

Two Decades Later: Nikkei and Lessons from the Fall

By Vaclav Smil Tuesday, December 29, 2009

Twenty years ago this week, Japan's Nikkei index reached its historic peak of 38,916. There are lessons from the fall for America and the world.

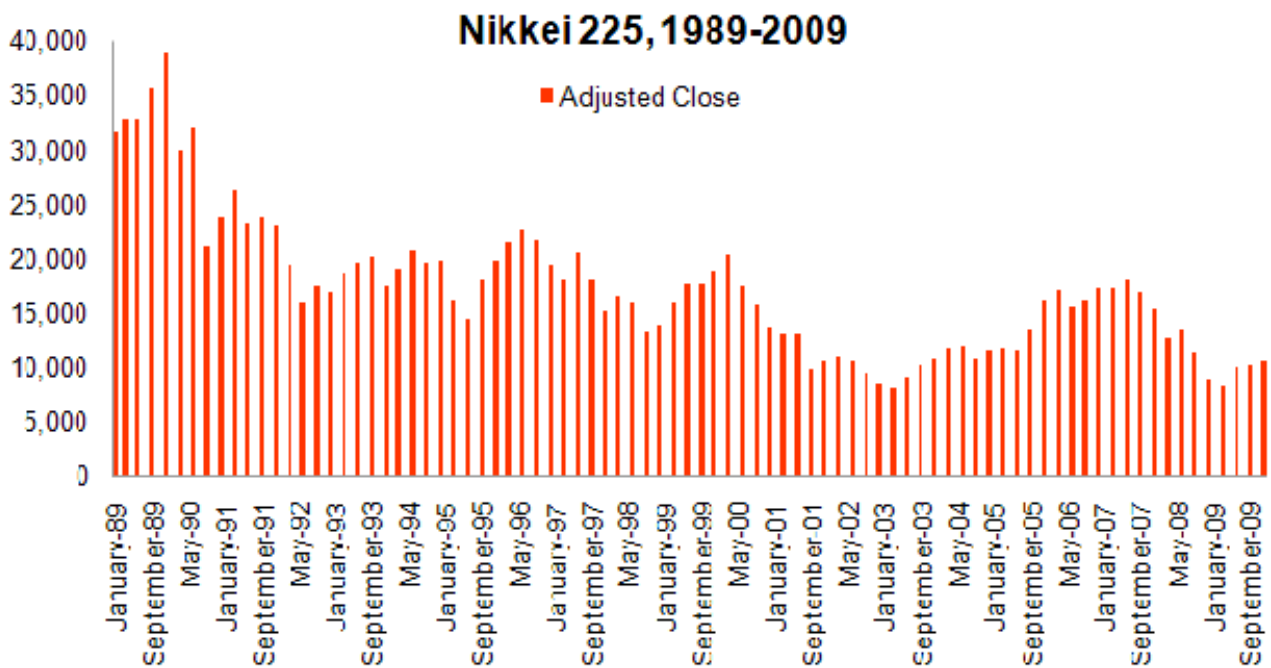


Some anniversaries are eagerly anticipated, others are recalled with sadness, and yet others would seem to be best forgotten. Twenty years ago this week, Japan's leading stock market index, Nikkei 225 (that country's equivalent of the Dow Jones Industrial) reached its historic peak of 38,916 points, a fitting conclusion to the decade that saw the index nearly quadruple during the preceding six years; Japan's GDP expand at an annual rate of about 4 percent; its currency strengthen beyond anything forecast in 1980 (in January 1980 the exchange rate was 239 yen per U.S. dollar, by December 1989 only 143 yen were needed to buy a dollar); and its worldwide prestige and admiration rising to such unprecedented levels that the fulfillment of [Ezra Vogel's forecast of Japan as number one](#) seemed only a matter of time. (Another anniversary is hiding here, as the first edition of that seemingly so prophetic—but ultimately so utterly failed—bestseller was published by the Harvard University Press in 1979.)

