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Session 1

Portrait of a Depopulating Society —Diversifying Values and a More Mature Prosperity—

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1 Changes in Corporate Behavior

This paper discusses—from a principally economic perspective—how conditions are likely to change in light of the population decline and the responses that might be required to ensure that these changes lead to prosperity.

First, one of the predicted changes associated with the decline in the population is a quantitative contraction in the economy. As shown in Figure 1, the author's model projects that national income will continue to rise until around 2010, when it will peak and thereafter go into decline. The fact that the economy—which has up until now been growing—will contract in size from now on represents a quantitative change and is likely to force changes in corporate behavior.

From “scale” to degree of added value

There will need to be a shift in corporate behavior from “scale” to degree of added value. In general, Japanese companies follow a product sales strategy of “low-margin, high-turnover,” whereby products yielding a small per-unit profit are sold in volume to generate a reasonable overall profit. At the very least, this strategy will no longer work and it will no longer be possible to turn a profit through volume. As sales and production volumes decline every single year, companies cannot continue to operate on an even keel with products that individually have little added value, and will thus have to abandon their low-margin, high-turnover strategy. As well as being a natural development, increasing the degree of added value in products—that is, raising the per-unit profit margin—is probably the only possible course of action.

There are two ways to increase per-unit profit (that is, to increase the degree of added value). One method is to reduce costs; the other is to increase retail prices. However, it is extremely difficult to reduce costs in a contracting economy. This is because the most effective method of reducing costs is to make use of economies of scale. If production volume is increasing from year to year, economy of scale operates as a positive factor; however, if production volume is declining from year to year, economy of scale has instead a negative effect and drives up costs. No matter how much effort is made to reduce costs in other ways, this will do no more than maintain the status quo, and it will be almost impossible to add more value by reducing costs. Thus, the only remaining option is to increase the retail price. As competition is fierce, however, it is not easy to raise prices like this. However, if a company is manufacturing products that cannot be made in other countries or by other companies, it will have more power to control prices and will be able to price its products in a way that is relatively profitable. In the future there will likely be a seismic shift in the way businesses are run, as they make the transition from volume to quality and add more value in this way; at the same time, companies will probably need to enhance their product development capability so as to increase the degree of value added.

From process innovation to product innovation

Companies will surely also have to make the transition from so-called “process innovation” (mechanizing manufacturing processes so as to drive down costs and preserve profits) to “product innovation” (whereby they will maintain profitability by bringing out revolutionary new products). This would naturally lead to great diversification in the way that businesses are run. With cost competition, competition focuses on how costs can be reduced, and there is essentially little diversification in the products manufactured. As the focus switches to product innovation, the key issues are what to produce, what types of product within a particular product category a company should target, and how the company should be run accordingly. Thus, it seems there will naturally be enormous diversification in the way companies are run.

2 Diversification in Patterns of Employment

In terms of corporate behavior, the changes described above are predicted. Other significant changes that can be imagined are changes leading to greater diversity, brought about by diversification in patterns of employment. It is no exaggeration to say that almost all workers in Japan still work within an employment system based on lifetime employment and seniority-based pay—a highly characteristic feature of the Japanese economy. This system of lifetime employment and seniority-based wages seems sure to collapse in the future.

Diversification in patterns of employment and lifestyles

The generally held view is that if the system of lifetime employment and seniority-based wages collapses, there will be a transition to a results-oriented employment system with performance-based pay. This is naturally a possibility, but it may not be the whole story. Even in the USA, where performance-based pay is firmly established, a considerable proportion of workers are working within a system of lifetime employment. In the world of performance-based pay, making a personal investment in order to get ahead may also entail the risk of pushing oneself too much, and there are reputedly many who put a premium on their own time and actively opt for the lifetime employment system instead.

Although the phenomenon of the “freeter,” or serial part-timer, is now being widely debated in Japan, this style of working is allegedly common in the USA and Europe. Briefly, such people work for a time to save money, then leave the company and use the money they have saved to pursue the kind of interests in which they can engage only while young. When the money runs out, they start working again. In present-day Japan, this way of working is highly disadvantageous, as under the current system of employment “freeters” do not build up any seniority. However, if the seniority-based wage system does collapse, this style of working will in general no longer be disadvantageous, and the ranks of the “freeters” will likely increase substantially. In short, when the system of lifetime employment and seniority-based wages collapses, it is not likely to be replaced by any single dominant new paradigm; rather, in one fell swoop a whole multiplicity of new ways of working will likely be spawned.

