Can Abenomics and a “third opening” revive the economy?

Executive Summary

Since the late 1980s, Japan’s economy has struggled to overcome years of recession and punishing price deflation, plus a declining population and aging citizenry. Among the forces pushing against these head winds: a small but growing group of entrepreneurs who are trying to bring creativity and energy to the economy, and the government of Prime Minister Shinzo Abe, which is attempting to spark growth through “Abenomics” and a “third opening” consisting of free trade. Reviews of these efforts are mixed, but many experts agree Abenomics is comprehensive and ambitious. Mary also agrees Japan’s fate is tied to implementation of the trade pact known as the Trans-Pacific Partnership and to the nation’s ability to solve its demographic crisis. As Japan attempts to rebuild its economy, economists and policymakers are debating a number of crucial questions. Will an aging population, falling birth rate and restricted immigration doom the Japanese economy? Should Japan restart its nuclear plants? Is Abenomics working?

Overview

Satoshi Sugie was working as an engineer at Nissan designing headlights when he decided to strike out on his own. “The Japanese are sometimes too conservative and don’t want to take a risk,” he says. “In 2010, I met a wheelchair user who told me he had stopped going to the store because he didn’t want to be seen as weak, and I realized that wheelchair design hadn’t changed in 50 years.”

So Sugie poached other engineers from Sony and Toyota and started working on a prototype for what would become the WHill, a four-wheel drive, personal mobility device that can be controlled via a smartphone app and looks like something that came out of Apple’s lab. He leveraged the prototype to raise $13 million, opened a sales and marketing office in San Francisco and began taking orders for his invention, which sells for $13,995 and is available in both Japan and the United States. 1

His venture is one small sign of change in Japan, where entrepreneurship is gaining strength and the government under Prime Minister Shinzo Abe is attempting to lift the world’s third-largest economy out of its doldrums by pursuing a sweeping reform program he calls Abenomics and a “third opening” built around the Trans-Pacific Partnership (TPP) and free trade. 2 Reviews are mixed—some statistics indicate Japan’s economy is improving; others don’t—but most experts agree Abenomics is comprehensive and ambitious.

Japan, an Asian nation of 127 million, has historically been wary of opening its markets to competitors. What’s regarded as the first opening occurred in 1853 when the gunboats of U.S. Commodore Matthew Perry forced Japan to begin trading with other nations. The second opening was after World War II, during the U.S. occupation. 3 Japan has also been lukewarm to entrepreneurs. Its business history is defined by rigid traditions of the diligent salary man and lifetime employment, with different companies locked together in the keiretsu system, networks of business relationships that foster close collaboration between companies but limit innovation and shield domestic markets from imported products. It also is defined by a sometimes too-close relationship between the public and private sectors.

Since the late 1980s, the economy has struggled, including years of recession and punishing price deflation. Additionally, for the last few years, Japan has imported more goods than it has exported, posting record trade deficits. 4 Imports are mostly oil, natural gas and coal. The only items on the top 10 list of imports that aren’t energy related are computers, medicine, iron ore, phones and broadcasting equipment. 5
Japan’s Decades of Weak Growth

GDP growth rate, United States and Japan, 1985–2017

The Japanese economy is projected to grow at an anemic average rate of 1.3 percent from 2015 to 2017, roughly half the projected rate for the United States. Japan’s economic output soared during the 1980s, driven by its thriving auto industry, but plunged after its stock market crashed in late 1990. During the 1990s and 2000s, known as the Lost Decades, growth mostly hovered below 2 percent. The country’s economy expanded by nearly 5 percent in 2010 after shrinking for two years during the worldwide recession, but has since grown little.

Because of high tariffs and policies that discourage imports, U.S. businesses interested in the Japanese market face a formidable challenge. The United States shipped $65.1 billion worth of goods to Japan in 2013, the most current official data available from the Office of the United States Trade Representative, down 6.9 percent from the year before. American businesses have long complained about Japan’s policies. In 2013, for instance, the American Automotive Policy Council, which represents Detroit’s Big Three automakers, said that the Japanese government manipulates its currency to favor exports and block foreign competition.

Abe, who briefly served as Japan’s prime minister in 2006–07, was elected again in 2012. The ambitious economic program he calls Abenomics seeks to correct the nation’s trade imbalance and end two decades of deflation, as well as address serious demographic issues. The plan’s three prongs, or “arrows,” include monetary easing, fiscal expansion and structural reform.

Abe’s first arrow is loose monetary policy. Because Japan’s benchmark interest rate has been at zero for years, that involves what is known as quantitative easing. Japan’s central bank, the Bank of Japan, is buying government securities to pump more money into the economy and thus raise consumer spending and bring about inflation—years of deflation battered the Japanese economy. The bank has gone through two rounds of bond buying, but it has been unable to raise inflation to 2 percent.

The second arrow, expansive fiscal policy, involved $116 billion worth of government spending, including for infrastructure projects designed to repair damage from the catastrophic Great East Japan earthquake of 2011. Other government spending goals included expanding foreign trade, investing in renewable energy, promoting research and development, supporting small businesses, improving access to health care and expanding tourism.

Map: Major Earthquakes in Japan
Japan’s location atop four shifting tectonic plates has made the country vulnerable to destructive earthquakes. The largest one on record, a 9.0-magnitude quake off the Tohoku coast of Honshu island in March 2011, killed nearly 16,000 people and caused an estimated $300 billion in damage. Six of Japan’s largest recorded earthquakes occurred during the last 100 years, although others killed hundreds of thousands of people during the 18th and 19th centuries.

