Leverage Longer Lifespans to Boost Growth: Japan Center for Economic Research Medium-Term Economic Forecast — Build working-senior friendly society

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Points:

- **Japanese economic growth rate set to slow under present circumstances**
- **Lifetime consumption rising with longer lifespans and working careers**
- **Boost consumption tax to 15% to provide for greater job diversity**

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The Japanese economy continues to expand thanks to strong economies abroad. However, caution is still needed in assessing the medium-term economic outlook. In our Medium-Term Economic Forecast, we consider the relevant issues.

World economic growth rates are rising in the short term, led by developed countries. The International Monetary Fund (IMF) revised in January their forecast a high of 3.9% world economic growth rate for 2018. Hidden in the backside, however, are a number of downside factors, and we believe that rates will slow over the medium term.

The first factor is a structural one, namely the erosion of the United States potential growth rate, which gauges the long-term production capacity of the country. This has followed from such factors as the retirement wave of the baby boom generation and a decline in work enthusiasm on the part of the prime-working generation. In China, meanwhile, excessive debt in the private company sector has mounted, and the unwinding of associated impaired assets could tip China's economy into recession or even economic crisis.

There is also risk that the macroeconomic policies of developed countries may destabilize their economies. In monetary policy, meanwhile, the United States is expected to continue raising interest rates in stages, and the European Central Bank (ECB) has also begun to reduce the value of its asset purchases. The large tax cuts in the United States will increase the fiscal deficit. This policy is very likely to precipitate a series of similar hikes in other countries and chill equity and real estate markets. If other countries retaliate against rising U.S. tariffs, touching off a trade war, world trade will contract.

The issue for the Japanese economy over the medium to long term is that the population aging still remains. This will constrain growth from both the supply and demand sides. On the supply side, the shrinking working age population will push down the potential growth rate. On the demand side, business firms, foreseeing that domestic markets will shrink, have been hesitating to invest in facilities or personnel and are stepping up overseas investments. With no expectation of higher wages, households are also tightening consumption.

Under our Baseline Scenario, which anticipates no change in these trends for business firms and households, Japan's growth rate will gradually fall from about 1% in 2016 - 20 to around 0.5% throughout the 2020s (see table). The consumption tax rate will be raised to 10% in October 2019, but this will not be sufficient to make up for the rise in healthcare expenditures following from the rising elderly population. The combined national and local primary balance surplus as the government's goal is not realistic during the forecasting period to the year of 2030.

Forecast of Principal Economic Indicators (Annual average %)

	Fiscal Year	2011-15	2016-20	2021-25	2026-30
Baseline Scenario	Real Growth Rate	1.0	1.1	0.6	0.6
	Nominal Growth Rate	1.3	1.5	0.8	0.9
	Potential Growth Rate	0.7	1.0	0.6	0.5
	Labor Force Growth Rate	0.0	0.3	-0.4	-0.5
	National+Local Primary Bal. / nominal GDP	-2.9	-1.8	-2.0	-2.0
	National+Local Net Debt / nominal GDP	186.6	190.4	194.1	201.7
Reform Scenario	Real Growth Rate	1.0	1.2	1.4	1.7
	Nominal Growth Rate	1.3	1.6	1.9	2.4
	Potential Growth Rate	0.7	1.1	1.2	1.6
	Labor Force Growth Rate	0.0	0.3	0.2	0.4
	National+Local Primary Bal. / nominal GDP	-2.9	-2.0	-1.3	0.0
	National+Local Net Debt / nominal GDP	186.6	189.7	182.7	170.1

