Chapter I

The Economy, Industries and Corporations

1 The Japanese Economy: Current Situation and Outlook for the Future

Japan's Phenomenal Postwar Economic Recovery

Though the Japanese economy had been virtually destroyed by defeat in World War II, the government made institutional forms and implemented far-sighted policies, achieving a recovery that is remarkable by any standard. During the so-called period of high economic growth (1955 to the early 1970s), the economy expanded at an average rate of 10% or higher per year.

Since the 1970s, the world economy has been shaken by profound changes in the international monetary system and by two oil crises. However, the Japanese government has managed to maintain a relatively strong economic performance among advanced nations by adopting effective macroeconomic policies. Labor and management have made contributions also, by agreeing to set wages voluntarily. The industrial structure has been transformed through technological innovation, and Japan has succeeded in staving off inflation and keeping the unemployment rate under 2%.

Astoundingly Low Growth Rate

In the early 1980s, economic theories stressing the importance of the market mechanism gained support in Japan, as in other industrialized nations. Informed by these theories, the Japanese government implemented administrative and fiscal reforms, and privatized some state-run corporations. However, during this period, trade imbalances among the advanced nations worsened, leading to the Plaza Accord of 1985, after which currency reform was carried out amid growing demands for Japan to open its markets. Accordingly, the yen rose sharply against the U.S. dollar, resulting in a recession. Japanese companies, manufacturers in particular, sought to remedy this by moving some of their operations overseas.

The Japanese government attempted to promote domestic economic growth by lowering interest rates to stimulate demand. Its macroeconomic policies were influenced by negotiations with the United States, at which the removal of structural barriers to imports and the reduction of Japan's huge trade surplus were discussed. Unfortunately, this resulted in excess liquidity, which induced speculation in land and securities. The prices of land, securities, and other assets soared to abnormal levels, thereby creating the "bubble economy" of the early 1990s. When the bubble burst, the economy entered into crisis and was saddled with an enormous volume of bad debts. Japan has since struggled to dispose of these bad debts and to counter what the OECD (Organization for Economic Cooperation and Development) has described as "astoundingly and exceptionally low economic growth."

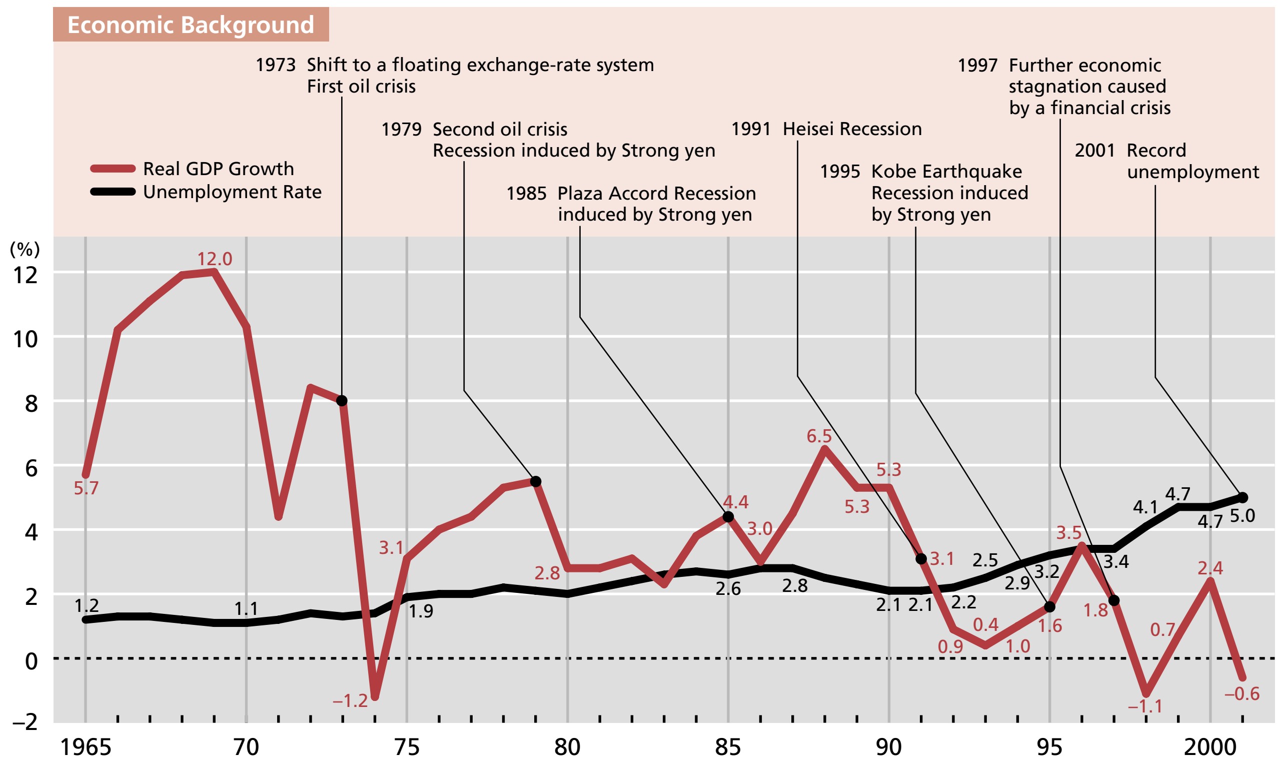
I-4 describes Japan's real GDP (gross domestic product), labor force, and real wage levels, compared with those of other advanced nations. Japan's real GDP grew at a robust and consistent rate for many years until 1992, when growth began to decline, while the labor force expanded at a relatively stable rate of 1% per year. Japan has succeeded in distributing the fruits of its high economic growth period equally, increasing both wages and the size of the workforce.

