

# JAPAN ECONOMIC CURRENTS

A COMMENTARY ON ECONOMIC AND BUSINESS TRENDS

## The Declining Birthrate in Japan

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Japan has entered an age of full-fledged population decline. The nation's total fertility rate, which is the average number of children a woman will bear over her lifetime, was 1.32 in 2006. While this is slightly above the 1.26 rate for 2005, the upward shift appears to be largely due to temporary factors, not to a bottoming out of the decline. Indeed, the government's population estimates are based on the assumption that the rate will continue to fall and that even in 2055, it will only recover to the 2005 level at the most. Because Japan's economic and social institutions, such as its social security system, were structured on the premise of population growth, a population decrease endangers them. Still, if only the birthrate could be returned to a growth trend, problems of this sort would greatly diminish. For this reason, a growing number of people are calling for measures to put the falling number of children back on the growth track.

### The relationship between working women and the childbirth decline

One of the debated points in the discussion of measures to promote fertility is the relationship between female participation in the labor force and the birthrate. The conventional thinking is that when the rate of participation goes up, the opportunity cost of bearing and raising children also rises, and so if other factors remain unchanged, the birthrate is likely to go down. When we examine the actual situation in the developed countries, however, we find that there is instead a mild tendency for birthrates to rise when female participation in the labor force moves up.

Japan is low in the ranking of both the fertility rate and the female employment rate. This makes it possible to argue that if more women were to join the labor force, more children would be born. Those making this assertion have, however, received a great deal of criticism. One of the rebuttals is that the people making international comparisons tend to arbitrarily limit the sample to certain

### Editor's Note

One of the gravest problems facing Japanese society today is the declining birthrate. It is both the hardest to solve and the one with the greatest impact. The birthrate is a fundamental factor that affects Japan's economic growth and security, and the premise that underpins our social security. In this issue, we present a commentary based on a detailed analysis of how this phenomenon is viewed in Japan and what aspects of it are problematic for Japanese people. With the causes yet to be fully illuminated, there are no magic solutions to the birthrate issue. An objective analysis of possible countermeasures is provided.

We also feature an American perspective on likely trends and qualities of Japanese society that may help Japan to cope with this challenge. It is a refreshing suggestion that characteristics regarded by many Japanese as "backward," such as strong family ties and the tendency for seniors to continue working, may in fact be strengths of Japanese society.

We hope these articles will help increase understanding of the issue of Japan's declining birthrate and offer insights when considering other Asian countries that will soon face similar challenges.

countries. If instead the analysis includes Mexico, Turkey and other countries with relatively low income

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levels, and also excludes Iceland, which has extremely high childbirth and female employment rates, the positive correlation becomes hard to discern. Another problem is that it is not easy to come up with theoretical reasons why women should have more children when they hold jobs. One more point is that the relationship between work and the total fertility rate is not static. Back in 1970 the correlation was generally negative, while in the mid-1980s it was virtually nonexistent.

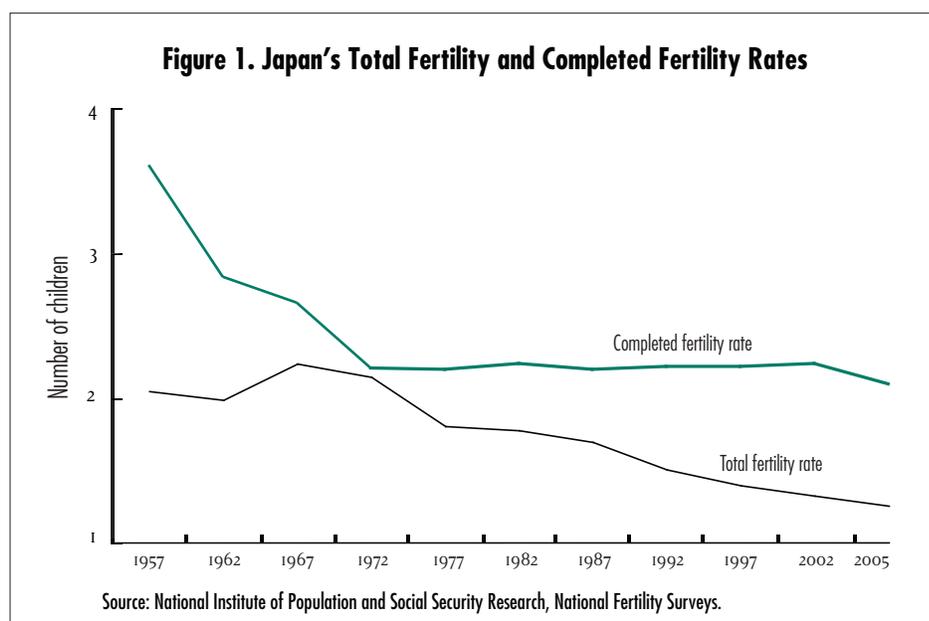
When we look at changes by country over time, we find that the birthrate has clearly bottomed out in a number of countries, such as France, the Netherlands and the United States. The overall trend, however, has been for female employment to rise and the birthrate to decline at the same time. Japan in the 1970s had a relatively high level of female participation in the labor force, but thereafter it rose little, while the birthrate fell sharply. Judging from this record, we cannot confidently proclaim that getting more women into the labor force will result in more children. To be sure, an upward trend in female employment could lead to changes in social arrangements that make it easier for working women to raise children, thereby lifting the birthrate. However, such an outcome is not necessarily assured.

