

Japan's Post-Quake Economic Outlook: Recovery and Reconstruction

An Interview with William W. Grimes

By Graham Webster
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The March 11 earthquake off the coast of Japan, followed by the devastating tsunami and an ongoing nuclear crisis in Fukushima, will create long-term challenges for both Japan and the world. Last week, in an [interview with Dan Sneider](#), NBR explored potential political outcomes from this tragedy.

This week, we spoke with [National Asia Research Associate](#) William W. Grimes (Boston University), an expert on the political economy of Japan and East Asia. Without downplaying the seriousness of events, Grimes explains that the economic repercussions may not be as bad as some had initially feared. This interview was published on the NBR website: <http://www.nbr.org>.

The disaster this month in Japan created extensive damage in certain areas of the country. What economic impact will this have?

It's a huge, horrible event. However, in terms of the economic impact on both the country and government, it's not as big as people are imagining when they look at the pictures. Most estimates are that the hardest hit regions account for around 4% of GDP. The reconstruction costs that I've been seeing are estimated at around 20-25 trillion yen. This is a big number, but the Japanese government can definitely afford it. If you compare this figure, for example, to Japan's gross debt of around 750 trillion yen, it's not insurmountable by any measure.

What impact will reconstruction spending have on the economy?

Following disasters like this, there is a lot of reconstruction to do. Even though you have a big net loss of wealth, the reconstruction adds new economic activity in the form of jobs and orders for all sorts of goods. Over the next couple of years, we will see significant rebuilding of infrastructure, residences, and various sorts of economic facilities—factories, stores, service centers, banks, etc. We should expect an enormous amount of new building, at least in some of the affected areas, and a lot of retrofitting and cleanup. All those activities are pretty manpower-intensive, which will provide important job opportunities for skilled, semi-skilled, and unskilled workers, as well as create orders for manufacturers, both inside and outside the country.

This all costs money. We may not be able to predict how everything will develop, but what was Japan's economic position before the earthquake?

The Japanese economy had been recovering last year before showing weakness in the fourth quarter. It looked like this quarter was going to see a return to pretty healthy growth that would continue through the year. Obviously, the first quarter numbers are now going to look pretty bad and the second quarter will also probably be negative. After that, we should see a resumption of moderate growth.

One of the main concerns before the quake was about Japanese debt and deficits. Japan's debt level is not actually an emergent problem, but with the gross debt exceeding 200% of GDP, it's definitely a serious long-term issue. Policy debates before the earthquake and tsunami were disappointing in both substance and tone. Within the DPJ, Prime Minister Kan has been on the side of making immediate efforts to lower the debt and balance the budget over the next five to ten years. Others have argued that it's too early to make those changes.

The LDP appears to share Kan's medium-term goals, but has been uncooperative on substance. Party leaders seem to have made the decision that bringing down the Kan government was more important than taking a chance on compromising with a weakened prime minister. As the opposition party, the LDP was in a position to say no without offering specific proposals of its own. Even though the FY 2012 budget would go into effect on April 1, despite not having been approved by the Upper House, because of the constitutional provision that the Lower House has precedence on that issue, the LDP and other opposition parties were threatening to hold up bills that were essential to budget implementation and issuance of deficit bonds unless Kan resigned.

The devastation caused by the earthquake and tsunami, as well as the continuing problems with the Fukushima reactor, call for all national leaders to cooperate in the public interest. This actually creates an important opportunity to come to an agreement on what measures will be needed to narrow the budget gap over the medium-term. I hope that Japan's leaders will do so.

Japan's economy is important to global markets. Given that the country is a major producer or consumer in a variety of sectors, what international effects can we expect to see?

Although there are some areas in which Japanese manufacturers are a critical link in the global supply chain, these manufacturers are not necessarily based in Tohoku, where the damage is worst. Nonetheless, because of uncertainty over electrical power supplies and the difficulty of internal transportation, we will likely see shortages developing in global supply chains. There are a number of factories that remain closed due to such issues. While we don't yet know at what point Japanese manufacturing will resume, it seems likely to me that most shortages will be addressed before they cause too much damage to global production. I suspect that there will be only a few very specific supply chains that suffer longer-term shortages.

Power generation will likely be an issue because of the ongoing disaster in Fukushima.

Indeed, I expect that this will make nuclear power considerably less attractive in Japan and pretty much everywhere else. In particular, the Fukushima crisis will make it extraordinarily difficult to build new nuclear power facilities, and they are going to be much more costly if they do get built. The crisis will probably lead to greater interest going forward in [natural gas](#), or maybe even coal. Natural gas is fairly cheap right now, and Japan has stable supplies of liquefied natural gas (LNG), so that alternative is probably at least as attractive as nuclear power in terms of energy self-sufficiency. But reverting to fossil fuels will probably make it impossible for Japan to meet its goals for reducing carbon emissions.

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