

The Wartime Japanese Economy

- Japan in the Depression
 - Macroeconomics Review
 - Fiscal and Monetary Policy in the 1930's
- The Wartime Japanese Economy
 - Labor Markets
 - Financial Markets
 - Price Controls

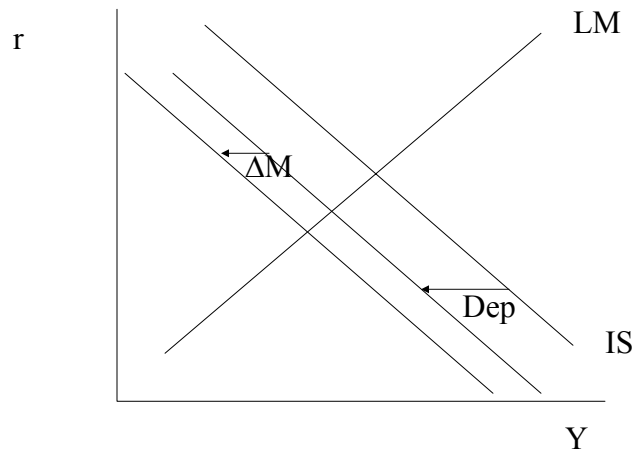
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The Japanese Economy from 1929 to 1936

- In 1929, US began to slip into the Depression
 - Overall Japanese tariffs were not that high until trade war of 30's
 - US entered an economic downturn in 1929, why did this become the depression?
 - Monetary Policy
 - Smoot-Hawley tariff
 - Raised barriers 20 % points
 - Opposed by over 1000 economists
 - Lead to movement to autarky point
- Innoe Junnosuke the MOF didn't believe that it would affect Japan
 - Tightened money supply
 - Put Yen back on gold standard
 - Cut gov't expenditure

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Impact



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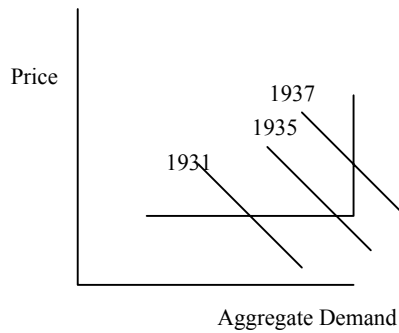
Results

- The Depression in Japan
 - Smoot-Hawley tariff cut silk exports by half
 - Over one third of farm families were engaged in sericulture
 - Aggregate Demand fell by 18% between 29 and 31.
 - Prices fell
 - Unemployment soared
- In 1931, the new MOF, Takahashi Korekiyo (who had served with Matsukata) adopted a Keynesian policy (before Keynes)
 - Took yen off gold standard
 - Value of ¥ vs. \$ fell from .49 to .19 between 1931 and 1932.
 - Surge of exports
 - Massive deficit spending
 - Government spending rose 50% between 31 and 35.
 - And GNP grew at over 10%/year over this period
 - Moved AD curves to the right
 - In 1936 Takahashi wanted to reduce mil exp.

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Wartime Controls

- Takahashi's successor continued expansionist policies



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Economic Performance in the 1930's Millions of 1934-6 Yen

	Gov't Exp	Non-Mil Gov't Exp.	Real GNP	Exports	Inflation	Int Rate	Real Int
1929	1532	646	13735	2100	20.0	8.84	-11.1
1930	1476	575	13882	2126	-18.1	9.24	27.3
1931	1843	776	13941	2240	-11.5	9.27	20.8
1932	1982	903	14557	2675	2.7	8.96	6.2
1933	2175	965	16025	2831	8.8	8.42	-0.3
1934	2062	781	17422	3642	10.6	7.83	-2.8
1935	2103	798	18366	4273	-1.8	7.65	9.5
1936	2135	578	18763	4387	2.4	6.94	4.5

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Prewar Inflation

	Inflation
1929	20.0
1930	-18.1
1931	-11.5
1932	2.7
1933	8.8
1934	10.6
1935	-1.8
1936	2.4
1937	5.8
1938	10.9
1939	23.0
1940	26.7
1941	13.2
1942	21.4
1943	16.1
1944	22.1

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Why it's bad to shoot economists...

