CHAPTER 2
HISTORICAL OVERVIEW OF CHINESE AND JAPANESE ECONOMY

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2.1 General Overview of Chinese Economy

Area & Geographical Profile

The Peoples Republic of China covers approximately 9.6 million square kilometers. It is the world's the second largest country by land area. Its landscape is diverse with, mountains and deserts. The Gobi and Taklimakan are the two deserts. The terrain in the west is rugged and elevated, with the Himalaya and Tian Shan mountain ranges forming China's natural borders with India, Nepal and Central Asia. Mainland China's eastern seaboard is low-lying and has a 14,500-kilometre long coastline, the 11th longest coastline in the world. It is bounded to the southeast by the South China Sea and to the east by the East China Sea.

Population

China's population as of 31st December 2010 is 1339.7 Mn. Nos. Urban population constitutes 49.7% of this total while balance is rural population1.
Agriculture

China is the world’s largest producer and consumer of agricultural products. Virtually all arable land is used for food crops. China is the world’s largest producer of rice and is among the principal sources of wheat, corn (maize), tobacco, soybeans, potatoes, sorghum, peanuts, tea, millet, barley, oilseed, pork, and fish. Major non-food crops, include cotton, other fibers, and oilseeds. In China, yields are high because of intensive cultivation. China’s cropland area is only 75% of the U.S. total, but China still produces about 30% more crops and livestock than the United States. Since 1980’s, many farmers have been encouraged to leave the fields and pursue other activities, such as light manufacturing, commerce, and transportation; and by the mid-1980s farming accounted for less than half of the value of rural output. Today, agriculture contributes only 10.2% of China’s GDP. There is still a relative lack of agricultural machinery, particularly advanced machinery. For the most part the Chinese peasant or farmer depends on simple, non mechanized farming implements. Good progress has been made in increasing water conservancy, and about half the cultivated land is under irrigation.

Animal Husbandry

Animal husbandry constitutes the second most important component of agricultural production. China is the world’s leading producer of pigs, chickens, and eggs, and it also has sizable herds of sheep and cattle.

Forests

The principal forests are found in the Qinling Mountains and the central mountains and on the Sichuan-Yunnan plateau. Because
they are inaccessible, the Qinling forests are not worked extensively, and much of the country's timber comes from Heilongjiang, Jilin, Sichuan, and Yunnan.

Transportation

During most of the 1950s, new road and rail links were built, while at the same time old ones were improved. During the 1960s much of the improvement of regional transportation became the responsibility of the local governments, and many small railways were constructed. Emphasis was also placed on developing transportation in remote rural, mountainous, and forested areas, in order to integrate poorer regions of the country and to help promote economies of scale in the agricultural sector.

Before the reform era began in the late 1970s, China's transportation links were mostly concentrated in the coastal areas and access to the inner regions was generally poor. This situation has been improved considerably since then, as railways and highways have been built in the remote and frontier regions of the northwest and southwest. At the same time, the development of international transportation was also pursued, and the scope of ocean shipping was broadened considerably.

Freight haulage is mainly provided by rail transport. The rail sector is monopolized by China Railways, which is controlled by the Ministry of Railways and there is wide variation in services provided. In late 2007 China became one of the few countries in the world to launch its own indigenously developed high-speed train. As rail capacity is struggling to meet demand for the transport of goods and raw materials such as coal, air routes, roads and waterways are rapidly being developed to provide an
increasing proportion of China's overall transportation needs. As of October 2010, China has more than 7000 km of rail track capable for 250+ km/h running. Besides, it has more than 2000 km lines capable for 300+ km/h running.

Communication Links

China possesses a diversified communications system that links all parts of the country by Internet, telephone, telegraph, radio, and television. China has 420 Mn. internet users as of 2010 with 31.6% penetration in total population. This includes 363.8 million broadband users\(^2\). According to the statistical data released on Jan. 11 by the Ministry of Industry and Information Technology of the People's Republic of China, at the end of 2010, the number of mobile phone users reached 859 million in China\(^3\).

Banks

The People's Bank of China (PBOC) is China's central bank, which formulates and implements monetary policy. The PBOC maintains the banking sector's payment, clearing and settlement systems, and manages official foreign exchange and gold reserves. It oversees the State Administration of Foreign Exchange (SAFE) for setting foreign-exchange policies.

In 1995, the Chinese Government introduced the Commercial Bank Law to commercialize the operations of the four state-owned banks, the Bank of China (BOC), the China Construction Bank (CCB), the Agricultural Bank of China (ABC), and the Industrial and Commercial Bank of China (ICBC).

The Industrial & Commercial Bank of China (ICBC) is the largest bank in China by total assets, total employees and total customers.
ICBC differentiates itself from the other State Owned Commercial Banks by being second in foreign exchange business and 1st in RMB clearing business. It used to be the major supplier of funds to China's urban areas and manufacturing sector. The Bank of China (BOC) specializes in foreign-exchange transactions and trade finance. In 2002, BOC Hong Kong (Holdings) was successfully listed on the Hong Kong Stock Exchange. The USD2.8 billion offering was over-subscribed by 7.5 times. The deal was a significant move in the reform of China's banking industry. The China Construction Bank (CCB) specializes in medium to long-term credit for long term specialized projects, such as infrastructure projects and urban housing development. The Agriculture Bank of China (ABC) specializes in providing financing to China's agricultural sector and offers wholesale and retail banking services to farmers, township and village enterprises (TVEs) and other rural institutions.

Three new "policy" banks, the Agricultural Development Bank of China (ADBC), China Development Bank (CDB), and the Export-Import Bank of China (Chexim), were established in 1994 to take over the government-directed spending functions of the four state-owned commercial banks. These banks are responsible for financing economic and trade development and state-invested projects.

ADBC provides funds for agricultural development projects in rural areas; the CDB specializes in infrastructure financing, and Chexim specializes in trade financing.

In addition to the big four state-owned commercial banks, there are smaller commercial banks. The largest ones in this group include the Bank of Communications, China CITIC Bank, China
Everbrite Bank, Hua Xia Bank, China Minsheng Bank, Guangdong Development Bank, Shenzhen Development Bank, China Merchants Bank, Shanghai Pudong Development Bank and Industrial Bank. The second tier banks are generally healthier in terms of asset quality and profitability and have much lower non-performing loan ratios than the big four.

The third significant group in Chinese banking market is the city commercial banks. Many of them were founded on the basis of urban credit cooperatives. The first one was Shenzhen City Commercial Bank in 1995. In 1998, PBOC announced that all urban cooperative banks change their name to city commercial bank. There are 69 city commercial banks set up from 1995 to 1998. In 2005 there were 112 city commercial banks in all of China. This number has increased through additional transformations to 140 in 2009. Most city commercial banks have strong ties to their local government and are majority or wholly state owned. Since 2005 some city commercial banks diversify their shareholders, inviting Chinese and international private companies to take minority shares, merging and cross-shareholding. Some of the banks have listed their shares. The city commercial banks market orientation is towards supporting the regional economy, but also towards financing local infrastructure and other government projects. Since 2008 a strong trend has emerged for city commercial banks to extend business beyond their home region. They are also often the main shareholder behind village and township banks (VTB). Some have founded so called small loans units to serve smaller business clients better. Taizhou City Commercial Bank, Bank of Beijing and Bank of Ningbo are examples for city commercial banks.

The total assets of the Chinese banking system were 94.3 trillion RMB, or $14.4 trillion in USD, at the end of 2010. The four
specialized banks controlled 45.9 trillion RMB, or approximately 48% of these assets.

Mineral Resources
China has abundant mineral resources. A total of 171 kinds of minerals have so far been discovered, of which 158 have proven reserves. These include 10 kinds of energy mineral resources such as petroleum, natural gas, coal and uranium; 54 kinds of metallic mineral resources such as iron, manganese, copper, aluminum, lead and zinc; 91 kinds of nonmetallic mineral resources such as graphite, phosphorus, sulfur and sylvine; and three kinds of water and gas mineral resources such as underground water and mineral water. Currently, the supply of over 92 percent of China’s primary energy, 80 percent of its industrial raw materials and more than 70 percent of its agricultural means of production come from mineral resources.

Coal resources demonstrate such features as: huge reserves and complete varieties but uneven distribution among different grades, with small reserves of high-quality coking coal and anthracite coal. Large oil reserves make China one of the 10 countries in the world with more than 15 billion tons of exploitable oil reserves. However, proven rate is very low, with verified onshore reserves accounting for only one fifth of the total and the proven rate for offshore reserves being even lower.

Metallic minerals such as tungsten, tin, molybdenum, antimony and rare earth have large reserves, and are of high quality and competitive in world markets. However, many important metallic minerals such as iron, manganese, aluminum and copper are of poor quality, with ores lean and difficult to smelt. China is one of the few countries in the world that have a relatively complete range of nonmetallic mineral resources. Currently, there are more than 5,000 nonmetallic mineral ore production bases with proven
reserves in China. Proven natural underground water resources in China amount to 870 billion cubic meters per year, of which 290 billion cubic meters are exploitable. The natural underground brackish water resources in China stand at 20 billion cubic meters per year.