This diversification in patterns of employment will naturally be linked to increasing lifestyle diversity. It is often said that Japan’s consumption structure is homogenous—that is, that everyone wants the same type of products. Demand is focused on the best selling item in any given product category. By comparison, the

consumption structures in Europe (in particular) and the USA are reputedly more diverse. There may be a variety of reasons for the homogeneity of the Japanese consumption structure; however, the principal reason is probably the prevalence of lifetime employment and seniority-based wages.

The dominance of the system of lifetime employment and seniority-based wages has encouraged a certain uniformity in people's lifestyles, and as a result practically all Japanese lead the same lifestyle. The fact that people are leading the same lifestyle rooted in the same employment system naturally leads to uniformity in demand for products, and this would seem to account for the homogeneity in the Japanese economy's consumption structure. However, as mentioned earlier, a collapse in the system of lifetime employment and seniority-based wages will lead to significant diversification in employment patterns and much wider diversity in people's lifestyles. From a purely economic perspective, this will naturally lead to more diversity in consumption, and companies will have to respond to this much broader spectrum of consumer demand. At the same time, however, there is the possibility of a much more sweeping change—that in the future social values will rapidly diversify.

Diversifying social values

In political science and sociology, social values are put forward as the values that come about through the existence of society. In post-war Japan, social values were seemingly fairly homogenous. The social value that exemplified post-war Japanese society was probably in essence the drive to raise one's income. After the war, the labor force participation rate—the proportion of the population that is employed—increased every year. Coupled with the march of technological progress, this resulted in a rapid year-to-year increase in per capita national income in post-war Japanese society. In short, for the Japanese it was virtually guaranteed that their income would continue to rise in practice. In this environment the principal social value was probably the drive to earn more money. Rising incomes probably also served to lend a sense of coherence and stability to Japanese society.

In sociological terms it is said that this is a value that grows stronger year by year, and as such, it has come to serve as a unifying force in society. In that sense, the Japanese economy has continued to spawn this spreading social value—the drive for higher earnings—and this has had a unifying and stabilizing effect on society. However, it is possible that this will change drastically in the future.

It was predicted above that the economy would go into a steady decline after peaking in around 2010. However, since the population is declining, per capita national income will essentially remain unchanged. As per-capita national income levels off, having hitherto risen consistently, this particular social value will at the very least no longer continue to spread. At the same time, as employment patterns and lifestyles become more diverse, it is also debatable whether income will retain its universal economic value. Thus, social values will become much more diverse. How will society retain its unifying force? If society is completely stripped of its unifying force, social stability will suffer and other social problems will arise. How society can maintain its unifying force is likely to become a topic of social policy debate. In any case, it is likely that just as diversification in employment patterns brings about lifestyle diversity, people's social values will also diversify, causing wholesale diversification throughout Japanese society.

3 A New Prosperity and the Conditions Necessary for Its Achievement

This diversification in both corporate behavior and people's behavior is probably inevitable. What of the "mature prosperity" described in the subtitle of this paper? As yet, it is not known whether or not this prosperity will really be "mature"; however, as it will at least be different from the type of prosperity experienced up to now, it could well be described as a "new prosperity." Amid this inevitable diversification it will be necessary to undertake the following three specific measures—which primarily raise issues bound up with government public policy—in order to achieve this new prosperity.

(i) Switching to a consumer-driven economy

As the population ages in the future, the savings rate will naturally and inevitably decline substantially. Since investment in Japan's economy will inevitably decline, Japan's economy will rapidly contract unless consumption can compensate for the deficit. It will thus be necessary to devise some means to make up for the investment shortfall by increasing consumption. Japan must therefore switch over from an investment-driven economy to a consumer-driven economy.

What will this require? In economic terms, companies have only the leeway afforded them by their reduced investment, and this leeway must be used to increase wages. Unless these funds are reallocated to wage increases, it will simply be impossible to make up for the investment shortfall through increased consumption. In short, it will be necessary to convert the Japanese economy to a consumer-driven economy in order to ensure its continued stability in the future. It may well emerge that in order to achieve this the government will have to intervene in the labor market more than in the past.

