

From Post-war High Economic Growth to Stable Growth

In the wake of the confusion and inflation that came immediately after the end of the World War II, once the Korean War (1950-51) was over, the Japanese economy, rebuilt from the devastation that followed Japan's defeat, entered a period of high Economic growth (1955 to the first half of the 1970s). With an annual average real growth rate of over 10% during this period, Japan has become the world's second largest economic superpower after the US.

In addition to the collapse of the fixed exchange rate system and the transition to a flexible exchange rate system, in the 1970s it experienced two separate oil crises. The first oil crisis saw Japan experiencing the trilemma (triple hardship) of inflation, current account deficit, and economic downturn, in 1974 it recorded negative growth for the first time since the end of the war, and the process of adjustment proved to be a very difficult one. By drawing on its experience from the first oil crisis, along with an appropriate response from the government, calm behavior on the part of companies and consumers, moderation in wage determination and a structural shift in industry due to technological innovation, Japan was able to respond to the second oil crisis without any relatively major confusion. Looking at its stable growth period overall, amongst developed countries the Japanese economy has performed well, with stable growth in the region of 3-5%, stable commodity prices, and a low unemployment rate.

However, in the 1970s Japan became an "exporting superpower," and from the 1980s onwards, amid a substantial underlying current account surplus, trade friction has intensified. Furthermore, since the transi-

tion to the flexible exchange rate system, there has been a shift towards a long-term strong yen tendency, and in the latter halves of the 70s and 80s and the mid-90s in particular, the strong yen made substantial strides forward. Companies which faced tough international competition due to the strong yen pushed forward with international specialization. In particular, given the rapid rise of the yen following the Plaza Agreement of 1985, progress towards international specialization moved up another gear, and companies have responded with measures such as boosting overseas production, increasing imports of labor-intensive, low-cost goods, and a move towards high-value-added exports.

Emergence and Collapse of the Bubble Economy, and Low Growth in the 90s

With a dramatic rise in the latter half of the 1980s in asset prices such as shares and land prices, followed by a sudden fall in the first half of the 1990s, Japan experienced the emergence and collapse of a bubble economy.

The currency realignment that resulted from the Plaza Agreement among the G5 countries in September 1985 caused a substantial and rapid rise in the yen, and hastened the downturn in the economy (the "strong yen recession"). In addition to developing economic policies aimed at boosting the economy, centered around international policy coordination and expansion of domestic demand, the government implemented positive easy monetary policy. With some advantages to the strong yen emerging, in the economic recovery that began in November, 1986 (the Heisei Boom), economic growth, centered on private sector demand, was high, and with a growth

rate of around 5%, Japan became one of the leading large economies of the post-war period, with labor demand becoming tighter. However, asset prices such as shares and land prices rose sharply, and the bubble was born. Triggered by a substantial rise in interest rates from the 90s onwards, and the implementation of measures to curb land prices, the bubble economy subsequently collapsed, and asset prices declined significantly.

Following the collapse of the bubble economy (90s), the Japanese economy for a long period continued to remain in the doldrums, referred to as “the 10 lost years.” With this as a factor, the following points can be made.

(1) This is the effect of stock adjustment. Due to the large accumulation of capital stock, housing, consumer durables and so forth in the bubble period in the latter half of the 80s, rapid and substantial stock adjustment was carried out during the economic downturn phase at the beginning of the 90s. (2) This is the effect of excessive corporate and household debt. Although companies and households in the bubble period acquired stock and land with loans, increasing both assets and liabilities, with the collapse of the bubble economy asset prices fell, debts remained uncleared, and as a result, Japan’s balance sheet deteriorated. Companies saddled with excessive debts reduced costs such as labor costs, prioritized the repayment of loans, and curbed investment (one could say that (1) and (2) are companies’ “3 problems of excess (employment, capital stock, debt”). Households, too, curbed their consumption. (3) This is the problem of non-performing loans. With banks’ profits under pressure from the burden caused by the amortization cost of non-performing loans, their financial intermediary functions weakened, leading to a credit crunch. As a result, corporate facilities investment was curbed. Furthermore, with the instability of financial systems due to bank insolvencies making companies and households more cautious in their behavior, business investment and consumption were curbed. (4) This is the effect of deflation. Amid the deflationary situation which prevailed from the latter half of the 90s onwards, corporate revenues and profits slumped, facilities investment was curbed, employment and wages were adjusted, and consumption

failed to grow. Moreover, deflation not only increases the debt burden of companies saddled with excessive debt, but the drop in asset prices, and stagnation in corporate profit that accompanies deflation turns borrowers’ loans into non-performing ones, thereby exacerbating the non-performing loan problem. There is also the aspect of economic stagnation causing a drop in commodity prices.

It is thought that deflation, together with the problems of excessive debt and non-performing loans, form a vicious circle, and have dragged down the Japanese economy.