### Behind lower birthrates: People who marry late or remain single

Among the measures commonly proposed to reverse the decline in the number of children are hiking the allowance for children, improving child-care centers and increasing the allowances for childbirth and child care. These are all means of providing support to married couples. When thinking about ways to promote fertility, people generally start from the idea that the reason more babies are not being born is that bringing up children is too expensive. It can be persuasively argued, however, that the main causes of the falling number of children are to be found before marriage, not after it. If the trend

toward men and women marrying later or remaining single is the chief culprit, measures to assist existing couples can have only an indirect effect.

So which are more important, factors preceding marriage or factors following it? Here our attention is drawn to data on the average number of children a couple will have up to 15–19 years from the start of their marriage, or the "completed fertility rate." The National Institute of Population and Social Security Research conducts a National Fertility Survey on a regular basis, and as shown in Figure 1, the results indicate that there was little change in the completed fertility rate from the early 1970s to 2002. On the average, each couple had 2.2 children. The total fertility rate, by contrast, steadily



declined over this period. We may say that when young Japanese men and women do marry, most eventually have two children.

There has been a slight change in the situation recently. The completed fertility rate dropped sharply to 2.09 in 2005, provoking concern about a loss of capacity of couples to produce children. But another factor was probably influential: the tendency among young Japanese to marry later and postpone having children. The Ministry of Health, Labor, and Welfare reports that the average age of women on first marriage was 27.8 years in 2004, up by 2.4 years from the average age 20 years earlier, while their average age on the birth of their first child was 28.9 years, up by 2.3 years. When women begin bearing children at that late age, giving birth to and raising two or three children is physically hard on them.

From this perspective, we find that the dwindling number of children can be largely explained by factors that precede marriage rather than factors that follow it, especially by the tendency of young people to marry late or remain single. Still, a persuasive rebuttal can be advanced. That is, this tendency among young people can be observed in many countries and is not peculiar to Japan. When we consider, for instance, the average age of women

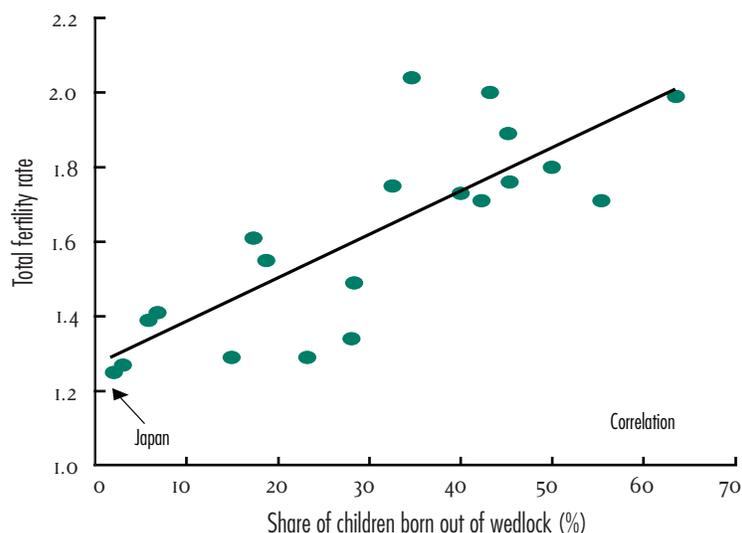
on first marriage, the age in Japan is not notably advanced. And yet the birthrate has continued to fall in Japan, as in some other countries, whereas it has rebounded in yet other countries.

