

JAPAN CHAIR PLATFORM

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Japan's Demographic End Game

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Easy money and large dollops of fiscal stimulus have turbocharged Japan's economy over the past year, boosting its growth above that of the other G-7 economies. The administration of Shinzo Abe hopes that this shock treatment, together with promised structural reforms, will not only permanently lift a resurgent Japan out of the economic doldrums in which it has drifted for more than two decades, but will also allow it to assume leadership in Asian-Pacific security and balance a rising China.

While Japan's recent economic performance is impressive, there is reason for skepticism about its durability. The easy money and stimulus are temporary measures. What really matters are the structural reforms—Abe's "third arrow"—and the scope of these remains vague. But there is also a more fundamental problem. Whatever Abenomics' near-term success, Japan's long-term economic and geopolitical prospects will remain doubtful so long as the country continues down its current demographic path.

Thanks to its chronically low fertility rate, world-record life expectancy, and aversion to migrants, Japan is ground zero for global aging. The youngest of the developed countries as recently as the mid-1970s, Japan is now the oldest—and its age wave will continue to roll in for decades to come. By 2050, the proportion of Japanese who are 65 or older is on track to reach 39 percent, up from 23 percent in 2010 and only 9 percent in 1980, when Japan Inc. seemed poised to conquer the global economy. Meanwhile, Japan's population, which is already contracting, will enter a precipitous decline, shrinking by over a half by the end of the century. Extending this dismal forecast even further into the future, the Japanese Ministry of Health, Labor, and Welfare projects, half seriously, the date when there will be only one Japanese citizen left living.

As Japan's demographic end game unfolds, sustaining robust economic growth will be difficult, if not impossible. Indeed, Japan's long-term demographic decline is likely to be mirrored by a long-term economic decline. This expectation is not rooted in pessimism, but in simple arithmetic. Over the next twenty-five years, Japan's working-age population will be contracting at an average rate of 1.0 percent per year. Even at full employment, real GDP could stagnate or decline, since the number of workers may be falling as fast or faster than productivity is rising. Unless economic performance improves significantly, Japan at best faces a future of secular economic stagnation—in other words, of zero growth from peak to peak of the business cycle.

Economic performance, in fact, is more likely to deteriorate than improve. Japan's workforce will not only be contracting, but also graying—and a vast literature in the social and behavioral sciences establishes that worker productivity typically declines at older ages, especially in eras of rapid technological and market change. At the same time, savings rates will decline as a larger share of Japan's population moves into the retirement years. If savings fall more than investment demand, as much macroeconomic modeling suggests is likely, either businesses will starve for investment funds or dependence on capital from higher-saving emerging markets will grow. In the first case, the penalty will be lower output. In the second, it will be higher debt service costs and the loss of political leverage, which history teaches is always ceded to creditor nations. Then there is the specter of growing protectionist sentiment. With the size of the Japanese domestic market stagnant or shrinking, businesses and unions may lobby for anticompetitive changes in the economy. We may see growing cartel behavior to protect market share and more restrictive rules on hiring and firing to protect jobs. We may also see increasing pressure on government to block foreign competition.

It gets worse. Even as economic growth slows, Japan will have to transfer a rising share of economic resources from working-age adults to nonworking elders. According to projections by the CSIS Global Aging Initiative, the cost of maintaining the current generosity of pensions and health benefits for the elderly would add an extra 7 percent of GDP to government expenditures by 2030. Japan cannot possibly raise taxes enough to cover this growing old-age dependency

burden, since potential future revenue increases are already largely precommitted to stabilizing or reducing its Greek-sized public debt. In the end, it will have to choose between slashing old-age benefits and cannibalizing other government spending on everything from education and the environment to foreign assistance and national defense.

To be sure, Japan enjoys a few comparative advantages that may allow it to mitigate the impact of population aging and population decline—at least for a while. The dependence of Japanese elders on government benefits is relatively low, which makes it easier for Japan to rewrite the social contract than it is for most Western countries. Public pensions have been cut repeatedly since the 1980s without triggering the kind of electoral backlash familiar to politicians in the United States and Europe. The long working lives of the Japanese constitute another important advantage. Fifty-five percent of Japanese men aged 60 to 74 are still employed, a larger share than in any other developed country except Iceland. While older workers may not be a perfect substitute for younger workers, they are better than no workers at all. Then there is the extended family. Nearly half of Japanese elders live with their grown children. This custom not only allows relatively poor Japanese elders to live with their more affluent children, but also allows relatively poor young adults to live with their more affluent parents. It thus cushions the burden of growing old-age dependency both by providing an extra source of support for the old and by providing a source of “trickle down” support for the young.

Yet in the end, none of this will be enough to stave off steep economic and geopolitical decline. According to projections by the Carnegie Endowment for International Peace, Japan’s share of the combined GDP of the G-20 countries will plummet from 12 to 4 percent by mid-century, a stunning outcome attributable both to Japan’s own demographic contraction and to the surging growth of large emerging markets, especially China. As recently as 2000, Japan’s economy was four times as large as China’s. By 2030, China’s economy could be four times as large as Japan’s. Throughout history, those states or alliances that have ultimately prevailed over their neighbors have usually turned out to be those whose populations and economies were growing faster than their neighbors. On the other hand, it is difficult to find any important instance of a state whose regional or global stature has risen while its share of the regional or global population and GDP has declined.

If Japan is to prosper in the long run—indeed, if Japan is to survive—it will have to alter its demographic trajectory. There are two ways, and only two ways, that it can do so: increase immigration and increase birthrates. The first will require a radical transformation of assumptions about national identity and the embrace of a more heterogeneous self-image. The second will require a radical transformation of traditional workplace and family cultures that confront women with a zero-sum trade-off between careers and children. The Abe administration is right to stress the importance of what it calls “womenomics.” In today’s rich world, it is no longer true that more working women mean fewer babies. In fact, just the opposite is true. Those countries that facilitate a dual role for women get more of both crucial inputs: workers and babies. Those that do not get fewer of both. It is no accident that Japan has both one of the very lowest fertility rates in the OECD and one of the very lowest female labor-force participation rates.

While Japan often clings to tradition and resists reform, when faced with great national challenges it has sometimes shown itself capable of sweeping social and cultural transformation, astonishing the world in the process. This happened in the nineteenth century during the Meiji Restoration that catapulted Japan into the ranks of industrial powers. It happened again after the Second World War when the nation rose from the ashes of defeat and reinvented itself as Japan Inc. The transformation that Japan must now embrace may lack the drama, but the stakes are no less momentous.

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