

Meeting Japan's Aging Challenge

BY RICHARD JACKSON AND KEISUKE NAKASHIMA,
CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES

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.

Richard Jackson is a senior fellow and director of the Global Aging Initiative at CSIS. Nakashima Keisuke is a research associate at the CSIS Global Aging Initiative.

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