The terms "small government" and "big government" have recently been bandied around; however, their usage has been completely misunderstood. The term "small government" is mistakenly used to denote government using a modest level of public finance; however, the difference between small government and big government relates to governmental intervention in the market place—"big government" denotes intervention in the market place whereas "small government" indicates lack of intervention. The asymmetry of the labor market means that leaving the market alone will not yield fair wage levels. Hence, in order to ensure fair wage levels, the government will have to intervene. Using the definition above, it thus appears that in the future the Japanese government will have to take a "big government" approach to the economy—at least in regard to the labor market.

(ii) Greater emphasis on "soft" aspects of public policy

As the birth rate declines, society ages, and sweeping social changes occur, it is naturally more vital than ever to maintain the foundations of society and the social infrastructure. As described previously, however, the savings rate has greatly declined; this would naturally seem to reduce Japan's overall investment clout and in turn significantly reduce its ability to maintain the social infrastructure. According to the author's forecast, the permissible amount of public investment (the level of public investment that the Japanese economy can realize) will almost halve in 30 years, declining by 47% over the period from 2000 to 2030. Thus, in the future demand for social infrastructure will diversify and grow; however, Japan will not have the savings necessary to realize it.

In this case it will be difficult for Japan to maintain the apparent “hardware” bias in its existing public policy, whereby it promotes the welfare of the people and attempts to increase society’s efficiency by building roads and constructing various other kinds of facility. For example, to resolve traffic congestion, the imposition of traffic regulations would provide an alternative solution to widening the road. It seems likely that if Japan is to change from road construction (that is, its “hardware-oriented” public policy) to traffic regulation (that is, a “software-oriented” public policy), it will naturally have to chart a public-policy course that places greater emphasis than before on these “software” aspects.

(iii) Reducing the scale of public finance and throwing off dependency on tax increases

Finally, public finance (which lies at the heart of public policy) will play an even greater and more significant role in the future, if this new prosperity is to be achieved. Currently public finance and tax increases are duly under debate in Japan, and the author has consistently asserted that tax increases do not represent the way forward for public finance in Japan.

As the ideals of public welfare and the welfare state have been pursued, public finance and national per-capita public expenditure in Japan have continued to grow rapidly in the post-war period. Irrespective of the system’s pros and cons, this rapid growth was made possible by the fact that the labor force participation rate (the proportion of people who were working) was increasing every year. The fact that the proportion of people working was on the increase meant that the overall capacity to shoulder the tax burden (which would also cover people who were not working) also increased. Thus, although per-capita public expenditure was increasing, a certain balance was maintained. However, from now on the labor force—that is, the proportion of people working—will decline year by year, which means that in the medium-to-long term the overall capacity to shoulder the tax burden (and cover non-working people) will decline year by year. Hence, the only way to keep the public coffers from bankruptcy will be to reduce per-capita public expenditure. Since tax hikes will only serve to precipitate the collapse of the public finances at some stage, tax increases represent a course that should be avoided.

In terms of future fiscal policy, the decline in the population will at the very least necessitate a reduction in the scale of public finances—probably a reduction that is proportionate to the population decline. This should free Japan from its predilection for relying on tax increases.

Within the realm of public policy, these measures essentially represent the basic conditions that are required. The promotion of these basic conditions should allow a new prosperity rooted in these basic conditions to emerge from the diversification of corporate and consumer behavior that will inevitably occur—a new prosperity that will characterize Japan’s shrinking society.