This Gradual but Long-term, Sustained Economic Recovery

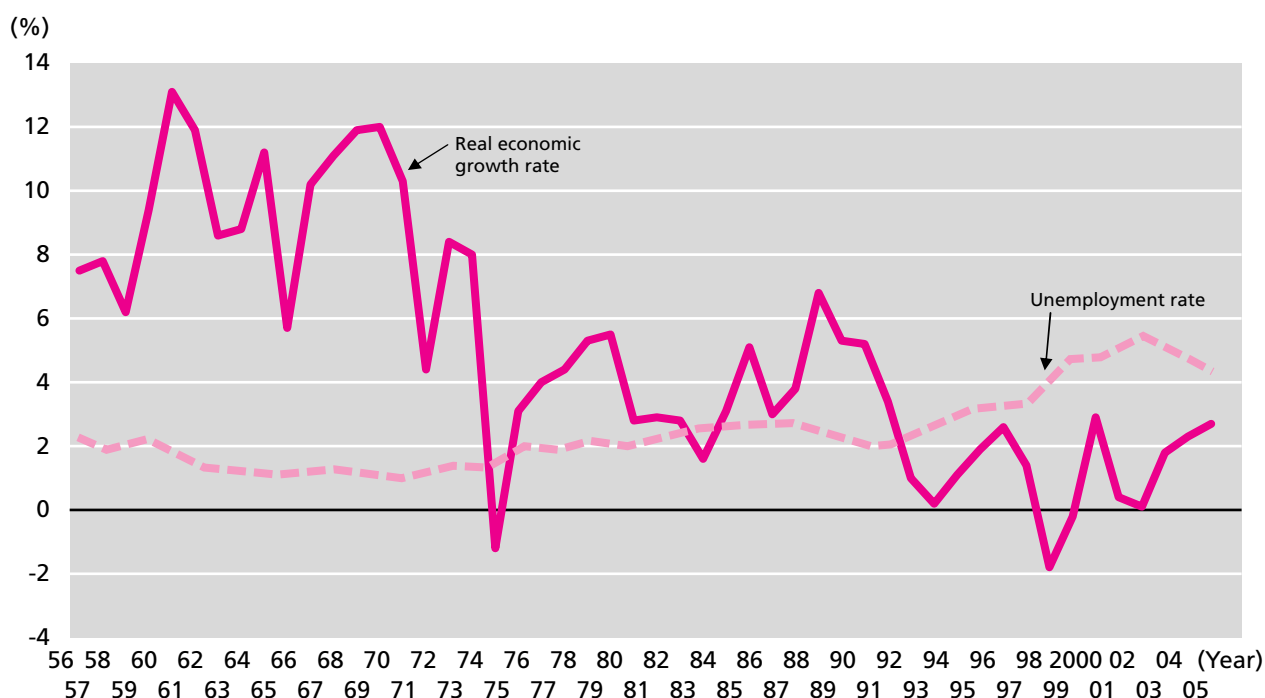
Despite temporarily passing through adjustment phases, at the time of the Iraq War in the first half of 2003, and due to adjustments in global IT-related sectors from the second half of 2004 to the first half of 2005, this economic recovery, which began at the start of 2002, continues to be a gradual and long-term one. Although at the outset it was a corporate sector-centered recovery, involving exports and business investment, through improvements in the employment and income environment in 2005, movements towards improvements in the household sector are also spreading. In terms of the long-term background to this economic recovery, one can cite the sustained expansion of overseas economies, and with progress made on the handling of the negative legacy left by the bubble economy, the almost complete resolution of the “3 excesses,” namely employment, capital stock, and debt (companies rectified excessive employment through restructuring; excessive capital stock through the rolling back of new investment, and disposal of facilities that were decrepit or lying idle; and excessive debt through repayment of liabilities, as well as debt repayment by asset disposal). In addition, among other factors, with the increased robustness of the corporate sector, one could also cite the continued improvements in corporate profits, as well as the favorable turnaround in the financial environment due to the progress made in the handling of non-performing loans. Set against this background, although there is a need to keep a close watch on the effects exerted on the oil price economy with global

oil prices skyrocketing, for the moment it would be fair to say that the effect on the Japanese economy is limited. Regarding prices, however, taking an overall view, although there is a situation of moderate deflation, oil prices are skyrocketing, corporate goods prices are on the increase, the extent of the fall in consumer prices is contracting, base costs have lev-

eled out, and one has now begun to see a movement towards a breakaway from deflation.

However, in terms of issues facing the Japanese economy, one could say that the question of how Japan can build a sustainable and dynamic economic society, given the decline in the population, is a major issue.

I-1 Real Economic Growth Rate, and Unemployment Rate

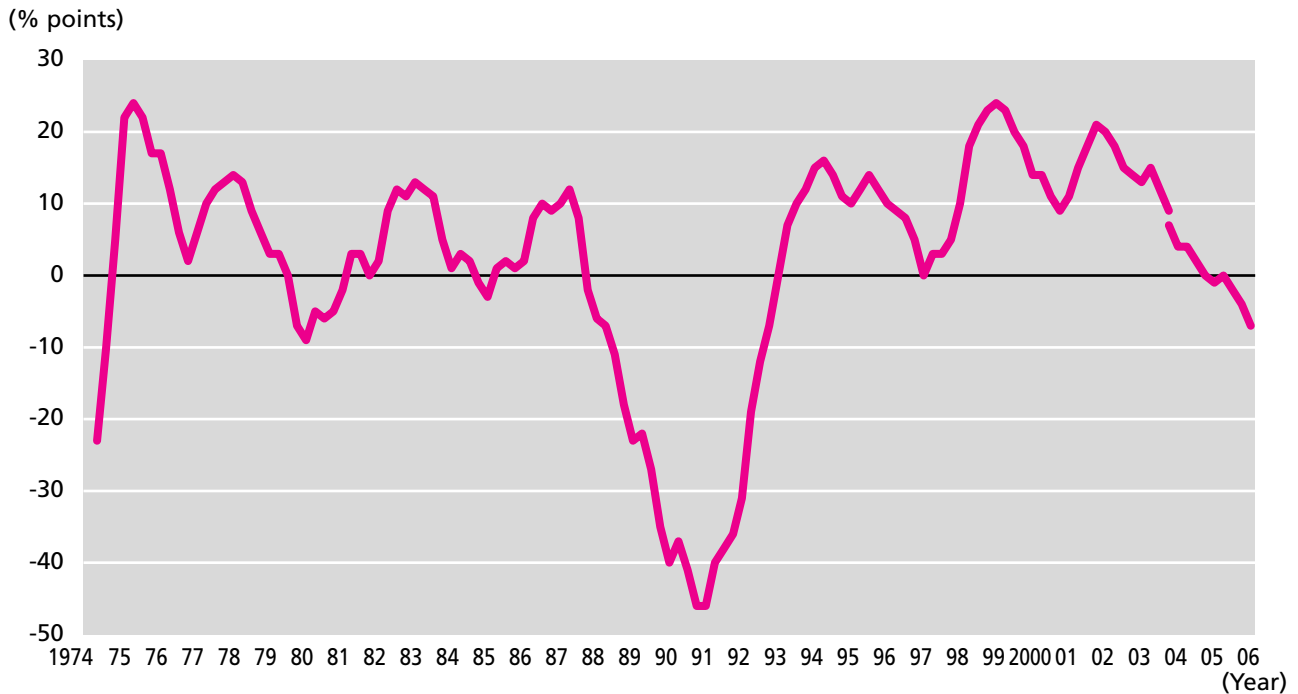


Sources: *National Accounts*, Economic and Social Research Institute, Cabinet Office; *Labour Force Survey*, Statistics Bureau, Ministry of Internal Affairs and Communications