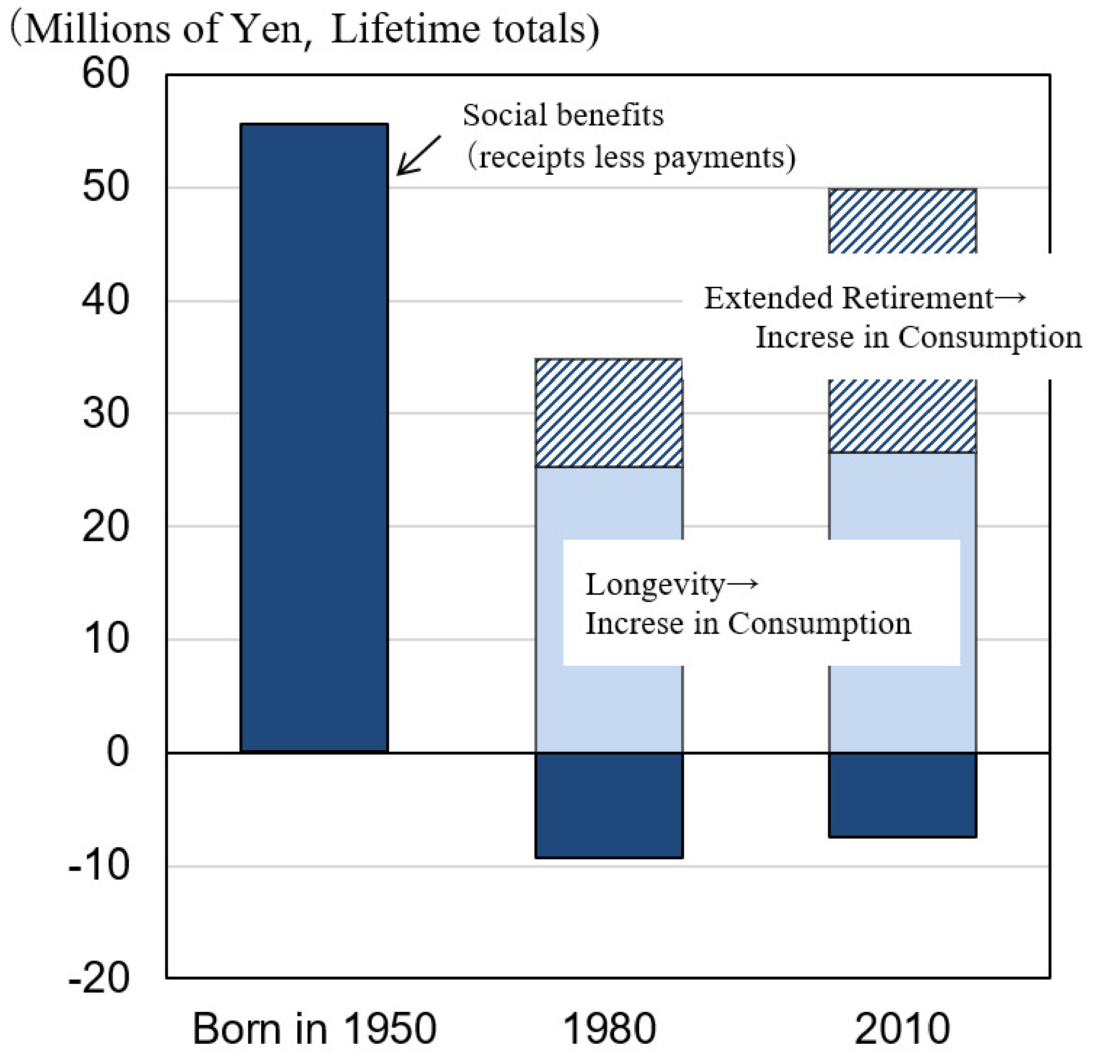
Note: National + local government figures represent year-end values.

Breaking out of this trend will require that the problem of societal ageing be turned into an opportunity. Over the past ten years, average lifespans for both men and women in Japan have lengthened by nearly two years. There has also been a steady increase in the lifetime during which people can live free from physical disability and obstructions to daily life. The Japan Gerontological Society has proposed that the definition of "elderly" be reviewed and the defining age be raised.

Given that lifespans are getting longer, we propose that policymakers take advantage of the steady increase in healthy lifespans by building a society in which seniors can continue working.