**Industrial Profile**

It is estimated that industry accounts for about 46.8% of China's GDP in 2010. Major industries are mining and ore processing; iron; steel; aluminum; coal; machinery; textiles and apparel; armaments; petroleum; cement; chemicals; fertilizers; consumer products including footwear, toys, and electronics; automobiles and other transportation equipment including rail cars and locomotives, ships, and aircraft; telecommunications equipment; commercial space launch vehicles; and satellites. China has become a preferred destination for the relocation of global manufacturing facilities. Its strength as an export platform has contributed to incomes and employment in China. The state-owned sector still accounts for about 40% of GDP. In recent years, authorities have been giving greater attention to the management of state assets—both in the financial market as well as among state-owned enterprises—and progress has been noteworthy.

By 2006 China had become the world's third largest automotive vehicle manufacturer (after US and Japan) and the second largest consumer (only after US). Automobile manufacturing has soared during the reform period. In 1975 only 139,800 automobiles were produced annually. In 2005 production rose to 5.71 million in 2005 and to 13.83 million in 2009. China has become the number-one automaker in the world in 2009. Domestic sales have kept pace with production. As of 2010, China has become the world's largest automotive vehicle manufacturer as well as the largest
The vehicle and component export is targeted to reach US$70 billion by 2010.

The market for domestically produced cars, under a local name, is likely to continue to grow both inside China and outside. Companies such as Geely and Chery are constantly evaluating new international locations, both in developing and developed countries.

China’s electronics industry has played a major role in driving the growth of national GDP, contributing an average of 10% annually to GDP growth since 2003. From 2001 to 2007, annual sales revenues grew at an average rate of 28%. Growth held above 20% for the first half of 2008, but dropped to single digits in the wake of the global economic slowdown in the second half of last year. Electronics trade has constituted more than 30% of China’s overall trade in recent years. In 2008, the trade value of electronics comprised 34.6% of national foreign trade, amounting to USD 885.43 billion.

The Chinese pharmaceutical industry has been growing at an average annual rate of above 15% over the last few decades. However, the industry is still small-scale with a scattered geographical layout, outdated manufacturing technology and management structures. The Chinese pharmaceutical industry has weak international trading competitiveness. As China joined the World Trade Organization (WTO), it is trying to integrate more completely into the global economy. The international competition is placing an intense pressure on the Chinese pharmaceutical industry. Investment conditions in China have improved due to the vast consumer demand for pharmaceuticals, the lower labor costs
and the changes resulting from economic reform. The industry is suffering from minimal innovation and investment in R&D and new product development. The sector's economies of scale have yet to be achieved. Most domestic manufacturers in the pharmaceutical industry lack the financial resources to develop their own branded products.

**Social Indicators**

Important social indicators of China are as given below:

a) Population less than 15 years old – 19%

b) Population more than 60 years old – Men- 7%, Women- 15%

c) Sex ratio in 60+ age group (men/100 women)- 91

d) School life expectancy (primary to tertiary education) - 12 yrs.

e) Life expectancy at birth- Men- 72, Women- 76

f) Infant mortality rate – 24

g) Literacy rate-Adult 15+age group- 94, 15-24 age group- 99

h) Improved drinking water coverage (%) - 89

i) Improved sanitation coverage(%) - 55

**Growth of economy**

The People's Republic of China is the world's second largest economy next to United States. Its economy has registered average growth rates of 10% during last three decades. It is also the largest exporter and second largest importer of goods in the world. China became the world's top manufacturer in 2011, overtaking the United States.

China initiated economic reforms during 1978. This led to significant and steady growth in investment, consumption and standards of living. The percentage of the Chinese population living below the poverty line declined from 65% in 1981 to 4% in 2007.
China implemented its economic reforms gradually. During the past 25 years China’s foreign trade has increased faster than its GDP\(^1\). Substantial state investment in infrastructure and heavy industries coupled with private sector expansion in light industry are some of the driving forces of China’s growth. There were approximately 10 Mn. small businesses in China in 2010\(^2\).

China has become a major competitor to other Asian export-led economies, such as South Korea, Singapore, and Malaysia on account of many multinational companies who use China as an export platform. The government has also focused on foreign trade as a major vehicle for economic growth. Agriculture and industry are the two sectors of the economy which together employ more than 70 percent of the labour force and produce more than 60 percent of GDP.

Even though China has some sophisticated manufacturing plants both acquired through trade and own development, majority of its factories are not fully equipped. The technological level and quality standards of its industry as a whole are still fairly low, in spite of marked change since 2000 on account of foreign investment to some extent\(^3\). China’s price structure included large subsidies which grew substantially in 1970’s and 1980’s. These subsidies are being eliminated slowly on account of China’s admission to WTO in 2001.

### 2.2 Historical Overview of Chinese Economy

Until the 1800s, foreign products commanded little market demand in China\(^4\). With the relatively low Chinese demand for foreign goods, foreign merchants often had to pay in silver for their purchases of Chinese tea and silk. Beginning in the early 1800s, British East India Company merchants found that opium, mostly grown in British-controlled India, had a high demand in China. This resulted in thousands of Chinese becoming opium addicts.
and growth in corruption of Chinese officials and merchants involved in the opium trade. An effort from Chinese government to prevent British opium merchants resulted in the first "Opium War," from 1839 to 1842 and the second "Opium War" from 1856 to 1860. China lost the Sino-Japanese War in 1895, and had to pay indemnities that economically bankrupted the Qing government. Qing Chinese officials tried to improve economy of China. However, the additional 1895 indemnity to Japan and the 1901 Boxer Indemnity to the Western powers and the limitations on Chinese financial resources created by the Opium War unequal treaties, bankrupted the Chinese government from 1896 onwards. This prevented the government from being able to continue to support Chinese economic development efforts. Foreign control of much of China's tariff administration also permitted the Chinese tariff rate to decrease from 5 percent to about 3 percent between 1860 and 1900. China was only permitted by treaty to collect its tariffs in fixed silver amounts, even though foreign trade and China's loans were in gold-denominated currencies. Therefore, following the drop in the world price of silver, actual tariff revenues collected fell about 40 percent between 1860 and 1900. China's foreign loans were conditioned on China granting "concessions" to foreign lenders, specifically the granting of foreign "rights" to build railways and other modern enterprises in China. This "battle for concessions" continued from 1897 until 1911, when the Hu Guang (the proposed railway from Wuhan to Guangzhou) Railway loan contributed to the 1911 Chinese revolution. The 1911 Chinese revolution, however, did not improve China's financial condition because China still did not have sufficient sovereignty to repudiate the costly unequal treaties. The 1911 Sun Yatsen government, then the Yuan Shihkai government, and then all Nationalist governments until 1949, kept taking out new foreign loans, often
just to pay off old foreign loans. From 1900 to 1949, Chinese central government annually spent about 40% of its budget on loan and indemnity payments. Another 40% was spent on its military development, leaving only 20% for government expenses and economic development. The costs of China's lack of tariff autonomy for Chinese-owned infant industries were probably significant. Because foreign businesses operating in China were able to avoid paying most Chinese taxes except for the nominal 5% tariff on foreign trade, Chinese government business taxes could only be collected from Chinese-owned companies. Chinese companies were therefore placed in a position of comparative tax disadvantage in their competition with foreign companies. The cost of indemnities and loss of Chinese government control over the ability to tax and regulate foreign-owned modern enterprises in China, added up to major losses of Chinese capital and economic development potential during the 1860 to 1949 period. China had to wait until World War II to regain its full sovereignty and consequent Chinese legal controls over its domestic economy and over foreign enterprises in China. Unfortunately the Nationalists and the Communists began a civil war soon after World War II ended, from 1946 to 1949, thus preventing the Nationalists from making full use of their newly gained full sovereignty to develop China's economy. Instead, China suffered from major inflation and the huge costs of civil war. In 1949, the Chinese Communists won the civil war, and then took over governing China. For the first time in 89 years, Chinese authorities had the opportunity to try to economically develop their country with the benefit of full political and economic sovereignty.

History of Chinese economy from 1949 till date can be clearly divided into four phases as given under:

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Phase 1 - 1949-1978

The Chinese Revolution in 1949 refers to the final stage of military conflict (1948-1952) in the Chinese Civil War. In some anti-revisionist communist media and historiography, as well as the official media of the Communist Party of China, this period is known as the War of Liberation.

In 1949, China followed a socialist heavy industry development strategy called as the "Big Push" strategy. This consisted of giving high priority for rapid industrialization and reducing consumption. The government took control of a large part of the economy and redirected resources for building new factories and creating entirely new industries. Thus, economic growth was jump-started. By the end of 1950, tight control of budget and money supply reduced inflation. Though most of it was done at the expense of suppressing the private sector of small to big businesses by the Three-Antis / Five-Antis campaigns between 1951 to 1952. The Three-Antis campaign targeted communist cadres who had become too close to China's capitalists. The Five-Anti campaign was aimed at the capitalists themselves and brought them into line on charges of bribery, tax evasion, theft of state property and economic information, and cheating on government contracts. These campaigns were notorious for being anti-capitalist, and imposed charges that allowed the government to punish capitalists with severe fines. In early days of the Communist party's rule, the leaders of the party had agreed that capitalism is to be utilized to help the building of the "New China" and finally merged into communism. This was thought on account of the fact that China did not have any heavy industry and minimal secondary production.