Notes: Regarding the real economic growth rate, up to and including 1980, *1990 Basis Revised National Accounts (68SNA)*, from 1981 to 1994, *1995 Basis Revised National Accounts (93SNA)* and from 1995 onwards, *2000 Basis Revised National Accounts (93SNA, chain-linked method)*"

I-2 Employment, Capital Stock, and Debt Situation

1. Employment conditions diffusion index ("excessive" - "insufficient")

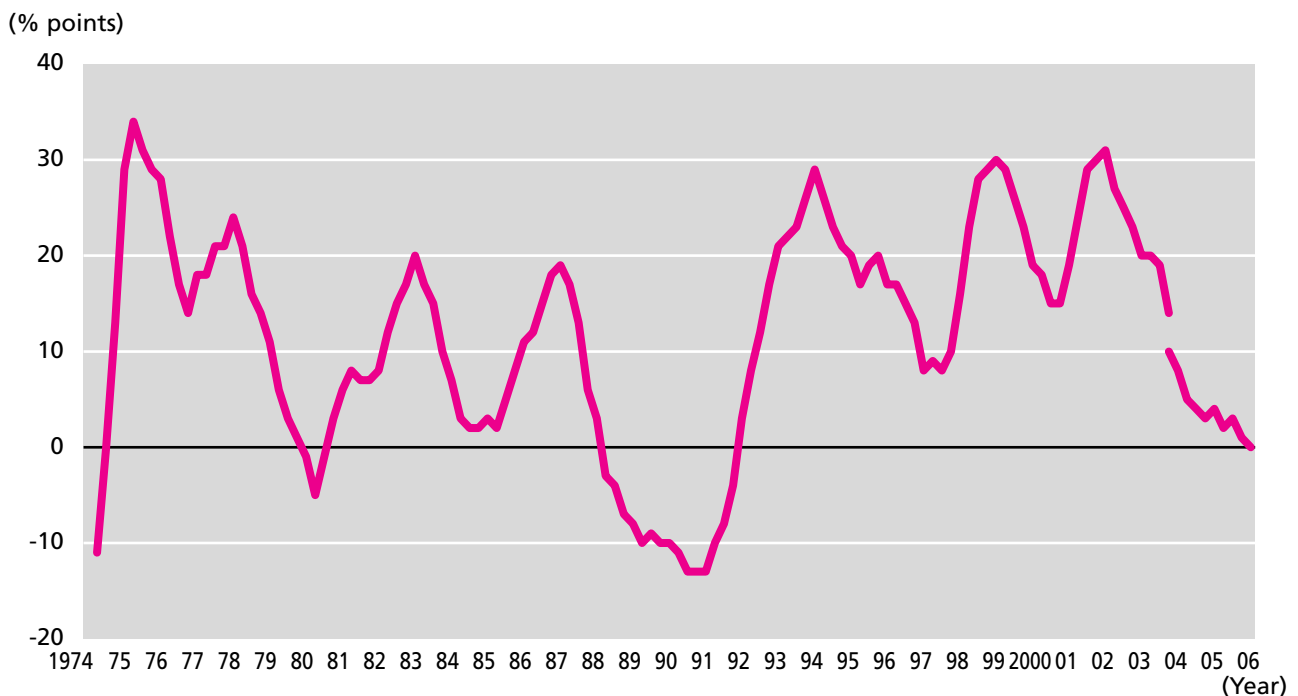


Source: Tankan (*Short-term Economic Survey of Enterprises in Japan*), Bank of Japan

Note: 1) All sizes of all industries.

2) From the March 2004 Survey onwards, the survey method changed. For this reason, there is a break in the graph.