When the Nikkei began falling, people thought it was yet another periodic correction. The index slipped below 30,000 in March 1990, but it promptly returned above that level just two months

later. But then a long slide set in, interrupted by many temporary stabilizations and rebounds whose brevity was no deterrent to yet more speculation that this time things would be different and the country's economy would regain at least some of its pre-1990 dynamism. But the downward markers ticked along: the index was below 25,000 by November 1990 (losing nearly 40 percent in 1990); the first dip below 20,000 came in March 1992; the 15,000 level was broken in June 1995; and the first slip below 10,000 came in September 2001.

And in Japan's case the stock market index was not detached from the rest of the country's economy. As the Nikkei index fell, so did the value of real estate and other assets. By 1995, the index of urban land prices in Japan's six largest cities fell by 50 percent from its 1990 peak, and then it continued to decline: a decade later it was just 25 percent of its top bubble value. During the 1990s, Japan's GDP managed to grow only 1.5 percent per year and the world's most feared exemplar of high value-added manufacturing began to lose jobs to its Asian competitors. My Sony CD player was made in China, my Nikon was assembled in Indonesia—only our old Zojirushi rice cooker was still made in Japan.



Source: Commodity Systems, Inc.

And Japan's economic malaise began to change the society. New phenomena included the previously unthinkable sight of homeless men living in cardboard boxes in underground tunnels and in parks (*homoresu* became another common Japanese adjective). The norm of lifelong employment by large companies began to unravel. Unemployment doubled, and by 2005 the annual suicide rate (always higher than in Europe and North America) reached 24 out of 1,000, about 50 percent above the rate during the high-growth time of the 1970s. No less importantly,

the ruling elite could not come up with brilliant solutions as the endless promises of banking, economic, and government reforms led only to new problems.

History has no other example of a country whose global standing switched so rapidly from that of a universally admired paragon of technical and manufacturing prowess and financial wizardry to that of a chronically failing economy and a fraying society. It took less than a decade for Japan to move from number one to number zero (as Gavan McCormack acidly noted when assessing the country's *fin de siècle* blues), and the first decade of the 21st century has not arrested this downfall. Nikkei struggled back above 15,000 by December 2005 and it was briefly above 18,000 by June 2007 before it fell to yet another low of 7,568.42 (less than 20 percent of its peak value) in February 2009, and it ends this year at barely above 10,000.

The Japanese economy managed modest gains during the three years before the global financial crisis pushed it even deeper into decline. After more than half a century of one-party rule a new party is in power but the old problems of deflation, financial mismanagement, and a precarious job market remain, as do the foreign challenges of dealing with the relentlessly rising China, a grossly overextended United States, and the perennially irrational North Korea.

Japan's Population Bombs

But the most fundamental factor in preventing any future resurrection of dynamic Japan is its changing population. Already, one out of five Japanese is 65 years or older, a share not surpassed by any other nation. Barring an unprecedented turnaround of demographic fortunes, Japan's median age will reach 50 by the year 2025, when nearly one out of every three Japanese will be over 65. And by 2050 there will be more very old people (one out of every seven Japanese will be 80 or older) than children (newborns to 14 years of age). That state of demographic affairs would be the first in human evolution as there has never been a society where octogenarians outnumber children.

Aging is not Japan's only serious demographic challenge: the country's population has already begun to shrink. As this combined aging and shrinking process continues, Japan's age-sex population structure—which had a pyramid shape typical of a vigorously growing population after World War II but now has a barrel shape indicative of an aging society—will assume a cudgel-like shape and the total will decline significantly: forecasts predict a population of about 121 million people by 2025 and about 100 million by 2050. This means that Japan could lose a fifth of its population in less than half a century (an equivalent of losing 60 million people in today's United States) and that by 2050 it may be less populous than Egypt or the Philippines.

