

# JAPAN ECONOMIC CURRENTS

A COMMENTARY ON ECONOMIC AND BUSINESS TRENDS

## Japan's New Population Projections and Their Impact on the Japanese Economy

by Kotoko Tonomura, Dai-ichi Life Research Institute (DLRI)

In January 2002, Japan's National Institute of Population and Social Security Research (NIPSS) released a report that charted a worrisome downward trend in Japan's birth rate over the next 50 years. According to the NIPSS report, total fertility rate (TFR) will fall from 1.36 in 2000, to 1.31 in 2007, and gradually stabilize around 1.39 by 2050.

The NIPSS report also turned some long-held demographic assumptions on their head. The long and steady decline of the Japanese birthrate has long been assumed to be the twin results of late marriages and a rising number of never-unmarried adults. But NIPSS researchers found that there has been a decline in the absolute number of children born to married couples.

The population pyramid of Figure 1 is drawn according to the medium variant of the new projections:

Japan's demographics are undergoing a rapid transformation from the triangular shape of Mt. Fuji in 1975 to an urn-shape in 2050. Total population, which stood at 127 million in 2000, will be 101 million in 2050 and gradually shrink to 64 million in 2100 – almost half of today's size. For the first time in its history, Japan will see its population decline.

Japan is now enjoying its last years of "Golden Population Age." Even though its population pyramid is already being deformed, the working age population (those aged 15-64) still account for 68 percent, with the first baby-boomers in their 50s and the second in their late 20s. The proportion of the aged population (those over 65) and children under 15 are still relatively small. Japan's average age is 41.4.

By 2025, the first bulge of baby-boomers will be retired, thereby shifting the proportion of Japan's aged to almost 30 percent and the working age generation to 60 percent. As a result, for every two active working persons, there will be one aged person to support. By 2050, the ratio will be 1.5 workers to 1 aged.

As the Japanese TFR has continuously hovered below the replacement level of 2.08 since the mid-1970s, it is no longer possible to avoid population decline. But Japan's real demographic problem lies not in the size, but in the proportion of each age group.

