The Graying of the Japanese Economy

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Charles Davidson: Welcome to another Federal Reserve Bank of Atlanta podcast. This particular interview is part of the Atlanta Fed's 2015 annual report, which is entitled "The Graying of the American Economy." The report explores the economic implications of an aging population, and there are few better examples of those dynamics in the world today than Japan. So we are hugely pleased and honored to be joined by Masaaki Shirakawa. Professor Shirakawa was the 30th governor of the Bank of Japan, which is of course Japan's central bank. He led the Bank of Japan for five years, through March 2013. Today, he's a professor of international economics at Aoyama Gakuin University, and today we are going to discuss the profound economic effects of the aging of Japan's population. Professor Shirakawa, thank you so much for joining us today.

We're also joined by Toni Braun, one of our research economists. Toni is an expert on aging and the economic implications of aging. Toni has spent considerable time and energy researching Japan's economy as well. Toni, thank you for your time as well.

Toni Braun: It's a pleasure to be here, thanks.

Davidson: Well, let's get going. Professor Shirakawa, populations in most of the developed world, as we know, are aging, including here in the U.S., but Japan has aged particularly quickly. As recently as 1990, I believe, about 12 percent of Japan's population was 65 or older, which at that point made Japan the youngest of the group of six large developed nations. Yet, just 15 years later, people 65 and older made up 20 percent of Japan's population. That number is higher today, which makes Japan the nation with the oldest population of the group of six. Japan's working-age population is actually declining, so it appears the population will continue to age rapidly. What has caused such rapid aging in Japan, Professor Shirakawa?

Professor Shirakawa: Rapid aging is basically a product of lower fertility rate and longer longevity. Both trends are more or less common across many industrial countries. The issue which you raise, "Why is aging in Japan so rapid?"—I would point to four possible explanations.

First, Japan's post-War baby boom was very strong but very short in international comparison. The second, Japan's post-War economic growth was so rapid. As income levels goes up, people tend to have fewer children, to the extent that Japan's growth rate was so rapid [that] over time we have a lower fertility rate.
Davidson: Interesting. This kind of fundamental demographic shift surely has serious economic effects. Are there sectors of the economy that can actually benefit from an older population?

Professor Shirakawa: Of course. There are sectors benefiting from rapid aging. Case in point is medical services and caring services. For aged people who are still healthy, enjoying retirement life is a high priority. Tourism, sports clubs, and restaurants are also benefiting from rapid aging. On top of that, many companies are competing to offer solutions to rapid aging by utilizing technology. A case in point is robotics, in which Japanese companies have a competitive advantage.

Davidson: Let’s turn to the challenges. For example, could aging play a role in Japan’s slow economic growth or even the weak performance of certain sectors such as financial markets and real estate?

Professor Shirakawa: The demographics affect the Japanese economy and society in a profound manner. In terms of the impact of the demographics on growth, in answering your question, I would like to [ask] one [question]: which G7 country recorded the highest growth of GDP [gross domestic product] per working age population in the past 5 years, past 10 years, and past 15 years?

Davidson: I happen to know the answer to that: it’s Japan!

Professor Shirakawa: Yes, the answer is Japan. However, as for GDP growth, Japan is among the lowest. The reason for this gap is simply that the working age population is now declining rapidly. In the stock market, as a whole, pricing is not based on per capita or per capita of working age population, but an average number such as GDP or corporate profit.

Real estate prices are also affected by demographics. Interestingly, the peak of real estate prices often coincides with the peak of the ratio of the working-age population to the total population. This is understandable because the working-age population demands housing. Therefore, the peak of the baby-boomer generation coincide with the peak of real estate prices. Eventually, the behavior of real estate prices affects the financial system. Also, as I said and these examples show, demographics affect the economy and the financial markets.

Davidson: Well, that’s a really powerful illustration of what we’re talking about here, the notion that the GDP per working age person has actually been growing quite nicely. What about the fiscal challenges posed by a graying population? Of course we face those here in the States as well.

Professor Shirakawa: Demographics also pose serious fiscal challenges. As you know, Japan is running a big fiscal deficit and debt-GDP ratio is quite high. Basically, the deficit is due to increased spending on public programs: pensions, medical services, and caring services, which is reflecting rapid aging. So, rapid aging affects the fiscal position. But to be more precise, what is important is not rapid aging per se, but adaptability of society to the changing demographics. In this regard, Japan is a bit delayed in changing ourselves to this changing reality of demographics.

Davidson: Interesting point. You’ve observed also that in Japan, amongst policymakers and academics—and I suspect this applies in the states and other countries as well—but people have been generally slow to appreciate the profound influence of demographics. Why do you think that is?

