



## Excessive Pessimism about the Shrinking Society

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Since the collapse of the bubble economy in 1991, the Japanese economy has remained stagnant for an unprecedented length of time. Initially, economists from various countries regarded this long-term stagnation as economic deceleration that was happening only in Japan due in part to poor policy responses. However, the financial crisis triggered by the Lehman Brothers' collapse in 2008 involving Europe and the United States and the slowdown in the economic growth of various countries have led to the rise of the so-called **secular stagnation** theory, which argues that long-term stagnation is not exclusively a problem of Japan, but a structural slowdown in growth of the overall advanced economies. Factors such as the falling birthrate and the aging population demographic change and dwindling investment opportunities are regarded as common factors. However, discussions in Japan are excessively pessimistic. This has created a vicious circle, in which companies are discouraged from making investments and consumer confidence is eroded, leading to further economic slowdown.



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Of course, the changing demographics, the prime basis of the pessimism in Japan — that is the falling birthrate and the aging population — is occurring most rapidly, and therefore is the most serious in the world. Nevertheless, the recent pessimism is believed to be excessive. Yoshikawa Hiroshi warns us about such excessive pessimism and is developing an argument to eliminate the population-decline pessimism. *Jinko to Nihon keizai* (Population and the Japanese Economy), Mr. Yoshikawa's 2016 book, casts a ray of light on Japanese society surrounded by a depressing atmosphere from the rapidly progressing decline in birthrate and the aging population. This book has become a bestseller.

As Yoshikawa points out, his argument is not simple optimism. He argues that the population problem — above all, the parallel progress of the population decline and the aging population — is the greatest problem for Japan in the twenty-first century. He warns us against excessive optimism, too.

Debates about population problems involve confusion over short-term problems and long-term problems. Population problems remind me of the insights of Peter F. Drucker, a great twenty-first century intellectual who passed away in 2005 at the age of 95. He taught at a university until eight months before his passing. He literally remained active throughout his life. The basis of his insights into the times was his deep thoughts about population problems.

Let me share one episode. All of Drucker's books, except one, immediately became worldwide bestsellers after they were published. The only book that did not become a bestseller was *The Unseen Revolution: How Pension Fund Socialism Came to America*, which was published in 1976. This book discusses the aging population in the United States. In those days, however, society in the United States was called a youth society and the color of the times was not *gray* but *green*. The book that became a bestseller instead of Drucker's was *Greening of America* by Charles Reich. Fifteen years later, however, those young people became middle-aged, and issues about the aging population began to be debated in the United States as well. Subsequently, Drucker's above-mentioned book, which discusses the aging population, suddenly began to sell well.

The number of people who are aged 65 now was determined sixty-five years ago. If one million babies are born this year, the number of people aged 20 will also be one million twenty years from now. Even if the birthrate rises significantly this year, those babies will join the labor force in fifteen or twenty years from now.

From this perspective, the aging population in Japan could have been predicted a long time ago as a matter of course. Population decline resulting from the falling birthrate was also predicted.

Nevertheless, this fact was mostly ignored and the measures which need to be taken in response to the changing demographics, such as institutional reform and changes in business strategies, have not been implemented. The awareness of these problems coincided with the problem of economic slowdown from the 1990s onward, especially from 1998 when the persistent deflation began. This led to the argument that both the economic slowdown and the persistent deflation were attributed mainly to the population problem. Actually, both the falling birthrate and the aging population had been in progress before the bubble economy that preceded the economic slowdown.

With regard to long-term economic development, *growth accounting* has been discussed. It is an identical equation which shows the growth capability of an economy with a focus on the supply side.

The idea is that the economic growth rate ( $\Delta Y/Y$ ) is equal to the sum of the degree of contribution of increase in the inputs of capital ( $\Delta K/K$ ), that of increase in the labor force ( $\Delta L/L$ ), and that of the growth of total-factor productivity (TFP). This means  $\Delta Y/Y = \Delta K/K + \Delta L/L + \text{TFP}$ .

In this equation, population decline is a problem because it leads to a decrease in the labor force on the right side. If the other elements — inputs of capital and productivity — remain unchanged, the decrease in the labor force leads automatically to a decline in the economic growth rate on the left side, according to this equation. This is the source of the population-decline pessimism. Moreover, if the population ages, senior citizens will spend more of their savings, resulting in a decrease in savings as resources for investment. This will decrease the inputs of capital, which will also push down the growth rate. In addition, a decrease in investments will result in a slowdown in productivity growth, which will further lower the growth rate. This argument led to the pessimism attributed to the population decline, falling birthrate, and aging of population.