China's progress during this phase can be judged from the various parameters like national income, the number of industrial working
class and industrial output. China’s national income grew five-fold in 25 years (1952-1978); the industrial working class grew from 3 million in 1952 to 50 million in the mid-1970s—this includes 28 million peasants who worked in communal industries under a policy of small-scale rural industrialization. Additionally, China’s industrial output increased at an average annual rate of 11.3 percent between 1952 and 1978\(^7\).

**Phase 2 - 1978-1990**

China began to make major reforms to its economy in 1978. The Chinese leadership adopted a pragmatic perspective on many political and socioeconomic problems. They substantially reduced the role of ideology in economic policy. Importance was attached to political and social stability, economic productivity, and public and consumer welfare. During these years stress was given on raising personal income and consumption and introducing new management systems to help increase productivity. Focus was given on foreign trade as a major vehicle for economic growth. In the 1980s, China tried to combine central planning with market-oriented reforms to increase productivity, living standards, and technological quality without worsening inflation, unemployment, and budget deficits. Reforms were commissioned in different areas of economy like agricultural, industrial, fiscal, financial, banking, price setting, and labor systems.

Foreign direct investment in several small “special economic zones” along the coast was permitted. However, the country lacked the legal infrastructure and knowledge of international practices to make this prospect attractive for many foreign businesses. Early 1980’s saw steps taken to expand the number of areas that could accept foreign investment with a minimum of red tape. In parallel, related efforts were made to develop the legal and other infrastructures necessary to make this work well. Thus 14
coastal cities and three coastal regions became "open areas" for foreign investment. These locations provided favored tax treatment and other advantages for foreign investment. In order to attract international capital to spur country's growth, Laws on contracts, patents, and other matters of concern to foreign businesses were also passed. However, the bureaucratic nature of China's economy, posed a number of inherent problems for foreign firms that wanted to operate in the Chinese environment. Hence, the government gradually added more incentives to attract foreign capital.

In 1978, on the eve of reforms, China was the world's 32nd ranked exporting country. By 1989 it was the world's 13th largest trading nation. In this period its share of world trade almost doubled. Moreover 90% of China's trade was with market economies. The economic progress made during this period is characterized by the double-digit real GDP growth in six years and more than 7% during four years. This was accompanied the first wave of foreign investment into China, and non-state enterprises started to develop. Highest GDP growth of 15.2% was recorded in 1984 followed by 13.5% in 1985.

**Phase 3 - 1990-2000**

The Chinese economy continued to grow at a rapid pace of about 9.5% in the 1990s, accompanied by low inflation. The Asian financial crisis affected China mainly through decreased foreign direct investment and a sharp drop in the growth of its exports. However, because China had a currency that was not freely convertible, and capital inflows that consisted overwhelmingly of long-term investment, it remained largely insulated from the regional crisis. Secondly, its commitment not to devalue had been a major stabilizing factor for the region. In spite of this, China faced slowing growth and rising unemployment based on internal
problems like burdening of a financial system on account of huge amounts of bad loans, and massive layoffs stemming from aggressive efforts to reform state-owned enterprises (SOEs). Irrespective of China's impressive economic development during the past two decades, major hurdles remained were, reforming the state sector and modernizing the banking system. More than 50% of China's state-owned enterprises were inefficient and reporting losses. The 15th National Communist Party Congress in September 1997 saw President Jiang Zemin announcing plans to sell, merge, or close the vast majority of SOEs in his call for increased "non-public ownership". These plans were endorsed by The 9th National People's Congress in its March 1998 session. China claimed success in its three year effort to make the majority of large state owned enterprises (SOEs) profitable, in the year 2000. During this phase China's GDP recorded double-digit growth for four years and more than 7% for six years. The growth was lowest at 3.8% during 1990.

China has been the world largest FDI recipient among developing countries since early 1990s. In recent years, FDI to China accounts for 1/4 to 1/3 of total FDI inflow to developing countries. Foreign investment has become an important source for China's investment in fixed assets. Its share in total annual investment in fixed assets grew from 3.8% in 1981 to its peak level of 12% in 1996. After the Asian financial crisis in 1997, FDI inflow fell and its contribution to fixed assets investment has also decreased to about 9% and 7% in 1998 and 1999, respectively. Contrary to popular belief, export-oriented growth in this phase has not created a net increase in China's manufacturing jobs. The primary reason is that privatization of SOEs led to massive layoffs, and foreign- and domestic-owned private enterprises have not made up for the huge shortfall. Employment in the SOEs declined

**Phase 4 - 2000-present**

Chinese legislators unveiled several proposed amendments to the state constitution, following the Chinese Communist Party's Third Plenum, held in October 2003. A proposal to provide protection for private property rights was one of the most significant proposals. A new emphasis was proposed on certain aspects of overall government economic policy, including efforts to reduce unemployment, to rebalance income distribution between urban and rural regions, and to maintain economic growth while protecting the environment and improving social equity. These amendments were approved by The National People's Congress in March 2004.

The 11th Five-Year Economic Program (2006-2010) of China was aimed at building a "harmonious society" through more balanced wealth distribution and improved education, medical care, and social security. This was approved by The Fifth Plenum in October 2005 and the National People's Congress on March 2006. The plan called for a relatively conservative 45% increase in GDP accumulated growth at constant prices and a 20% reduction in energy intensity (energy consumption per unit of GDP) by 2010. China's economy grew at an average rate of 10% per year during the period 1990-2004 which was the highest growth rate in the world. Irrespective of attempts by the government to cool the economy, China's GDP grew at 10.0% in 2003, 10.1%, in 2004, and even faster 10.4% in 2005. China's total trade in 2006 surpassed US $1.76 trillion, making China the world's third-largest trading nation after the U.S. and Germany. Such high growth is necessary if China is to generate the 15 million jobs
needed annually to employ new entrants into the national job market.

The National Bureau of Statistics (NBS) of China published the revised figures for 2007 fiscal year in which growth happened at 13 percent instead of 11.9 percent (provisional figures). This was confirmed by the World Bank\(^1\). China's gross domestic product stood at US $3.4 trillion while Germany's GDP was US $3.3 trillion for 2007. This made China the world's third largest economy by gross domestic product. Based on these figures, in 2007 China recorded its fastest growth since 1994 when the GDP grew by 13.1 percent.

To specifically deal with the Global financial crisis of 2008-2009, China launched its Economic Stimulus Plan. This plan primarily focused on increasing affordable housing, easing credit restrictions for mortgage and SMEs. Besides, it also planned to lower taxes such as those on real estate sales and commodities, pumping more public investment into infrastructure development, such as the rail network, roads and ports. By the end of 2009 it appeared that the Chinese economy was showing signs of recovery. At the 2009 Economic Work Conference in December 'managing inflation expectations' was added to the list of economic objectives, suggesting a strong economic upturn and a desire to take steps to manage it.

By 2010 it was evident that China was poised to move from export dependency to development of an internal market. Wages were rapidly rising in all areas of the country and Chinese leaders were calling for an increased standard of living. In mid-2010, China became the world's second largest economy next to USA, surpassing Japan's economy.

In the second quarter of 2010, China's economy was valued at $1.33 trillion, ahead of the $1.28 trillion that of Japan's...
economy. It is also predicted that China could become the world’s largest economy (by nominal GDP) sometime as early as 2030.

2.3 Important Indicators of Economy of China

Following are some latest important indicators of economy of China:

- China’s nominal GDP was US $ 5.88 trillion and GDP (Purchasing Power Parity) was US $ 10.08 trillion in 2010.
- Its nominal GDP per capita was US $ 4283 and PPP GDP per capita was US $ 7518 in 2010.

Table 2.1 gives estimated sector wise break up of this GDP in 2010.

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of Sector</th>
<th>% Share</th>
</tr>
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<tbody>
<tr>
<td>1</td>
<td>Industry</td>
<td>46.8</td>
</tr>
<tr>
<td>2</td>
<td>Services</td>
<td>43.0</td>
</tr>
<tr>
<td>3</td>
<td>Agriculture</td>
<td>10.2</td>
</tr>
</tbody>
</table>

(Source: Official communication, 23 May 2011; National Bureau of Statistics, China).

China’s total labour force stood at 819.50 Mn. Nos. as of 2009. Its unemployment rate was 4.2% in July 2010.

Main industries in China are mining and ore processing, iron, steel, aluminum, and other metals, coal; machine building; armaments; textiles and apparel; petroleum; cement; chemicals; fertilizers; consumer products, including footwear, toys, and electronics; food processing; transportation equipment, including automobiles, rail cars and locomotives, ships, and aircraft; telecommunications equipment, commercial space launch vehicles, satellites etc.
China’s exports in 2010 stood at US $1.58 trillion. Major products exported by China to the world include electrical and other machinery, including data processing equipment, apparel, textiles, iron and steel, optical and medical equipment.

Table 2.2 gives China’s main export destinations and their % shares in total exports of China for the year 2009.

Table 2.2

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Export Destination</th>
<th>% Share</th>
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<tbody>
<tr>
<td>1</td>
<td>USA</td>
<td>17.94</td>
</tr>
<tr>
<td>2</td>
<td>Hong Kong</td>
<td>13.80</td>
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<tr>
<td>3</td>
<td>Japan</td>
<td>07.60</td>
</tr>
<tr>
<td>4</td>
<td>South Korea</td>
<td>04.35</td>
</tr>
<tr>
<td>5</td>
<td>Germany</td>
<td>04.30</td>
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</tbody>
</table>

(Source: Official communication, 23 May 2011; National Bureau of Statistics, China).

