent employment has been the rule in big Japanese companies beginning with the first economic successes in the 1920s. It gives Japanese workers the important feeling of job security. A high demand for the few available engineers forced companies to bind these employees to the company. It was also used in small Japanese companies. These employment practices came about as the result of labour shortages in the 1920s, when companies competed to recruit and retain the best workers by offering better benefits and job security. By the 1960s, employment at a large prestigious company had become the goal of children of the new middle class, the pursuit of which required mobilization of family resources and great individual perseverance in order to achieve success in the fiercely competitive education system.

Employees are expected to work hard and demonstrate loyalty to the firm, in exchange for some degree of job security and benefits, such as housing subsidies, good insurance, the use of recreational facilities, and bonuses and pensions. Wages begin low, but seniority is rewarded, with promotions based on a combination of seniority and ability. Leadership is not based on assertiveness or quick decision making but on the ability to create consensus, taking into account the needs of subordinates. This system rewards behaviour demonstrating identification with the team effort, indicated by singing the company song, not taking all of one's vacation days, and sharing credit for accomplishments with the work group. Pride in one's work is expressed through competition with other parallel sections in the company and between one's company and other companies in similar lines of business.

Thus, individuals are motivated to maintain wa (harmony) and participate in group activities, not only on the job but also in after-hours socializing (nomikai). The image of group loyalty, however, may be more a matter of ideology than practice, especially for people who do not make it to the top.

3.5 Adoption of US management techniques

William Edwards Deming (October 14, 1900—December 20, 1993) was an American statistician, college professor, author, lecturer, and consultant. Deming is widely credited with improving production in the United States during World War II, although he is perhaps best known for his work in Japan. From 1950

onward he taught top management how to improve design (and thus service), product quality, testing and sales (to last through global markets) through various methods, including the application of statistical methods.

Deming made a significant contribution to Japan's later renown reputation for innovative high-quality products and its economic power. He is regarded as having had more impact upon Japanese manufacturing and business than any other individual not of Japanese heritage. In 1947, Deming was involved in early planning for the 1951 Japanese Census. The Allied powers were occupying Japan, and he was asked by the U.S. United States Department of the Army to assist with the census. While Deming was there, his expertise in quality control techniques, combined with his involvement in Japanese society, led to his receiving an invitation from the Japanese Union of Scientists and Engineers (JUSE). JUSE members as part of Japan's reconstruction efforts sought an expert to teach statistical control. During June - August 1950, Deming trained hundreds of engineers, managers, and scholars in statistical process control (SPC) and concepts of quality. He also conducted at least one session for top management. Deming's message to Japan's chief executives: improving quality will reduce expenses while increasing productivity and market share. A number of Japanese manufacturers applied his techniques widely and experienced theretofore unheard-of levels of quality and productivity. The improved quality combined with the lowered cost created new international demand for Japanese products.

3.6 High literacy rate

The Japanese education system which in controlled by the central government, maintained uniform, high standards and was extremely competitive. In Japan, university entrance examinations determined a person's future, and only the cream of the crop was admitted to the best universities, whose graduates obtained the best jobs. Therefore, students at all levels studied intensely in preparation for entrance examinations which they called 'examination hell'. The result was a highly educated society with well developed work habits. On the whole, the Japanese students received more, if not better education than their counterparts in other countries.

The Japanese school year was 60 days longer than the USA and Japanese schoolchildren typically studied many hours a day after school with tutors or in private schools. About 33% of Japanese high school graduates entered universities, compared to over 55% in USA. The education system was centralized under the Ministry of Education, which stressed high standards, especially in Maths and Science. This and the fact that Japanese universities turned out more engineers than the US help to explain Japan's technological progress.

3.7 Education in detail

Education is an important issue in Japanese society. These are the three ways that a young Japanese child is educated in Japan: by attending a public school for a compulsory education, by attending a private school for a compulsory education, or by attending a private school that does not adhere to standards set by the Ministry of Education, Culture, Sports, Science and Technology (MEXT). While high school is not compulsory, more than 90% of the population attends high school. There are, however, many high schools which are not strictly academic, including agricultural and technical high schools.

Japanese tradition stresses respect for society and the established order and prizes group goals above individual interests. Schooling also emphasizes diligence, self-criticism, and well-organized study habits. More generally, the belief is ingrained that hard work and perseverance will yield success in life. Much of official school life is devoted directly or indirectly to teaching correct attitudes and moral values and to developing character, with the aim of creating a citizenry that is both literate and attuned to the basic values of culture and society.

The official structure provides compulsory, free schooling and a sound and balanced education to virtually all children from ages 6 to 15. Upper-secondary school, including non-strictly academic institutions, from grades ages 15 to 18, although not compulsory, attracts about 94 percent of those who complete lower secondary school. About one-third of all Japanese upper-secondary school graduates advance to tertiary education - to full four-year universities, two-year junior colleges, or to other institutions.

Traditionally, Japan has been a highly education-minded, regimented society. Education was esteemed, and achievement was often the prerequisite for success in work and in society at large. There is a common belief that having a high literacy rate automatically results in a more productive society. A higher motivation level (i.e. better work ethic) in both the schools and at work has a more significant effect on the economy than a high literacy rate. First, it has been attributed that as a part of the success of Japan to the fact that it boasts a 99 percent literacy rate, and second the rest of the difference is due to the incredible motivation and work ethic that is almost universal in Japan. A combination of high literacy rates and the willingness to spend much more time and effort doing work, would be a natural outgrowth of that work ethic.