The last arrow involves a broad range of adjustments to the economic and financial structure, including opening up labor markets (possibly to foreign workers) and making farming more efficient. Abe also is pursuing structural change by cutting corporate taxes; tinkering with regulations on energy, the environment and health care; and incentivizing career opportunities for women. Getting more women in the workforce would expand Japan’s labor force, which has dropped 6 percent in the past 10 years, largely because of an aging and decreasing population. ¹¹

To foster new small businesses, Abe is supporting the Kakehashi Project, an incubator funded by the Japanese government to encourage Japanese start-ups to launch in Silicon Valley. ¹² Incubators in hubs such as Samurai Startup Island have also sprouted. ¹³ Going independent remains challenging in Japan, though. In a survey conducted by the Global Entrepreneurship Monitor, only 6 percent of the Japanese surveyed believed there were opportunities to start a business in their country. ¹⁴

Key parts of Abe’s strategy are interwoven in what real estate development firm Mitsui Fudosan calls “Kashiwa-no-ha,” or the Smart City, in Chiba prefecture. Its concept centers on creating a regionalized, energy-efficient planned city where residents can work, play and shop in a small-town environment that is still connected to a major metropolitan area, in this case, by rail to Tokyo about 28 miles away. Construction on the Smart City began in 2005; according to Kiyoko Hama, a representative of Mitsui Fudosan, 5,000 people now live there. ¹⁵

“Kashiwa-no-ha,” or the Smart City, in Chiba prefecture outside Tokyo, is a new regionalized, energy-efficient planned city with about 5,000 residents. (Scott Sowers)
The development is geared to saving energy, promoting a healthy lifestyle and providing an environment that encourages job creation through entrepreneurship. The community's major buildings are all adjacent to the train station, and the town is walkable.

Energy needs are controlled by a community-wide “energy management system.” Its smart grid system includes large banks of batteries to store power. On a smaller scale, residents are encouraged to reduce their carbon footprints by turning off appliances and using the fleet of community vehicles.

Improving access to health care is another principle of Abenomics. The Japanese telecom giant Nippon Telegraph and Telephone (NTT) is using optical-fiber broadband information and communication technology to bring new health care initiatives to the 600 residents of Hinoemata, a tourist destination in Fukushima prefecture known primarily for its buckwheat soba noodles and kabuki theater productions. The technology takes the form of a landline-based telephone with a video screen and large, easy-to-read number buttons.

Hinoemata Mayor Mitsuyoshi Hoshi says, “In 2011, NTT contacted us and said they wanted to distribute step counters to the villagers so they could register their steps, track their blood pressure, body weight, and send all that data to a regional health center. All the households would also be supplied with an Internet connection.”

The closest hospital to the village is two hours away by twisting mountain roads. The villagers are encouraged to send their vital signs to the local health clinic using electronic blood pressure cuffs, blood sugar measuring devices and electronic scales.

The data is sent via a videophone, designed and sold by NTT, that gives the patient face-to-face contact with doctors and nurses. “The younger generation already uses the Internet, but if we can make a simpler product for the older people, there’s a lot of possibility there,” says Hideki Ishida, an executive with NTT East.

Abe also is pushing structural change in Japan’s agriculture system, which, through tariffs, restricts imports and protects a farm workforce of aging part-timers.

After World War II, reform laws redistributed farmland from large landlords to tenant farmers. The average size of the smaller parcels was 7.4 acres. The government assumed the small farmers would eventually sell out to larger farmers, but soaring land prices kept the system intact as the smaller farmers chose not to sell.

For the past 60 years, Japanese agriculture has been dominated by JA-Zenchu, or JA, known in English as the Central Union of Agricultural Cooperatives. The group is an independent lobbying organization that maintains strong control over Japanese agriculture. Change under Abenomics is coming down to fights over the JA’s power, the fees that farmers pay to the JA and the high tariffs on pork and beef.

Japan’s farmers are old—their average age in 2010 was 70. Most young people are not interested in farming as a career: Of Japan’s 1.5 million farmers, only 420,000 work full time. The JA, which is tightly linked with Abe’s Liberal Democratic Party (LDP), employs 240,000 people.

Non-Japanese food companies back the Trans-Pacific Partnership—an agreement among 12 countries, including the United States, Japan, Vietnam and Australia, that would phase out tariffs between the members and lead to increased trade—because the pact might open the door to a Japanese market hungry for lower food prices. The TPP remains politically controversial in some would-be member countries, including the United States.

Japan would also like to export more food and has set a goal of doubling food exports by 2020. Since Abe relaxed price supports for rice, prices for the Japanese diet staple have fallen to their lowest level since 2006. “The TPP is pushing for all that, but we don’t know where it’s going yet,” says Shihoko Goto, an associate with the Wilson Center, a foreign policy think tank in Washington, D.C. “Part of the base of Abe’s political party is agriculture.”

As Japan proceeds with its third opening and seeks to revitalize its economy, here are some of the questions under debate:

### Weighing the Issues

**Will an aging population, falling birthrate and restricted immigration doom the Japanese economy?**

Demographic factors present some of the largest impediments to putting the Japanese economy back on track. The country’s population, which started falling in 2004, is aging more quickly than that of any other nation. More than 22 percent of the population is already over 65, and a government report indicates that by 2060 the population will fall from 127 million to 87 million—and nearly 40 percent of them will be over 65. Council on Foreign Relations senior fellow Sheila Smith said, “Many of [Abe’s] reforms call for significant adjustments in the norms of Japanese society. It’s a huge agenda, and there is no one silver bullet.”

**Working-Age Japanese Population Declining**

Percentage distribution of Japan’s population, 2015, 2030 and 2050
Abe is looking at ways to increase birthrates, including taking some unusual measures, such as assigning lifelong gynecologists to women and providing financial help to singles looking for partners. Another way to raise birthrates is to get more women in the workplace: “Evidence shows that workforces with a higher female participation rate also have higher birthrates,” said Kathy Matsui, chief Japan equity strategist at Goldman Sachs in Tokyo.

While a falling population means smaller markets, an aging population does present business opportunities—especially in health care. By 2020, more adult diapers will likely be sold in Japan than those made for children. Telemedicine systems, similar to the system NTT is testing in Hinoemata, also are being put into service in Japan by Biotronik, based in Berlin. “If you go to a hospital in Japan, it’s not

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Notes: Data calculated from projections for the total population for each listed year.


Japan’s population is projected to age significantly in the next 35 years. The share of Japanese age 65 and older will grow from 26 percent of the population in 2015 to 31 percent in 2030 and 36 percent in 2050, according to United Nations projections. The share of 35- to 49-year-olds, meanwhile, will shrink from 21 percent of the population in 2015 to 16 percent in 2050, while the share of 15- to 34-year-olds will drop from 21 percent to 18 percent.

