Economic Growth through Drastic Changes in How People Work

—A Society That Capitalizes on Longevity—

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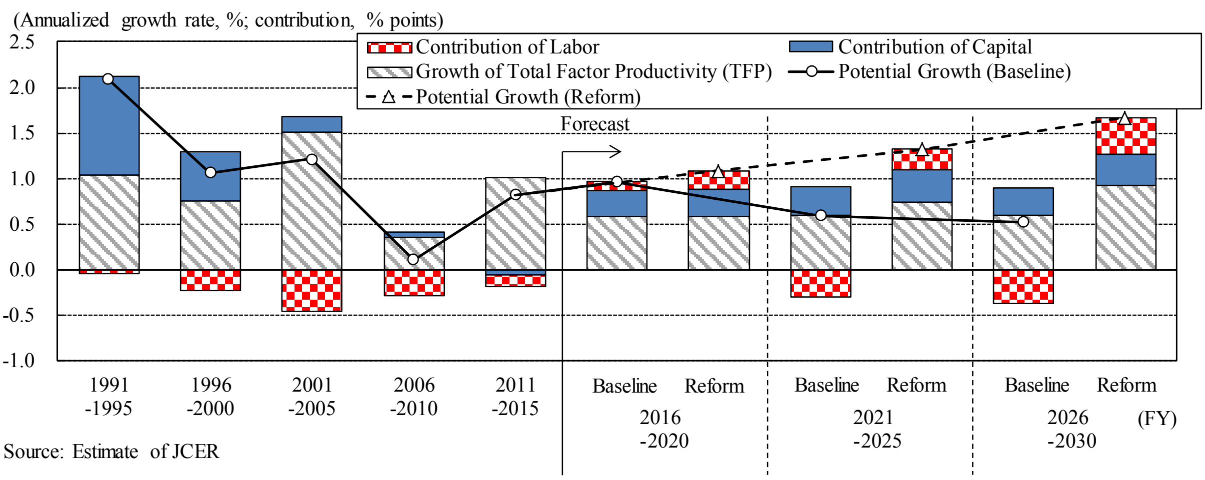
JCER Medium-Term Economic Forecast Team[1]

Japan's economy, at the moment, has been expanding on the back of strong overseas growth, but it may require caution in the medium term. Japanese companies remain hesitant to expand domestic facilities or invest in human resources at home on concerns that the market may shrink in the near future. They are focusing on expanding operations overseas while investing in labor-saving measures on the domestic front. However, they are facing difficulty in absorbing new technologies after scaling back investments in human resources. Meanwhile, wages will probably remain stagnant and labor share of income will continue to decline.

Drastic working reform may serve as a catalyst to reverse this trend. Japan must overhaul its current social system, under which many people retire when they reach 65 and women quit working after having children, because such a system discourages elderly people and women from fully participating in the labor force. Employers should also come up with measures to allow people to spend their time at work more efficiently. Consequently, the nation's workforce should be empowered both quantitatively and qualitatively. An increasing number of foreigners living in Japan will help the nation boost its economy by overcoming labor shortages. Moreover, Japan can improve its fiscal condition and eliminate intergenerational income disparities more easily if elderly people remain in the labor force for a longer period of time. In other words, Japan must capitalize on the longevity of its population by reforming its social structures.

Decomposition of Potential Growth



Source: Estimate of JCER

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Baseline Scenario

- Real growth to hover around the mid-0% range as labor force continues to shrink
- Wages to stagnate as capital and human-resource investments remain low
- Primary deficit to remain at 2% of the GDP even after the consumption tax rises to 10%

Growth: Potential growth rate to fall to the mid-0% level in the 2020s

The nation's potential growth rate will gradually decline from the 1% level of the latter 2010s. Growth in total factor productivity is assumed to decline slightly from the current level to around the mid-0% level throughout the projection period. A decline in working-age population will reduce labor's contribution to the potential growth rate, with the result that the rate in the 2020s will fall to the mid-0% range, almost the same level as growth in total factor productivity. Real economic growth will also track the potential growth rate. On the demand side, companies will not accelerate their capital investments because they will remain cautious about business expansion amid poor growth expectations for the domestic market. Wages will stagnate and consumption lack vigor because companies will hold down investments in human resources.

