

## Japan's Death of Birth

By Russell Redenbaugh and Natalia Davis

In contrast to the astounding growth of its Asian neighbors, Japan's economic power went on the wane a decade ago. This development has important consequences for the American economy, and an economically weak Japan can pose problems for U.S. foreign policy interests in the region. Economic policy is partly to blame for Japan's decline, but a startling trend toward negative population growth is more troubling and more damaging in the long term.

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Japan is the second largest economy in the world, the third largest trading partner with the United States, and the most politically stable country in Asia.

Its economy and stock market boomed until 1989. Since then, the Nikkei has fallen from 39,000 to 11,500. If it had merely kept pace with the S&P 500 it would be over 160,000 (Figure 1). Surely there are economic causes for this decline: poor monetary policy, deflation, and high marginal tax rates often receive the blame. With a personal income tax rate of 50%, a corporate income tax rate of 41%, a value added/sales tax rate of 5%, a payroll tax of 13.3% and an inheritance tax of 70%, very little incentive is left to work, save or invest.

Yet even if economic policies were fixed, we conclude that Japan's problem may persist because it has a more fundamental social cause: The Japanese people have stopped forming families and having babies. This death of birth, if not reversed, threatens Japanese culture and its contributions to science, technology, art, design, consumer products, automobiles, and even comic books. (Figure 2).

Japan's fertility rate has collapsed. (Figure 3). This drop was at first an anomaly but it has become a pervasive, durable trend. With a fertility rate of 1.38, increasing life expectancy (extending the already long Japanese life expectancy) and strict immigration regulation, Japan's unfunded retirement liabilities and its massive government debt will be spread over very few workers.

The primary economic consequence of Japan's demographic collapse is a mounting unfunded pension liability. Each retired generation depends upon a successive generation of workers not only to produce goods and purchase financial assets from retirees, but also to pay taxes and other contributions that fund pensions for current retirees. This is the chain that has been broken in Japan, and it cannot be quickly repaired. It takes 18 to 20 years to get a new worker. Worse, a baby boom exacerbates the situation in the short term by further increasing the ratio of nonworkers to workers. The baby arrives, and the mother leaves the workforce (Figure 4).

Japan's hostile immigration policy exacerbates its human capital shortage. The United States has solved the nonworker to worker ratio problem by importing workers.

In Japan, however, with more than a decade of a soft economy and current unemployment stuck between 5 and 6 percent, all of the policy focus is on the present level of unemployment.

Government "fake work" projects actually lower current employment and national output. The

government last year decided to spend \$2.7 billion on an emergency work-creation program. The goal: to create more than 500,000 temporary jobs over the next three years.<sup>1</sup> These temporary jobs only put a further tax on the workers in the private sector by increasing the unfunded liabilities.

A string of economic stimulus packages has helped run up Japan's national debt to about \$5 trillion, or some 135% of annual economic output—by far the highest level in the industrialized world.<sup>2</sup>

Other policy suggestions include extending the age of retirement. This should be done but it only buys small amounts of time. What's next? If the fertility rate continues to decline, then who will fund these mounting liabilities? Deferring the liability will only work if there is someone accepting the deferment (Figure 5).

What has really changed in Japan that makes motherhood a less than popular option? We have seen again and again the fertility rates slip in developing countries as women are offered more and more career choices but in Japan this is extreme.

In Japan, feminism is still a new idea. It was only sixteen years ago that women were granted equal rights in the workplace, and young women who wish to have a serious career still find that acquiring a husband, not to mention having a child, can be a quick route to professional decline.<sup>3</sup> Having a child in this environment could be seen as limiting one's future. And if one were to choose to have a child, how stable does the future look? Over the past decade, Japan's future has grown more uncertain and unpredictable. Because of the recession and the inflation of real-estate prices, many young Japanese continue to live at home well into their twenties.<sup>4</sup> This is not exactly conducive to dating and marriage.