### Each Age Group

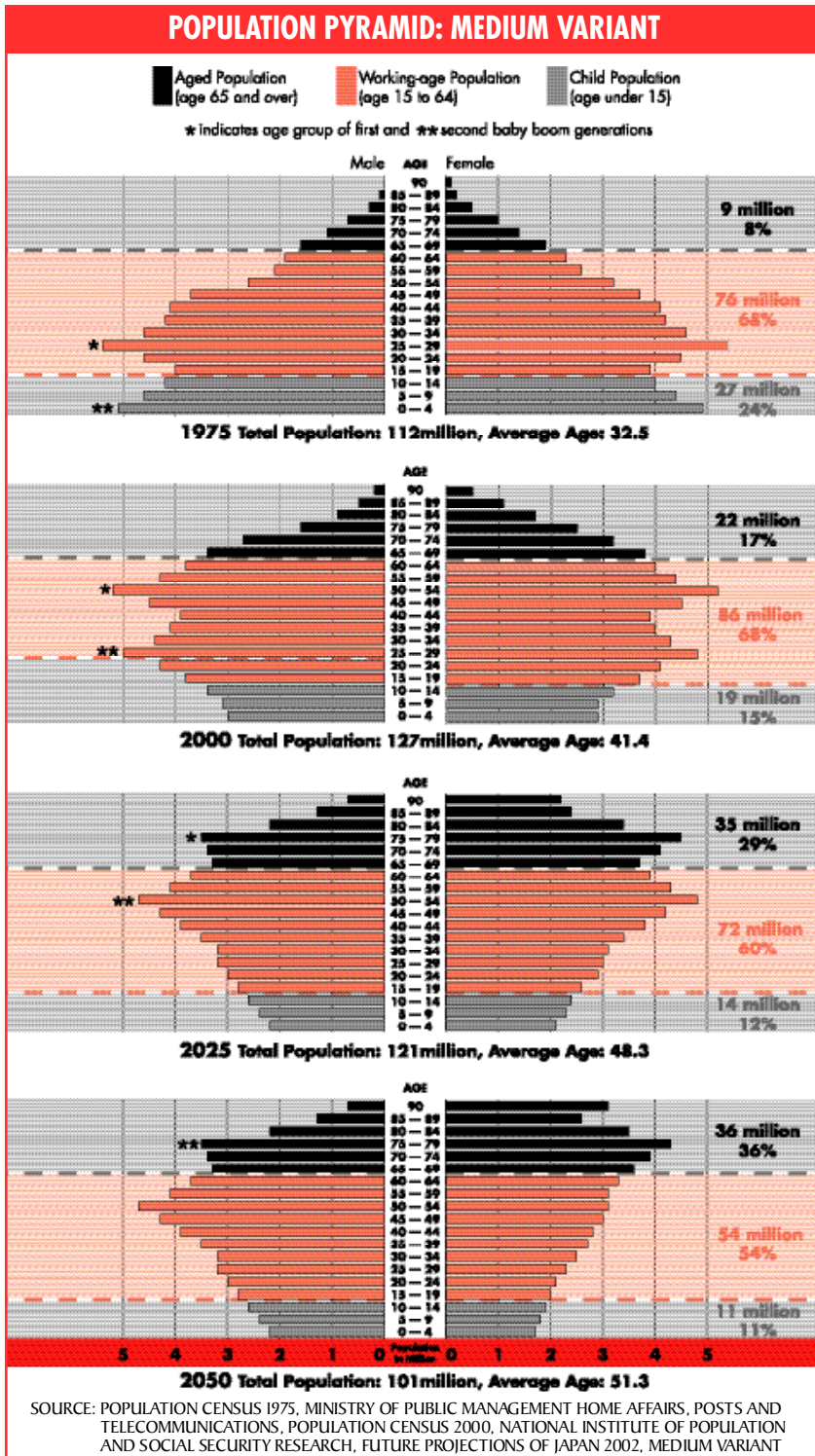
The number of children under 15 will rapidly shrink from 19 million in 2000 (15 percent of the total population) to 11 million (11 percent) in 2050.

Japan's working-age population has already started to fall from its 1995 peak of 87 million. But by 2050, it will have lost about 32 million (40 percent) of its potential workforce. Only ten years after that, when the first baby-boomer generation begins to retire, Japan will face a serious decline in the working-age population. More than 700,000 workers (about 1 percent) will disappear every year. And the situation will worsen in the 2030s with the retirement of the second baby-boomer added to the growing effect of low fertility rate in the past years. By that point, the number of working-age population will decline by 900,000 people per year.

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Consequently, the aged population will expand. The aging problem weighs most heavily in the first 20 years of 21st century, with the number of the aged growing at 700,000, or about 2 percent per year. Right now some 22 million Japanese are aged (17.4 percent). But this proportion will jump to 36 million (35.7 percent) by 2050 – 1 out of 3 Japanese will be older than 65.

Three primary factors have caused this rapid demography change: the sharp and continuous drop in Japan's birthrate, the rapid growth in the longevity, and the serious lack of public policies.

## Birthrate

As it did in other industrialized countries, Japan's TFR started its long and continuous dip after the late 1960s. This trend was especially pronounced in Japan as women's educational levels and social status enhanced rapidly. But because the Japanese economy expanded at such an extremely high speed and scale, its socioeconomic structure could not keep pace with the rapid demographic changes.

With their higher social status and income level catching up that of men, many Japanese women no longer feel obliged to marry and are loathe to lose their freedom and financial security once they quit. And due to the fact the Japanese

labor market is not yet flexible enough to ensure that women can regain comparable jobs after leaving the workforce for family reasons, most surrender their career paths for life. These combined factors lead to the tendency of women to postpone marriage or to never marry at all, thus lowering the fertility rate further. Furthermore, traditional stereotyped gender roles that assign child rearing and nursing duties to women alone (while men are the bread-winners) has been and still is the main cause of the lowered birthrate.