Movements Toward Self-sustained Economic Recovery

Since 1997, the Japanese economy has experienced, among other things, a rise in the rate of consumption tax aimed at fiscal reconstruction, reduced public demand, an Asian currency crisis, and the insolvency of major financial institutions, which contributed to an acute downward economic spiral from the end of 1997. In response, the Japanese Government has attempted to shift from “administrative policies aimed at financial protection” to one of introducing market principles into financial administration. It has also supplemented public works projects by emergency economic measures and has taken measures to expand demand through steps toward permanent tax reductions. The effect of such policies brought a halt to the bottoming out of the Japanese economy in Spring 1999, and since the later half of 1999 the recovery of the Asian economy has also been partly responsible for the subsequent succession of moderate improvements.

However, the short-lived economic recovery that began in Spring 1999 has ended. The Japanese economy has been in a “slow deflation” (Cabinet office) since the beginning of 2001, and under that influence the worsening of the business situation is progressing further. Prices are not only dropping on goods affected by expanding imports from China and the influence of information technology (IT); overall price levels are also falling, and it is feared that there will be even greater deterioration in this area. Accordingly, the complete-unemployment rate continues to rise, and between July and September 2001 it rose above the 5% mark for the first time.

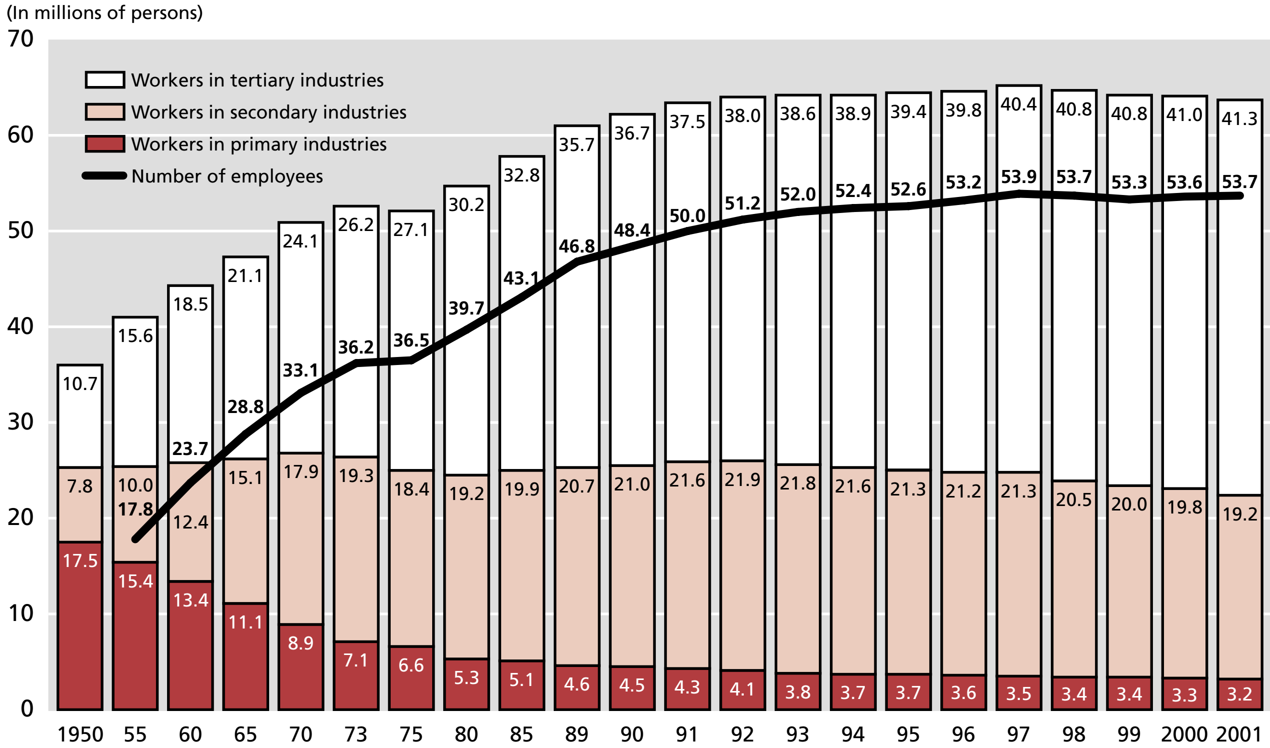
I-1 Real GDP Growth and the Unemployment Rate



Sources: Cabinet Office; Ministry of Public Management Home Affairs Posts and Telecommunications

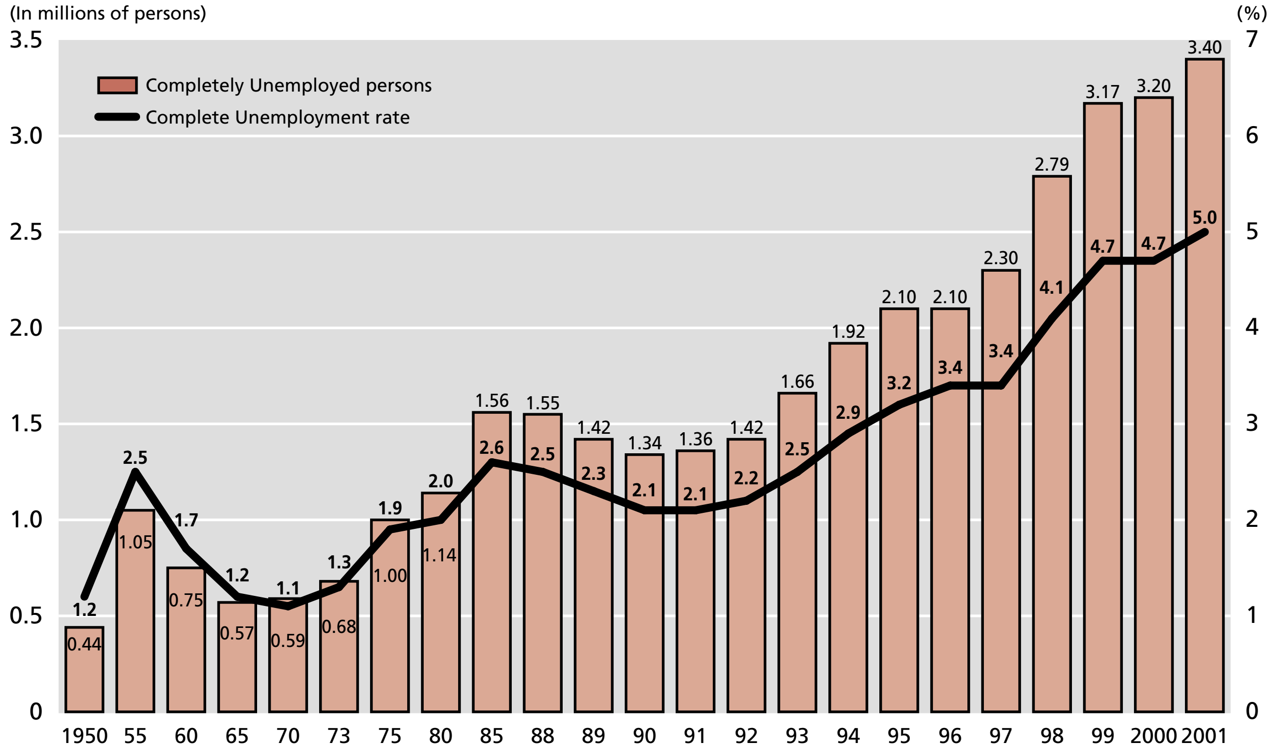
Note: Concerning the growth ratio in GDP, since 1981, this is based on the figures of the 1995 Standard Amended System of National Accounts (93 SNA), before 1981, the figures used are based on the 1990 Standard Amended System of National Accounts (68 SNA).