Figure 1 Estimated national income

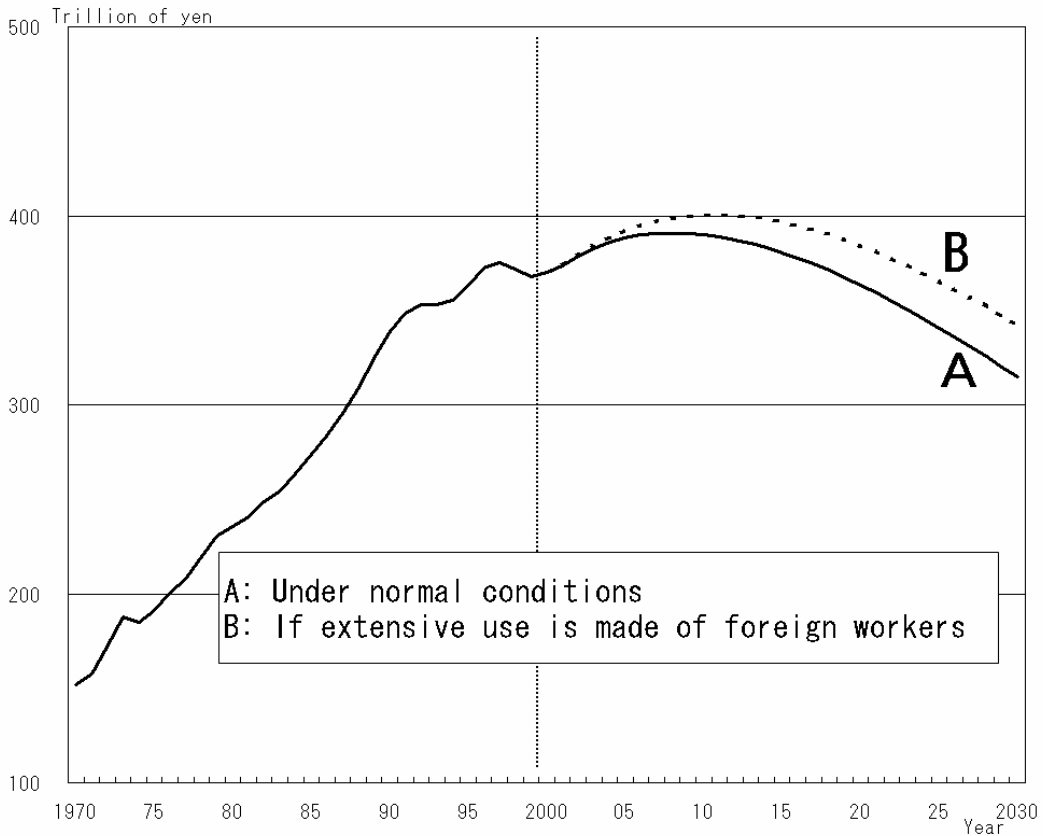


Figure 2 Efficiency in capital investment (increase in rate of labor productivity/rate of increase in capital equipment ratio)

