

INVIGORATING THE ECONOMY OF AN AGING SOCIETY WITH A FALLING BIRTHRATE

By Itoh Motoshige

Will Japan's Economy Decline as the Population Ages and the Birthrates Falls?

Japan is facing a serious challenge as its society ages rapidly and the birthrate plunges. The country's population is expected to decline from 2006, and many workers are to retire from 2007. The country's production labor population (15 to 64 year olds) reached a peak 10 years ago in 1995 and has subsequently continued to turn down.

Japan's postwar systems and practices have been predicated on a constantly growing economy. Unless the country's pensions, finances, corporate hiring structures and other mechanisms change to suit today's new reality of a graying society with a low birthrate, the consequences will be dire. While the government has been working on structural reforms, many consider the speed of those reforms to be too slow.

I served as the chairman of the Competitive Power Working Group for the Cabinet Office's "Japan's 21st Century Vision." In this forum, we debated, from a range of perspectives, the issue of Japan's economic rejuvenation in relation to the long-term health of its society. In this paper, I will take up and discuss some of the points that made a particular impression on me.

In Japan and overseas, we frequently hear the pessimistic view that the aging of society and the baby bust will cause economic stagnation. To be sure, if the current state of affairs continues, and the mechanisms that are old fashioned now remain unreformed, Japan's economy will lose its vitality. The government debt and pension problems that are currently afflicting the country typify this situation. The first point on which we all agreed in the Working Group was that, if Japan were to sit back and do nothing, the country would face serious difficulties.

However, even though it is commonly believed that an aging society with a falling birthrate must lose its vitality, this does not necessarily have to be the case. A second point on which we all agreed was that implementation of social reforms designed for an aging population with a falling birthrate could further rejuvenate the economy.

The invigoration of an economy or society involves a range of elements. Here though, we will consider just the simplest – the economic growth rate. Under the environment of an aging society and falling birthrate, will Japan's economic growth rate really decline?

While economists have produced reams of research on economic growth, the research by Massachusetts Institute of Technology (MIT) Professor Robert Solow, winner of a Nobel Prize for Economic Sciences, is well known. According to Solow, the growth of advanced industrialized economies like the United States can be explained by two factors. One is the expansion of the productive factor, caused by such elements as population increase, improvement in the labor quality resulting from improvements in people's education levels and an increase in facilities as a result of capital accretion. The other factor is improvements in the efficiency of business methods in areas like production and distribution, and technological innovation. Solow contends that nearly 80% of the long-term economic growth trend of the industrialized nations can be explained by the second factor – production innovation and technological innovation – and that labor and capital increases account for only around 20% of growth. If this hypothesis is correct, to argue that the economic growth rate must fall just because the population decreases would be somewhat wrong.

Another interesting way of looking at technological innovation and production innovation is from the perspective of longer-term patterns of economic growth. Over the long period of history from around the year AD 0 to the start of the 17th century, the level of per capita income throughout the world hardly grew at all. To paint a picture illustrating this, the standard of living of a Roman citizen around the year 0 and a French citizen around 1600 were almost identical. From the 18th century, however, per capita incomes in industrialized countries began to rise exponentially. Over a period of about 300 years, they increased several hundred to several thousand times. The driver of this growth was tech-

nological innovation and operational innovations in the areas of production and distribution. In light of these trends, the outlook for Japan's growth potential in the 21st century need not be bleak.

Maximizing Market Mechanisms

So what is needed to vitalize Japan's economy? From the viewpoint of economics, to energize the economy it is important to effectively utilize the available economic resources to the utmost. I would like to consider the effective use of economic resources from the following three perspectives.

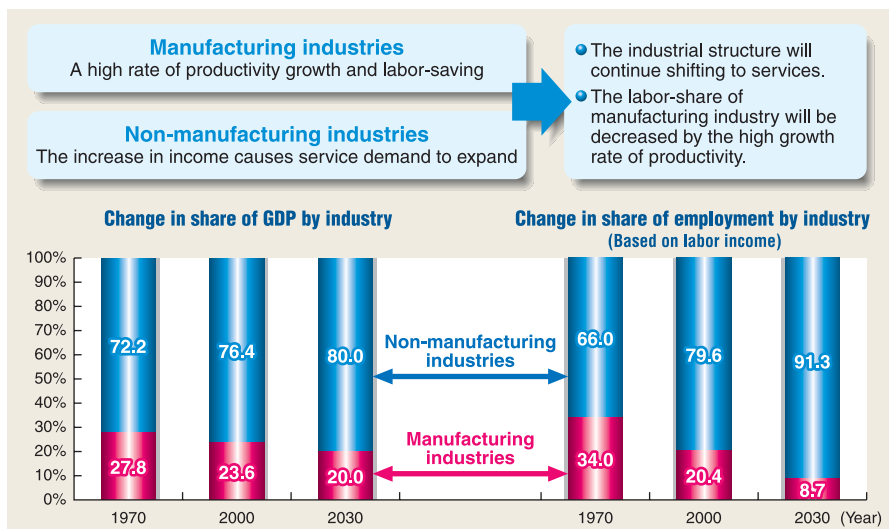
The first is using the country's existing available resources – people, materials and money – as effectively as possible. The second is to try to raise the quality of human resources – generally considered the most effective economic resource. The third is to pursue an open society that can make the maximum use of overseas economic resources.