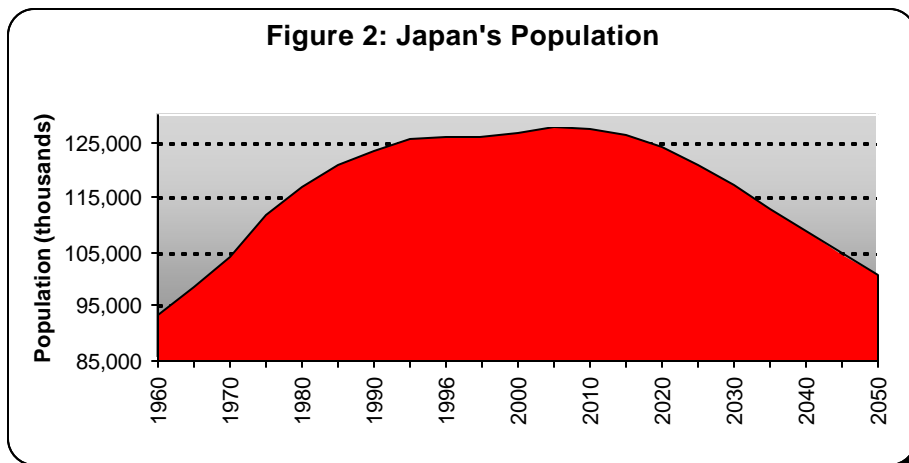
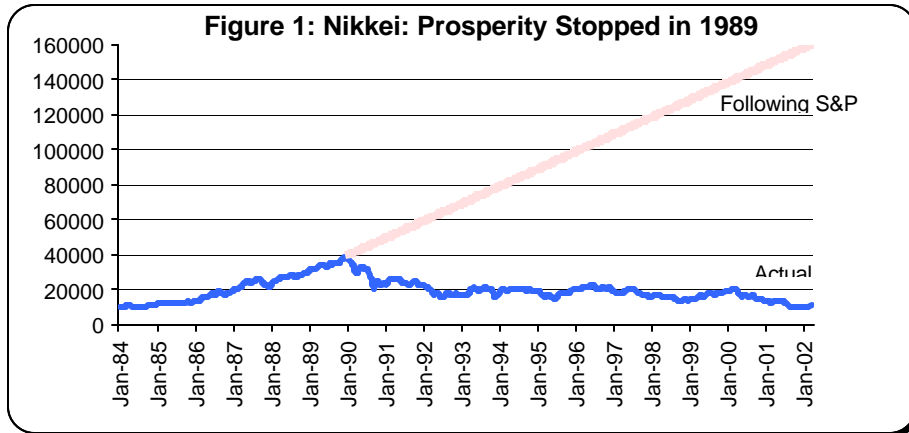
Japan watchers should watch demographics. Clearly, economic policies need to change, but they will not address Japan's more fundamental problems if they do not begin to solve the nation's shortage of workers and investors. Watch the social changes that might signal a trend towards parenting...towards the possibility of child investment. Watch such statistics as marriage rates. If more people marry, they are more likely to build a family. Watch for subtle shifts of attitudes and values that could signal the emergence of a new trend, a trend of Japanese couples investing for a distant future by beginning a family. This could show up in the books that they read and the clothing that they buy. We saw significant shifts in the United States after 9/11, which signaled a small baby boom. Church attendance increased, marriage rates increased, investment in homes and home furnishings increased and the clothing style reflected a more serious, less frivolous nation. Watch for the shift towards parenting, for without it, Japan will experience little more than a cyclical recovery.

The United States, however, does not confront the same population problem. Our fertility rate bottomed in the early 1980s and has moved back up to the replacement level. Additionally, we continue to be a country of immigrants. In fact, the U.S. is importing capital and labor. The generational problem has been solved.

More importantly, the U.S. is in a special circumstance. The dollar is the global reserve currency. There is no risk of it being replaced by the yen, a theory popular in the 1980's, or the

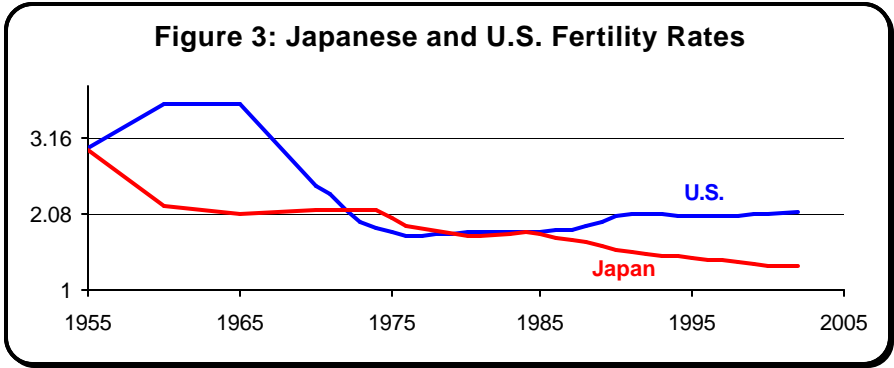
Euro, which has yet to prove its longevity. The U.S. financial markets are global, deep, transparent and a repository of a large portion of the world's retirement assets.