However, such pessimism is only generated when the economy is closed and systems including the employment system remain unchanged. There are various ways to overcome this. One way is to change the mandatory retirement age, which is currently about 60 to 63. The productive age is defined as 15 to 64 at present. However, if healthy, motivated people are allowed to work even at 70 or 75 years

old, the labor force will increase significantly. A rise in the rate of the employment of women will also increase the labor force.

Japan is one of world's top countries in terms of longevity. The mandatory retirement age in Japan is youngest among developed countries, although the average lifespan in the country is longest in the world. This is one of Japan's greatest contradictions as the world's longest-living country. As for capital, an increase in direct investment from overseas, as well as domestic investment, will lead to an increase in the inputs of capital and raise the economic growth rate. In addition, TFP as the comprehensive productivity will be boosted if companies enhance their research and development efforts and increase their investments in people (human resource development). If this occurs, increasing hope for the future of the economy, the young generations will have dreams for the future. This will consequently halt the declining birthrate.

If the elderly population increases without a significant extension of the retirement age, the burden on the working generation will only increase. Young people will not have dreams for the future, will delay marriage, and won't have children. Yoshikawa emphasizes that innovation is a greater growth promotion factor than population. I think he is right.

Let's also examine the population-decline pessimism in relation to demand. It's true that a decline in the overall population is likely to result in a decline in demand. However, the domestic market is not the only market. Growing economies, including ones in Asia, can be regarded as markets.

The aging population means that the focus of the market (demand) shifts to the older generation. At the moment, companies have yet to respond fully to needs of the senior market.

When Drucker came to Japan in the mid-1980s, I discussed the population problem with him. He said, "In the first half of the twenty-first century, Japan will have three extremely advantageous development factors. All of them start with 'E.' They are Energy, Environment, and Elderly, or senior citizens." He continued, "While Japan is at the forefront of aging, many other countries will follow. Japan will be the first to reach the peak of aging, so the country will be forced to be the first to respond to the situation by producing, one after another, what will be demanded in an aged society, including systems and customs such as employment and healthcare, as well as products, services, and technologies. The countries that follow Japan and reach the peak of aging one after another will be markets with a demand for products, services, and systems that were developed by Japan first. Looking back on Japan's history, it implemented reforms during the Meiji Restoration and successfully overcame crises such as the economic crisis after its defeat in World War II, the oil crisis, pollution and the environmental crisis, and even the strong yen after the Plaza Accord. The two E's, or the environment and energy, will form the basis of the world values in the twenty-first century, and in this respect, Japan will be able to take advantage of its past achievements and capabilities. Regarding the elderly as the last E, Japan will address this issue by looking squarely to it because it cannot turn its back.

### **Take aging as a chance and take on new challenges, instead of only being negative about it**

If we are only negative about aging, it will remain impossible to put a brake on the declining birthrate,

worrying about the collapse of the pension system or the nursing care system, which only results in an increased burden on younger generations. This will only accelerate the population decline and increase the proportion of senior citizens in the shrinking population.

It is true that the total population of Japan began to decline after reaching its peak around 2010, and the population of productive age had begun to decline rapidly as early as ten years before. However, the average life span is close to 90 and the number of senior citizens who are healthy and highly motivated to work has been growing recently. It is therefore anachronistic to regard people aged 65 or older automatically and institutionally as the elderly. The life of Drucker, who remained active until the age of 95, serves as a model. In the United States, the Age Discrimination in Employment Act of 1967 was established to prohibit age discrimination in employment. The demographics in Japan have changed more dramatically than in any other country. Nevertheless, those systems and practices that were introduced when the average life span was around 50 years have remained almost unrevised. Japan has been facing the declining birthrate, aging population, and population decline as a reality by accepting such out-of-date systems and practices as given conditions. This is how pessimism has become a major trend.

Population-fatalism is useless. We can never accept simple optimism but as long as we are only pessimistic, we cannot solve anything. Pessimism is also defeatism. It only creates excuses for not doing what we should.

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Born in 1942. Graduated from Waseda University and joined the Nihon keizai shimbun (Nikkei) newspaper. Served as Managing Director and Chief Editorialist of the Nikkei and Chairman of the Japan Center for Economic Research (JCER). He is presently a member of the Trilateral Commission; Vice-chairman for the Foundation Council, Japanese-German Center Berlin; Councilor of the Aspen Institute, Japan; and Chairman of the World Trade Center Tokyo. His publications include *A New Development Model for Japan: Selected Essays 2000–2008*, *Chosei no jidai* (An Era of Adjustment) and *Nihon no sentaku* (Japan's Choice). He earned the Vaughan-Ueda Prize in 1988 and the Japan Press Club Award in 1989.

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