The first point of the effective use of existing economic resources can be achieved by further acceleration of the deregulation, privatization and other reforms that the Japanese government has been pursuing. Unfortunately, at the current point, large volumes of economic resources are still being used inefficiently. The most glaring example is Japan's postal service.

The postal service treats its employees as public servants, and they account for nearly 30% of all the national public servants in Japan. It has amassed nearly ¥350 trillion in postal savings and postal life insurance funds, exceeding the total amount of private deposits held by Japan's four largest banks. Japan Post is not charged corporate tax, and the postal savings are guaranteed by the government. The main object of privatizing Japan Post is to free up its financial assets and personnel by transforming a public agency that is currently very restricted into a business for more effective utilization.

While the postal service is symbolic of Japan's problems, the same kind of

Figure 1 Japan's Industrial Structure in 2030



Source : Japan's 21st Century Vision, Council on Economic and Fiscal Policy

issues, to a greater or lesser extent, can be seen in many other areas as well. In Japan, manufacturing contributes around 20% of the country's GDP, while the remaining 80% comes from services and other non-manufacturing areas. In the non-manufacturing sector, there are many highly inefficient areas controlled by public and other regulations. Typical areas are medical services, welfare, education and agriculture. If these areas are publicly managed as activities of financial burden in the environment of an aging society with a falling birthrate, the burden of those financial encumbrances will surely grow. However, if Japan heads in the direction of reducing restrictions and controls as much as possible, it will be able to develop new markets and industries in these areas.

Raising productivity by 4% in the manufacturing sector would have almost the same macro-economic impact as raising production by 1% in the non-manufacturing sector. In this sense, too, Japan must aggressively adopt deregulation and privatization to vitalize its non-manufacturing sector.

The report on "Japan's 21st Century Vision" touched on the latent competitiveness of Japan's industry and the vitalization of individual fields in greater detail. There are various ways of introducing market mechanisms in areas where they have not yet been properly applied. This includes clarifying the

concepts of government and the private sector, public and private, and reviewing the role of the government and the form of its organizations.

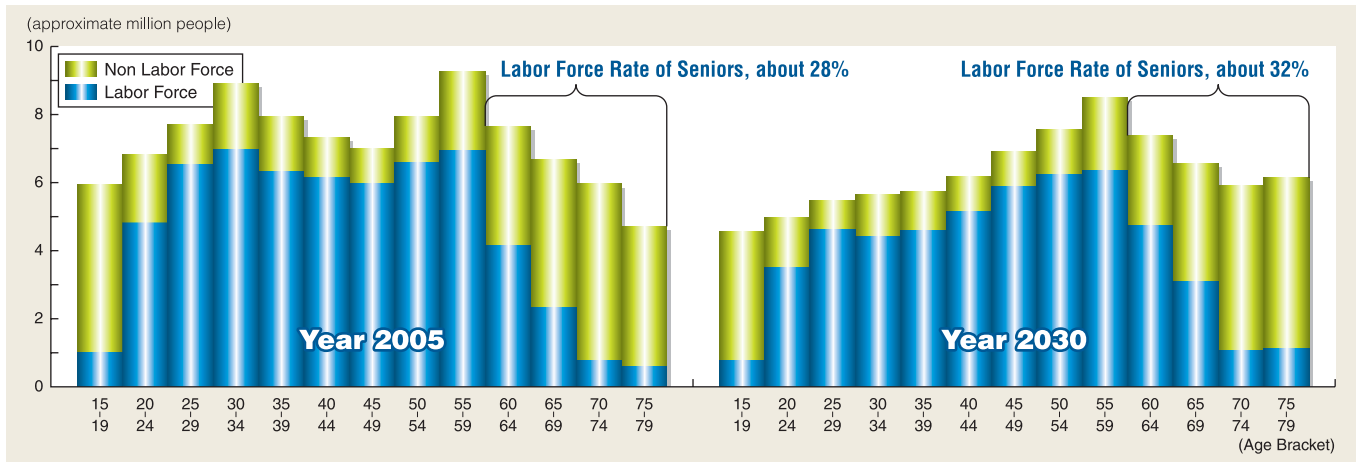
Enhancing "People Power"