### Longevity

The average life expectancies of Japanese men and women were 50 and 54 respectively in 1947. Today it is 78 for men and 85 for women. If UN definition of an 'Aging Society' and 'Aged Society' is applied, Japan passed the level of the former in 1970 when the aged accounted for 7.07 percent of total population. And in less than a quarter of a century, it has become an 'Aging Society' where more than 14 percent of the population is over 65.

The speed of aging varies widely according to countries. It took 82 years for Sweden and 114 years for France to achieve the 'Aged Society' threshold. The United States became an Aging Society in 1940s and still remains there with senior

citizens comprising 12.3 percent of the population. The problem caused by the aging is more serious and difficult to conquer when the aging speed is so fast. The government has no time to lose in taking necessary actions.

### Public Policies

This rapid demographic change contrasted with the slowness of the Japanese government in taking action. While most other nations facing the same aging problem have swiftly taken various measures in order to stop or slower the aging pace of its population, the Japanese government began to take action only after it saw the shocking fertility rate of 1.57\* in 1989.

In comparative NIPSS studies, Japan lags behind other industrialized countries in terms of government-supported child care facilities, the amount of children's allowances paid, the utilization rate of child-care leave, and the proportion of benefits paid to the elderly and non-elderly.

### The Effect of the Population Aging to the Japanese Economy

Japan's declining and aging population will force it to reflect deeply on the two thorny problems. First is the core question of economic growth, as shown in

Figure 2. Economic growth rate can be calculated by multiplying the rate of productivity increase per capita by the population growth rate. The miraculous economic growth after the World War II period in Japan was largely due to the expansion of population. This effect has been apparently diminishing in recent years and will continue to do so over the next 50 years. In theory, it is still possible for the economy to grow under the pressure of shrinking population – policymakers have only to pursue as much productivity growth to compensate for the potential growth lost in the population. In reality, however, achieving this goal as the working-age population decreases by 40 percent in only 50 years is ambitious.

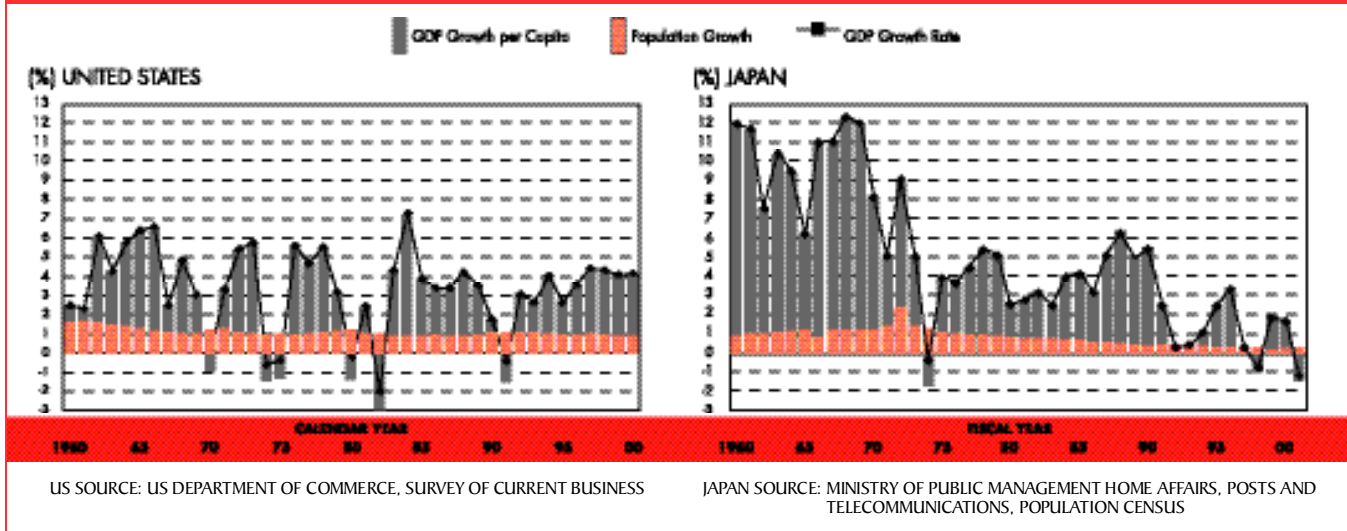
The United States still enjoys a notable population growth, which contributes between one-third to one-quarter of annual GDP growth. According to the United Nations' 'World Population Prospects of 2000' report, the US population will