- Assassination of Takahashi marks a shift from free market principles to state control
 - Militarists were emulating Soviet Gosplan
 - Saw the rise of SU after revolution and decided that a command control economy was better for Japan
 - Created Kikakuin (Planning agency) to guide industry
 - Didn't care much about consumption or welfare
 - Problem with central planning is finding a suitable rationing mechanism to use instead of prices

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Japanese Economic Performance During WWII

¥mln	Real GNE	Growth	Private Cons.	Growth	Gov't Cons	Growth	Imports
1936	17157		11003		2618		4296
1937	21220	0.24	11540	0.05	4247	0.62	4518
1938	21935	0.03	11382	-0.01	5491	0.29	4658
1939	22117	0.01	10839	-0.05	4688	-0.15	4752
1940	20796	-0.06	9723	-0.10	7896	0.68	5280
1941	21130	0.02	9410	-0.03	6134	-0.22	4985
1942	21405	0.01	8956	-0.05	6460	0.05	3823
1943	21351	0.00	8469	-0.05	7445	0.15	3380
1944	20634	-0.03	7006	-0.17	7301	-0.02	2470

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Labor Market Legacies

- Abegglen talks about three pillars of the Japanese LM: Enterprise Unions, Bonuses, and Life time employment.
- Many of these features date back to wartime policies
- Unions
 - Unions were initially banned in 1931
 - Initially low levels of unionization and mostly Industrial Unions
 - Why the change following the war?
 - 1938 passed law creating Patriotic Industrial Associations: “an organic organization in which employers and employees are bound together by their respective functions.”
 - Workers and managers were to talk over production problems
- Wage controls and seniority wage system
 - Gov’t established pay scales, starting salaries, wage increases,
 - Established seniority system based on government pay scales

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Unionization in Japan

	<u>1930^a</u>	<u>1947</u>	<u>1964</u>	<u>1975</u>	<u>1988</u>
Total Union Members (%)	354,312 (100)	6,268,432 (100)	9,652,350 (100)	12,472,974 (100)	12,157,134 (100)
Enterprise Union Members	127,463 (36)	5,119,690 (82)	8,819,041 (91)	11,361,378 (91)	11,155,771 (91)
Industrial Union Members	164,547 (46)	403,120 (6)	476,008 (5)	682,728 (5)	468,490 (4)
Craft Union Members	24,974 (7)	610,882 (10)	65,607 (1)	169,569 (1)	370,297 (3)
Other Union Members	37,328 (10)	134,740 (2)	291,694 (3)	259,299 (2)	162,576 (1)

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Price Controls

- Government began to implement direct controls on economy in 1937
 - Almost 400,000 bankruptcies in August 1938
- What's wrong with price controls?
 - In 1939, established a ration system with low prices
 - lead to hoarding
 - For example, by end of 1943, aircraft industry had shortage of aluminum because army and navy were hoarding it
 - commodities disappeared from official markets
- Government countered with more controls
 - Enormous rise in black market
 - Government established an economic police force
 - Ultimately decided to take control over all prices and wages

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Impacts

- Eliminated last traces of realism of Japanese price structure
- Rivalry developed between different sectors
- British embargo on imports exacerbated problems
- Quality of life began to fall
- Solution? Government tried to force firms to stress production
 - Businesses would be converted from profit seeking ventures to public ventures
 - Required new inflows of capital to perform transformation
 - But how do you finance investments when they are not profitable?

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Impacts (Continued)

- In 1942, war situation began to look worse and Japan switched to full control over industries
- Converted Textile mills to aircraft factories
 - Spindleage fell 82% between '37 and '46
 - In 1943 ordered all textile mills, metals firms and chemical firms converted into armaments firms
 - Vastly increased concentration in Japan
- Japanese consumers suffered far more than those in most warring countries
- These problems (along with fall of Saipan) in large measure lead to the fall of the Tojo government in 1944

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Financial Markets (Background)

- Concentration in J banking had been rising in late 20's due to financial crises
 - Number of banks declined from 1799 in 1923 to 1031 by 1928
- Much of the movement occurred after the financial panic of 1927
 - Government responded by specifying a minimum amount of capital (¥1mln for most banks, ¥2mln for city banks)
 - banks who could not meet this requirement had to merge
- objective was eliminate small “organ banks”
 - “organ banks” were small banks that supplied loans to a very small number of firms
 - had no possibilities of diversifying risk
 - sharp contrast to zaibatsu
- Banking concentration rose sharply between 28 and 32
- 1932: number of banks declined to 538

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The Beginning of Financial Repression

- Temporary Funds Adjustment Law divides firms into three categories:
 - Firms in war related industries which received almost automatic approval of loans
 - Firms that sometimes got approval
 - Firms that would not usually get approval
- 1938 Total National Mobilization Law which gave government control over major aspects of economy
 - e.g. labor, materials, facilities, prices, credit
 - IBJ became central agent in allocation of credit

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Financial Repression Continues