China’s imports in 2010 were US $1.39 trillion. Major products imported by China from the world include electrical and other machinery, oil and mineral fuels, optical and medical equipment, metal ores, plastics, organic chemicals.

Table 2.3 gives China’s main import destinations and their % shares in total imports of China for the year 2009.

Table 2.3

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Import Destination</th>
<th>% Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Japan</td>
<td>12.64</td>
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<td>2</td>
<td>South Korea</td>
<td>09.90</td>
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<tr>
<td>3</td>
<td>USA</td>
<td>07.31</td>
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<tr>
<td>4</td>
<td>Germany</td>
<td>05.33</td>
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<tr>
<td>5</td>
<td>Australia</td>
<td>04.28</td>
</tr>
</tbody>
</table>

(Source: Official communication, 23 May 2011; National Bureau of Statistics, China).

China has FDI Stock of US$ 100 Bn. as of 2010. China has foreign reserves of US $3.05 trillion in 2011.
China’s currency is Renminbi (RMB) and its unit is Yuan (CNY). Its fixed exchange rate as on 7th March 2011 was
1 USD = 6.548 RMB.

2.4 Strengths and Weaknesses of Chinese Economy

STRENGTHS

Following are some of the strengths of China in general and Chinese economy in particular:

i) Clear vision and pragmatic approach to policy making is the biggest strength of China. China aims to achieve the status of global power by 202022 (beyond its current status of regional power in Asia and its status as a member of the P-5 Group of Nuclear Nations).

ii) China had sustained high growth since launching of economic reforms in 1978 leading to significant reduction in poverty levels.

iii) China is largest populated country in the world providing large and growing market and expanding opportunities for two-way international business.

iv) China has adopted business friendly policies and procedures for encouraging Foreign Direct Investment. China is one of the world’s largest receivers of foreign direct investments. World Bank estimates reveal that around 880 billion are invested in China annually23.

v) China’s another strength is its integration with the global economy24. China has largely adhered to openness to international trade and investment, one of the characteristics of successful market economies. China has become a significant player in world trade especially through its competitiveness in exports and high level of foreign exchange reserves.
vi) China’s tremendous growth is based on the technological products largely developed incrementally, often as refinements of imported pre-existing technologies. This "import/assimilate/re-innovate" model has proven to be a successful strategy, as China courts foreign companies to move their manufacturing facilities, then coerces those companies to share their technology with the state.

vii) China is spending substantial money towards innovations. In 2008, China spent $66 billion in R&D, the highest amount of any developing nation and the fourth-highest in the world. Consequently, patent applications in China jumped by 18.2 percent in 2008 and another 8.5 percent in 2009. This is in contrast to the economic downturn which has taken a toll on the R&D budgets of most American companies.

viii) Cheap labor rates have played an important role towards the Chinese economic boom. Even though their work force is cheap it is also productive and disciplined. An incredibly large population of relatively well-educated workers has kept the labor supply abundant and wages low. The resulting reduction in variable costs is a huge incentive for overseas manufacturers to shift their production facilities to China, where overhead cost is significantly less than their country of origin. Companies are so attracted by the savings potential that they set up shop in China despite the government’s requirement that they share technology. This policy though controversial, has helped fuel China’s economic boom as a part of the "import/assimilate/re-innovate" model.

ix) Its infrastructure has undergone massive improvements in the form of extensive high-speed rail networks and rapidly expanding Internet access. China has well-developed
infrastructure in main business centres and in Special Economic Zones which is being extended to other areas.

x) A number of highly impressive technological achievements were possible in China, due to strong directives from China’s central government. China is now home to the world’s largest hydroelectric dam and the world’s fastest supercomputer. China now produces more than two gigawatts of solar power each year, more than a quarter of the world’s total.

WEAKNESSES

Several weaknesses plague China’s economy. Some of these are as under:

i) There is a lack of synchronization between economic liberalization and political liberalization. In other words China has highly centralized political power regime.

ii) Corruption at local level governance has been one of the major weaknesses of China. Central government’s inability to control affairs of local government has always proved to be a hindrance to China’s economic growth. Economic reviews of China indicate that attempts made by central government to counter this menace have been a slow and long-drawn process.

iii) There exist large regional disparities in the levels of economic development in urban and rural areas.

iv) Unemployment in China is growing and there are many restrictions on internal movements of labour which cause discontent.

v) Chinese government significantly distorts prices in three factor markets viz. interest rates, energy prices and land prices. On account of this there is significant misallocation of resources.
China still regulates interest rates of its state owned commercial banks, keeping both nominal and real interest rates low for both depositors and borrowers when compared with interest rates in other developing countries.

China keeps its energy prices below market-determined levels. Hence, its state-owned oil companies have not increased domestic prices for gasoline and other refined petroleum products in line with recent increase in world prices.

In China, the government effectively controls all land. In rural areas, peasants may lease land, but not formally own it. Because peasants lack legal title to the land that they farm, they cannot use it as collateral to finance agricultural equipment or other improvements that might increase farm productivity and output.

vi) Legal System in China is below international/western standards especially in areas of property rights /IPRs. Chinese laws and regulations often lack clarity. Their enforcement may be arbitrary and sporadic. Government policy influences court decisions. In this legal environment, property rights are insecure. Individuals and private firms must depend on their connections with central, provincial, or local government officials to protect themselves and their property.

The burden of official corruption is very high. Chinese economist Angang Hu estimated that corruption costs China about 15 percent of its GDP a year in lost tariff and tax revenues and skimmed government funds. Provincial and local government officials extract from private firms through non-tax costs, including fees, forced expenditures on
unwanted provincial or local goods or services and entertainment of provincial or local government officials.

A weak rule of law, the lack of democratic accountability, and the disintegration of comprehensive central government planning give the State Owned Enterprises (SOEs) and the State Influenced Enterprises (SIEs) significant competitive advantages over private domestic firms.

vii) There exist large number of loss making SOEs and SIEs. Generally, large SOEs and SIEs have good connections with Chinese leaders, central government ministries, or prominent provincial or local government officials. These patrons use their influence to secure favorable laws, better regulatory treatment, and preferential access to loans from the four major state owned commercial banks and other depository institutions for the SOEs and the SIEs.

Major state owned commercial banks and other depository institutions lend to the SOEs and the SIEs without regard to their ability to repay their loans. Frequently, local government officials have more say over the lending decisions of local branch managers of the four major State owned commercial banks and other depository institutions than do either senior bank executives in Beijing or Shanghai or central government officials from the People's Bank of China (PBC) or the China Banking Regulatory Commission (CBRC). Despite some recent efforts of the central government officials to curb such non-market loans, the flow of non-market loans to the SOEs and the SIEs largely continues. These non-market loans allow many unprofitable SOEs and SIEs to continue operations or to invest in new capital assets when market discipline would force these
SOEs and SIEs to shutter operations or to forego the acquisition of capital assets.

viii) There exist sizeable Non-Performing Loans in the Banking/Financial Sector. Banks and other depository institutions have accumulated an extraordinarily large "legacy" of non-performing loans (NPLs) from past non-market lending, whether through policy loans, loans obtained through connections or outright corruption. Private estimates of the size of the China's bad loan problem are staggering. According to some private agencies, NPLs comprise 40 percent of all loans. It is also estimated that the China's NPLs range between 46 percent of GDP and 56 percent of GDP.

ix) There are many macroeconomic Consequences of the Chinese dysfunctional Banking System. China has a very high national saving rate. The unnecessarily high national savings rate contributes to what Chairman of the Council of Economic Advisers Ben S. Bernanke describes as a "savings glut" in Asia. Large-scale non-market lending by the major state owned commercial banks and other depository institutions to the SOEs and the SIEs restricts the availability of loans to private domestic firms. This limits the ability of Chinese entrepreneurs to invest in new capital assets, expand their businesses, and hire additional workers. Economic growth in China is mainly attributable to increases in the quantities of factor inputs rather than efficiency gains or innovation. It has been observed that the growth in China's total factor productivity decelerated dramatically during last few years. Total factor productivity
measures the growth in output that is not attributable to increases in factor inputs such as labor and capital assets. Thus, total factor productivity represents the gains from efficiency improvements and technological innovation.

The combination of a high rate of labor productivity and a dropping rate of total factor productivity means that the marginal productivity of new capital assets is falling. There is further evidence that domestic firms are investing in too many capital assets or the wrong types of capital assets given the China's comparative advantage in plentiful, low-cost labor.

x) China's supply of cheap labor is going to run out sooner than most people think. China and its citizens are becoming wealthier and workers intend to migrate to urban areas. Hence, new source of cheap labor is getting reduced in rural/countryside areas. Workers are already becoming more vocal in their demand for higher wages and better benefits. Another demographic reality is of an aging population of workers due to the nation's "one-child" family policies.

xi) Sector of real estate development has been plagued by "malinvestment" or poorly planned investment decisions. It is estimated that China is growing at a rate of adding 20 cities per year on account of highly speculative real estate developments. This is resulting in excess housing for its people. As China’s population growth begins to taper off, demand for those properties may be hard to come by. The losses from these bad investments may have an effect of offsetting gains made by smarter investments elsewhere and these inefficiencies will make it difficult for China to maximize its potential as it moves forward.
xii) China's Human Rights record is poor. It has restrained civil liberties.