*\*NOTE: This number is significant because it fell short of the historical low of 1.58 of 1966. The year is very particular because, according to the Chinese calendar, every 60 years falls a mythological period in which girls are believed to grow up to be quarrelsome and will have difficulty finding a spouse. As a result, many people refrain from having babies that year.*

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## ECONOMIC GROWTH AND POPULATION



double in the coming 50 years, to some 400 million people, almost four times as large as that of Japan.

The second core question is the impact of demographics on social security and fiscal problems. According to Japan's Ministry of Health, Labor and Welfare, if necessary reforms cannot be achieved, the premium rate for employees' public pension plan is expected to rise as high as 25 percent on annual income basis in 2025 compared to 14 percent today. The Potential National Burden Ratio (Proportion of Taxes, Social Security Contributions, Fiscal Deficit as a percentage of NI) which now stands at 46.9 percent, is expected to soar as high as an unsustainable 80 percent in 2050, according to a

simulation made by our institute a few years ago.

### Policy Implications

Population experts agree that the Japanese level of TFR is extremely low and that Japan should swiftly take some action toward this difficult problem. But if other nations' experiences are valid, slowing the pace of Japan's aging society will take great scale of operation and certain amount of time for policy reforms to take effect. There's no time to lose.

In order to minimize the negative impact of the structural change in the demography, policies should be concentrated in two pillars:

First, reallocation of the national budget. Disproportionate fiscal emphasis put on the side of the

aged should be revised and family policies should be promoted to a national project level as well.

Second, efforts should be made to expand the potential labor force by attracting women and healthy aged persons into the workforce. In tandem, efforts should be undertaken to encourage women to have larger families. In order to do so, the government should not hesitate to correct the customs and socioeconomic systems that hinder women's labor participation. Realization of a truly gender-equal society would be the ultimate goal for Japan. ■

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# American Business in Japan, 1990-2002

by Glen S. Fukushima, Cadence Design Systems, Japan

The U.S.-Japan Business Conference, which held its 39th annual meeting in Tokyo, October 20–22, has been an interesting barometer of the changes in the U.S.-Japan economic relationship that have occurred over the past decade.

When I attended my first Business Conference 12 years ago, I had just joined AT&T after nearly five years at the Office of the United States Trade Representative (USTR). That 27th Conference, held in Osaka in July 1990, came immediately after the Bush Administration and the Kaifu Cabinet had reached a settlement on the Structural Impediments Initiative (SII), in which Japan agreed to undertake reform in six areas: distribution system, land use policy, infrastructure investment, *keiretsu*, exclusionary business practices, and the differential in pricing of products sold domestically and abroad. The Bush Administration had pursued SII in 1989 and 1990 largely in response to pressures from the U.S. Congress expressed in the form of the Trade Act of 1988 and its Super 301 provision.

## Market Access Issues

Despite the numerous trade agreements concluded between the

two governments in the 1980s and early 1990s, problems of market access and trade imbalances persisted. This was reflected in the many complaints voiced by American executives at the Business Conference over such issues as automobiles, auto parts, semiconductors, supercomputers, flat glass, photographic film, insurance, financial services, etc. Many of these issues attained even greater prominence as a result of the U.S.-Japan Framework Talks agreed to between President Clinton and Prime Minister Miyazawa immediately after the G-7 Summit in Tokyo in July 1993.