I-2 Labor Force Statistics



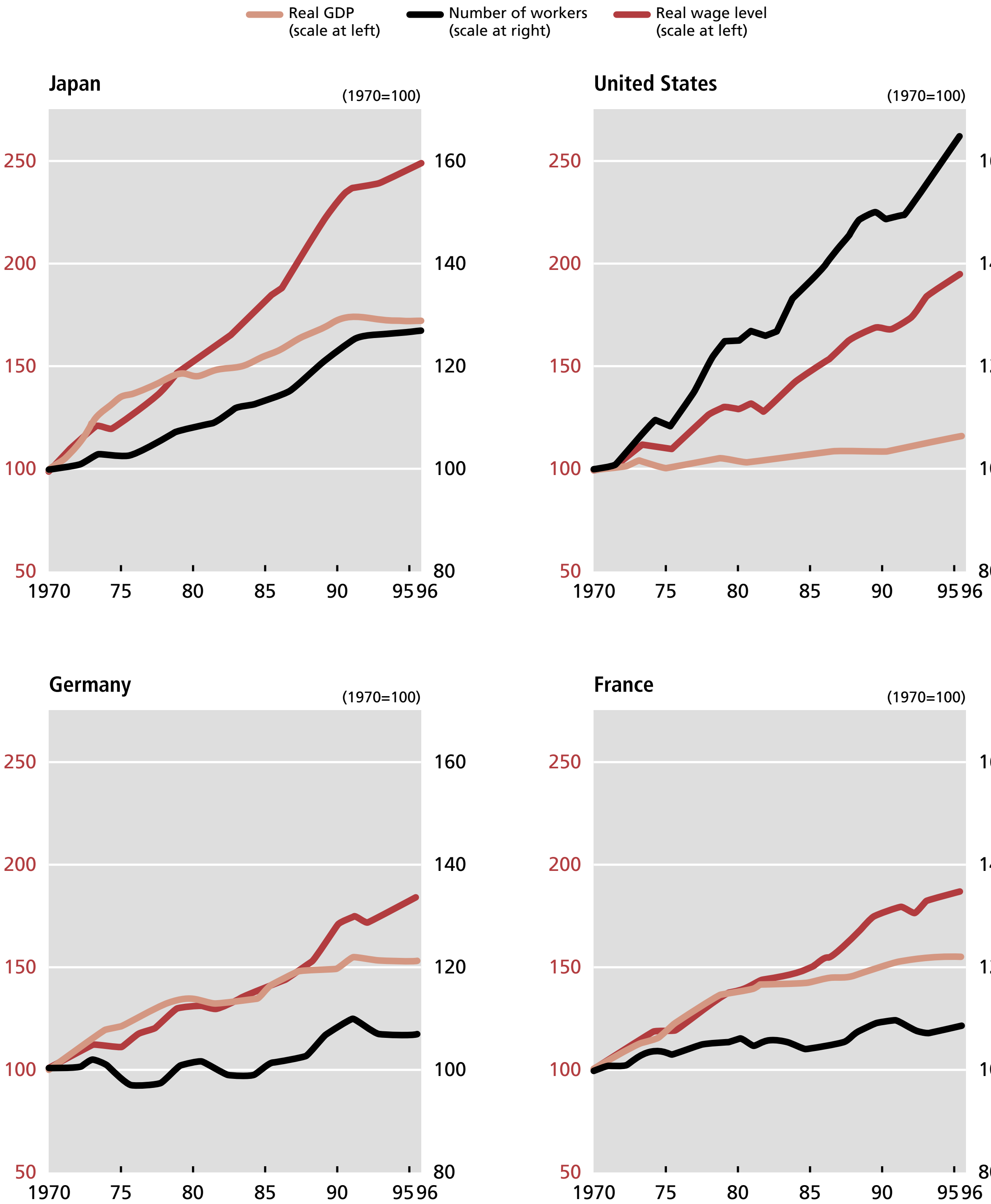
Source: *Labor Force Survey*, Statistics Bureau, Management Coordination Agency