2. Production capacity diffusion index ("excessive" - "insufficient")

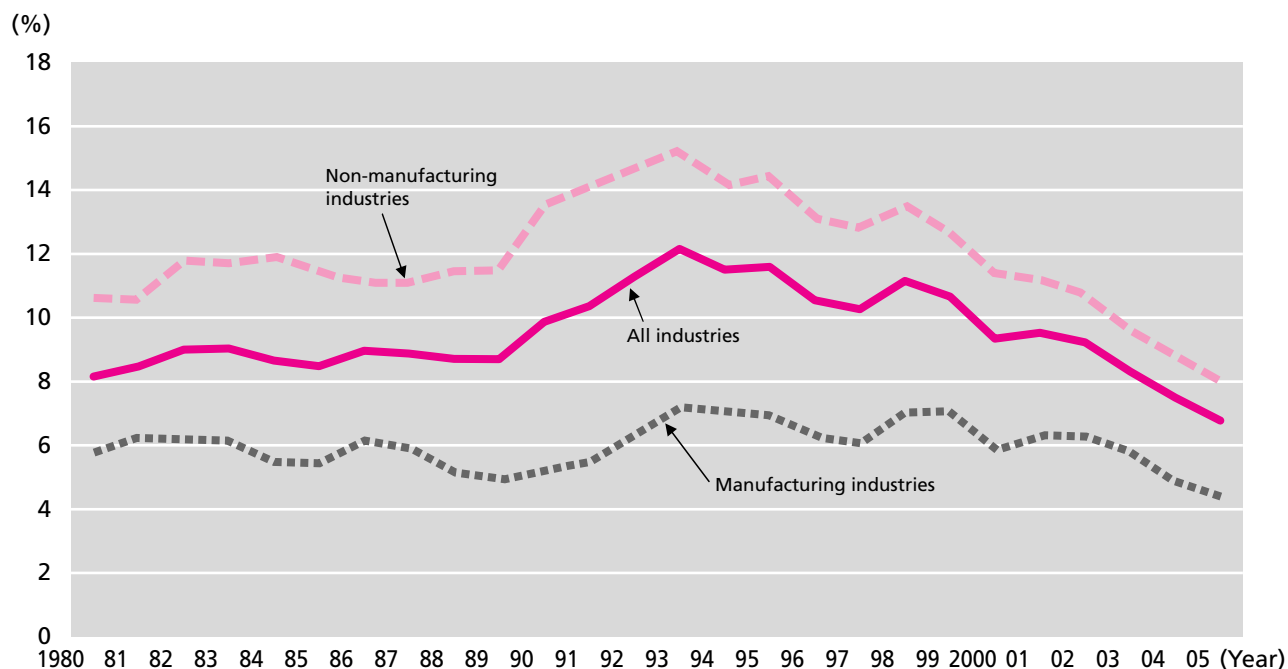


Source: Tankan (*Short-term Economic Survey of Enterprises in Japan*), Bank of Japan

Note: 1) All sizes of manufacturing industries

2) From the March 2004 Survey onwards, the survey method changed. For this reason, there is a break in the graph.

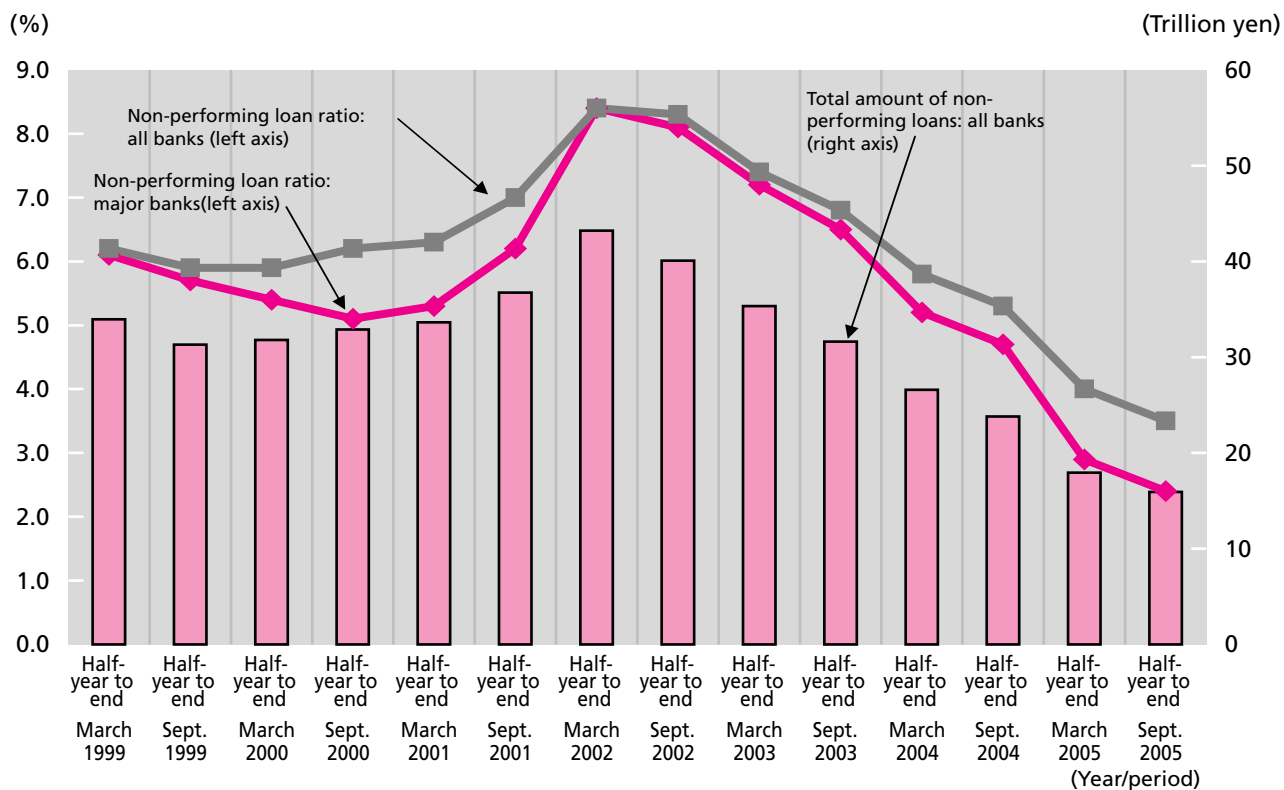
3. Interest-bearing debt/cash flow ratio



Source: *Financial Statements Statistics of Corporations by Industry, Quarterly*, Ministry of Finance

Note: Interest-bearing debt/cash flow ratio = interest-bearing debt (long-term loans + short-term loans + bonds)/cash flow (=ordinary profits × 0.5 + depreciation expenses)