But a significant shift occurred seven years ago. On June 28, 1995, the United States and Japan reached a settlement in Geneva on the contentious issues of autos and auto parts. And the Clinton Administration began to shift its attention away from U.S.-Japan economic matters to bilateral security cooperation. This stemmed from several factors, among them the concerns about North Korea's nuclear development that surfaced in the spring of 1994, the rape of a 12-year-old Okinawan girl by three U.S. servicemen in September of 1995, and the tensions between China and Taiwan in the spring of 1996.

In the meantime, the Japanese economy had entered a period of stagnation in the aftermath of the bursting of the bubble in the early 1990s. This had several implications. First, by the mid-1990s, Japan was no longer seen by Americans as the feared economic rival symbolized by the title of Ezra Vogel's 1979 book, *Japan As Number One: Lessons for America*. Second, the slow-growth Japanese market was seen to be less attractive than in the past. Third, by contrast, the "BEMs" (big emerging markets) of East Asia—China, India, Indonesia, and South Korea—were seen to offer major growth potential for U.S. exports and investment. Fourth, partly due to yen appreciation, Japan's trade surplus with the United States had declined. And finally, the more than 30 bilateral trade agreements concluded with Japan during the first Clinton Administration were seen by the U.S. Congress, business, and mass media as proof that most major bilateral trade problems had been resolved.

At the same time, by 1995 the U.S. economy was in full recovery. The prosperity of the United States over the next five years was unprecedented—strong economic growth (attaining a high of 7.3

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## American Business in Japan, 1990-2002

percent in the fourth quarter of 1999), high stock market prices (despite periodic fluctuations), the lowest unemployment rate in over 30 years (hitting a low of 3.9 percent in certain months), and low inflation (although partly due to massive imports).

### Shift in Attitudes

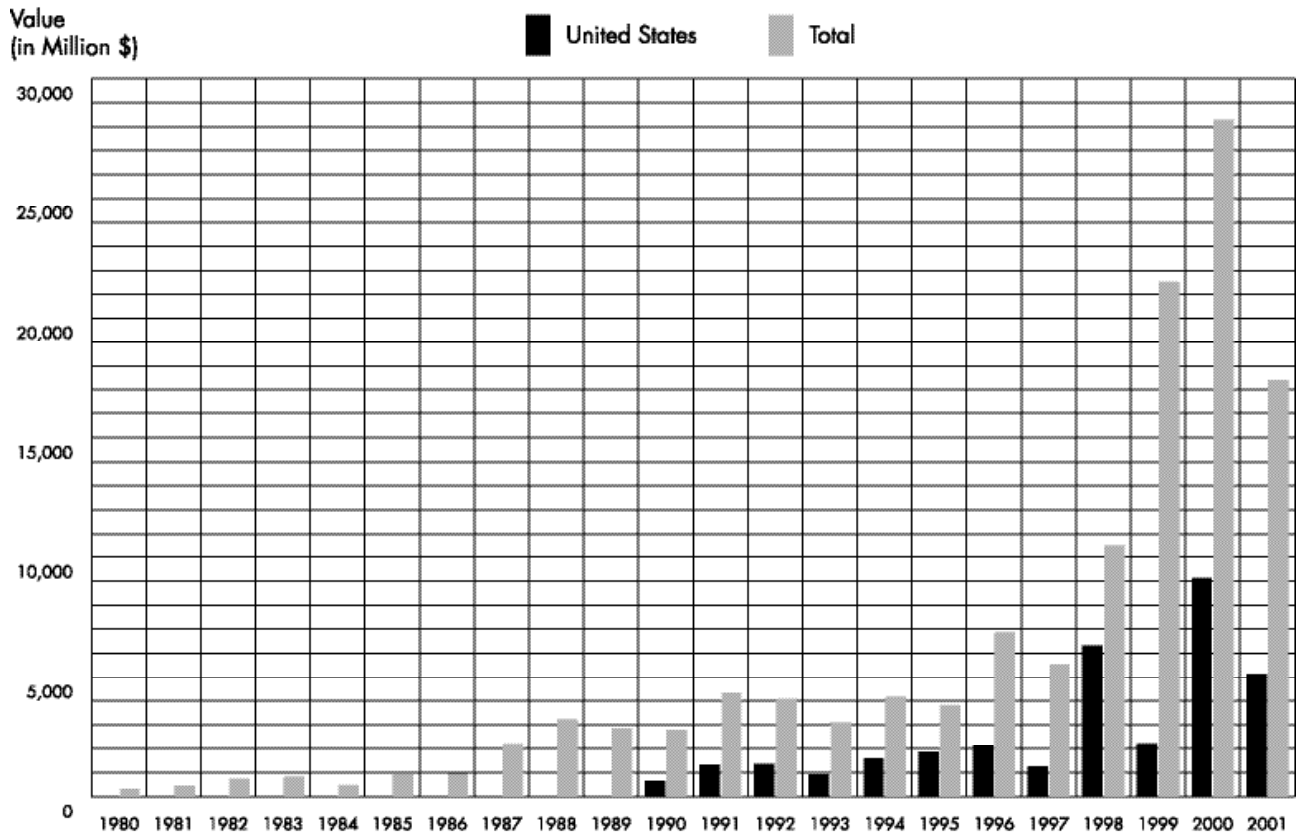
These changes in the economies of the two countries brought about a shift in the attitudes of the two business communities