Professor Shirakawa: Although people have come to realize demographics are important, compared with some years ago, it is still underappreciated. People intuitively understand that the demographic issue is quite important. But at the same time, people know this problem is so intractable. Also, it still takes time for the full impact of demographics to be materialized. So, understandably, people do not want to face up to the reality.

On top of that, the argument of deflation sometimes diverts people’s attention from the most important issue, and that is demographics. Deflation is often referred to as an easy explanation for Japan’s low growth. But I do not think this is the root cause of the problem.

Davidson: So you’re saying that in some cases, perhaps people have thought that deflation was more of a root cause of some of the issues in Japan’s economy, when in reality, it was really demographics?

Professor Shirakawa: I don’t think that demographics is the single factor for deflation. What people are worrying about, under the name deflation, is something different from deflation in the narrow sense. What people are worrying about are broader issues. If we analyze the situation in such a manner, then we have to address the issue directly.

Davidson: Right, right. Very good. So what about policy recommendations. Do you have any concerning how Japan might address these issues?

Professor Shirakawa: Your question is about Japan, or is it about possible lessons for other countries?

Davidson: I guess we can take both of those actually, and I’d like to ask Toni to weigh in on that as well.

Braun: Yeah, certainly one alternative that’s been discussed in Japan, as well as the United States, is moving from a pay-as-you-go social security system to one that’s defined contribution. So, an example of defined contribution in the United States would be 401(k) plans. In the United States, the 401(k) plans are associated with your employer, but you could imagine a social insurance arrangement where there is money withheld from your account, and that money is your money, but it’s earmarked for your own personal retirement. These types of programs are fairer in the economy where we have a large fraction of retirees. Under the current U.S. system and Japanese system, workers are financing the benefits of current retirees, and if you have a lot of retirees, then the load on workers can be quite substantial.

Professor Shirakawa: Toni mentioned about the importance of a funded system. I totally agree with the importance of a funded system. Given very diverse demographics, to maintain a "pay-as-you-go" is not that easy. But already this system is incorporated into our system, and to change a system is quite difficult in a democratic society. A society should quickly adjust itself to a changing reality. Once the society goes beyond a certain point of aging it is rather difficult.

Braun: So "agers" vote more than young people, so it’s hard to push through policies that require maybe fewer benefits for retirees.

Davidson: Toni, can you explain what you mean, when you say a "pay-as-you-go" system?
Braun: Yes, a "pay-as-you-go" system is an example of what we have in the United States. We have a trust fund, so current contributions by workers fund, primarily, benefits for retirees and also the trust fund. Now, if we look at the projections for the United States from the CBO—the Congressional Budget Office—they're showing that the trust fund resources will be exhausted in about the next 15 years. Under current U.S. law, what that means is at that point, contributions—in terms of payroll taxes of workers—will fund one-for-one benefits. It looks like right now, that could mean a significant cut in benefits, as much as 30 percent.

So, it's not a time bomb that's going to blow up today. It's kind of a slow-moving time bomb, but it is a time bomb that, as we've seen in Japan, as the fraction of retirees gets larger, it become more and more difficult to undertake significant changes in social security.

Davidson: Right. I want to throw out one more point here. It sounds like the transition is really the difficult part involved here if we move to our "pay-as-you-go" system to some other system. The devil is in the details of how you get there, basically. Is that right?

Braun: Yes, that's absolutely right because if we moved instantly to a fully funded system, you have the current retirees, and how do you provide for them? Their benefits are funded by current workers and if you instantly went to fully funded, then how do you finance their retirement? So, you would need some way of compensating the current retirees as you transition to a fully funded system.

Professor Shirakawa: I agree with what you said. You allowed me to say something about the demographic scene in the U.S. I would say the most important lesson to be learned from Japan's experience is people should not be dismissive of the argument about demographics. Thirty years ago, Japan was already starting a discussion about demographics. At that time, I was quite dismissive of the argument by alarmists; in retrospect, I was wrong. Gradually, I have come to realize that the demographic issue is quite important. Based on my past experiences and conversations with policymakers in other parts of the world, they are generally discerning about demographics.

Davidson: So people are starting to take it more seriously and appreciate just how powerful these forces are?

Braun: Well, we're hoping that as part of this annual report, people will become more informed and perhaps become somewhat less sanguine in the United States as well.

Davidson: Professor Shirakawa, Toni, thank you both so much for your time. It's been, I think an enlightening and interesting discussion. Thank you very much.

Professor Shirakawa: Thank you very much.

Braun: Thank you.

Davidson: Thanks, everybody, for listening, and while you're here, please explore the rest of our annual report, which will include two subsequent parts. The second part of the report, which will be online in late April, will examine the effects of aging on the nation's labor market. Finally, in late May, we will post a look at aging and GDP growth. Don't forget to listen for our other podcasts here at fbatlanta.org. Thanks very much.

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