Specifically, we assume that institutions can be adopted by mid this century to bring the labor force participation rate for people in their seventies up to the present rate in their sixties, and that the age at which national pension payment begins be set at seventy-five. The figure below compares how this would impact three generational cohorts, namely the generation born in 1950 shortly after the end of the war, the generation born thirty years later in 1980, and the generation born thirty years after that in 2010.

The Effect of Longevity and Extended Retirement



Note: JCER Estimation. Deflated by 2011 prices.

Our findings show that later generations will work longer and enjoy more lifetime consumption, and since their consumption will increase to the extent they live longer, intergenerational inequities could potentially be corrected. The younger the generation, the longer lifespans will be relative to that of the generation born in 1950, so lifetime consumption will be larger for them as well. If later generations work ten years longer, their lifetime income will rise, which means they will enjoy that much more consumption. We estimate that the generation born in 2010, by living and working longer, will enjoy nearly 50 million yen in additional consumption.

The portion of the figure representing "Social benefits" shows the per-capita lifetime net balance of social security receipts less tax and social security premium payments. Although the 1950 generation enjoys a net surplus, the others have a net deficit, the youngest having the greatest. Observers often highlight this fact as an example of intergenerational inequity. However, with an increase in worker numbers and the consequent revenues from taxes and social security premiums, the medical and nursing care insurance premium burden for the younger generations would fall, increasing their disposable income. Moreover, to this is added the consumption they can enjoy from living and working longer, bringing them closer to the surplus in social insurance benefits received by the 1950 generation.

In reality, however, certain conditions will be necessary. First, the elderly must be encouraged to continue working. This will require that the old age pension for active workers as it exists now be scrapped. Under this system, when a pensionable worker's income reaches a certain level, the amount of pension he receives is reduced. This may be considered a factor in undermining the willingness to continue working. It will probably also be necessary to revise the mandatory retirement system to introduce more flexibility.

Our forecast provides for a Reform Scenario envisioning a society in which seniors are encouraged to continue working. It assumes an extension of the working period by about five years by the year 2030. It also anticipates greater female labor participation and greater employment of foreigners.

It will be essential to design employment agreements which can accommodate a diversity of workers. This will mean promoting "job-type employment," under which job descriptions and the scope of responsibilities are clearly specified. It also means ample provision of services and the relevant personnel to support workers with childrearing and nursing care responsibilities. These changes would be funded through staged increases of the consumption tax rate to 15%.

As a foundation for promoting economic growth, vigorous efforts must be made to improve the environment for trade and investment. With a view to halting protectionism, Japan should follow up the Trans-Pacific Partnership with other economic partnerships. Reinvigorating trade will in turn boost productivity within the country. The effective corporate tax rate should be cut to 25% in order to encourage investment in domestic companies.

We believe that a growth rate of nearly 2% will be achieved by 2030 under the Reform Scenario incorporating the above steps (see table). We believe it would greatly ameliorate the impact of the shrinking labor force population, which has been a major factor in undermining the potential growth rate under the Baseline Scenario. With the stimulation of business activity, such factors as making employment agreements and working hours more clear and specific will cultivate the productive work styles, and rising labor productivity will in turn increase the growth rate.

In the future, more and more people will reach the age of 100. Building a framework which leverages longer lifespans in this way is certain to strengthen the forces for growth.

Translated by The Japan Journal, Ltd. The article first appeared in the "*Keizai kyoshitsu*" column of *The Nikkei* newspaper on 16 March 2018 under the title, "*'Choju' ikashi seichoryoku wo takameyo, Nihon Keizai Kenkyu Senta Chuki Keizai-yosoku: Korei de hatarakeru shakai jitsugen wo* (Leverage Longer Lifespans to Boost Growth: Japan Center for Economic Research Medium-Term Economic Forecast — Build working-senior friendly society)." *The Nikkei*, 16 March 2018. (Courtesy of the author)

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