unimaginable 10 years ago. In recent meetings of the bilateral Business Conference, Japanese executives have had difficulty persuading their skeptical American counterparts that Japan is now truly on a course toward economic recovery. On the other hand, Americans reporting on their country's political and economic climate have been optimistic to a point unthinkable 10 years ago.

With this backdrop, the Business Conference in recent years has

become less of a forum for debates and complaints (although these have not completely faded from the scene) and more of an opportunity to share ideas, learn from each other's experiences, and find common areas for potential cooperation. The joint statement from a recent meeting, for example, listed 16 areas where the two business communities can work together, including promoting structural reform and deregulation, renegotiating the U.S.-Japan Tax

### FOREIGN DIRECT INVESTMENT (FDI) IN JAPAN ON FLOW BASIS



SOURCE: MINISTRY OF FINANCE, INTERNATIONAL BUREAU, RESEARCH DIVISION; US DATA OF FDI IN JAPAN IS AVAILABLE AFTER 1990.

Treaty, enhancing competition in telecommunications, encouraging reform in pensions and financial services, advancing e-commerce and cyber security, and preventing credit card fraud.

### Elements of change

What are the major factors behind this transformation over the past decade? First, the nationality of capital continues to decline in importance, at least for American executives. With the globalization

of business over the past decade, even in Japan, the rise in foreign direct investment, including mergers and acquisitions, has made it increasingly difficult to draw clear lines between purely “American” and purely “Japanese” companies. The impressive growth in foreign direct investment into Japan is indicated in the attached chart.