Whatever the eventual total might be, Japan is on course to become the most aged of all aging affluent societies, and given its traditional reluctance to allow even moderate levels of immigration it will also have an exceptionally challenging time coping with the consequences of a major population decline. The unfolding double trend of aging and population decline is unwelcome news for Japan's high value-added manufacturing because the shrinking cohorts of younger people are the ones that are best suited to perform the exacting work of electronic assembly lines or to make reliable Toyotas and Hondas.

It could be argued that this impact will be relatively limited because the fate of Japan's manufacturing has been already much affected by the universal process of globalization, as Japanese manufacturers have moved large shares of their capacities abroad. What will be most adversely affected are Japan's admirable infrastructure of public transportation, the country's food production and, inevitably, its healthcare system. Japan's dense network of railroads and highways and its famous rapid trains and excellent subways require meticulous maintenance (a necessity made clear by the fact that during peak times *shinkansen* trains, travelling at around 300 kilometers per hour, leave Tokyo in three-minute intervals)

Although many tasks required for maintaining and reconstructing highways, railways, and subways have become highly mechanized, such work still entails a great deal of physical labor that is not suited for an aged workforce. And those are tasks that will not be turned over to Japan's growing family of robots as easily as vacuuming floors, making faces, or (one of the latest of a rather frivolous array of robotic innovations) simulating babies. Food production will be another challenge. When measured in terms of dietary energy supply (kilocalories per day per capita), Japan already imports more than 60 percent of its foodstuffs—while the average age of its farmers has reached 60 years and while many rural areas have been experiencing steady depopulation for decades.

The shortages of caregivers and nurses have already led the Japanese to sign the first agreements to bring in workers from Indonesia and the Philippines: but, ever averse to any major immigration, the Japanese have, so far, allowed groups numbering only hundreds of workers from each country per year (and, admittedly, the Japanese language is a barrier, particularly for communicating with elderly patients speaking in dialects).

One Great Silver Lining

But there is one great silver lining in all of this, and its beneficiaries will be the Americans, not the Japanese. Twenty years ago, in the summer of 1989, it became increasingly obvious that the Evil Empire was on its way out. At that time, Japan was widely seen as the principal economic rival and one that might possibly be thinking about becoming something other than a faithful ally. And even those of us who did not believe that Japan would be number one in the 21st century had to admire the country's dynamism, its innovative drive, its mastery in producing a large range of products of outstanding quality, its large trade surpluses, its high savings rate, its strengthening currency, and its well-functioning cities.

And (to add an open verbal and moral insult to the deepening economic injury), in 1989, two very influential Japanese—Akio Morita, the co-founder and chairman of Sony Corporation, and Shintaro Ishihara, a consummate political backroom dealer who ran that year for the leadership of the ruling Liberal Democratic Party (LDP)—published their provocative views under the title of *[The Japan That Can Say No](#)*. They described a world dependent on Japanese innovation (what would it do without Japanese semiconductors?), offered a scathing and scolding examination of American business practices, extolled the superiority of Japanese morals and behavior, and Ishihara openly attributed the wave of America's Japan bashing and fear of Japan's ascendance to racial motivation.

Looking back, it is remarkable to what extent America lost its collective nerve when faced with the Japanese economic challenge, and to what degree many of its decision makers actually believed that Japan would be soon taking over as the world's leading economic power. Ishihara was right when he wrote about the congressmen who "were actually brandishing sledgehammers, smashing Toshiba electronic equipment, with their sleeves rolled up. It was just ugly to watch them behave so." A fearful U.S. Congress forced the Japanese automakers to adopt "voluntary" export quotas, and in 1987 it imposed a 100 percent tariff on Japanese goods ranging from computer disk drives to TV sets. In the same year, it began to fund Sematech, an industry-government consortium of 14 U.S. semiconductor companies formed to prevent what appeared to be Japan's coming total dominance of that critical industrial sector.