Prices: The consumer price inflation to be slightly less than 1% during the period

The GDP gap will remain below 1% as is currently the case. The rate of increase in consumer prices will be slightly less than 1%. The accommodative monetary policy will continue with particular attention paid to interest rates.

Wages and employment: Real wages to remain unchanged; more women, elderly people to join

A reduction in human resource investments, such as job training, will become a factor in causing lower productivity and wage stagnation. The rate of wage increase per person will be about 1%, about the same as the increase in consumer prices. Real wages, therefore, will remain almost flat.

As for the labor participation rate, it is assumed that the rate for women of child-raising age will gradually rise to show flatter M-shaped curve by fiscal 2030. The rate for elderly in early 60s is also assumed to increase because the pension eligibility age will be raised. Even then, the labor force will trend downward in part due to a decline in working-age population. As a result, labor share of income will gradually decline while the unemployment rate will fall to the mid-2% level.

Fiscal balance: Improvement to be modest; deficit to remain past 2030

It is assumed that the consumption tax rate will rise to 10%, applied reduced rates to certain products, in October 2019 and will stay at this level thereafter. The fiscal balance will gradually improve toward 2020 in part due to an increase in tax revenue as the mild economy growth continues. However, the fiscal balance will cease to improve in the 2020s partly because of an expansion in social security spending related to rising elderly population and expenditures on measures associated with the consumption tax hike. As a result, the central and local governments will have a combined primary deficit of about 2% of the GDP.

Current-account balance: Gradually decline to about 2% of the GDP

The corporate sector will continue to have excessive savings. This is because companies' investments will remain modest even as their earnings expand. An increasing percentage of households will draw down their savings as the population ages, reducing the overall household saving rate. Meanwhile, growth in the world economy will decelerate, leading to a slowdown in the rate of increase in Japan's exports in 2020 and thereafter. An increase in crude oil prices will raise the value of Japan's imports, thereby, somewhat increasing the nation's trade deficit. The current-account surplus will decline to about 2% of the GDP even as the balance of income rises.

Industries: Manufacturers to rely on external demand as domestic demand falls; medical and welfare sectors to drastically expand hiring

Projections for each industrial sector under the baseline scenario have been compiled with the use of an input-output model. Japan's manufacturing industry will increase its reliance on export-competitive sectors, such as production machinery, industrial electric equipment, and "other transport machinery"[2] as domestic demand declines. In addition, the arrival of a "super-aging" society means that demand for workers in the medical and welfare industry[3] will continue to expand. However, securing workers may become a challenge since a decline in population will likely lead to labor shortages.

<Assumptions for the economic outlook>

- The world economy: It is assumed that the global growth rate will decelerate from 3.9% in 2018 to 2.4% in 2030. As for the exchange rate, the yen will gradually strengthen to about 100 against the dollar in 2030. Crude oil prices will rise to about $118 per barrel, in line with the World Energy Outlook of the International Energy Agency (IEA). In addition, the Trans-Pacific Partnership (TPP) agreement will be enacted by the 11 participating countries by fiscal 2020, and its effects will begin to surface by 2030.
- Population: It is based on a fertility and mortality median estimate released in April 2017 by the National Institute of Population and Social Security Research.

[2] This refers to transport machinery and related industries (vessels, trains, aircraft, industrial transport vehicles, etc.) other than automobile.

[3] This industrial forecast follows the input-output table of the Ministry of Internal Affairs and Communications in designating the category of "medical and welfare" industry. In addition to medical care and elderly care, "medical and welfare" includes "social insurance operations" such as pension and health insurance, and "social welfare," such as social-welfare offices, nursery schools, child guidance centers, elderly homes, and facilities for disabled people.