I-3 The Completely Unemployed and the Complete Unemployment Rate



Source: *Labor Force Survey*, Statistics Bureau, Management and Coordination Agency

I-4 Changes in Real GDP, Number of Workers, and Real Wage Rates in the Advanced Nations



Sources: *Labor Force Statistics*,1998; *National Accounts*, OECD, 1998
Note: In the graphs above, real wage level was calculated by subtracting a private consumption expenditure deflator from income per employee.

2 Japanese Corporate Management Systems

Japanese Management Systems

Japanese corporate management systems differ in several respects from those used in the United States, where these systems are characterized by the acquisition of and/or merger with other companies, and by bold labor adjustments. To begin with, Japanese companies pay relatively small dividends to their shareholders—due mainly to the reciprocal stock ownership system—the result of which is that a considerable portion of the shares issued by Japanese companies does not circulate in the market, but is held by other companies belonging to the same corporate group. Besides preventing takeovers (through the buying up of stock), this practice of reciprocal stock ownership has stabilized management and contributed to corporate growth through capital gains produced by continuous stock-price appreciation.

Development of Corporate Groups

Stability and growth of corporate management creates abundant funds via high stock prices—from the capital market, or as financing from banks—and through accumulation of retained profits. Using these funds, existing businesses are expanded and new businesses are developed. When Japanese companies branch out into new types of business they tend to do so by establishing affiliates or subsidiaries, and entrusting the new business to them once they are viable. Diversification of this sort can ultimately result in the formation of a corporate group.

Keiretsu: Affiliated Companies

These kind of corporate groups most typically arise in industries that compete well in the international arena, e.g., manufacturers of automobiles and electric machinery. Manufacturers of auxiliary equipment and parts, with the finished goods maker as the central figure, establish an efficient social division of labor system. They also facilitate continuous technological innovation and new product development, since group members share management and technical information. The term used to describe division of labor system is "Keiretsu."

In-house Training of Human Resources

For human resource development, Japanese companies have come to focus on in-house training and education, because the expansion of existing businesses and development of new ones has been taking place mainly within the company or the corporate group. Companies are now upgrading their training and education programs, and familiarizing their employees with new technologies at training institutes in addition to OJT (on-the-job training).