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Distribution by age group, 2015

Distribution by age group, 2030

Distribution by age group, 2050

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uncommon for a doctor to see 100 outpatients a day. Of these patients, [many] are going for prescriptions or routine checks. They don't necessarily need to go," said Jeffrey Annis, president of Biotronik. "How to better manage this as Japan ages? One option is … telemedicine. There is no doubt that [it] is going to grow."

"How to better manage this as Japan ages? One option is … telemedicine. There is no doubt that [it] is going to grow."

Japanese senior citizens work out with wooden dumbbells on the grounds of a Tokyo temple in September 2015 to mark that nation's Respect for the Aged Day. The nation's population is one of the world's oldest, which presents economic challenges. (Yoshikazu Tsuno/AFP/Getty Images)

Yoko Ishikura, a professor emeritus at Hitotsubashi University, works as an independent consultant in global strategy competitiveness and says Japan's economy is in serious trouble because of the problems posed by an aging population and low birthrate. "I don't think most Japanese realize how quickly we are losing our working population," she says. "We're aging, and unless we do something about it, I think the economy will go into a downward spiral if we don't take measures pretty quickly."

Toshio Nagashima, the manager for Vegi Dream, a Toyota subsidiary that is growing 1,000 tons of bell peppers a year, says Japan's profound demographic problems already are affecting its economy. "These problems are the very reason that lots of Japanese companies are targeting foreign markets and people are hesitating about spending money here," he says. As of midsummer 2015, household spending had dropped in 14 of the previous 15 months. 22

Toshio Nagashima, the manager for Vegi Dream, a Toyota subsidiary that is growing 1,000 tons of bell peppers a year, conducts a tour of his farm. (Scott Sowers)

William H. Saito, an entrepreneur who is an adviser to Abe, doesn't buy into the gloom: "Assuming things like the Second Machine Age and Industry 4.0 are happening, a shrinking and aging population, which the rest of the world will soon experience, will be a positive."

Saito is referencing thinking defined in "The Second Machine Age: Work, Progress, and Prosperity in a Time of Brilliant Technologies," a 2014 book by Erik Brynjolfsson and Andrew McAfee. These Massachusetts Institute of Technology educators point to transformational technological advances, including self-driving cars and IBM's Watson computer, as examples of why humans should be optimistic about the future. 23

Industry 4.0 is a term for the transformational forces at work in the business world resulting from the increased use of data analytics, cybersecurity solutions, cloud-based technology, robots and interconnectivity. 24

"The key building blocks are already in place for digital technologies to be as important and transformational to society and the economy as the steam engine," Brynjolfsson and McAfee wrote. "In short, we're at an inflection point—a point where the curve starts to bend a lot—because of computers. We are entering a second machine age."

22 23 24
Saito believes technology will save us all, and that a smaller population won’t be a problem for Japan because machines will help humans do more with less. Goto at the Wilson Center agrees. “Is really about can we make lemonade out of the lemons?” Goto asks.

Yet reversing a falling birthrate is difficult. Japan’s fertility rate is 8.4 children per 1,000 inhabitants; only Germany’s is lower, at 8.2 per 1,000. 29 One-quarter of the population is 65 or older. 31 The Pew Foundation rates Japan as No. 1 in its old-age dependency ratio, a comparison of the number of people 65 and over with the number of working-age people. Its ratio is 72—twice as high as in the United States. 33

Although government can’t do much about birthrates or aging, it can do something about immigration policy—which in Japan remains controversial and problematic. In February 2014, the government prepared a report recommending that the country accept 200,000 new permanent residents while also stressing that it was not changing immigration policy. 34 Abe has issued temporary visas for construction workers on the condition that the workers return home once projects are completed. Many of the construction workers are helping Tokyo prepare for the 2020 Olympics. But even with the temps figured in, the government projects a total labor shortage of 150,000 workers. 35

“The subject of immigration used to be such a taboo, but now we are at least talking about it, which is a good step,” says Ishikura of Hitotsubashi University. She points to South Korean and Chinese immigrants working in 7-Elevens—the Japanese-owned convenience store chain has 17,000 outlets in Japan, more than twice as many as in the much larger United States. 36 The convenience store workers are often students who don’t become permanent residents. 37

Less than 2 percent of Japan’s working population is foreign born, one of the lowest rates in the world. Abe is allowing some health care workers from Indonesia, the Philippines and Vietnam to come to Japan and work toward long-term residency. However, their formal training often is not recognized in Japan and they must learn Japanese within three to four years or they are sent home. As a result, the program has never reached its goal. 38

**Should Japan restart its nuclear plants?**

In March 2011 a major earthquake shook Japan, spawning a tsunami. Almost 16,000 people died; damage was estimated at $300 billion. 39 The disasters cut off power and cooling to three nuclear reactors in Fukushima prefecture in northern Japan. 40 Before the accident, nuclear accounted for 30 percent of Japan’s energy output and plans were in place to raise that to 50 percent. 41 In the wake of the meltdown, all 54 Japanese reactors were taken off line as a precaution. To replace the offline reactors, Japan began running generators off fossil fuels. Its oil imports rose 4 percent between 2010 and 2012 while imports of liquefied natural gas went up 24 percent. The costs of power generation jumped 41 percent. 42

Shutting down all the reactors after the accident “has increased our dependence on fossil fuels,” said Japanese energy official Toshikazu Okuya. “Money has flowed out of the country and electricity prices have risen.” 43

Environmentalists want the reactors left off, but the business community generally wants them turned back on.

Converting to renewables is not yet a viable option, according to analysts. “For utilities, there is no economic incentive to add clean energy,” said Ali Izadi-Najafabadi, an analyst at Bloomberg New Energy Finance in Tokyo. “In the long term, it hurts the country, including manufacturers.” 44

Public sentiment about nuclear power is mixed, and legal battles have erupted as the process of turning the reactors back on moves from the stress-test stage to active. In April 2015, a Japanese court in the Kagoshima district rejected an injunction filed by residents to leave the local plant turned off. 45

In the meantime, “Japan’s nuclear village”—a widely used term that includes the pro-nuclear forces consisting of academics, utility providers, the financial sector, the government and the media—urges both restarting the reactors and developing renewables. 46 “The most important thing is to optimize different power sources such as nuclear, thermal and renewables,” said Hajimu Yamana, a professor at the Kyoto University Research Reactor Institute. 47

Nagashima, who gets the power to run his Vegi Dream pepper farm from a natural gas cogeneration plant, opposes restarting the reactors. “Lots of Japanese people believe in the potential of alternatives such as solar, geothermal heat, etc.” he says. “I think the problem constraining the alternatives’ development is too much regulatory and administrative policies.”