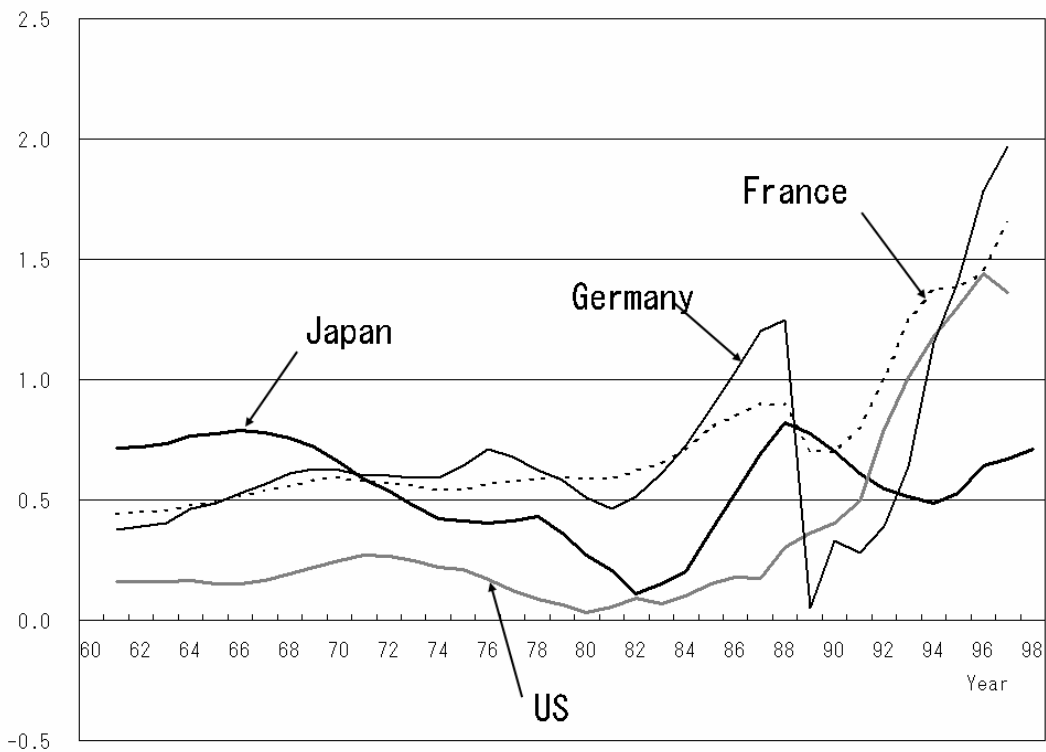


Figure 3 Wage levels classified by age group

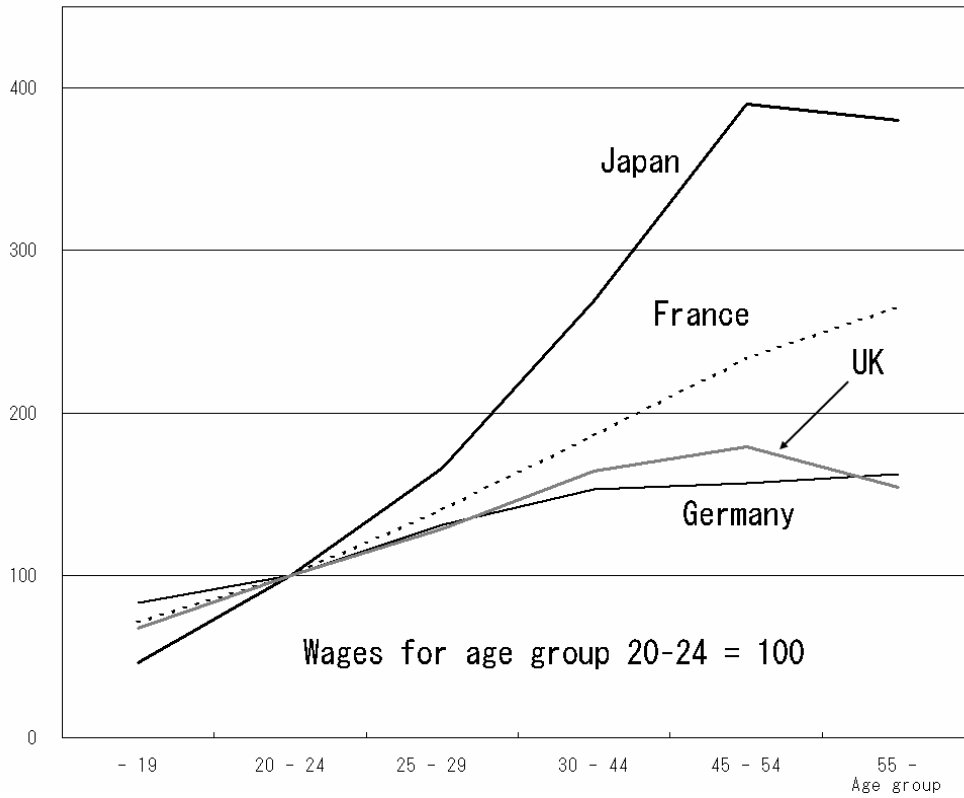


Figure 4 Estimated national savings rate, consumption, and aggregate investment

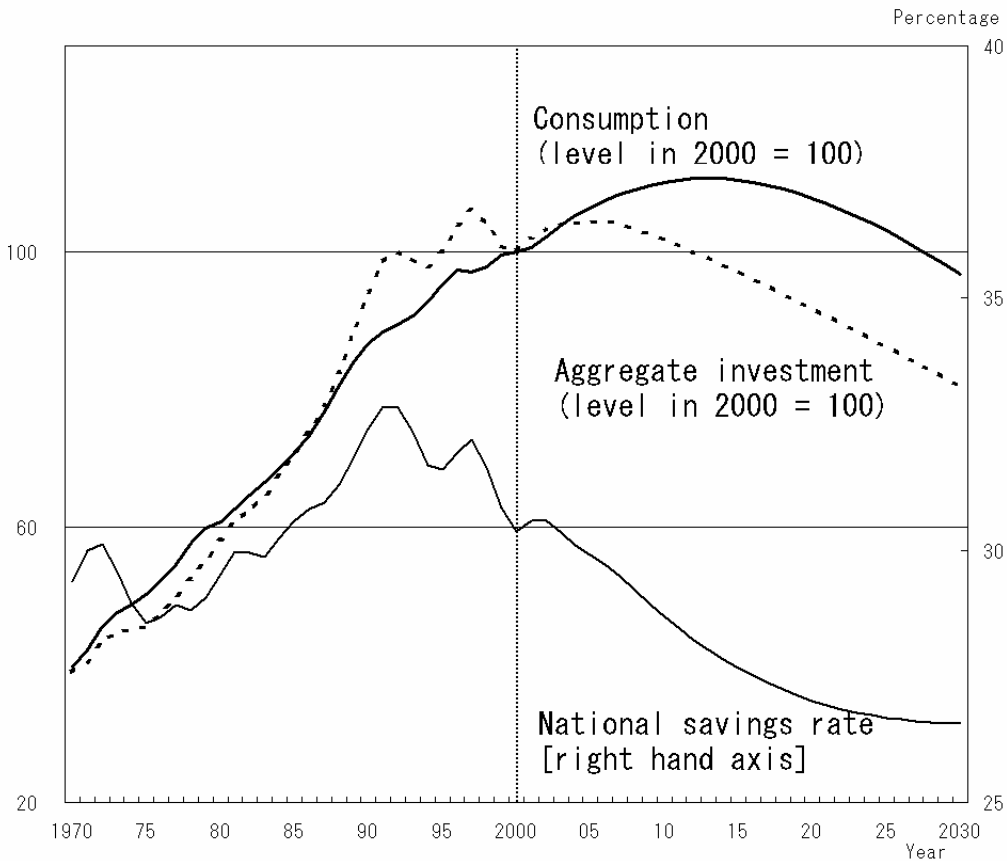


