

Japanese economy: depressed due to lack of population

[Sociology](#), [Population](#)



Japan, like America and most of Europe is now in a liquidity trap. The debt overhang from the 80's bubble initiated this process, but Japan's problems also have strong demographic roots " as a declining working-age population depresses the demand for investment" According to the World Population Data Sheet, Japan's population growth rate which peaked during 1945-50 at 15. 3% has now dipped into the negative and is declining at the highest rate in the world.

Due to a declining population, people aged above 65 now account for a record high of 24. 1% outnumbering children below age 1436 while the figure was 12% in 1990. The working age population is estimated to fall by about 40% by 2050. Due to decrease in working age population, labour force and thus marginal productivity of labour is also declining.

As a consequence, macroeconomic growth is bound to be impeded. 39 In fact when we see the real GDP per working-age adult, we realise that if demographically adjusted, the Japanese stagnation tale is a myth.

This low population growth is attributed to factors such as high costs of raising children, country's reluctance to accept immigrants, low fertility and women choosing to work rather than give birth.

Population aging can affect investment in two ways: first, if a decrease in labour force is substituted with capital, domestic investment would increase. Second, a declining population would cause decline in demand which would reduce domestic investment. However, since population aging shifts consumption to the service industry (such as medical and nursing services)

where it's difficult to substitute labour by capital, the second effect will dominate.

Moreover, as working age population declines, there may be a permanent excess of supply over demand. As aggregate demand shifts downwards due to decrease in population, it intersects the constant aggregate supply curve at a lower price and lower quantity, which means both deflation and recession. This decreasing population growth rate is a headache for Japan also due to "shrinking pool of taxable citizens and ballooning social welfare costs to care for an increasing number of elderly". Over the 2000s decade, the population growth rate and inflation were found to correlate positively in 24 advanced countries. This reflects how real income generation is undermined by population aging. Moreover, due to technical advancement there is stagnant market and sluggish exports.

With lower demand, companies stagnate; if its sales aren't growing, its profits can't grow unless it cuts costs which is what Japanese businesses have done. Few have taken the alternative route to raising prices, as it makes no sense to risk losing market share when the market isn't growing. 47 However, lower costs mean lower wages or even laying off. 48 The seasonally adjusted unemployment rate expectedly dipped by 4.1% in the month of March, 49 the lowest since November, 2008. The jobs to applicants ratio was 0.86, as per the Labour Ministry. 50 Hence, the Japanese don't consume or invest first (leading to the paradox of thrift), because they won't borrow as the asset price bubble has caused a major psychological barrier against debt. Secondly because an aging population reduces consumption

expenditure, addition to the wages being on a decline. Finally, the Japanese also expect prices to continuously fall which has turned into a self fulfilling prophecy 51 and sent the economy spiralling into recession.

Steps taken by the bank of Japan and the government

The BOJ and the government have taken various Keynesian policy measures in the past five years to improve Japan's economic condition. To expand money supply, the BOJ gradually cut the interest rates to virtually zero (0 to 0.1%) by October 2010. It introduced a 'funds supplying operation' in 2009 which lends money to banks against collaterals for three months at policy interest rates. It launched an 'asset purchase programme' in 2010 that primarily focused on government securities but also included private assets (like corporate bonds).

In 2012, the target size of purchases by the end of 2013 was increased to 101 trillion yen. It also announced introduction of Stimulating Bank Lending Facility to provide unlimited long-term funds at interest rate 0.1% to financial institutions. In January 2013 BOJ replaced its 1% price stability goal with a 2% target. Prime Minister Shinzo Abe has now introduced a three pronged approach, combining aggressive monetary easing, fiscal stimulus and structural changes to shake off Japan's deflationary lethargy and push it on a path of growth, creating around 600,000 jobs.

First, monetary market operations will be conducted by BOJ that will increase monetary base at the rate of 5 trillion yen a month. The planned doubling of monetary base, to be achieved through purchases of government bonds with

longer maturities and private assets, is aimed at weakening the yen and reaching a 2% inflation target. Second, the government will give a strong fiscal stimulus of 10.3 trillion yen to encourage economic growth. This money will be spent on disaster prevention and reconstruction, stimulating private investment and other measures. It will also create about 600,000 jobs.

However, it will be impossible for Japan to solve its debt situation without improving revenues. In 2012, Japan passed a legislation to hike the consumption tax in two stages: 5% to 8% in April 2014 and to 10% in October 2015 in order to contain its public debt. This is essential for achieving its target of halving the primary fiscal deficit by 2015. The doubling of tax will generate revenue of about 13.5 trillion yen, of which about 20% will be used to improve social security systems. The rest will be used to finance the deficit. In order to offset the blow of this tax hike, Mr. Abe is considering a \$50 billion economic stimulus. Third, extensive growth enhancing structural reforms will be implemented to untangle the web of regulations and trade restrictions that hinder growth and innovation.