Businesses responded to the loss of a reliable power source by developing large-scale backup battery systems, alternative-energy sources and smart grids for their factories and plants. The same Toyota Motor East facility where Vegi Dream operates lost power for several days after the earthquake. The company worked with the government and the local utility provider to install a natural gas-fired generator and a smart grid system that connects the main factory with nine other surrounding manufacturing plants—also owned by Toyota—and the village town hall a few miles away.

Ichiro Suzuki, spokesman for Toyota Motor East, says, “We expected the supply-demand balance for electricity would be very tight because of the long-term shutdown of nuclear reactors caused by the East Japan earthquake. The biggest challenge was the deregulation needed to supply electricity to the other factories.” Similar backup battery systems and smart grids also are in use at the Smart City project and at a complex of test houses being built by Honda in Saitama.

Junichi Takeuchi is the CEO of Fasotec, a Chiba technology company that is pioneering the use of 3-D printers to produce realistic models of human organs used to train surgeons. He’s accepted that, despite problems, nuclear power will be part of Japan’s energy makeup for years to come.

“We as a people in Japan have understood the great risks of nuclear and gained major distrust,” he says. “On the other hand, we do not have many feasible options. The best option, of course, is to find alternative energy resources as soon as possible while buying time by operating a part of the nuclear plants with extra care.”

Of the country’s 54 reactors, 42 are operable and 7 are expected to be restarted over the next two years. 48 As of early October 2015, one reactor is currently operating while a second is scheduled to start by mid-October. 49

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Jun Yamadera, a graduate of the Samurai Startup Island program, runs the technology firm Eyes Japan. It’s located about a three-hour drive from the crippled nuclear plant. Living and working that close to the danger zone has given him mixed feelings about the future of nuclear energy in Japan. “Oh, boy, I really don’t know,” he says. “I have studied nuclear power since as I learn, I realize there’s more I don’t know. I am not pro-nuclear or anti-nuclear. But I am pro-data and pro-science. However, I do believe humans always invent things like the wing by jumping from the cliff.”

Is “Abenomics” working?

Shinzo Abe, now three years into his second term, has loosened monetary policy and poured money into Japan’s infrastructure. Some early verdicts are coming in, and they are mixed. Although the Nikkei stock index has been rising since he was elected, Japan’s GDP fell 1.2 percent in the second quarter of 2015. Price deflation is still an issue as the core Consumer Price Index dropped 1 percent, not including food prices.

Overall, GDP has been going up since Abe’s election, but slowly. It has increased only 2.3 percent since the start of 2013. 43 Although most sources give him kudos for trying new medicine on old problems, Abe has his critics. Reforming the agriculture system will dilute power from the JA, the face of the farm lobby and a political powerhouse with strong ties to Abe’s party. Health care companies also are complaining about changes to the centralized health system that could increase the availability of foreign-made drugs and medical devices.

“We have to protect the universal health insurance system to which everyone belongs,” said Takashi Hanyuda, a member of Abe’s political party and vice president of the Japan Medical Association, a powerful doctors’ lobby. “If the system starts to break down a little, it will turn into a flood and it would be extremely hard to halt the trend.” 45

Some critics also raise the specter of hyperinflation because of all the cash being pumped into the monetary system, but so far there’s not much evidence to support this fear. 44 Japan’s record high debt-to-GDP ratio of more than 230 percent also garners lots of dire warnings. That the debt is held domestically and at low interest rates is often lost amid the gloom. Most of the debt is held by entities of the Japanese government, including the Bank of Japan, and that when is calculated in, the debt numbers fall to a less distressing figure of below 140 percent. 45

Japan Carries World’s Highest Debt-to-GDP Ratio

Government debt as a percentage of GDP, by country, 2013

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The Japanese government’s debt equaled 230 percent of the nation’s gross domestic product in 2013, well above second-ranked Greece (180 percent) and third-ranked Italy (143 percent). By comparison, the United States’ debt-to-GDP ratio was 123 percent, while Germany and South Korea had ratios of 62 percent and 51 percent.

People going through their daily lives have a more specific complaint: Some say Abenomics is not helping them. “I am in Fukushima and I don’t feel it,” says Yamadera, the tech entrepreneur. “But maybe some people in big cities may be getting an advantage.”

Ishikura, a frequent speaker at international business management conferences, remains a believer in Abe’s reforms. “Abenomics has done good things,” she says. “His fiscal and monetary policy has worked to some extent, and companies are showing good earnings, but structural reform is slower and will take time. Much remains to be seen.”

Since it became clear in October 2012 that Abe was a lock to win that year’s election, the Nikkei stock index has doubled; however, real wages have been flat for more than two years. 55

Goto of the Wilson Center also remains bullish about Abenomics. “You can talk about the stock market, which has boomed. People are encouraged to invest in stocks again, which has pushed up the GDP,” she says. “Abe has also brought back political stability by coming up with a strategic plan. For a while we had a revolving door of prime ministers, and it was kind of a joke.”

Background

Shoguns and Samurai
during the Asian banking crisis. Unpegged from a stabilized exchange rate, the baht immediately lost as much as 20 percent of its value. Thailand then brought lending rates up 2 percentage points to 12.5%

Another financial blow landed in 1997. Thailand's central bank floated the value of the baht, its national currency, against the U.S. dollar in an attempt to spur its economy, beginning what has become known as the "Lost Decade." All of this eventually edged the country out of crisis but fell far short of a full recovery.

At the end of 1990, the Japanese stock market nosedived as businesses went bankrupt, banks closed and capital losses reached $2 trillion. Taxpayers bailed out the banks, corporations were restructured and trade with longtime nemesis China increased. All of this eventually edged the country out of crisis but fell far short of a full recovery.

The "Lost Decade"

Borrowing Perry's tactics, Japan forced Korea, which was rich in coal and iron, to open its ports for trade. Japan also wanted Korea to declare itself independent from China.