- 1939 passed Corporate Profits Distribution and Fund Raising Order
 - Allowed the gov't to direct IBJ in making specific loans
 - Limited stock returns
 - Tied dividend payouts to par value of shares not performance.
 - Reduced dividends and made stocks more like bonds
 - Initial policy motivated by sense that stock dividends stole funds from firms
 - Japanese share prices fell by 30%
 - But what do you do when “unpatriotic capitalists” respond to your “good” policies by causing a market crash

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More Repression

- 1940 Bank Funds Application Order
 - Gov't now controlled both short and long-term lending
 - Government argued that the firm must “be set free from the control of stockholders who just pursue profits”
 - Firms were to execute government plans and not pursue profits
- Zaibatsu and business people opposed but couldn't block everything
 - Eventually control by Honsha over zaibatsu was reduced
 - e.g. control of Sumitomo Honsha replaced by Sumitomo Wartime Council
 - Power of zaibatsu began to be reduced

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Still More Financial Repression

- 1942 Created National Financial Control Association
 - Objective was to help banks make loans in consortia under the direction of the BOJ
 - Loan consortia reduced lending risk
 - Banks were told to perform monitoring function of stock holders
 - Certain banks were designated to monitor firms
 - Banks could not reject loans from munitions companies
- Most munitions companies were located in urban areas and so regional firms suffered capital shortages
 - Regional banks had trouble lending to non-essential firms and often had to merge with urban banks.
- Gov't sought to have no more than one bank per prefecture
 - by 1945, 34 of 46 prefectures only had one bank in it

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By 1943 the economy was in trouble and the gov't responded by more capital controls!

- Almost completely removed shareholders from control of companies
 - Control was handed over to managers
 - Stocks became more like interest bearing securities
 - Stocks still had more risk, therefore no one wanted them
- This created more problems because couldn't monitor managers or get them sufficient capital
- Created Designated Financial Institution System
 - MoF would designate 1-2 banks for each munitions firm
 - Many conventional firms became munitions firms and established ties with certain banks
 - e.g. Ajinomoto became Dai Nippon Kagaku Kogyo and for the first time established ties to Mitsubishi
 - Since munitions firms had better access to capital this kind of transformation made sense
- Role of the financial institution as a supplier of funds skyrocketed
- Many companies established ties with banks during this period

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Sources of Industrial Funds (Hoshi-Kashyap)

Year	Internal Funds	New Shares	New Bonds	Bank Loans
1934	54.8	55.4	2.8	-11.4
1935	51.6	32.9	1.0	14.9
1936	47.4	33.5	-2.3	18.3
1937	33.3	35.5	-0.1	31.9
1938	30.5	34.6	5.4	29.9
1939	27.1	24.5	7.9	38.4
1940	30.4	26.7	5.5	38.3
1941	33.6	29.1	10.1	28.1
1942	31.2	25.7	8.9	32.8
1943	30.3	22.6	7.8	35.8
1944	24.2	9.1	8.3	57.8

Source: Ministry of Finance (1978; pp.462-463).

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Financial Institutions Assignment for Munitions Companies and the Post-war Main Bank Relation (Hoshi-Kashyap)

	1962	1974
Number of companies that we can check main bank relation	111	112
(A) Designated institution (DI) is the largest lender and one of the top 10 shareholders	70	61
(B) A financial institution in the same keiretsu as DI is the largest lender and one of the top 10 shareholders	11	21
(C) DI is the largest lender though it is not one of the top 10 shareholders	13	5
(D) A financial institution in the same keiretsu as DI is the largest lender though it is not one of the top 10 shareholders	4	1
(A)+(B)+(C)+(D)	98	88
Number of companies that belonged to 4 largest <i>zaibatsu</i>	27	27
(E) DI is the largest lender and one of the top 10 shareholders	17	14
(F) A financial institution in the same keiretsu as DI is the largest lender and one of the top 10 shareholders	5	7
(G) DI is the largest lender though it is not one of the top 10 shareholders	4	1
(H) A financial institution in the same keiretsu as DI is the largest lender though it is not one of the top 10 shareholders	0	1
(E)+(F)+(G)+(H)	26	23

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The Transformation of Japanese Finance (Summary)

Year	Law
1937	Temporary Funds Adjustment Law
1938	Total National Mobilization Law
1939	Corporate Profits Distribution and Fund Raising Order
1940	Bank Funds Application Order
1941	Emergency Cooperative Lending Consortium
1942	National Financial Control Association/Reform of BOJ Law
1943	Designated Financial Institution System Introduced

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Funding Sources of Japanese Firms

	Ret. Earnings	Stocks	Bonds	Loans
1931-35	67	40	1	-9
1941-45	29	20	9	42
1951-55	43	8	2	41

Corporate Governance

	Share holder Directors as a % of all Directors	
	1935	1942
	14.5	10.6
		1960
		0.3

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