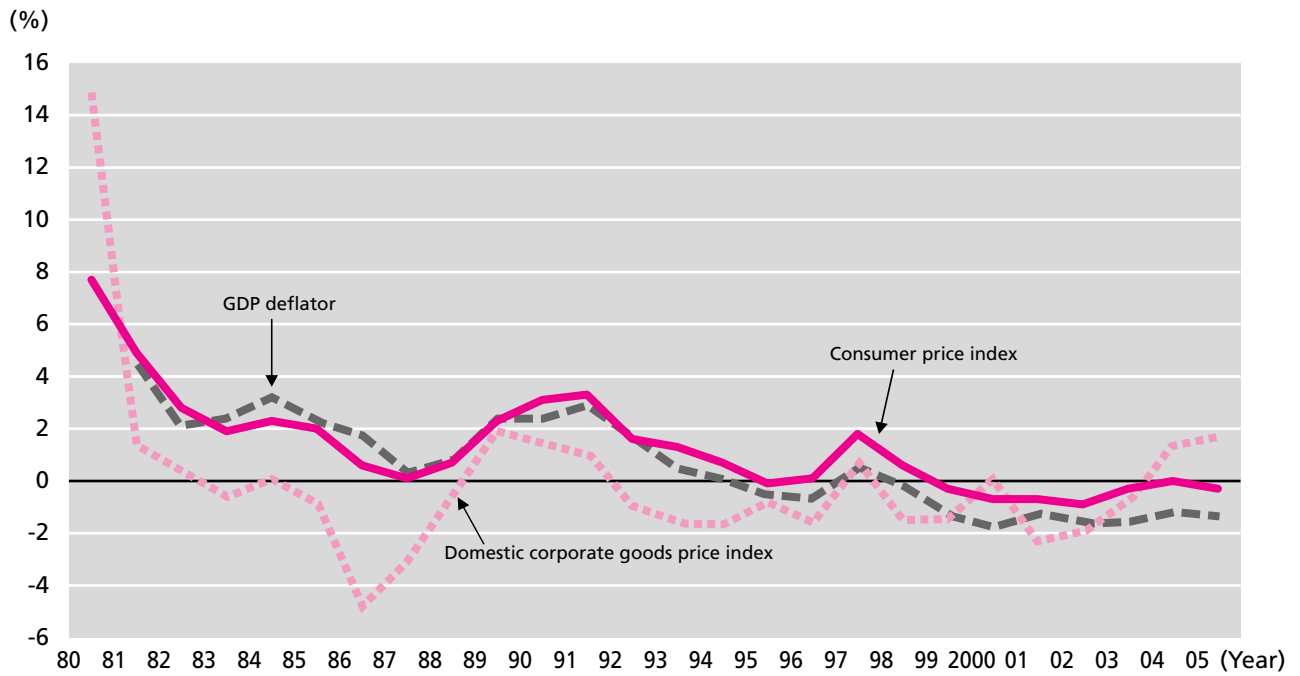
I-3 The Non-performing Loans Situation



Source: *Status of Non-Performing Loans*, Financial Services Agency

Note: Total amount of non-performing loans = Non-performing loans based on the Financial Reconstruction Act

I-4 Trends in Prices



Sources: *National Accounts*, Economic and Social Research Institute, Cabinet Office; *Consumer Price Index*, Statistics Bureau, Ministry of Internal Affairs and Communications; *Corporate goods Price Index*, Bank of Japan

The Recent Labor Situation

From the 1990s and the period of the Heisei Recession onwards, with the Japanese economy feeling the effects of the collapse of the bubble economy, and due to the fact that long-term stagnation has persisted, the employment and unemployment situation continues to be a very difficult one. In particular, in the economic downturn phase from 1997 onwards, the employment and unemployment situation rapidly deteriorated due to factors such as the slump in rapid production activity. The sense of employment excess grew stronger up until the first oil crisis hit its peak, corporate restructuring moved forward, and harsh adjustments were made in the areas of employment volume and wages. In 1999, the ratio of active job openings to active job applicants stood at just 0.48, the lowest ever recorded, and in 2001, for the first time the unemployment rate entered the 5.0 to 5.9% range, reaching 5.0%. Since 1998, not only has the number of people in work continued to decline, but the downward tendency in nominal wages has also continued.

In this economic recovery, which began at the start of 2002, despite the fact that at the outset, the employment situation continued to be very difficult, with the total unemployment rate reaching its highest level of 5.4% in 2002, due to companies' round of restructuring, and a reduction in the sense of employment excess amid a sustained economic recovery, the job openings to applicants ratio is on an upward trend, the total unemployment rate is now showing a downward tendency, and the number of employees is also increasing. The ratio of active job openings to active job applicants in 2005, at 0.95, was second only to the 2002 figure of 1.08 (however, in December 2005, it reached 1.03 (seasonally adjusted value), the first time since 1992 that it has entered the 1.0 to 1.9% range). In 2005, the corporate sense of employment excess, too, has almost disappeared ("Short-term Economic Survey of Enterprises in Japan"). In 2005, there was an increase in the number of employees for the third year running, and there

was also a rise in the number of employed person, for the second year running. For the first time in seven years, the labor force population, which had continued to decline due to factors such as the aging of the demographic structure, and the increased tendency to remain not in labor force, is on the increase. Although the unemployment rate remains as high as ever, it has nevertheless come down to 4.4%. Against this background, although difficult conditions in the labor market for new graduates still remain, companies are showing a stronger interest in recruiting new employees.

As we have seen, although the employment and unemployment situation remains a very difficult one, improvements can be observed. However, if one looks at these improvements in more detail, variation between them can be observed.

The improvements in employment are principally in non-regular employment. The ratio of active job openings to active job applicants for regular staff employees in 2005, at 0.58 (estimate), is at a lower level than that of the overall ratio of active job openings to active job applicants (0.95). The rise in the number of employees is due to the increase in non-regular workers (in 2004 and 2005, there has been a prominent increase in dispatched workers, contract employee or entrusted employee). Even during this economic recovery phase, the number of regular staff and employees, which hit its peak in 1994, continues its downward trend ("The Special Survey of the Labour Force Survey," "Labour Force Survey (Detailed Tabulation)").

If one looks at the results by industry and corporate size, set against steady increases in the medical, health care and welfare, and service industries, there continues to be a decline in the construction industry. Moreover, delays in employment improvements are being observed in small businesses with between 1 and 29 people.