In our report, we used the expression "people power." While the idea of "people power" might mean enhancing the capabilities of people as human capital (to express the concept in a slightly more conventional way), the reason we used the expression here is not that we see human resources simply as an economic resource, but that we recognize the lifestyle of each citizen and wish to project the aim of a society in which each individual can find his or her own respective place.

Enhancing the quality of personnel could mean increasing opportunities for education and acquiring skills, but, from the perspective of "people power," we must not simply stop at this level but consider the lifestyle of each individual.

The driving force of Japan's economic growth in the postwar period was generally supported by Japanese employment practices typified by lifetime employment and age-based remuneration. Today, however, these approaches are changing significantly. Various problems have been identified, such as the need to secure a place in society for casual part-time workers and young people who are

Figure 2 The View of the Population and Labor Force Population (by Age Bracket)



Source : Japan's 21st Century Vision, Council on Economic and Fiscal Policy

Notes : Labor force rate (by age bracket) = labor force population (working population and unemployed population) / population
As a labor market that allows diverse working styles is established, the labor force rate of seniors will be increased.

“Not in Education, Employment, or Training” (NEET), for women whose opportunities have been circumscribed in the past, and for senior citizens whose numbers will vastly increase in the future. The core problems with the Japanese system are now breaking out all over the place in more specific forms. Up to a short time ago, detractors joked that, under the old system: “Children only study and working age adults only work; then they retire and have nothing to do.”

In our report, we discussed these specific individual problems. Here, I will not go into those issues except to say in general that, if we can solve them and provide employment or education opportunities in which each citizen can make more flexible choices, Japan's people power would certainly be enhanced.

To add yet another point, that Japan's population will share a plethora of knowledge – a set of phenomena covered loosely by the term “literacy” – can also lead to the vitalization of the country's whole economy. Specifically speaking, typical examples of literacy include economic or financial literacy, legal literacy and IT literacy. For example, for Japan to break away from a bureaucratic, discretionary-type system and strengthen its rule-based mechanisms, it will certainly require greater legal literacy among its citizens. The effective utilization of Japan's private financial assets, said to total ¥1,400 trillion, will be necessary for the country's economic

vitalization, but this will require a higher level of financial literacy from many of the country's citizens.

■ A More Open Country

As stated above, while the effective utilization of Japan's domestic economic resources is vital, this is not sufficient in itself. Whether or not Japan can utilize its overseas economic resources more effectively holds the key to the future invigoration of Japanese society. Japan must become an open society in every way, including people, goods and money.

Looking at the changes in Japan's postwar economy, it is clear that the movement of people, goods and money has become a major driving force for change. Even in this process, however, barriers have still stood in the way of opening up markets and society. There are forces resisting to open Japan's society to the outside world on such issues as; trade liberalization under the World Trade Organization, negotiations toward free trade agreements (FTAs) with Asian countries; and the promotion of direct investment from overseas countries in Japan. As the old Japanese saying, “to agree with the whole argument but disagree with each part of it,” aptly indicates, many are in favor of the opening of society on a general level, but when it comes to the opening of the particular area that affects them individual-

ly, they oppose any opening.

Unless we eliminate such domestic resistance and actively make Japan into an open society, the country's future in the 21st century will not be bright. Naturally, transforming Japan into an open society is not simply a matter of removing trade barriers and impediments to the movement of people. It will be necessary to redevelop infrastructure and systems to suit the liberalization of markets and society. Take the movement of people as an example. That Japan must accept more people from overseas is obvious. However, this does not mean that we should simply bring in overseas labor blindly. Rather than unskilled labor, Japan should actively invite skilled workers, and develop systems to enable them to assimilate into Japanese society. Naturally, we must also strengthen systems to bar entry to illegal workers, who are not a positive influence in Japan's society. By applying both “the accelerator and the brake,” Japan could open up to the flow of people for the first time in a meaningful way. The country must not only open up to overseas workers, but must also actively draw in foreign students and young people, and work to stimulate regional and cultural exchange at the grass roots level.

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