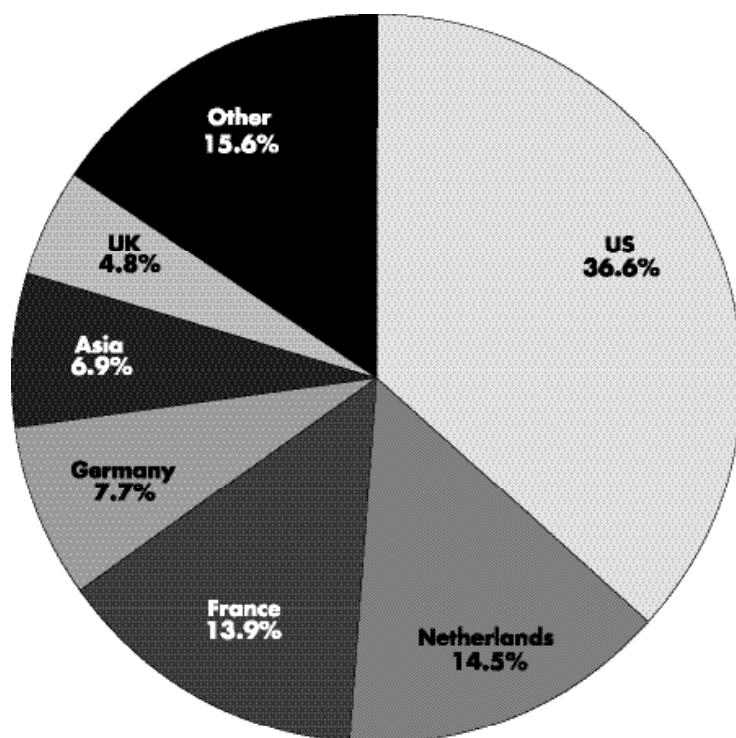
Second, and related to this, the globalization of the work force means that there is much less of an identity between the nationality of a

company, the nationality of its employees, and the geographic location of business activity. So, for instance, one of the most closely watched business executives currently working in Japan, Nissan’s CEO Carlos Ghosn, is a Brazilian national of Lebanese ancestry educated in France and running a Japanese-French automobile company in Japan.

Third, the role of the government in the economy continues to decline and the private sector is increasingly taking the lead even in establishing certain regulatory regimes, as in e-commerce. The events of September 11, 2001, have reminded the world of the importance of government in providing for safety and security and in combating terrorism. But the importance of government in setting the framework of U.S.-Japan economic activity has declined dramatically over the past decade.

Fourth, the strengthening of multilateral economic institutions—especially the World Trade Organization (WTO)—has shifted attention away from bilateral dispute resolution to multilateral forums and procedures for the resolution of economic disputes. For U.S.-Japan trade conflicts, a turning point came with the Kodak-Fuji film case of

**FOREIGN DIRECT INVESTMENTS IN JAPAN IN 2001 ON STOCK BASIS  
(SHARES PER COUNTRY)**



SOURCE: BOJ, BALANCE OF PAYMENTS, INTERNATIONAL INVESTMENT POSITION OF JAPAN, REGIONAL DIRECT INVESTMENT POSITION END OF 2001 (LIABILITIES), 1996–2000  
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the early 1990s, where a dispute that a decade ago would have been dealt with bilaterally, was resolved in the WTO.

Fifth, the growth of the U.S. services economy is reflected in the American business community in Japan. There is far greater representation than in the past by firms engaged in professional services—banking, insurance, securities, consulting, information and telecommunications, etc.—in contrast to traditional manufacturing.

Sixth, the opening of China over the past decade to trade and investment and its joining the WTO have posed new opportunities and challenges for the United States and Japan, many of them shared by the two countries.

Finally, globalization has posed other issues that must be dealt with by both Japanese and American companies—including those related to structural, regulatory, tax, workforce, education, telecommunications, financial, and environmental issues. Corporate governance is another issue in which the two countries can benefit from each other's experience. This has opened the way for greater

trans-Pacific dialogue, sharing, and collaboration.

### Prospects

Given the tremendous changes in the U.S.-Japan relationship over the past decade, it is hazardous to predict how the relationship will look a decade from now.

However, the relationship over time is likely to evince the 18 trends of greater maturity, equality, balance, stability, independence, interdependence, cooperation, diversity, breadth, localism, multilateralism, complexity, closeness, frankness, specialization, learning, harmonization, and deepening.

Some of these trends may appear on first glance to be contradictory, but this reflects the increasingly complex and multidimensional nature of the relationship between the world's two largest economic powers. It also points to the need to manage the relationship effectively to maximize the benefits and minimize the liabilities to both countries. ■

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