In terms of differences between the sexes, the situation for males continues to be relatively difficult,

and in terms of the total employment rate in 2005, the average for males stands at 4.6%, while the figure for females is 4.2%.

In terms of age group differences, the employment and unemployment situation faced by the young is a particularly difficult one. In 2005, the total unemployment rate of those aged 15 to 24 still remains high, at 8.7%. Moreover, amid a difficult employment environment for the young, there is a high level of “freeters” and those not in employment, education or training (NEET). Following the substantial increase in the number of freeters from the 1982 figure of 500,000 to 2.17 million in 2003, although a decrease has been observed amid improvements in the employment situation, the figure of 2.01 million in 2005 still remains high. Moreover, the transition from non-regular employment to regular employment is proving to be a difficult one (the proportion of those moving from non-regular employment to non-regular employment is rising, whereas the proportion of those moving to regular employment is falling). Following the rise in the number of NEET to 640,000 in 2002, the figure has remained unchanged up to 2005. However, the job openings-to-applicants ratio is low among the elderly too, and the unemployment rate, particularly among men in the 60 to 64 age bracket, is high.

Furthermore, with this economic recovery phase, there are striking regional disparities in the pace of employment improvements. In Hokkaido, Tohoku, Kinki, and Kyushu, the total unemployment rate remains between 5.0 and 5.9%, as before. The ratio of active job openings to active job applicants ratio is low in Hokkaido, Tohoku, Shikoku, Kyushu and elsewhere, with the range of increase in the ratio of active job openings to active job applicants getting smaller. It is thought that discrepancies in the concentration of industries (such as IT-related industries, and manufacture of transportation equipment), which are providing the momentum for this economic recovery, as well as differences in the degree of dependence on the ever-dwindling number of public works projects, are behind these regional disparities in the employment situation.

Furthermore, with this economic recovery, improvements in wages are lagging behind compared to improvements in corporate profit. In terms of the

background to this, amid deflation and intensification of competition, it is thought that companies are attempting to improve their financial standing, and taking a firm stance on curbing labor costs. Although the total cash earnings (establishments with five employees or more) decreased for four years in a row, from 2001 to 2004, the rise in the composition ratio of part-time employees on low wage levels is also contributing to the decrease in the total cash earnings. In 2005, high wage increases for ordinary workers meant that the lowering effect caused by the increase in the composition ratio of part-time employees was reduced, and as a result, for the first time in five years, there was an increase in the total cash earnings, up by 0.6% year-on-year. If one looks at the breakdown of the total cash earnings, there have been increases in scheduled earnings, non-scheduled cash earnings, and special cash earnings. Wages in real terms have increased for the first time in five years, up by 1.0% year-on-year. One could say that improvements in corporate profits have finally had an impact on wages.

Having said that, in terms of the recent wage situation, one could cite the fact that achievements in company performance are now reflected in bonuses rather than wage increases, and that companies are increasingly introducing performance-based wage systems, in addition to attaching less importance to seniority factors. Moreover, given the rising proportion of non-regular employees, a widening in the wage disparities between regular employees and non-regular employees can be observed.

Since the enactment of the Revised Labor Standards Act in 1988, working hours are tending to decrease. In 2005, the number of actual working hours (establishments with five employees or more) fell by 0.6%. Down by 0.7%, scheduled working hours have decreased for five years running. With a 1.1% increase, non-scheduled working hours have increased for four years running, reflecting the economy's recovery. However, compared to the recovery period of the 90s, in this economic recovery phase an improvement in the employment situation can be observed, even to the extent that the increase in non-scheduled working hours is reflecting an increase in regular employment.

Furthermore, while the proportion of those working less than 35 hours a week to employees (employed person at work) in non-agricultural and forestry industries is on a long-term upward trend, the proportion of those working 60 or more hours a week leveled out after falling significantly from 1989 to 1993. Following that shift, since 1999 it has been rising, albeit gradually (“Labour Force Survey”). With rising percentages of both those with shorter working hours, and long working hours, one can observe a polarization of working hours. However, there is a tendency among middle-aged men and regular work-

ers to put in long hours.

In view of this, one could say that the increasing variation in wages and employment, as well as the increase in working long hours, are points to which attention must be paid.

Hereafter, amidst a decreasing population there will be calls for the creation of an economy and society which would enable sustainable development through the enthusiastic work of a diverse range of people and by making full use of their abilities, all while raising the quality of employment.

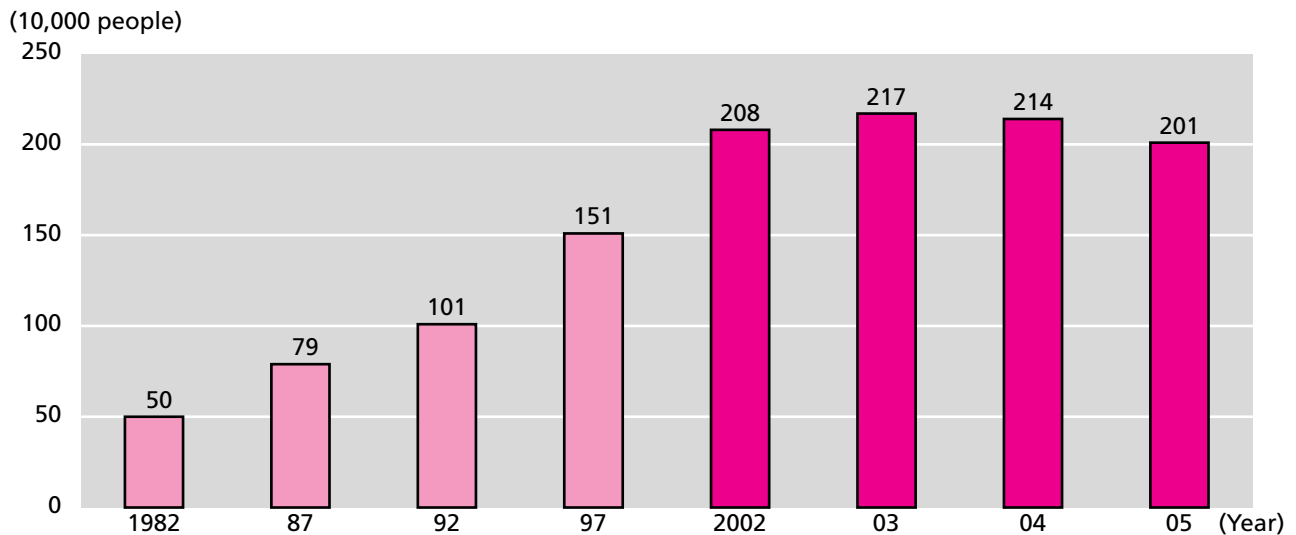
I-5 Trends in the Unemployment Rate, and Ratio of Active Job Openings to Active Job Applicants



