



The Labor Shortage in Japan's Economy

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The labor shortage that has rapidly emerged is not a simple business issue but a significant challenge for Japan's economy to address for years to come.

Tightening job market

The areas affected by the labor shortage appear to be increasing. We often see reports stating, “A construction company went out of business because it could not get enough workers,” “Public spending is delayed because of labor shortages,” “The operations of a restaurant chain, which had relied on part-time workers to expand its business, had to be cancelled,” and “Payment conditions for workers such as contract employees and part-timers are improving.”

Let us confirm the data. The job market has improved rapidly amid the continued economic expansion since November 2011. The ratio of job openings to applications, which stood at 0.82 in November 2011, improved to 1.10 in July of this year, which is the highest it has been in the twenty-two years since June 1992. The unemployment rate, which was 4.1% in November 2012, stood at 3.8% in June this year. It dropped to 3.5% in May, but increased slightly as of the most recent date. It is assumed that women who had previously remained at home have started to look for part-time jobs thanks to the improved business conditions, which, if nothing else, appears to indicate an improvement in the job market.

These changes in the job market are gradually producing adverse effects on Japan's economy. First of all, as mentioned above, the most recent effective



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opening-to-application ratio stood at 1.10. The ratio of job openings to applications is provided by the number of job applications (the numerator) divided by the number of job openings (the denominator). A ratio in excess of 1 therefore means that the number of jobs available surpassed the number of people who are seeking jobs. In other words, Japan has fallen into a situation of a labor shortage where there ceased to be a balanced situation between supply and demand.

This is also how companies have started to look at the situation and make decisions about it. According to the Bank of Japan's national economic survey of companies, the number of companies that responded that they are suffering from a shortage of employees has been larger than the number of companies that responded that they are overstaffed since March of this year, whether they are large, medium, or small companies. The most recent survey conducted in June reports that the labor shortage in small and medium companies has reached the highest level since the economic bubble burst.

The decrease in the labor force will continue in the future

We wonder how the labor shortage will progress going forward. To make an assessment of this issue, we need to understand the background of the sudden labor shortage.

Let's take a look at the relationship between demographics and the labor force. Japan's working-age population, which peaked at 87.3 million in 1995, continued to decrease consistently and stood at 79 million in 2013 (as of October 1). In parallel with this decrease, the labor force continued to drop from a peak of 67.93 million in 1998 to 65.77 million in 2013: a decrease of 2.16 million in fifteen years.

Despite this decrease in the labor force, no labor shortage was actually observed. On the contrary, the deteriorating employment situation was regarded as an issue of greater concern. This is because the demand for labor fell even more, reflecting the economic situation at the time, although there was a decrease in the supply of labor due to population factors. That is to say, the latent causes of the shortage in the labor force, while they did not become apparent, continued to flow as undercurrents and gradually gained momentum, making the ceiling of the labor force, or the demand, lower and lower.

No sooner had the economy turned for the better with an increase in the demand for labor, than Japan's economy had to address a reaction to the lowered ceiling of the labor force. This is the reason for the sudden labor shortage.

This labor shortage trend is our future. The working-age population will decrease further, from 67.73 million in 2030 to 44.18 million in 2060 (according to the National Institute of Population and Social Security Research, based on the average number of births and deaths). Based on this assumption, it is estimated that the labor force will drop significantly, despite efforts to enhance the labor force participation rate of women and

the elderly to some extent. Having said that, it is not that easy to envision the future of the labor force, because we need to factor in the prospects of future labor forces according to age and gender.

A report was produced by Kuwahara Susumu, the principal economist at the Japan Center for Economic Research, who estimated the labor force ratios in 2030 and 2060 based on the data. The report shows that the labor force is projected to decrease from 65.77 million in 2013 to 59.54 million in 2030 and 40.17 million in 2060, even reflecting a certain increase in the labor participation rate and the effects of government policies. The annual rate of decrease for the period from 2013 to 2030 will be 0.6% on average, and it is expected to accelerate to 1.3% during the period from 2030 to 2060. It is reasonable to consider that the labor shortage will intensify on a long-term basis in the future, unless the economy stagnates and the demand for labor remains extremely weak.

The meaning of eliminating the supply-demand gap

It is important to pay attention to the narrowing of the supply-demand gap as the labor shortage becomes more and more apparent. The supply-demand gap is an index that shows the strength of actual demand vis-à-vis the potential production capability of Japan's economy, estimated from the supply capability.

According to the calculation published by the Cabinet Office, the supply-demand gap for the period from January to March 2014 narrowed to minus 0.3% (excess supply). Given the significantly negative economic growth for the April to June period, the gap widened to minus 2.2%. However, considering the possible “rebound of the rebounded economy” in the July to September period, the supply-demand gap must have reduced again, and if solid growth continues, it will move into the positive area (short supply).

This shows that Japan's entire economy is undergoing a sea change from a demand shortage situation to a supply shortage situation. To adapt to this significant change in the situation, we need to reconsider the basic direction of economic policies. In other words, the country has been in a situation of a demand shortage, with economic policies focused on increasing demand. Both the drastic monetary stimulus, the first arrow of Abenomics, and the increase in public spending, its second arrow, were economic policies in the age of a demand shortage in the sense that the goal was to create demand. Going forward, however, it is important to enhance the supply capability. That is what the growth strategy, the third arrow of Abenomics, is driving at. From now on, we must work on the economic policies under the constrained supply.

It is also important to consider the settlement, or an exit strategy, of the demand stimulus measures that have been taken to date. There are two types of exits: one for financial policies, and the other for fiscal policies. In terms of financial policies, the major



challenge is how we can return to a normal situation from a condition of drastic monetary easing, while in terms of fiscal policies, we are faced with the equally challenging issue of fixing the budget deficit that ballooned as a result of lavish public investments.

Going forward, our economy will face a more serious labor shortage, which will manifest the changes in aspects of Japan's economy as a whole. The Japanese government, while keeping this reality in mind, must change its stance in terms of its economic policies.

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Born in 1947. Graduated from the University of Tokyo and joined the Economic Planning Agency (currently the Cabinet Office), Japanese Government. Served as Director General of the Research Bureau at the Agency and Director General of the National and Regional Planning Bureau at the Ministry of Land, Infrastructure, Transport and Tourism. Has served as Professor at Hosei University since 2003.

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