Nominally, Japan still edges out China as the world's second-largest economy, but even a very conservative purchasing power parity adjustment puts China well ahead of Japan. Japanese companies in general (and the electronics industry in particular) still design many elegant products, but both my sleek Toshiba notebook and Sony Vaio run on Intel microchips and even their domestic Japanese versions prominently advertise their use of Microsoft software. But Japan—despite avoiding America's excess of toxic mortgages, hedge fund speculations, and endless trade deficits—finds itself in an even more parlous economic shape than the world's largest economy.

Twenty years ago, Japan loomed large among the concerns of American policy makers as few long-term trends seemed as worrisome as the country's apparently unstoppable rise to the global economic dominance. Twenty years later, any talk about Japan as number one seems entirely risible, and I cannot even imagine what Japan would now say "no" to (politely or assertively). Morita died in 1999, but Ishihara, now 77 years old, is still at it: after abandoning the LDP he has been the governor of Tokyo since 1999—but I do not think he is writing a sequel to his bestseller. Japan's economic stumble has lasted for so long that it has now become conflated with the country's inevitable demographic retreat, and this reality makes it virtually certain that the combination of competitive advantages that seemed so formidable during the 1980s is highly unlikely to return.

Nations rise and fall, and they stay in positions of strategic dominance or economic ascendance for different (and unpredictable) periods of time. Japan's quest for an empire lasted half a century (from its first war with China from 1894 to 1895 to its defeat in August 1945). Japan's quest for the leading role in the global economy lasted roughly 40 years (beginning with the end of the U.S. occupation in 1952 and ending with the economic unraveling of the early 1990s) and in its final phase it involved an economic confrontation with the United States that engendered a great deal of exaggerated confidence in Japan and deep concern and self-doubt about the nature of America's resilience and the effectiveness of its response. In the span of two generations, the two nations confronted each other in two very different modes of rivalry, and both encounters had enormous consequence for them and for the world.

Americans are now besieged by deep economic problems almost entirely of their own making: but at this time, at least, they have hardly any reason to worry about Japan. As it moves into its new (and truly uncharted) demographic and economic era, Japan will not implode and turn into a dysfunctional polity. If the past two decades are any guide, it may not manage its retreat

brilliantly, but I believe it will find ways to deal with its new challenges without causing any grave perturbations on the global scene, without generating more problems for the already overloaded decision makers in Washington, and without losing its deserved status as a well-functioning society. Japan's demographic and economic retreat will remain a great and long-lasting concern for the Japanese—but it also amounts to one less worry for America.

Finally, there is an important lesson hiding behind this anniversary. I will never forget the feel of Japan during the late 1980s, the peak of its power and, even more so, of its confidence and arrogance. In 1988 and 1989 there was no other place on the planet like Tokyo's Ginza. One could see such congregations of polished large Mercedes SEs and SELs, such elegantly dressed crowds, and such free spending, driven by the worldwide profits of Japan, Inc. and the soaring purchasing power of its currency. The notion that in just a few years this time of shining opulence and unlimited prospects would become known as the time of deluded *baburu ekonomi* was not on anybody's mind.

Ten years later, I thought about that Japanese spectacle as my wife and I waited for our rental car at the San Francisco airport. We had reservations but the demand was so heavy during those frenzied years of another bubble economy (this time an e-driven one, built on the razed orchards of Silicon Valley) that people had to wait for the just-returned cars to be serviced and sent out again into that endless sea of vehicles on the Bayshore freeway. And in 1998 the expert voices were telling us that this time it is really different, as the New Economy was supposed to suspend the old rules and as an endless growth was to become perfectly compatible with that brilliant dot-com model of changing the world. No wonder that during the late 1990s (remembering so well the Japanese lesson) I could not convince most people that this too, shall end: but it did and (fast forward another decade) the entire state (nay, the entire nation), not just the wonder valley, is now broke.

The lessons of Japan of 1989 and those of the United States of 1999 might be useful when judging the seemingly inexorable ascent of China in 2009: no economic trees grow to heaven.

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