China and Japan had been meddling in Korean affairs for years, and the two sides fought a war in 1894–95 over who would control Korea. Although experts predicted a quick victory for China, Meiji's military modernization gave Japan a decisive victory. The peace treaty recognized Korea's independence and granted Japan trading privileges in China. The treaty also handed over Taiwan, the Pescadores Islands and the Liaodong Peninsula in Manchuria to Japan, along with a cash settlement.

However, just after the treaty was signed, the Russians enlisted support from Germany and France to take over the Liaodong Peninsula, an arrangement that would become known as the "Triple Intervention."

“Years of disputes between Russia and Japan over control of the area led to a 1904 Russian attack on the Japanese fleet at Port Arthur, a warm-water port at the peninsula's tip. Japan declared war on Russia, and the fighting proved costly for both sides. U.S. President Theodore Roosevelt in 1905 brokered a treaty that gave Japan control of Korea, much of southern Manchuria and half of Sakhalin Island. The Russians weren't interested in Korea and focused their energy on maintaining a presence on Sakhalin and on avoiding paying the Japanese any kind of indemnity. Roosevelt helped foster an arrangement where no money changed hands and the Russians kept the northern half of Sakhalin. He won the Nobel Peace Prize for his efforts, and Japan was now a major power in the Pacific.

“The war with Russia marked the first time an Asian country had defeated a country from the West,” says Goto of the Wilson Center. In 1910 Japan annexed Korea. Although legal questions swirled, the arrangement remained in place until after World War II.

Imperial Japan was not driven by ideology or religion, as much as it was by economics. Japan is not rich in natural resources. The war with Russia was all about access to coal and iron. Japan moved quickly into its own version of modern imperialism.

When World War I started in 1914, Britain called on the Japanese to honor the 1902 Anglo-Japan Alliance. Japan complied by declaring war on Germany. Although not a major player in the fighting, Japan took advantage of being on the winning side of World War I to issue 21 demands that gave it even greater control over China and mineral-rich Manchuria.

The buildup to World War II saw Japan invade Manchuria in 1931 as the "Mukden Incident," which raised suspicions that Japan blew up a railroad bridge as a pretext to send in its army. In 1937, Japan went after China again in an attempt to overthrow the Nationalist government of Chiang Kai-shek. In 1940 Japan attacked French Indochina to cut off China's supply route; on Dec. 7, 1941, it bombed the U.S. Pacific fleet at Pearl Harbor, drawing the United States into World War II. The war in Asia ended with Japan surrendering after the United States dropped nuclear bombs on Hiroshima and Nagasaki in August 1945.

Rise to Economic Power

U.S. Gen. Douglas MacArthur was put in charge of the punishment and eventual rebuilding of Japan after the war. The occupation produced a democratic constitution that moved political power from the emperor to a new parliament called the Diet. By 1947, concerns about Japanese militarism had been replaced with fears of a Chinese communist-controlled Asia.

During the seven-year occupation, MacArthur attempted to break up the zaibatsu, or "financial clique," system of interlocking businesses that dated back to the 1500s. The original 10 cliques or groups included Mitsubishi, still a major player in the auto industry. The groups were usually formed between a merchant needing capital to expand his business and a shogun or government leader who could benefit from an alliance with the merchant. If the group prospered, it would add other businesses to strengthen the organization.

As the occupation ended in 1952, Japanese business interests teamed up with the government and concentrated on building an economy based on steel production, electronics, shipbuilding and eventually cars.

Financing and enlarging the newly reorganized firms fell back to the zaibatsu, except the structure and makeup of the groups had changed slightly and they were now known as keiretsu, which means "business association." The keiretsu system gained strength and legitimacy in 1953 after the Diet changed the anti-monopoly laws put in place by the United States during the occupation.

During World War II, 11 automakers produced trucks for Japan's war effort. Ten of those companies survived the war, including Toyota, Nissan and Isuzu. Along with a new company called Honda, they turned to making consumer goods.

The new arrangements of the old zaibatsu alliances began to reorganize themselves horizontally, which brought companies from different industries together, and vertically, which linked different companies in the same business. The new groups formed around key banks as opposed to the government. The original six horizontal keiretsu included Mitsui, Mitsubishi, Sumitomo, Fuji, Sanwa and the DKB group. The vertical group of electronics firms included Hitachi, Toshiba, Sanyo, Mitsubishi (Panasonic) and Sony. The vertical automotive group included Toyota, Nissan, Honda, Isuzu and Daihatsu.

Holding companies shielded owners and reduced risk; insurance firms and other related industries joined the mix, with stock ownership shared by all the players. Critics of the system say it encouraged monopolies, discouraged competitive pricing, limited innovation and overprotected domestic markets from imported products.

Proponents say it reduced risk, improved stability and allowed firms in different sectors to share R&D efforts. "It still exists in Japan, and many Asian countries have the same kind of system," Goto says. "Some say it stifles creativity, but when one company is not doing so well, another one can prop it up. If an employee is struggling at one company, they may move him to a different position within a different company in the organization."

The oil crises in the 1970s boosted Japan's economy because the nation's automotive industry began specializing in affordable, fuel-efficient vehicles that sold widely in the United States and elsewhere. "The war with Russia marked the first time an Asian country had defeated a country from the West," says Goto of the Wilson Center. In 1910 Japan annexed Korea. Although legal questions swirled, the arrangement remained in place until after World War II.

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At the end of 1990, the Japanese stock market nosedived as businesses were bankrupted, banks closed and capital losses reached $2 trillion. Taxpayers bailed out the banks, corporations were restructured and trade with longtime nemesis China increased. All of this eventually edged the country out of crisis but fell far short of a full recovery.

The actual parameters of what became known as the Lost Decade are imprecise. Some experts reference two Lost Decades, when economic growth stagnated and financial markets tumbled. The Nikkei 225 stock market index peaked in December 1989 at 38,916, and bottomed out in March 2003 at less than 8,000. By June 2007, the index was back up to 17,000 but then took another hit in February 2009 when it fell to 7,508. It started a steady ascent late in 2012, heading over 20,000 in summer 2015. As of early October 2015, the index is over 18,000.