2.5 Future of Chinese Economy

China has emerged as the second largest economy behind USA. However, expert opinions on future of Chinese economy are divided.

Positive opinions about future of Chinese economy

i) China’s economy will overtake that of the U.S. by 2035 and will be twice that of the U.S. by 2050. China’s economy is now dominated by internal growth rather than exports.

ii) In the next ten years, China’s economy will still increase at a rate 7% - 8%. In 2020 years, should price index remains the same as today, GDP will amount to 38 trillion, per capita GDP will reach 26,000 yuan.

However, the level of per capita GDP is still very low in China at the moment, GDP per capita’s growth is still at a slow rate. GDP per capita will have to be further increased in order to raise China's standard of living so as to bridge the present income gap between the rich and poor. Domestic demand will increase as the economy grows. Therefore extensive production of goods and services can further push and sustain the economy's growth.

There are abundant human resources in China, and labour cost in China is much lower than the other industrialized countries. China's education system is also being fast developed, thus more people will achieve higher level of education than in the past. With comparative advantage in cheap labour cost and increase of human capital brought about by education, future for China's economy can be only even brighter.
China's labour force will get even bigger as the China is urbanizing at a fast pace, changing from a rural and agricultural society to an urban and industrialized society. Through this transition, more manpower can be utilized. Urban infrastructure will be further enhanced and an increase in urban population will bring about higher consumption level, thus driving the economy further. The presence of such a big market, coupled with the increase in consumption power of the population brought about by urbanization, will create greater prospects for almost every industry. Market will become more efficient and industries will grow even faster than before. Domestic demand for goods and services will grow, creating better opportunities for production and investment.

iii) Professionals across the world feel that China is no longer an emerging economy - it has arrived and is firmly on the radar screen of business, government and citizens across the planet\(^{28}\). There is a very clear understanding of the current scale and future potential of the Chinese economy and the majority of businessmen expect it to continue developing at an accelerated pace. According to majority of professionals Chinese economy is expected to grow between 6-8 from 2011-2020.

iv) It is believed that the Chinese stock markets will overtake the New York Stock Exchange in size and that Chinese companies could become the largest grouping amongst the global 500 by 2040.

v) Information Technology and Energy are expected to be the highest growth sectors of Chinese economy in the period from 2011-2020.

vi) The rise of Chinese multinationals and Chinese business
practices are expected to influence day to day operations of international businesses both in China and in their domestic markets.

vii) It is expected China will increasingly become the launch market for new products and services. Some experts believe that it will be considered common for US and European workers to be employed by Chinese owned companies by 2030.

Bearish opinions about future of Chinese economy

i) According to critics in negative camp, China’s economic growth is unsustainable. According to them reason for this is the property bubble in China. Fixed asset investment accounts for a disproportionately large chunk of the Chinese economy. According to them, China’s economy is not real; rather, its breakneck economic growth is centrally planned by Beijing. It is also argued that China’s vast foreign exchange reserves are meaningless and that they will be used up in dealing with the aftermath of the Chinese real estate bust.

ii) The real-estate prices along the coastal cities in China are grossly overinflated and due for an abrupt adjustment. When measured in terms of affordability, it is obvious that Chinese property is in a gigantic asset bubble. According to some reports, billions of square feet of commercial real-estate is unoccupied in China. According to some reliable sources, there is rampant speculation in China’s residential real-estate. China’s banks have been doing their part to fuel this speculative orgy. For instance, the South China Morning Post recently reported that in 2010, China’s banks originated CNY8 trillion in new ‘official’ loans and this amount exceeded Beijing’s loan target. It is also alleged that the Chinese banks
loaned out an additional CNY3 trillion via 'off the balance-sheet' arrangements orchestrated through various Trust entities.

According to *China Daily*, outstanding Yuan-denominated loans stood at CNY47 trillion at the end of October 2010, which is an astronomical sum when you consider that China’s economy is worth only CNY37 trillion. Unfortunately, this rampant credit growth is not slowing down and apparently, Chinese banks have already created new loans worth CNY1.5 trillion in 2011.

It is not clear whether bust in housing will impact China’s broader economy or will the damage be confined amongst the property speculators and developers?

 iii) Critical concerns have been raised about human rights, the environment, freedom of speech, inequality, internal tensions, stresses on the banking system and the potential for overheating.

### 2.6 General Overview of Japanese Economy

#### Area and Geography

Japan has an area of 377,835 sq. km. It is a country of islands, extending along the eastern or Pacific coast of Asia. About 73% of the country is mountainous, with a chain running through each of the main islands. Japan’s highest mountain is the world-famous Mt. Fuji (12,388 feet). As Japan is situated in a volcanic zone along the Pacific depth, frequent low-intensity earth tremors and occasional volcanic activity are felt throughout the islands. A massive earthquake (magnitude 9.0) and tsunami struck northeastern Japan on March 11, 2011. Hot springs are numerous and have been developed as resorts.

#### Population
As of 2010 Japan’s population is estimated at 127.08 million. Its population growth rate as of 2011 is estimated to be -0.278%.

_Agriculture_

Less than 15% of Japan’s land is arable. The agricultural economy is highly subsidized and protected. With per hectare crop yields among the highest in the world, Japan maintains an overall agricultural self-sufficiency rate of about 40% on fewer than 4.6 million cultivated hectares (14 million acres). Japan normally produces a slight surplus of rice but imports large quantities of wheat, corn, sorghum, and soybeans, primarily from the United States. Japan’s small agricultural sector, however, is also highly subsidized and protected, with government regulations that favor small-scale cultivation instead of large-scale agriculture as practiced in North America.

_Transportation_

Japan’s road spending has been large. The 1.2 million kilometers of paved road are the main means of transportation. Japan has left-hand traffic. A single network of speed, divided, limited-access toll roads connects major cities and are operated by toll-collecting enterprises. New and used cars are inexpensive. Car ownership fees and fuel levies are used to promote energy-efficiency.

Dozens of Japanese railway companies compete in regional and local passenger transportation markets. Some 250 high-speed Shinkansen trains connect major cities. All trains are known for punctuality. There are 176 airports and flying is a popular way to travel between cities. The largest domestic airport, Tokyo International Airport, is Asia’s busiest airport. The largest international gateways are Narita International Airport (Tokyo area), Kansai International Airport (Osaka/Kobe/Kyoto area).
and Chūbu Centrair International Airport (Nagoya area). The largest ports include Nagoya Port.

**Communication**

Japan is a large user base of mobile and internet users. It had 107.49 Mn. No. mobile users as of March 2009. Japan had internet user base of 99.18 Mn. Nos. as of March 2011. Its internet population penetration is 78.4%.

**Banks**

The Bank of Japan is the central bank of Japan with head quarter in Tokyo. The Bank's objectives are to issue banknotes and to carry out currency and monetary control and to ensure smooth settlement of funds among banks and other financial institutions, thereby contributing to the maintenance of stability of the financial system. Development Bank of Japan is a policy-based quasi-government financial institution established as Special Corporation by Development Bank of Japan Law (1999). It provides long-term funding with focus on community, regional economic development and environmental preservation. Japan Bank for International Cooperation is a quasi-government institution which administers loans under statutory mandate to support international economic activities like supporting overseas projects of Japanese corporations; Overseas Economic Cooperation Operations - supporting developing economies.

The Japanese banking system has undergone structural reform since 2001. Most state-owned financial institutions were privatized and a lot of bad loans were eliminated. There are a lot of problems with the financial institutions - their profitability rates are low and they are ridden with nonperforming loans. There are too many unsustainable institutions and this obstructs profitability. Lending is also not risk-averse. Commercial banking is not entirely private, since the government often bails-out the failing establishments. A
new system has been under way, which will allow any Japanese
financial institution to request injection of public funds.

One significant trend in Japanese commercial banking since 2007
has been towards widening of the fee-based business. Unlike what
the customers would think, this step is not just means of
responding to a larger variety of needs, but also a new profit
channel.

Japan's financial system has remained stable as a whole in the
backdrop of critical situation of the global financial system that
began in the autumn of 2008. Recently, Japanese banks have
taken measures that contribute to enhancing the stability of
Japan's financial system, such as strengthening their capital bases
through capital increase and reducing market risk associated with
stockholdings. As for Japan's financial system, while credit costs
have been suppressed so far, the loan quality has been
deteriorating. Market risk associated with stockholdings is still
high at banks. Interest rate risk is looming as the result of
increases in long-term investment. In this situation, Japan's
financial institutions are making continuous efforts to improve
their risk management and strengthen their capital bases, while
properly assessing their risk-return balance.

Mineral Resources

A deposit of gold, magnesium, and silver meet current industrial
demands, but Japan is dependent on foreign sources for many of
the minerals essential to modern industry. Iron ore, coke, copper,
and bauxite must be imported, as also many forest products.

Industrial Profile

Japanese manufacturing is much diversified, with a variety of
advanced industries that are highly successful. Industry is
concentrated in several regions, in the following order of
importance: the Kanto region surrounding Tokyo, the Tokai region
including Aichi, Gifu, Mie, and Shizuoka prefectures (the Chukyo-Tokai industrial region); Kinki (Kansai), including Osaka, Kyoto, Kobe. In addition, a long narrow belt of industrial centers is found between Tokyo and Fukuoka, established by particular industries, which have developed as mill towns. The fields in which Japan enjoys high technological development include consumer electronics, automobile manufacturing, semiconductor manufacturing, optical fibers, optoelectronics, optical media, facsimile and copy machines, and fermentation processes in food and biochemistry.