The point to note is the relationship between marriage and childbirth. Japanese women rarely bear children before getting married. Of all children, only some 2% are born out of wedlock (and are not legally legitimate). By contrast, the share of children born out of wedlock has climbed above 40% in Britain, France and nations in Scandinavia, where birthrates have recovered. There are even countries like Sweden, where the parents

of more than half the children are not legally married. Japan differs substantially from other members of the Organization for Economic Cooperation and Development in respect to this relationship between marriage and childbirth. And as Figure 2 demonstrates, a clear positive correlation exists between the share of children born out of marriage and the total fertility rate.

In countries with a large share of children born out of wedlock, it is common for couples to live together for some time in what is essentially a marriage before they legally marry. In addition, children born out of wedlock

**Figure 2. Children Born out of Wedlock and Fertility Rates in OECD Countries**



Source: Compiled from data including Ministry of Health, Labor, and Welfare, Jinko dotai tokei tokushu hokoku (Special Report on Vital Statistics), 2005.

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are granted virtually the same rights as legitimate children, and couples with de facto marriages receive the same child-raising assistance as legally married couples. In such a situation, there will not necessarily be any direct connection between the number of children and the tendency to marry late or remain single. In Japan, by contrast, late marriage can throw off the timing for having children, and remaining single can eliminate the chance altogether. In this very different situation, marriage trends impact directly on the number of children born.

A variety of factors lie behind the tendency to marry late or remain single. Japanese women are strongly inclined to reject prospective marriage partners without equal or higher levels of education, and as they acquire advanced educations, it becomes harder for them to find a suitable partner. Another factor, one that has shown signs of receding recently, is the large number of financially unstable young people who are "freeters" jumping from job to job or are "NEETs," those who are "not in employment, education, or training." To such youngsters, marriage is something far from their reach. In Japan's case, marriage has to come first before

other life decisions are addressed. This sort of thinking can also be seen in Southeast Asian countries, albeit with differences in degree.

### Can birth promotion measures boost the number of children?

Views differ sharply within the government on what to give priority among measures to boost the number of children. In one camp are those who say that the emphasis should be placed on economic assistance, such as financial support through child benefits, medical-care subsidies, child-care and education assistance. There are solid grounds for holding this position. For instance, in 2005 the Cabinet Office conducted an opinion poll among women on parenthood policy measures, and when the surveyed were asked what was most important to reverse the fertility decline, by far the most popular response, picked by 69.9%, was "economic assistance measures." Again, in its 2005 basic survey on births, the Ministry of Health, Labor, and Welfare asked why they had fewer than what they saw as the ideal number of children. The top reply, picked by 65.9%, was "because raising and educating children is too expensive."

Another camp within the government wants priority placed on making employment compatible with bearing and raising children, using the promotion of child-care centers, improved maternity leave, the facilitation of reemployment after raising children and other similar measures. In the Cabinet Office opinion poll, a fairly large group of respondents favored such measures for balancing children and work. In double-income families that earn a fair amount of income, these measures are more important than financial support. We need to note, though, that the positions of the two camps are not antagonistic. Perhaps equal weight should be placed on both sets of measures. But in any event, attention should be paid to the following points.

1. First, support to balance children and work influences choices people make as a matter of individual freedom. From the policy perspective, such support is more fundamental than economic support and is of greater urgency. Bringing up children is a very human act. No matter how it is viewed, it would be unnatural to place restrictions on this human behavior and force women to make a choice

between holding a job and raising a family.

2. Second, there is a need for measures to raise the policy effectiveness of economic assistance by channeling it on a preferential basis to those who truly need it. Instead of distributing assistance widely and equally, it is better and more effective to focus it on households in which income imposes a constraint on having children.

benefits and other such fiscal support for families. And while corroborative studies have found some evidence that increasing the support to balance children and work can enhance female employment, few have shown that such support also leads to more children.

The tendency among countries that have succeeded in the recovery of birthrates is to position their assistance programs as a "family policy." That is,

approach to supporting children and their families. What should be Japan's stance in this respect? An examination of recent public documents shows that "reversing the birthrate decline" has become a key policy objective. In my opinion, however, policies should be framed as measures to assist families as a whole, including children, rather than targeted measures to turn the birthrate around.

Children bring economic benefits to society. They stimulate economic growth and make financial resources available for social security. These positive influences on society are known as external economic effects. In this way, children are public goods that create these effects, and they are, in this sense, truly a treasure of society. We should provide economic assistance to the households in which this social treasure is being brought up at considerable cost. When we view measures to cope with the dwindling number of children in this light, they are clearly highly meaningful even if they do not work directly to boost the birthrate.