Summary Table of the Baseline Scenario

Indicator	Unit	Fiscal year				
		06-10	11-15	16-20	21-25	26-30
Real GDP	annualized growth rate, %	0.0	1.0	1.1	0.6	0.6
Nominal GDP	annualized growth rate, %	-1.0	1.3	1.5	0.8	0.9
Consumer Price Index (all items)	annualized growth rate, %	-0.1	0.7	0.9	0.7	0.9
Compensation of employee, per capita	annualized growth rate, %	-0.8	0.2	1.2	1.1	1.0
Labor force	annualized growth rate, %	-0.1	0.0	0.3	-0.4	-0.5
Unemployment rate	period average, %	4.4	3.9	2.8	2.6	2.5
Primary fiscal balance of central and local gonvernment	period average, % of nominal GDP	-4.0	-4.8	-2.6	-1.9	-2.0
Debt of central and local govenment	period average, % of nominal GDP	148.6	182.7	190.3	192.6	198.4
Current account	period average, % of nominal GDP	3.6	1.6	3.9	3.2	2.1

Note: Compensation of employee is devided by "employee" of Labour Force Survey

Reform Scenario

- Elderly people and women will increase their labor participation. An influx of foreigners will also add to the labor market.
- Wide-area economic partnerships will expand, further promoting trade and investments. Real economic growth will reach 2%.
- The consumption tax will rise to 15% to bolster elderly care, education, and childcare services. Primary fiscal balance will go in surplus.

Employment: The labor force to expand, joined by elderly people, women, and foreigners

The labor participation rate will rise due to both elderly people and female workers. For male workers, the participation rate for those between 60 and 64 will become comparable to the current level for those between 55 and 59, and the rate for those between 65 and 69 will reach the current level for those between 60 and 64. Among women, the participation rate for younger workers (those between 25 and 29) will see an increase. Those who are older will also have a greater labor participation figure as they remain in their jobs. The number of foreign residents in Japan will rise to 200,000 a year. They, too, will contribute to the labor market. As a result, the nation’s labor force, which is projected to decline under the baseline scenario, will rise if this course is followed.

Growth: The growth rate to rise to 2% in 2030; labor share to remain unchanged

The domestic market will expand because of an increase in the labor force. The rate of growth in real consumption, which remains at the lower 0% range under the baseline scenario, will accelerate to as much as 1.5% a year in 2030. Corporate investments will become more aggressive in response to increasing growth expectations. International trade will become more active and Japan will attract more foreign investments on expectations that the country will conclude other wide-area economic partnership agreements following the TPP. Total factor productivity will rise to about 1%, 0.5 percentage point higher than the baseline scenario, as the economy becomes more competition promotive. Real economic growth will also approach 2% in 2030, and stable growth of about 1.5% will continue over the forecast period. Average compensation per employee will rise, while labor share of income will remain unchanged.

Fiscal balance: A consumption tax hike to wipe out deficit by 2030

The consumption tax will rise by an additional 5 percentage points during the 10-year period from 2021 until 2030 in response to expanding demand for elderly care, childcare, and education. The corporate tax rate will gradually fall to 25% by 2030 to spur production activities. The combined primary deficit for the central and local governments will disappear in 2030.

Current-account balance: Remain at around 4% of the GDP

Regarding the external balance, an expansion in exports is expected. This is because the world economy will grow at a pace exceeding the level projected in the baseline scenario, brought about by the conclusion and enactment of wide-area economic partnership accords, such as the TPP, even though the rate of growth may decelerate. The current account balance will remain close to 4% of the nominal GDP.

<Assumptions for the economic outlook>

- The world economy: The U.S. will return to the TPP. The Regional Comprehensive Economic Partnership (RCEP) accord, as well as the Free Trade Area of the Asia-Pacific (FTAAP) agreement, which is a pact among Asia-Pacific Economic Cooperation (APEC) nations, will be concluded early. As a result, the world economy will grow at a rate 0.3 percentage points higher than what the baseline scenario indicates, thanks to increased trade and investments.
- Population: A net influx of foreigners will be 200,000 people a year in 2030.

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Nominal GDP	annualized growth rate, %	-1.0	1.3	1.6	1.9	2.4
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Current account	period average, % of nominal GDP	3.6	1.6	3.9	3.7	3.9

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