Figure 5 Estimated permissible expenditure on public works projects, and renewal and maintenance costs

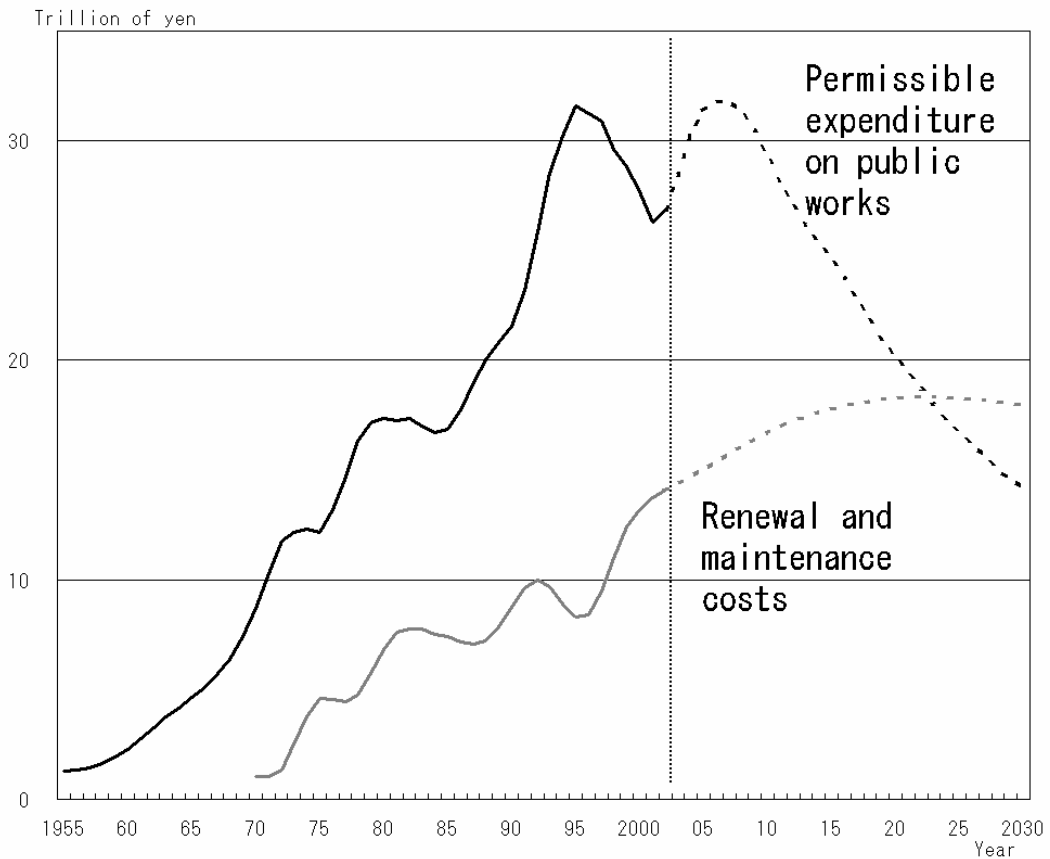


Figure 6 Per-capita public expenditure and percentage of population that is of working age