Social Indicators

Important social indicators of Japan are as given below:

a) Population less than 15 years old – 13.6%
b) Population more than 60 years old – Men- 16%, Women- 42%
c) Sex ratio in 60+ age group (men/100 women)- 74
d) School life expectancy (primary to tertiary education) - 15 yrs.
e) Life expectancy at birth- Men- 80, Women- 87
f) Infant mortality rate – 3
g) Literacy rate-Adult 15+age group- 100, 15-24 age group- 100
h) Improved drinking water coverage (%)- 100
i) Improved sanitation coverage(%)- 100

Growth of Economy

Japan experienced rapid economic growth for three decades from 1960. Japan was world’s second largest economy from 1968 until 2010, when it was replaced by the People’s Republic of China. Japan had average growth rates of 10% in the 1960s, 5% in the 1970s, and 4% in the 1980s. However, in the second half of the 1980s, rising stock and real estate prices caused the Japanese
economy to overheat, resulting in the Japanese asset price bubble. The economic bubble came to a sudden end as the Tokyo Stock Exchange crashed in 1990–92. The real estate prices peaked in 1991. Throughout the 1990s, the growth in Japan was at 1.5% much slower than growth in other major developed economies. Government’s efforts to revive economic growth throughout the 1990s were unsuccessful. Hence, prime Minister, Junichiro Koizumi adopted policies to promote exports. This yielded positive results and raised GDP on an average of 2.1% annually from 2003 to 2007. The global financial crisis and a collapse in domestic demand saw the economy shrink 1.2% in 2008 and 5.0% in 2009. According to the International Monetary Fund’s assessment on 20/4/2011, Japan has the highest public debt in the world with 225% of GDP.

Japan has inadequate natural resources to support its growing economy and large population. Many kinds of minerals were extracted throughout the country but most mineral resources had to be imported in the postwar era. Local deposits of metal-bearing ores were difficult to process being of very low grade. Japan had large and varied forest resources, which covered 70 percent of the country in the late 1980s. However, these were not utilized extensively. Because of political decisions on local and national levels, Japan decided not to exploit its forest resources for economic gain. Domestic sources met between 25 and 30 percent of the nation’s timber needs. Agriculture and fishing were the best developed resources after years of painstaking investment and toil. The nation therefore built up the manufacturing and processing industries to convert raw materials imported from abroad. This strategy of economic development necessitated the establishment of a strong economic infrastructure to provide the needed energy, transportation, communications, and technological know-how.
Japan is dependent on foreign sources for many of the minerals essential to modern industry, in spite of the fact that deposits of gold, magnesium, and silver meet current industrial demands. Iron ore, copper, bauxite, and alumina are being imported along with many forest products.

2.7 **Historical Overview of Japanese Economy**

History of Japanese economy can be studied through two phases viz. Pre War and Post war period.

**Prewar period (1868-1945)**

Meiji restoration was a chain of events that restored imperial rule to Japan in 1868. This restoration led to enormous changes in Japan's political and social structure. After the Meiji restoration, the country was opened up to Western commerce and influence. Japan has gone through two periods of economic development. The 1st began in 1868 and got extended through to World War II. The 2nd began in 1945 and continued into the mid-1980s.

Economic developments of the prewar period were characterized by the "Rich State and Strong Army Policy" by the Meiji government. Meiji period from 1868 to 1912, saw, leaders inaugurating a new Western-based education system for all young people. This consisted of sending thousands of students to the United States and Europe and hiring more than 3,000 Westerners to teach modern science, mathematics, technology, and foreign languages in Japan. The government undertook building of railroads and improving roads. A land reform program to prepare the country for further development was also inaugurated.

To promote industrialization, the government offered help to private businesses to allocate resources and to plan. In parallel, the government also thought that, the public sector was best equipped to stimulate economic growth. The role of government was to help provide the economic conditions in which businesses
could flourish. In the early Meiji period, the government built factories and shipyards that were sold to entrepreneurs at a fraction of their value. Many of these businesses grew rapidly into the larger conglomerates. Government enacted a series of probusiness policies thereby emerging as chief promoter of private enterprise.

In the mid 1930s, based on mid-1930s exchange rates, the Japanese nominal wage rates were 10 times lower than the U.S. The price level is estimated to be lower about 44% than that of the U.S.

**Post War Period (1945 to present)**

Real economic growth from the 1960s to the 1980s can be called a "miracle". Japan recorded economic growth of 10% average in the 1960s, a 5% average in the 1970s and a 4% average in the 1980s\(^3\).

In the late 1990s, growth slowed drastically, mainly due to the Bank of Japan's failure to cut interest rates quickly enough to counter after-effects of over-investment during the late 1980s. Some economists believe that Japan entered a liquidity trap, because the Bank of Japan failed to cut rates quickly enough. Hence, to keep its economy afloat, Japan ran massive budget deficits by adding trillions in Yen to Japanese financial system. This was done to finance large public works programs.

Japan's public works projects could not stimulate demand enough to end the economy's stagnation by 1998. To overcome this problem, the Japanese government undertook "structural reform" policies in 1998. These were intended to remove speculative excesses from the stock and real estate markets. These policies led Japan into deflation on a number of occasions between 1999 and 2004. Princeton economics Professor and Nobel Laureate Paul Krugman, in his paper "Japan's Trap" in 1998\(^3\), argued that based
on a number of models, Japan had a new option. His plan called for a rise in inflation expectations, to cut long-term interest rates and promote spending.

Japan also used another technique called “Quantitative Easing”. As against to flooding the money supply with newly printed money, the Bank of Japan expanded the money supply internally to raise expectations of inflation. This policy initially failed to induce any growth, but it eventually began to affect inflationary expectations. By late 2005, the economy finally began a sustained recovery. GDP growth for that year was 2.8%, with an annualized fourth quarter expansion of 5.5%. This surpassed the growth rates of the US and European Union during the same period. An important feature of this recovery is that domestic consumption has been the dominant factor of growth, unlike previous recovery trends.

The Quantitative Easing strategy did not succeed in stopping price deflation irrespective of having interest rates down near zero for a long period of time. Some economists and some Japanese politicians termed this as deliberately causing hyperinflation. The zero-rate policy was ended in July 2006. In 2008, the Japanese Central Bank had the lowest interest rates in the developed world and deflation was not eliminated.

Some economists have suggested that improvements to bankruptcy law, land transfer law, and tax laws will aid Japan’s economy. In recent years, Japan has been the top export market for almost 15 trading nations worldwide.

Japan’s economy received a big jolt in early 2011 due to the earthquake and the subsequent tsunami.

2.8 Important Indicators of Economy of Japan

Following are some latest important indicators of economy of Japan:
Japan's estimated nominal GDP was US $5.46 trillion and GDP (Purchasing Power Parity) was US $4.30 trillion in 2010. Its estimated nominal GDP per capita was US $42,500 and PPP GDP per capita was US $34,200 in 2010. Table 2.4 gives estimated sector wise break up of this GDP in 2010.

Table 2.4
Sectorwise break up of this GDP

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of Sector</th>
<th>% Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Industry</td>
<td>24.90</td>
</tr>
<tr>
<td>2</td>
<td>Services</td>
<td>73.80</td>
</tr>
<tr>
<td>3</td>
<td>Agriculture</td>
<td>01.40</td>
</tr>
</tbody>
</table>

(Source: CIA World Factbook, July 2011)

Japan's total labour force stood at 65.64 Mn. Nos. as of 2010. Its estimated unemployment rate was 4.9% in 2011. Main industries in Japan are motor vehicles, industrial and transportation equipment, electronics, chemicals, steel, machine tools, processed foods and non-ferrous metals.

Japan's exports in 2010 were at estimated at US $765.2 billion. Major products exported by Japan to the world include hi-tech engineering parts and electronics products. Table 2.5 gives Japan's main export destinations and their % shares in total exports of Japan for the year 2010.

Table 2.5
Main export destinations of Japan

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Export Destination</th>
<th>% Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>China</td>
<td>19.41</td>
</tr>
<tr>
<td>2</td>
<td>USA</td>
<td>15.39</td>
</tr>
<tr>
<td>3</td>
<td>South Korea</td>
<td>08.10</td>
</tr>
<tr>
<td>4</td>
<td>Taiwan</td>
<td>06.80</td>
</tr>
<tr>
<td>5</td>
<td>Hong Kong</td>
<td>05.00</td>
</tr>
</tbody>
</table>

(Source: The Statistical Handbook of Japan, 2011)
Japan's imports in 2010 were US $ 636.8 Billion. Major products imported by Japan from the world include fishery products, agricultural products like fruits, textiles etc. Table 2.6 gives Japan's main import destinations and their % shares in total imports of Japan for the year 2010.