Sources: *Labour Force Survey*, Statistics Bureau, Ministry of Internal Affairs and Communications; *Report on Employment Service*, Ministry of Health, Labour and Welfare

I-6 Trends in the Numbers of Freeters and Young not in Labor Force (NEET)

1. Trends in the numbers of freeters



Sources: For the years 1982, 1987, 1992 and 1997, taken from the *White Paper on the Labour Economy 2004* For 2002 and subsequent years, *Labour Force Survey (Detailed Tabulation)*, Statistics Bureau, Ministry of Internal Affairs and Communications

Notes: 1) For the years 1982, '87, '92 and '97, the age of freeters has been limited to those between 15 and 34.

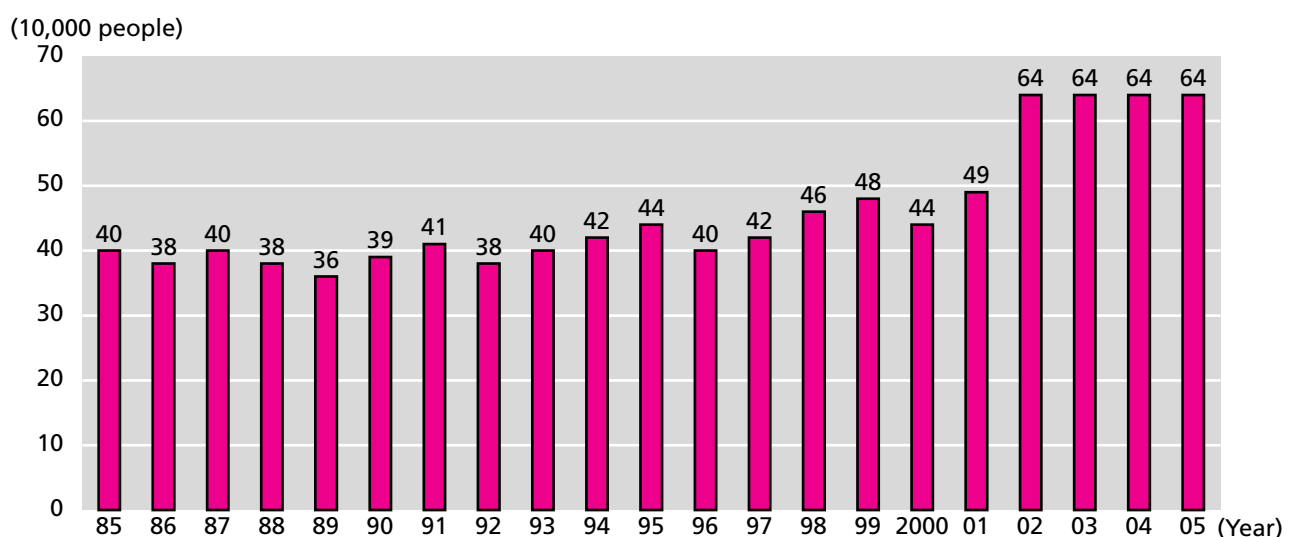
① Defining those who are usually engaged in work and called *arbeit* (temporary workers) or "part-time workers" at the workplaces with males being those who have continuously been in work for 1 to less than 5 years, and females being those who are unmarried and mainly engaged in work figures have been calculated.

② Defining people usually not in engaged as those who neither keep house nor attend school, and who wish to do "*arbeit* (temporary work), part-time work", figures have been calculated.

2) For the years 2002 to 2005, the definition of freeters is restricted to those who have graduated and are aged between 15 and 34, with women defined as those who are unmarried, ① those currently in work defined as employed people whose job is referred to as "*arbeit* (temporary workers)" or "part-time work" and ② people currently not engaged in work as those who neither do housework, nor attend school, and who wish to do "*arbeit* (temporary work), part-time work". Using these definitions, figures have been calculated.

3) Regarding the values for the years 1982 to 1997, and 2002 to 2005, it should be heeded that values do not link up, due to the differing definitions and so on of freeters.