Another financial blow landed in 1997. Thailand's central bank floated the value of the baht, its national currency, against the U.S. dollar in an attempt to spur its economy, beginning what has become known as the Asian banking crisis. Unpegged from a stabilized exchange rate, the baht immediately lost as much as 20 percent of its value. Thailand then brought lending rates up 2 percentage points to 12.5%.

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As the value of its currency continued to fall, Thailand asked the International Monetary Fund (IMF) for an emergency loan to stabilize the economy. Countries with investments in Thailand, including Japan, were hurt by the falling value of assets as loans were compromised. Two months later, the U.S. Dow Jones industrial average dropped 554 points, and two of Japan’s largest financial institutions collapsed, with losses exceeding $3 billion. Problems spread globally, including to South Korea, Russia and Indonesia. In June 1998, Japan announced it was in a recession for the first time in 23 years. GDP increased slowly over the next 10 years, but the growth rate trailed many other advanced countries, including the United States and Germany.

Abe’s first term as prime minister began in September 2006 and lasted a year and a day. He had served in the Diet, the Japanese parliament, since 1993 and came from a politically active family. Scandals rocked his administration; four of his Cabinet members resigned and another committed suicide. Abe resigned in 2007. The economy seemed to be on the road to recovery from the turmoil of the 1990s, but then fell back into recession along with much of the world in 2008–09. In 2009, Japan’s flirtation with immigration came to an ugly end. When the economy was still booming in 1990, Japan issued work visas to the South American descendants of Japanese who had emigrated in the early 1900s to work on coffee plantations. By 2009, more than 300,000 Brazilians and Peruvians lived in Japan. With the economy mired in recession, Japan asked the foreign workers to leave, offering them cash settlements to fly to South America and promise not to return. More than 20,000 South American workers took the offer.

The deadly March 2011 earthquake and tsunami, which killed nearly 16,000 people and left a quarter-million homeless, also dealt Japan another economic blow. In 2012, Abe was again elected as prime minister after promising to turn the country’s economic fortunes around—a tall order. Japan was still carrying the highest debt-to-GDP ratio in the world, at 240 percent. For comparison, Greece’s ratio currently hovers around 175 percent. Experts continue to debate the seriousness of the problem, how the ratio is calculated and what anybody could or should be doing about it.

### Current Situation

#### Free Trade and the TPP

Assessing Japan’s business environment begins with a status check of the various negotiations swirling around the Trans-Pacific Partnership. Although recent events have moved the TPP to the front of geopolitical and commercial discourse, the roots of the agreement stretch back to a free trade agreement signed by New Zealand, Chile, Singapore and Brunei in 2005. The United States entered the negotiations in 2008 due to an interest in expanding financial services and investment opportunities.

In July 2013, Japan became the twelfth and final member to join talks. Abe is especially interested in implementing the TPP because it represents a chance to expand automobile exports and restructure Japan’s agriculture industry. “Japan must remain at the center of the Asian-Pacific century,” he said in 2013. “If Japan alone continues to look inward, we will have no hope for growth. This is our last chance. If we don’t seize it, Japan will be left out.”

#### Japanese Vehicle Production Rose in 2014

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<thead>
<tr>
<th>Year</th>
<th>Number of Motor Vehicles Produced, in Millions</th>
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<td>2005</td>
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Automakers manufactured nearly 9.8 million cars, trucks and buses in Japan in 2014, an increase in all three categories from 2013. Motor vehicle production in Japan climbed from 2005 to 2008 before falling by nearly one-third in 2009 during the recession. Production fell again to 8.4 million vehicles in 2011, but rose in 2012 and has since fluctuated between 9.6 million and 9.9 million vehicles.

On Oct. 5, 2015, the 12 TPP members reached final agreement on the trade accord, and experts say Japan will be a big winner if member legislatures approve the accord. Exports of Japanese cars, textiles and chemicals are expected to go way up.

“The TPP could be a huge boost for our economy because we have never had a free trade agreement with the United States,” says Masato Otaka, spokesman for the Japanese Embassy in Washington, D.C. “A tariff reduction would override all other trade agreements and make it all about the competition.”

The trade pact is “definitely on our radar,” said Geoffrey Pazzanese of Federated Investors, a financial services company in Pittsburgh that has more than $350 billion in assets under management. “To me the biggest winner, country-wise, will be Japan.”

The U.S. food and agriculture community and other businesses interested in exporting products to Japan wanted provisions that would gradually remove all tariffs on trade between member states. According to Bernard K. Gordon, a professor emeritus of political science at the University of New Hampshire who has written about trade and the TPP, opening up free trade with Japan would add $60 billion to the U.S. export market.

From 1980 to 2010, Japan recorded a trade surplus every year. That changed when Fukushima melted down and the country shuttered its nuclear power plants. Imports of oil and natural gas shot up, resulting in trade deficits, the worst in 2014. Japan still had trade surpluses with the United States, Hong Kong, South Korea, Taiwan and Singapore but ran deficits with Australia, Russia, the United Arab Emirates, Malaysia, China and Saudi Arabia. Japan’s exports rose steadily from the 1960s until the 2008–09 recession, when they fell precipitously. They have still not returned to their prerecession peak.

### Robotics

The Japanese remain keenly interested in everything dealing with robotics, a fascination that can be traced to the “karakuri,” automated puppets of the Edo period of the 17th to 18th centuries. Astro Boy burst onto the pop culture scene by way of Japanese manga, or cartoons, in 1952. Honda began work on a humanoid robot that eventually became Asimo in 1986; Sony unleashed its mechanical dog, Aibo, in 1999.
Japanese technology firm Cyberdyne, which shares a name with the fictional maker of Hollywood’s evil Terminator robot—according to a company spokesman, this was purely unintentional—is melding human and machine with the introduction of several products designed to assist the elderly and disabled. Those include its HAL system, which stands for “hybrid assistive limb.” (Incidentally, the computer-gone-amok in “2001: A Space Odyssey” is named HAL.) According to a study by the Yano Research Institute, the robotics care industry will be worth $300 million by the end of the decade.

Robots also are moving into the travel and tourism industry, as seen at the Huis Ten Bosch theme park in Nagasaki, where 10 robots will serve as staff members at the Henn-na Hotel. Huis Ten Bosch Co. President Hideo Sawada told a news conference, “In the future, we’d like to have more than 90 percent of hotel services operated by robots.”