Table 2.6
Main Import destinations of Japan

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Import Destination</th>
<th>% Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>China</td>
<td>22.00</td>
</tr>
<tr>
<td>2</td>
<td>USA</td>
<td>09.72</td>
</tr>
<tr>
<td>3</td>
<td>*Australia</td>
<td>06.29</td>
</tr>
<tr>
<td>4</td>
<td>*Saudi Arabia</td>
<td>05.29</td>
</tr>
<tr>
<td>5</td>
<td>*UAE</td>
<td>04.12</td>
</tr>
</tbody>
</table>

* Shares for 2009 (Source: The Statistical Handbook of Japan, 2011)

Japan has FDI Stock of US$ 161.4 Bn. as of December 2010. Japan has estimated foreign exchange reserves of $1.035 trillion at the end of year 2010. Japan's currency is Yen. Its exchange rate as on 2/9/2011 was 1 USD = 76.76 Yen.

2.9 **Strengths and Weaknesses of Japanese Economy**

**Strengths**

i) There exists good demand for Yen in the foreign exchange markets, as it is viewed as a safe-haven currency. This is attributable to the fact that Japan has been running a large current account surplus and is the biggest creditor nation in the world. Hence, Japan is perceived as among the most robust countries in the world in terms of foreign currency funding.
ii) Japan is in Asia, which is the very centre of global growth. Japan’s trade with China by way of exports has increased by almost five times and imports have increased by almost three times since 2000. This shows that economic ties between Japan and China are becoming stronger. As Chinese economy is expanding very fast, this is going to benefit Japan in a big way.

iii) Japan’s another strength is its high level of technological capabilities. Japan’s technological capabilities are particularly high in environmental and energy-related fields. Global trends like the substantial increase in demand for infrastructure in emerging economies, the shift to a low-carbon society, and the growing role of environmental protection, the need for Japan’s advanced technologies in such areas is bound to rise in the future.

iv) Japan has substantially helped to the world businesses by introducing systems like Kaizen, Just in Time (JIT), 5 S method etc. Kaizen means "Continuous Improvement". This system can be applied in quality, technology, processes, company culture, productivity, safety and leadership. In Japan this system is applied in business, home, social activities as well as personal life. JIT has immensely helped to reduce inventories and working capital required in manufacturing industries. 5 S method is a structured program to implement workplace organization and standardization. It improves safety, work efficiency, productivity and establishes a sense of ownership. 5 S stands for Seiri (clearing up), Seiton (organizing), Seiso (cleaning), Seiketsu (standardizing) and Shitsuke (self-discipline).
v) Japanese society possesses "soft power" of safety, reliable business operations, courteous service and overall trust level in businesses. These are increasingly being sought for in global trade, which will work for benefit of Japan.

vi) Japanese people in general and workers in particular are highly disciplined and honest. An excellent example of this was observed in recent earthquake and Tsunami, after which Japanese people showed extreme discipline and not many thefts were reported.

vii) The level of literacy in Japanese society is high.

viii) Japanese people have developed an ability to work as team which has developed an excellent cooperation amongst workers and managerial staff. This has yielded excellent results in manufacturing industries.

ix) Japanese people take pride of their country as well as the company they work for hence there is very low employee turnover in these companies.

x) Japan's domestic market is highly sophisticated hence their products are of high standard. Secondly, domestic market being limited, manufacturers are compelled to sell products in export markets which demand good quality. Thus culture of offering good quality products has deeply penetrated in Japanese manufacturing industries. These companies follow superior production processes; adopt pollution-prevention and energy saving technologies.

xi) Japan has also developed supporting industries including sophisticated materials and parts makers.

Weaknesses

i) Continuing deflation for prolonged period since mid nineteen nineties. A fundamental cause for this is the long-term down trend in the growth potential of Japan's economy.
ii) Japan suffered from decline in productivity growth due to the burst of the bubble economy in mid nineties. This was on account of the excesses in production capacity, employment and debt built up during the bubble period, and as a result, Japan's growth rate declined.

iii) Rapid aging of population, specifically, the working-age population, which makes up the core group in production as well as consumption and the payment of taxes. According to the official Japanese reports, the proportion of people in the age group of 65 and above in Japan reached the world's highest at 21% in 2005. Government statistics also revealed that Japan now has the world's lowest percentage of people under the age of 15; they constitute only 13.6% of its population. Japan's fertility rate was 1.37 in 2008 after having dropped to a record low of 1.29 in 2005. The shrinking of the working-age population, which accounts for the bulk of consumption, has decreased the size of the domestic market. Moreover, consumption by the working-age generation is further constrained by the growing burden of supporting the elderly. Japan also faces problem of population decline. Japan's present population of 127.6 million could shrink by a third within 50 years if current trends continue. That would lead to a smaller workforce and to a serious impact on Japan's economy, besides constricting its social-security resources.

iv) Xenophobia (fear of unknown)
Japanese people suffer from xenophobia, which prevents them to mix with foreigners easily.
v) Majority of the Japanese have inadequate communication skills due to low proficiency in English, which is used in international trade.

2.10 Future of Japanese Economy

Japan faced with a tragedy of severe earthquake and tsunami which affected millions of people. Hence, forecasting future of Japanese economy is not easy.

The crisis facing Japan has created short-term economic disruptions in several areas including manufacturing, supply chain production, infrastructure and multiple utilities and services. It seems that manufacturing and services will be disrupted for some time as the country focuses on supplying basic necessities and infrastructure: clean water, food, shelter, clothing, electricity.

The surplus could disappear by 2018, if economic trends continue, leading to a weaker yen and a steeper yield curve for Japanese government bonds. Japanese companies are facing supply-chain issues and problem of more expensive electric power after the earthquake. This may force some Japanese companies to shift their manufacturing companies out of Japan.

It is not clear to what extent shift in production and output will have an impact on Japan's GDP and possibly stall future growth. According to economists, earthquake is expected to hamper the country’s growth, on the annualized basis, by 4% in the second and third quarters of 2011. Automobile industry has been hit seriously. Several leading Japanese manufacturing companies have announced cut in their production. Bank of Japan has predicted that in next year, the country's economy will grow 3.1%. Economic researchers, point out that some industries in the country, such as technology, are in better position to recover versus their situation following the Kobe earthquake in 1995.
Many technology, computer and semiconductor companies are more prepared with improved factory construction, greater geographic diversification and better supply chain alternatives to weather the crisis.

From what has been reported, the Bank of Japan has significantly increased its money supply to shore up the currency and the financial system. It also appears that the Tokyo stock market is functioning with little to no disruptions. In the long-term, infrastructure and construction could be on the uptick, as rebuilding and recovery gets underway in the country.

Many US and international companies have operations, suppliers and customers tied to Japan which could be impacted in both near and longer-term. Many industries, including those in energy, technology, consumer goods, insurance, auto manufacturers, shipping, consumer goods, manufacturers and suppliers, could be adversely affected. However, the economies of other nations and regions may grow as manufacturing and production gets shifted away from Japan.

It is predicted that, it will take time, but Japan will rebuild. Some economists think the rebuilding efforts could start a long awaited expansion of the Japanese economy.

As far as impact of this disaster on India is concerned, it is felt that project of Delhi Mumbai Industrial Corridor (DMIC), will be affected to some extent. It is expected that investments of private companies may get diverted to Japan rebuilding. However, Japanese Government has assured to continue providing funds on same scale as before.
2.11 Effects of Globalization and Privatization in China and Japan

China entered the World Trade Organization (WTO) in December 2001 after more than two decades of reforms aimed at gradually shifting the country toward a free market economy that is more open to foreign investment and trade. These reforms not only gained the country acceptance into the global trading body, they have also earned the praise of the World Bank and other economists who herald China as a great success story of economic globalization.

China has indeed become a magnet for foreign investment and an export powerhouse. Its strong economic growth over the past 25 years (averaging more than 9 percent annually) is unparalleled in modern history. China's "economic miracle" also coincided with a dramatic drop in extreme poverty. However, official figures on exports and investments do not give a complete picture of the experience of the Chinese people during this period of rapid social and economic change. Several indicators cause concern about China's embrace of economic globalization policies.

China is an economic powerhouse in the world, largely because of its political decisions to open its borders and adopt a "free" market system. However, many are concerned that the benefits of economic globalization in China are enjoyed by the few at the expense of the many. In keeping with a now familiar pattern of globalization, the gap between the haves and the have-nots in China has greatly increased. In the early 1980s, the richest 10 percent of the population earned less than 20 percent of the national income. By 2005, the top 10 percent earned 45 percent of the income, while the bottom 10 percent earned only 1.4 percent.
The state of the ecology is one of the most critical factors that will determine China’s future. Admittedly, many SOEs were not perfect stewards of the environment. Mao’s industrial development was mainly focused on creating a system of social equity. The link between natural resources and social well-being was poorly understood in many aspects. However, as bad as some industrial practices were then, China’s shift into an export-oriented market system has pushed its natural resources to the brink of collapse. China is now a corporate haven of low worker and environmental requirements and its benefactors are mainly foreign firms and western consumers. In 2003, foreign funded enterprises accounted for 55 percent of China’s exports. Additionally, research shows that most foreign investment flows out of China. Along with many other countries, China is experiencing the paradox of globalization—economic indicators may rise, yet an increase in poverty, loss of jobs, and social inequities often accompany the financial indicators of “success.” With the mounting rural crisis, worker abuses, ecological degradation, income gap, and many other problems, China is standing at the crossroad.