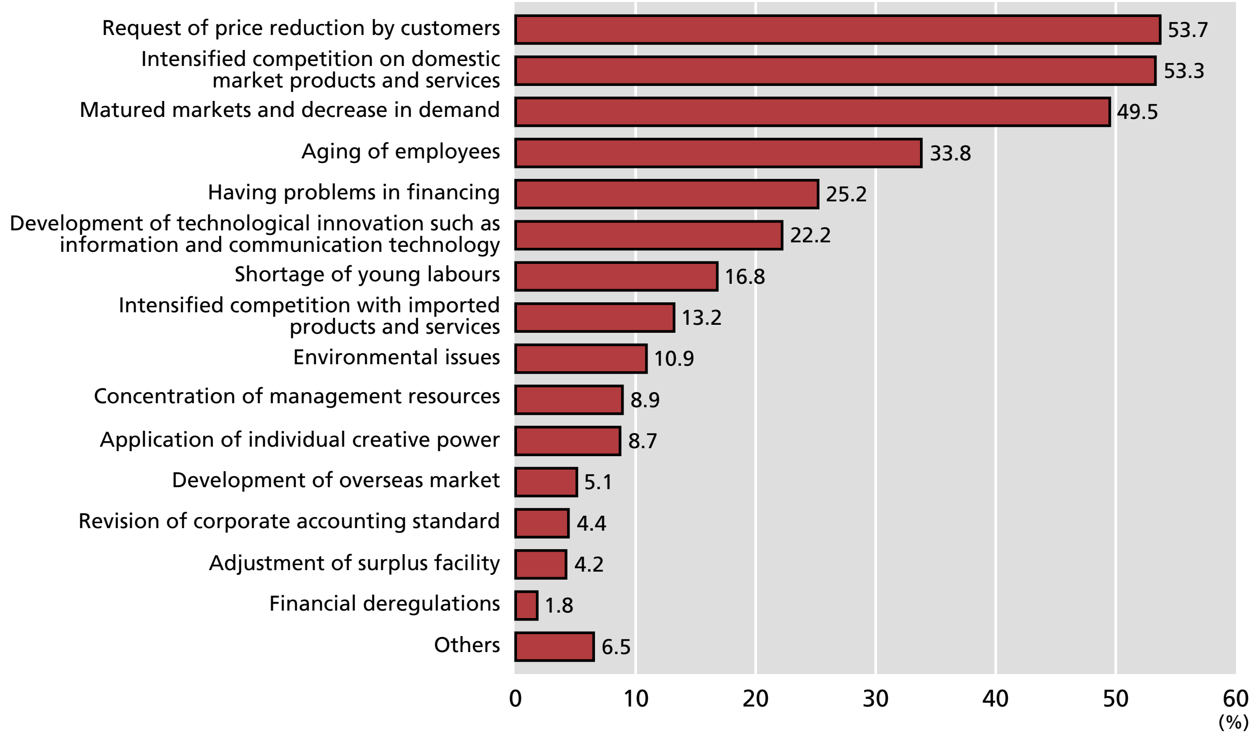
The "Lifetime Employment" Practice

The establishment of Japan's long-term employment system (often called "lifetime employment") is owed largely to this emphasis on in-house human resource development. Under this employment practice companies are extremely careful in their personnel adjustments. They make every effort to ensure employment opportunities for their employees by transferring them from slow departments to busier ones, or to affiliates, thus retaining cumulative expertise and technologies within the company. The long-term employment system has both contributed to the development of Japanese companies and controlled the rise in unemployment.

Imminent Management System Revisions

However, as the long-term course of the recession that began in the 1990s persists, and the gap between successful and foundering firms widens, Japanese companies have been forced to address flaws in management systems. They are now beginning to sell off stock shares that are unlikely to pay dividends or rise in price, and to cancel reciprocal stock ownership agreements. Labor shifts are increasing and there is growing emphasis on mid-career recruitment—particularly of specialized skilled positions—in business spheres where technological innovation typified by IT is proceeding at a rapid pace, because companies cannot rely on their labor resources trained in-house for this type of employee. Moreover, faced with criticism from the international community that it prevents foreign companies from entering Japanese markets, and needing to lower costs even more, the Keiretsu system is gradually changing. Japanese companies have begun to engage in more transactions with companies outside their corporate groups.

I-5 Ratio of Reasons for Requiring Restructuring of Business within 5 Years from Now



Source: *Industrial Labour Situation Survey (2000),* Ministry of Health, Labour and Welfare

I-6 Personnel Adjustment Status by Industry

(January–March 2002; %)

By industry		Total	Construction	Manufacturing	Transportation, telecom-munication	Wholesale, retail	Finance, insurance	Real estate	Services
Total		100	100	100	100	100	100	100	100
Companies implementing personnel adjustments		31	35	42	20	23	14	13	22
Personnel adjustment methods used (multiple responses permitted)	Restrict overtime work	16	14	24	7	11	4	5	10
	Increase number of paid holidays and vacation days	4	7	6	2	2	1	2	4
	Dismiss or refrain from renewing contracts of temporary, seasonal, or part-time workers	5	7	7	2	2	1	2	3
	Suspend of curtail mid-career employment	5	6	8	3	4	2	4	3
	Reassign personnel	10	8	15	4	6	3	3	7
	Employee loan	5	4	10	3	2	3	1	2
	Lay off personnel	3	3	6	—	1	—	1	1
	Recruit volunteers for early-retirement, dismissal	7	10	9	6	6	4	2	3
None of the above		69	65	58	80	77	86	87	86

Source: *Survey of Labor Economy Trends*, Ministry of Health, Labour and Welfare
Note: These figures indicate the ratio of companies planning personnel adjustment to all respondents