Japan has the second-highest density of robots in the world, at 323 per 10,000 workers, trailing only South Korea with 437 per 10,000 workers. The same group said that in 2013 China unseated Japan as the biggest market for robots in the world. Japan came in second, with more than 25,000 robots purchased domestically. The United States came in third with 23,700 robots purchased.

Loosening immigration to fill all those jobs and bolster Japan’s falling population remains a touchy issue. “Many think accepting more immigrants would be a quick fix, but when it was tried before with the Latin Americans it didn’t go so well,” Goto says. “They can talk about immigration all they want, but real economic growth is not going to happen unless we get more productivity out of our service industries and our white-collar sectors,” Ishikura of Hitotsubashi University says. “We need to get more productivity.”

“We don’t really have the infrastructure to accept a lot of immigrants,” embassy spokesman Otaka says. “We’re not used to it, but I do think we will be seeing more in terms of nursing and care workers. It will be looked at industry by industry.”

Looking Ahead

Women-omics

From Abe on down, everybody seems to agree that the savior of the Japanese business world will probably be female. “With our shrinking workforce we need to make the best of the resources we have,” Ishikura of Hitotsubashi University says. “Our women are very well educated, and if we had the same ratio of women in the workplace as other developed countries, our GDP will go up.”

He adds, “The Abe administration has empowered women by declaring it as a pillar of the third arrow. The city of Yokohama has been doing things like getting private companies to help pay for day care so that women can stay in the workforce.”

Abe is keen to expand the country’s research in robotics, which is leading Japan down some unusual roads in the form of “muscle suits,” mechanically assisted exoskeletons being developed at the National Institute of Technology and Evaluation (NITE) by educators and scientists such as Hiroshi Kobayashi, whose intention is to “release man from hard labor.”

An engineer by training, Kobayashi began his research in an attempt to help people with gait disorders learn to walk again. “We wanted to make people’s lives more comfortable and raise the quality of life,” he says. As the research moved forward, the suits were imagined for use on farms, manufacturing plants and eventually in health care where caretakers are frequently tasked with lifting the elderly into beds and bathubs.

“In the past when workers lifted people, they had to really exert themselves, which also had the effect of causing anxiety among the elderly people they were caring for,” Kobayashi said. “The muscle suit makes lifting so much easier, and the people being cared for don’t have to worry about being dropped.”

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Traditionally, Japanese women are seldom promoted from low-level jobs, and they drop out of the workforce when they marry and have children. Abe’s proposed goals include filling 30 percent of Japanese leadership posts with women by 2020.
In the United States, women hold 14 percent of the executive jobs; in Japan they hold 1.1 percent. In January, 20,000 Japanese children were on waiting lists for nursery school, and Abe’s administration was weighing tax incentives that would encourage more women to work full time and allow more foreign laborers into the country to work as housekeepers. Although questions remain about whether men will accept more women in the workplace and whether women will want to stay on the job, lower wages and higher expenses render the question moot for many families. “It’s already happening out of economic necessity,” says Goto of the Wilson Center. “Many people have no choice and have had to become a two-income family.”

Ishikura looks forward to seeing Japanese business initiate changes that might help draw more women into the workplace and keep them there. “I’m hoping the time of long workdays and evaluation based on tenure and seniority are disappearing,” she says. “They’ll say it’s too risky to quit their job. Somehow, we have to get them to think that not taking a risk is also a risk.”

Despite forces resisting entrepreneurship, efforts continue at the incubators and within Japan’s formal educational system. Waseda University, a highly ranked private school in Tokyo, began an Incubation Promotion Office in 2001. By 2014, the program had hatched 73 ventures, a relatively small number. Of the school’s 50,000 undergraduate and graduate students, only 300 a year embark on the entrepreneurial track. The program is run by Tadashi Takiguchi, who has taken his students on field trips to Silicon Valley and Israel while remaining keenly aware that he’s up against an entrenched culture.

Fostering Entrepreneurs

As part of the government’s drive to increase entrepreneurship, Yoshiaki Ishii, director of the New Business Policy Office in the Ministry of Economy, Trade and Industry (METI), is on the lookout for promising start-ups to support with government resources. He was instrumental in revising Japanese business regulations in 2006 to allow the formation of limited liability corporations and limited liability partnerships. Changes to the law simplified regulations and reduced start-up registration costs from $30,000 to pennies. The even higher cost of incorporating was cut from about $100,000 to practically nothing. Business registrations the following year increased from 80,000 to 101,000.

“Venture businesses innovate, and young people create jobs,” Ishii said. “Older, established companies hire a lot of people, but they’re not making new jobs. We have to find a way to support new ventures. The odds are formidable. In the United States and Britain, one out of 10 companies is a start-up. In Japan, it’s one out of 20, a ratio that Abe wants to double.”

Ishii puts part of the blame on Japanese society’s view of risk-taking, which is generally not favorably. “The fact is, even if a guy wants to start his own company, it’s often their wife, their mother or their wife’s mother who stops them,” Ishii said. “They’ll say it’s too risky to quit their job. Somehow, we have to get them to think that not taking a risk is also a risk.”

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Talking about the difference in the mindset of the Japanese business student as compared to their U.S. counterparts, he said, “At Stanford or Harvard, the No. 1 goal is becoming entrepreneurs.” In Japan, “it’s totally different.”

About the Author


Chronology

1853–1946 Japan enters an imperial period by going to war with China and Russia, sliding with Britain in World War I and joining the Axis powers in World War II.

1853 Commodore Matthew Perry arrives in Tokyo Bay with four armed ships and forces the shogun to begin trading with the United States.

1874 One of the original business conglomerates known as zaibatsu forms around government contacts and a shipping company called Mitsubishi; this company later makes automobiles.

1868 Emperor Meiji puts Japan on course for modernization by establishing the Meiji Restoration, a time of economic revival as new international connections begin opening.

1910 Hitachi is founded by Namhei Odaira; the new company builds a 5-horsepower electric motor for Kuhara Mining, which had been Odaira’s employer.