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3. Third, it is by no means clear how far the birthrate can be lifted using either set of measures. There is no correlation between the total fertility rate and the share of a country's gross domestic product that is used for child

rather than formulating measures with the explicit aim of lifting birthrates, they put together programs designed to assist children and their families. Of course, a family policy may have an underlying objective to avert a crisis from a birthrate that falls too far, but on the surface, it is a comprehensive

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## Meeting Japan's Aging Challenge

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Everybody knows that Japan is ground zero for global aging. Fertility has been at or below replacement longer than in any other country and life expectancy has risen to the highest in the world. With an elderly share of 20 percent, Japan is already the oldest country in the world—and its age wave will continue to roll in for decades to come. By 2025, the elderly share of Japan's population will be passing 30 percent and by 2050 it could be approaching 40 percent. Meanwhile, Japan's working-age population began to shrink in the late 1990s and its total population in 2005. The Japanese government, half seriously, projects the date there will be only one Japanese left.

The apocalyptic demographic projections have led many in the West—and some in Japan—to conclude that the future is one of inevitable economic decline. And indeed, there is no question that the aging of its population is one of the most serious long-term challenges facing Japan today. It will throw into question the ability of society to provide a decent standard of living for the old without imposing a crushing burden on the young. If current trends continue, it will also push Japan toward a secular stagnation in economic and living standard growth—and a

greatly diminished geopolitical role in the world.

CSIS, however, remains optimistic about Japan's future. We are optimistic because, despite the magnitude of the demographic challenge, Japan enjoys a number of economic, social and cultural advantages that most Western countries do not. We are also optimistic because Japan, in its long history, has repeatedly risen to great challenges and

rising costs of supporting their graying populations. To the surprise of many, including ourselves, Japan scored in the "middle vulnerability" rather than the "high vulnerability" group. Why? Not because Japan doesn't face a massive future fiscal burden for old-age benefit programs. In fact, it faces one of the largest. Rather, it was because, in constructing the Index, we looked beyond the cost projections and took into account various measures of society's ability to

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reinvented itself to meet radically changed circumstances—often to the astonishment of the rest of the world. We believe that Japan will rise to the new challenge of aging—and in doing so, it will help lead the way for aging countries everywhere, especially in East Asia.

In 2003, CSIS issued a report called the *Aging Vulnerability Index* that ranked the vulnerability of the 12 major developed economies to the

adapt to the challenge—and here Japan scored very well.

Perhaps Japan's biggest advantage is the relatively low level of elder dependence on government. Public benefits, including everything from pensions to social assistance, account for just one-third of the after-tax income of elderly households in Japan, about what they do in the United States. In most European countries, with their more generous

welfare states, more than half of elderly income comes in the form of a government check, and in France two-thirds does. (See Table 1.) Elders in Japan make up for the gap in part through greater savings during the working years. Another difference is that Japanese elders continue to work at much higher rates than elders in other developed countries. In Japan, 29 percent of men aged 65 and over remain in labor force. In the United States 20 percent do, in Germany 5 percent, and in France just 2 percent. The Japanese extended family also continues to play an important role in providing support in old age. In Japan, more than 40 percent of elders live with their grown children, while in many European countries the share is less than 15 percent and in Sweden it is less than 5 percent.

The strength of these alternative sources of income support, combined with Japan's remarkable cultural ability to build social consensus around shared sacrifice, has made it politically easier to reign in the rising cost of public old-age benefit programs. Since the mid-1980s, Japan has enacted four major rounds of cost-cutting public pension reform that have repeatedly reduced per capita benefit levels and raised retirement ages, often with an explicit appeal to "equity between

the generations." Meanwhile, reform efforts elsewhere in the developed world have often encountered fierce resistance—from a powerful senior lobby in the United States and from labor-linked political parties in Europe.

Unfortunately, the alternative sources of support of Japanese elders are beginning to weaken. The share of elders living with their children, though still relatively high, has been continuously declining since the 1980s. While this is in part because rising incomes have made it easier for elders to live alone, Japan's traditional Confucian ethic is also under assault from the rise of Western "individualistic" values. Even as the family weakens, Japanese elders may find their employment opportunities more limited. This may seem paradoxical given the emerging shortage of younger workers. But as Japan's agricultural and service sectors come under assault from globalization and new technologies make old skills obsolete at an accelerating pace, the jobs that many elders now rely on may disappear. If Japan does not help them continuously upgrade their skills, they may become increasingly unemployed or even unemployable.