 Millions of those who are negatively impacted are becoming more vocal day by day. China’s official media reported that last year there were 74,000 incidents of social unrest, up from 10,000 in 1993. There is a strong resurgence of Maoism, especially among the working poor. Since President Hu Jintao and Prime Minister Wen Jiabao took office in 2003, there have been signs of policy adjustments. The plights of marginalized groups are increasingly covered by the media, and the government has taken some measures to address their grievances. Instead of saying “development is the absolute need,” the new government is now advocating for “scientific development” and “people-centered development.” Yet, so far the adjustments have not touched the
essence of the neoliberal policies carried out in the last two decades.

One of the effects of Japan's globalization has been the collapse of the previously well-entrenched system of lifetime employment\(^4\). There are many social groups for whom globalization has brought positive changes. For women in Japan, globalization has forced changes in employment legislation, although it would be fair to say that social change may not have kept up with the pace of legal reform. There are growing numbers of workers forced to the fringes of the Japanese economy, working as casual laborers either independently or under the frequently exploitative control of managers.

### 2.12 Main sources of information used

For China information main sources of information are National Bureau of Statistics of China (NBS) and Ministry of Commerce. Besides, some other important sources used are publications of Asian Development Bank, World Bank and United Nations Statistics. Publications like China Economic Review, China and World Economy have also been referred. Books by Brahma Chellany and Raghav Bahl have also been useful for quoting data about China.

As far as Japan is concerned data published by The Statistical handbook of Japan published by Ministry of Internal Affairs and Communications has been extensively used. Besides, reports published by the Bank of Japan have been also used.

### 2.13 Chapter Summary

The People's Republic of China is the world's second largest economy next to United States. It is also the largest exporter and second largest importer of goods in the world. China became the
world's top manufacturer in 2011, overtaking the United States. China's exports in 2010 stood at US $1.50 trillion. USA, Hong Kong and Japan are top three export destinations of China. China's imports in 2010 were US $1.30 trillion. Japan, Hong Kong and South Korea are top three import destinations. Clear vision, pragmatic approach of leadership, low labour cost, world's largest market, business friendly policies and integration with world economy are some of the strengths of China. While, highly centralized political regime, authoritarian rule, large disparities in urban and rural areas, high bad loans and legal system below international standards are some of the weaknesses of China. As far as future of Chinese economy is concerned there are both positive and bearish views.

China's economy is expected to grow at 7-8% in next two decades. It is expected to surpass USA to become number one economy in World by 2035. According to bearish views, there is property bubble in China which may burst any time. Critical concerns have been raised about human rights, the environment, freedom of Speech, inequality, internal tensions, stresses on the banking system and the potential for overheating.

Japan was world's second largest economy from 1968 until 2010, when it was replaced by the People's Republic of China. Japan suffered from a severe earthquake and Tsunami, which affected its industries badly. Japan's exports in 2010 at estimated at US $765.2 billion. China, USA and South Korea are its top three Exports destinations. Japan's imports in 2010 were US $636.8 Billion. China, USA, Australia are its top three import destinations. Some strengths of Japan are strong Yen, robustness of its foreign currency funding.
technological capabilities, disciplined work force, quality products etc. As against this some weaknesses are continuing deflation, rapidly decreasing working population and low proficiency in English.

Recent earthquake is expected to hamper Japan's growth, on the annualized basis, by 4% in the second and third quarters of 2011. Some economists think the rebuilding efforts could start a long awaited expansion of the Japanese economy.
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### APPENDIX 1 A

**MAJOR MILESTONES IN CHINESE ECONOMY**

<table>
<thead>
<tr>
<th>YEAR</th>
<th>MILESTONE/EVENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1839-1842</td>
<td>First Opium War</td>
</tr>
<tr>
<td>1856-1860</td>
<td>Second Opium War</td>
</tr>
<tr>
<td>1895</td>
<td>First war with Japan</td>
</tr>
<tr>
<td>1901</td>
<td>Qing Empire of China and the Eight-nation Alliance signed The Boxer Protocol.</td>
</tr>
<tr>
<td>1911</td>
<td>First Chinese Revolution</td>
</tr>
<tr>
<td>1937</td>
<td>Second war with Japan</td>
</tr>
<tr>
<td>1949</td>
<td>Second Chinese Revolution when Chinese communists won “War of Liberation”.</td>
</tr>
<tr>
<td>1951-52</td>
<td>Three-antis/Five-antis campaigns</td>
</tr>
<tr>
<td>1958</td>
<td>Mao Zedong introduced “Great Leap Forward”</td>
</tr>
<tr>
<td>1966</td>
<td>Mao announced: Cultural Revolution</td>
</tr>
<tr>
<td>1969</td>
<td>China descended to anarchy, factions of Red Guards started in fighting.</td>
</tr>
<tr>
<td>1976</td>
<td>Mao Zedong expired and power passed on to Deng Xiaoping.</td>
</tr>
<tr>
<td>1978</td>
<td>China began economic reforms, permission for FDI in SEZs.</td>
</tr>
<tr>
<td>1979</td>
<td>Shenzhen SEZ set up</td>
</tr>
<tr>
<td>1980</td>
<td>Communist party started transforming system of central planning and state-owned enterprise.</td>
</tr>
<tr>
<td>1983</td>
<td>GDP growth rate of 13.5%.</td>
</tr>
<tr>
<td>1983</td>
<td>Completion of 1st phase of establishing four SEZs which brings in US 41802 Mn. FDI.</td>
</tr>
<tr>
<td>1984</td>
<td>Highest GDP growth rate of 15.2% recorded.</td>
</tr>
<tr>
<td>1984-91</td>
<td>Second Phase brings in US 421546 Mn. FDI.</td>
</tr>
<tr>
<td>1992</td>
<td>Shanghai SEZ set up</td>
</tr>
<tr>
<td>Year</td>
<td>Event</td>
</tr>
<tr>
<td>------</td>
<td>-------</td>
</tr>
<tr>
<td>1997</td>
<td>President Jiang Zemin announces to sell, merge, close SOEs.</td>
</tr>
<tr>
<td>2000</td>
<td>Majority of SOEs turn to profit.</td>
</tr>
<tr>
<td>2003</td>
<td>Proposal to provide protection to private property rights.</td>
</tr>
<tr>
<td>2007</td>
<td>China becomes world's 3&lt;sup&gt;rd&lt;/sup&gt; largest economy replacing Germany, by registering GDP of US $3.38 trillion.</td>
</tr>
<tr>
<td>2010</td>
<td>China becomes world's 2&lt;sup&gt;nd&lt;/sup&gt; largest economy replacing Japan, by registering GDP of US $5.87 trillion.</td>
</tr>
</tbody>
</table>
APPENDIX 1 B
MAJOR MILESTONES IN JAPANESE ECONOMY

<table>
<thead>
<tr>
<th>YEAR</th>
<th>MILESTONE/EVENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1854</td>
<td>Japan’s Tokugawa Shogunate first opened the country to Western commerce and influence.</td>
</tr>
<tr>
<td>1871</td>
<td>The imperial government denied the autonomy of all 260 domains in Japan.</td>
</tr>
<tr>
<td>1882</td>
<td>Creation of Bank of Japan</td>
</tr>
<tr>
<td>1895</td>
<td>First war with China.</td>
</tr>
<tr>
<td>1896</td>
<td>The Civil Codes and the Commercial Codes were promulgated, under which large part of business transactions were standardized.</td>
</tr>
<tr>
<td>1904</td>
<td>Russia and Japan war.</td>
</tr>
<tr>
<td>1904-11</td>
<td>Electrification mainly due to the proliferation of intercity electrical railroads created economies of scale in the nascent industrial belt facing outward onto the Pacific.</td>
</tr>
<tr>
<td>1937</td>
<td>Second war with China</td>
</tr>
<tr>
<td>1941-44</td>
<td>Total war with US-</td>
</tr>
<tr>
<td>1944-45</td>
<td>Economic collapse due to lack of inputs</td>
</tr>
<tr>
<td>1945</td>
<td>Japan surrendered to the United States and its allies in war.</td>
</tr>
<tr>
<td>1945-50</td>
<td>Start of Three-step deregulation (reforms under control)</td>
</tr>
<tr>
<td>1961</td>
<td>Anti-rationalization rally.</td>
</tr>
<tr>
<td>1968</td>
<td>A remarkable economic upsurge put the country in third place among industrial nations with 10% annual growth</td>
</tr>
<tr>
<td>1985</td>
<td>Growth plummeted to 3.5% due to global oil shocks.</td>
</tr>
<tr>
<td>1985</td>
<td>Plaza Agreement between the US and Japan</td>
</tr>
<tr>
<td>1988</td>
<td>Japan achieved 2nd highest per capita income</td>
</tr>
<tr>
<td>1991</td>
<td>Real estate prices peaked</td>
</tr>
<tr>
<td>1990-92</td>
<td>Economic bubble erupted</td>
</tr>
</tbody>
</table>
1996  Japan recorded budget deficit of 4.3%.
1998  Japan recorded budget deficit of 10%, a $ 500 Bn. Rescue plan implemented to encourage bank lending and borrowing. Structural reform policies introduced.
1999-2004  Japan suffered from deflation.
2005  Sustained recovery of economy began with GDP growth of 2.8%.
2006  The zero-rate policy ended.
2008  Lowest interest rates of Japanese bank amongst developed world.
2011  Japan suffered from earthquake of magnitude 9 followed by Tsunami.