1922 Ford Motor Co. builds an assembly plant in Yokohama, Japan, to sell cars to the Asian automotive market.

1937 Toyota Motor is founded by Sakichi Toyota, the inventor of a wooden hand loom.

1939 Toshiba is formed when two firms, Shibaura Engineering Works and Tokyo Electric Co., join forces; it grows into an electronics giant.

1941 Japan bombs Pearl Harbor. The United States enters World War II by declaring war on Japan.

1945 The United States drops nuclear bombs on Hiroshima and Nagasaki, killing more than 120,000 people and ending World War II. ... The U.S. occupies Japan, as Gen. Douglas MacArthur attempts to untangle the zaibatsu system from the Japanese business world.

1946 Sochiro Honda mounts a small engine on a bicycle and finds what would become the Honda Motor Co.

1947–Present Japan rebuilds its economy after World War II to become an economic powerhouse.

1947 A new constitution gives every citizen the right to vote and establishes a parliamentary system.

1952 The U.S. occupation of Japan ends.

1955 Tokyo Telecommunications Engineering Corp. begins selling transistor radios in the United States under the brand name Sony.

1973 The OPEC oil embargo cuts Japan’s energy supplies. The world’s attention begins to turn to fuel-efficient cars.

1982 Honda opens its first auto factory in the United States in Marysville, Ohio.

1989 Sony takes over Columbia Pictures and enters the feature film industry.

1991 The “Lost Decades” begins when bad loans made to major corporations cripple the Japanese economy and the stock market crashes. Some experts say this bad economy actually lasted two decades.

1997 The Asian financial crisis starts in Thailand and harms the Japanese economy; it spreads in coming months to Russia and Brazil.

2000 Toyota Prius goes on sale worldwide as hybrid auto technology moves into the mainstream.

2007 Toyota surpasses General Motors in total sales to become the world’s largest automaker.

2011 A severe earthquake rocks Japan and causes a tsunami. The nuclear reactor in Fukushima melts down and leaks radiation into the atmosphere and the sea. All the country’s nuclear reactors are taken offline.

2012 Shinzo Abe makes an unlikely political comeback by winning the election for prime minister and launching “Abenomics,” promising to reboot the country’s economy.
Toyota surpasses General Motors again as the world's largest automaker after GM retook the title in 2011. Japan announces its interest in entering the Trans-Pacific Partnership.

Mitsubishi, Kawasaki, Hitachi and Toshiba move into arms sales as Abe lifts the ban on exporting military hardware. Nikkei stock index reaches an 18-year high, but the value of the yen falls 50 percent against the U.S. dollar. The first nuclear reactor returns to operation.

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The Next Step

Aging Population

Moore, Jack, "Two Numbers: Japan Has More Than 80,000 Centenarians, and Tokyo Can’t Afford Their Gifts," Newsweek, Sept. 23, 2015, http://tinyurl.com/lyzq2vu. The number of Japanese who are at least 100 years old grew to nearly 62,000 in 2014, costing the government $2 million for commemorative gifts that it sends to centenarians.

Nikaido, Yuki, "Japan’s population decline the steepest on record," The Asahi Shimbun, July 2, 2015, http://tinyurl.com/lup9ew. Japan’s population declined for the sixth year in a row in 2014, and the number of people age 65 or older accounted for one-fifth of residents for the first time in history.


International Trade


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Nuclear Power


Women in the Workplace


Lewis, Leo, “Number of Japanese women in work reaches record high,” Financial Times, July 31, 2015, http://tinyurl.com/prj8tlase. The number of working women in Japan rose to nearly 28 million in June, the highest ever, representing 43 percent of the country's workforce.

Organizations

Embassy of Japan
2520 Massachusetts Ave., N.W., Washington, DC 20008
202-238-6700
Japan's official embassy in Washington; hosts many social and business-related events.

Foreign Press Center/Japan
6F Nippon Press Center Building, 2-2-1, Uchisaiwaicho, Chiyoda-ku, Tokyo 100-0011, Japan
81-3-3501-5251
http://fpcj.jp/index/Nonprofit foundation that helps foreign journalists gather news in Japan; also offers fellowships and scholarships.

Japan Association of Corporate Executives
1-4-6, Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan
81-3-3211-1271
Fax: 81-3-3212-3774
www.doynkai.or.jp/english/opinion/index.html
Group of top Japanese business executives; founded in 1946 to support reconstruction of economy after World War II.

Japan Business Federation
1-3-2 Otemachi, Chiyoda-ku, Tokyo 100-0004, Japan
81-3-6741-0111
www.keidanren.or.jp
Japanese business lobbying association, also known as Nippon Keidanren.

Japan Chamber of Commerce and Industry
New York office: 145 W. 57th St., #6, New York, NY 10019
212-246-8001
http://www.jcci.or.jp/home-e.html
Chamber's New York office made up of large and small businesses throughout Japan.

Japan Commerce Association of Washington, D.C.
1819 L St., N.W., B2, Washington, DC 20036
202-463-3947
Fax: 202-463-3948
www.jcaw.org
Professional organization of Japanese business community members.

Japan International Cooperation Center
Odakyu Dai-ichi Seimei Bldg., 16th Floor, 2-7-1, Nishi-shinjuku, Shinjuku-ku, Tokyo 163-0716
http://sv2.jice.org/en/
81-3-6968-2702
Fax: 81-3-6838-2701
Outreach and coordination agency promoting mutually beneficial relationships between Japan and other nations.

Japan National Tourism Organization
One Grand Central Place, 60 E. 42nd St., Suite 448, New York, NY 10165
212-757-5640
Fax: 212-307-6754
www.jnto.go.jp/eng/
Attached to the Embassy of Japan, the group promotes travel to Japan.

National Association of Japan-America Societies
1819 L St., N.W., Suite 200, Washington, DC 20036
202-429-5545
Fax: 202-429-0027
www.us-japan.org
Private nonprofit organization that offers educational, cultural and business programs about U.S.-Japan relations.

New Energy and Industrial Technology Development Organization (NEDO)
Washington office: 2000 L St., N.W., #605, Washington, DC 20036
202-822-9292
Fax: 202-822-9289
www.nedo.go.jp/english/index.html
Japanese industry, government and academic organization dedicated to international research.

U.S.-Japan Business Council
1615 H St., N.W., Washington, DC 20062-2000
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