Furthermore, our retirement system is not government based. The United States, unlike Japan, has moved from a “defined benefit” retirement system to a “defined contribution” system where individuals invest in private accounts, own their financial assets and will need to sell them to finance retirement. The younger workers who need to buy these assets need not be U.S. taxpayers or even present in the United States. They need to be productive workers who save for their retirement by owning U.S. financial assets.



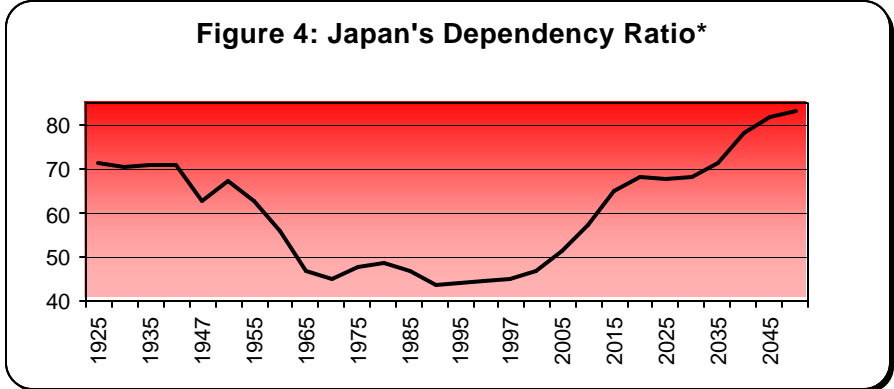
**It's Over** (population chart)

In modern economies prosperity and population growth go hand in hand. In Japan prosperity peaked in 1989 as did population. Current trends suggest an absolute population decline beginning around 2009.



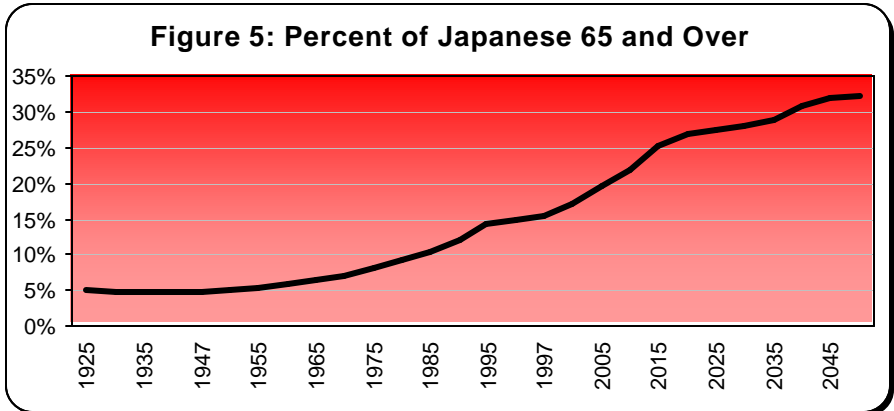
**Fading Future (Fertility Rate Graph)**

Fertility rates track with optimism about the distant future. In the U.S. the prosperity that began in the early 1980s is reflected in decisions to invest in children. In Japan parents must see a less bright future. Fertility continues to collapse.



**It Gets Worse Before It Gets Better (Dependency ratio)**

Figure 4: Japan’s dependency ratio – the ratio of under-18 and over-65 to working-age population – bottomed as the economy peaked in 1990. It is projected to increase from 57% to 68%. If the birthrate increases, this ratio gets even worse!



**Retirement is not an option: Percentage of Japanese 65 and Over**

A third of the population cannot retire and be supported by the remainder.

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<sup>1</sup>“Japan’s New Deal: Collect Deer Scat, Count It, Then Collect a Paycheck,” *The Wall Street Journal*, April 15, 2002.

<sup>2</sup> *Ibid.*

<sup>3</sup> “Shopping Rebellion,” *The New Yorker*, March 18, 2002.

<sup>4</sup> *Ibid.*

<sup>5</sup> Population data and charts from the Japanese Ministry of Public Management, the Population Reference Bureau, and the OECD.

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