Meanwhile, reductions in public pension benefits have been pushed so far that they are threatening

Table 1  
**Government Benefits in 2000, as a Percent of After-Tax Elderly Income\***

	Average	3rd Quintile
US	35%	54%
Japan	35%	n.a.
Canada	42%	62%
Sweden	57%	70%
Netherlands	54%	74%
UK	50%	75%
Spain	64%	77%
France	67%	78%
Italy	59%	83%
Germany	61%	84%

\*Excludes health and other in-kind benefits.  
Source: *The CSIS Aging Vulnerability Index*

the adequacy of the system. The government projects that the "macroeconomic slide" introduced in 2004 will reduce the Employees' Pension Insurance system's replacement rate to just 52 percent by 2025. This projected replacement rate, moreover, overstates the actual living standard of future retirees, since once benefits are awarded they are no longer indexed to wages during retirement or indeed, with

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the macroeconomic slide, even fully indexed to inflation. What's worse, replacement rates will almost certainly need to be cut again. The government's projections assume that massive general revenue subsidies and a large-scale reserve fund drawdown will help prop up the system's finances. Japan's current fiscal outlook makes the first assumption questionable. As for the second, it is difficult to see how near-term surpluses that are not being economically saved can later be used to cover long-term deficits.

The next time that the government turns to the public to ask for another round of sacrifice, it may meet much more resistance than it has in the past—and not just from pensioners. There is now growing resentment among the working public about scheduled hikes in contribution rates, and widespread agreement among policymakers that contributions cannot be raised further than scheduled in current law. We see this resentment in the growing number of workers, especially young workers, who are evading joining the system and are not paying their full contributions. The recent fiasco in which the Social Security Agency lost as many as 50 million pension account records has not improved public confidence. According to a June 2007 Yomiuri

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Shimbun poll, 76 percent of the public distrusts the public pension system, and the share rises to 87 percent among people in their twenties.

As time goes by, moreover, it is also becoming clear that along with its advantages, Japan labors under two significant disadvantages. Japan's conservative workplace and family culture often confronts women with a zero-sum trade off between jobs and family, which is why Japan has both one of the lowest fertility rates in the OECD *and* one of the lowest female labor-force participation rates. Indeed, Japanese women who work outside the home are often triple-burdened—by jobs with long hours and inflexible schedules, by taking care of demanding children (and husbands) and by looking after elders. Some Japanese watchers joke that they have to be "superwomen" to do all three. The United States and much of Europe, especially France and the Scandinavian countries, have been

much more successful at allowing women to balance jobs and family. An aging United States in particular also enjoys another big advantage that an aging Japan does not—namely, its long historical tradition of welcoming and assimilating migrants from younger and faster growing countries around the world.

To meet the challenge of its aging society, Japan will have to ensure that support systems for the elderly are not only sustainable but adequate. It will have to strengthen the private employer pension system by requiring that all benefit promises, including severance pay, be fully funded. It will have to cultivate a long-term investment culture that raises the dismally low rate of return on household savings. And it will have to search for ways to strengthen the traditional ethic of filial piety before it weakens irreparably. Beyond retirement policy, Japan will have to engineer a more far-reaching

transformation of its society and economy that allows it to make the most efficient use of its increasingly scarce human capital. It will have to overhaul a notoriously rigid educational system to ensure that it gives young people the skills they need to keep the economy internationally competitive. As its workforce shrinks and ages, it will have to move beyond the traditional "three box lifecycle" of education, work and retirement. Future workers, regardless of their age, will have to maintain and upgrade their skills and knowledge through "distance learning" and continuing education programs.

Above all, Japan's workplace and family culture will need to evolve in ways that help women meet the multiple demands society is placing on them. Japan needs more women to work to make up for the deficit

of entry-level workers. But it also needs more babies to avoid long-term population decline. Government officials, business leaders, and educators will have to join forces to combat stereotypes of women in the workplace and the family and persuade society as a whole that productive careers for women are not incompatible with raising children. The importance of success cannot be overstated, for at a 1.3 fertility rate there is no long-term solution to the aging challenge. Even if Japan were to raise the retirement age into the mid-seventies, it wouldn't be enough to keep the labor force from shrinking and economic growth from slowing. Higher levels of immigration would certainly help. But it is doubtful that Japan will be willing to accept the social and cultural changes that large-scale immigration would bring.

In some ways, the transformation that Japan must now embrace will be every bit as sweeping as that which catapulted it into the ranks of industrial countries during the Meiji Restoration—or allowed it to emerge from the defeat of World War II as a global economic superpower. Just as Japan pioneered the "Japan Inc." development model in the early postwar era, it now needs to fashion a new aging model. If it succeeds, it will not only help ensure its own future prosperity in what is being heralded as the East Asian Century, but will also help point the way for other fast-aging countries in the region—especially the Tigers, which are now making the transition from "aging society" to "aged society" even more rapidly than Japan did and which share many of the same strengths and weaknesses. Once again, Japan stands at one of history's great crossroads.

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