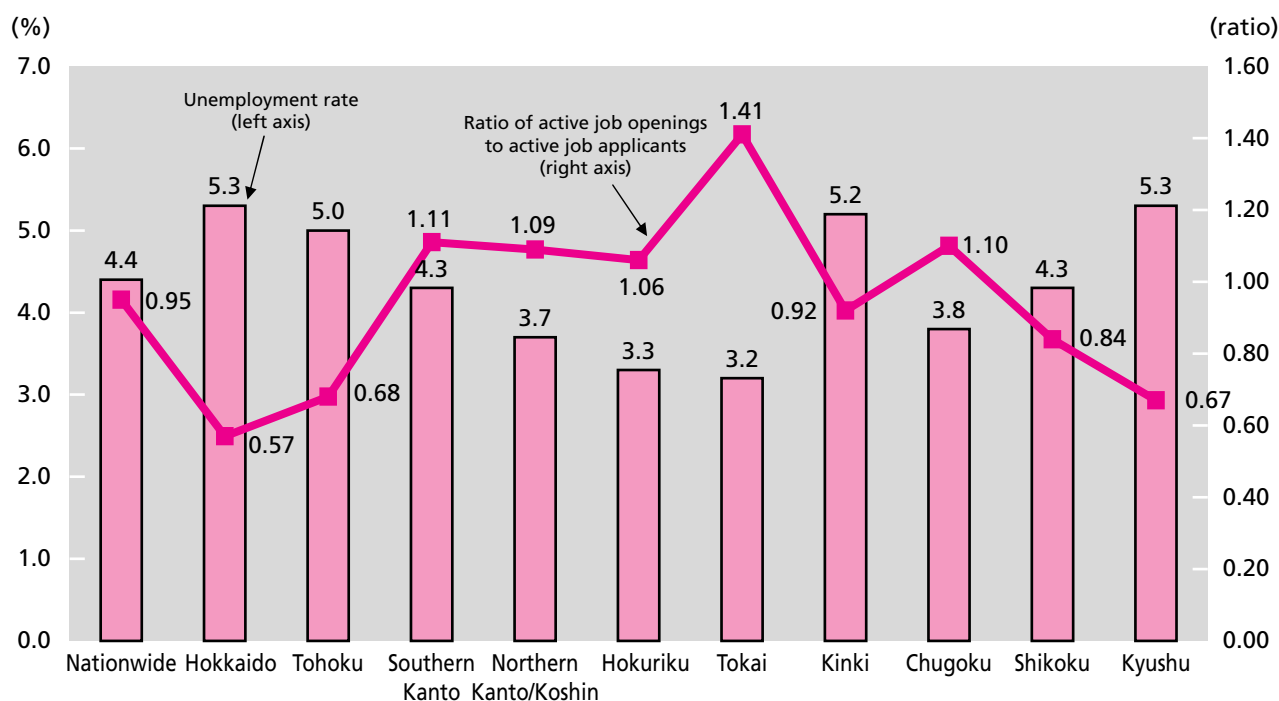
2. Trends in the numbers of young not in labor force in "others" (NEET)



Source: *Labour Force Survey*, Statistics Bureau, Ministry of Internal Affairs and Communications

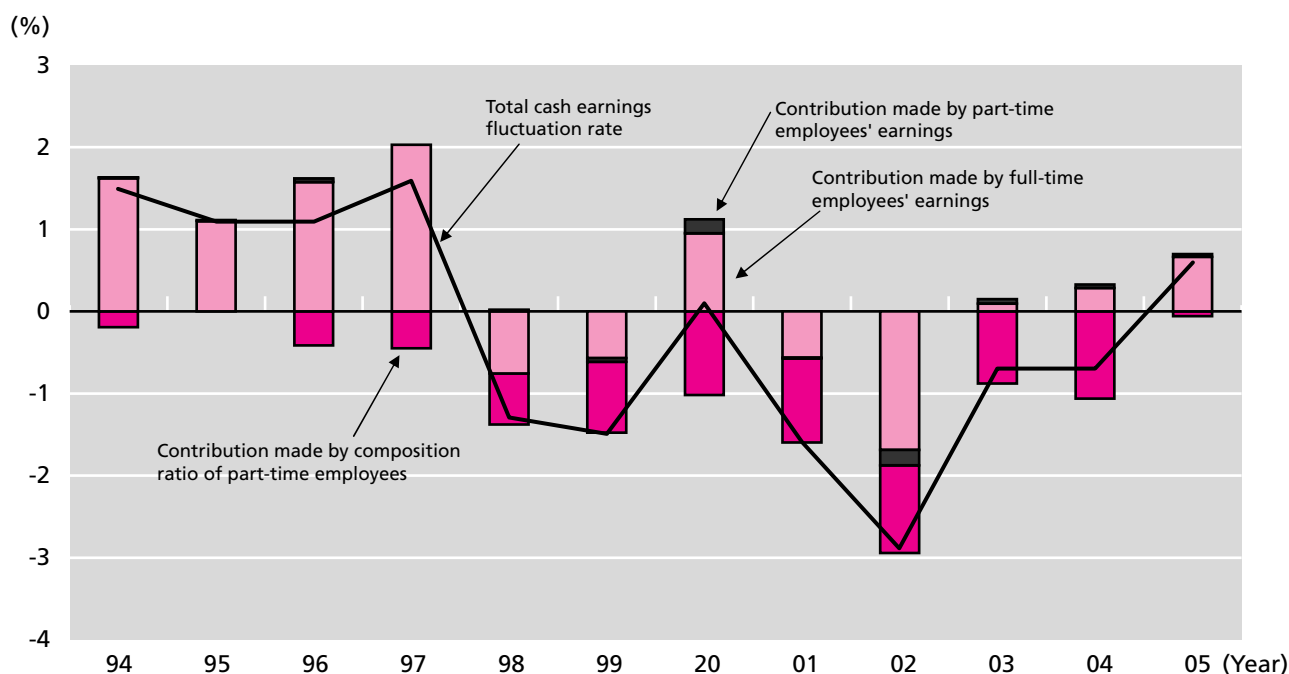
Notes: Within the non-labor force population aged between 15 and 34, and in the "others" (those who neither do housework, nor attend school)

I-7 Unemployment Rate and Ratio of Active Job Openings to Active Job Applicants by Region (2004)



Sources: *Labour Force Survey*, Statistics Bureau, Ministry of Internal Affairs and Communications; *Report on Employment Service*, Ministry of Health, Labour and Welfare

I-8 Contributory Factors in Fluctuations of Total Cash Earnings (for establishments with five employees or more)



Source: *Monthly Labour Survey*, Ministry of Health, Labour and Welfare

I-9 Trends in the Proportion of Workers with Short/Long Working Hours to Employees (employed person at work) in Non-agricultural and Forestry Industries



Source: Labour Force Survey, Statistics Bureau, Ministry of Internal Affairs and Communications