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For Ailing Japan, Longevity Takes Bite Out of Economy

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TOKYO -- At first glance, Tomiya Isshiki's retired life seems carefree. The trim 67-year-old leads a vigorous calisthenics session every morning in his local park. To wind down, his group claps along to a cheerful song. "In our 50s and 60s we are young buds," go the lyrics. "At 99, we reach fruition."

But that bright message also makes Mr. Isshiki nervous. In a country with the world's longest average lifespan, he is worried about outlasting his savings. "I'm retired, and the proportion of working people is falling," he says. With fewer workers, there will likely be lower pensions to support those like himself. "We are all worried about the future, so we have to save."

Japan is wrestling with an unprecedented demographic time bomb. With the average woman bearing 1.33 children, the government projects Japan's population will start declining in three years. By around 2007, the proportion of the population over 65 will have jumped to 20% from 10% in just 21 years, a rate of graying that's nearly twice as fast as any other major nation.


Tomiya Isshiki

Until very recently, most Japanese assumed these population pressures were problems looming in the future. But evidence is mounting that consumers and businesses, anticipating this future, are already taking action that is hurting the world's second-largest economy now. Anxious households are saving far more than expected, stifling economic growth. An expensive, aging work force is squashing corporate profits -- and thus stock-market values -- by adding extra payroll costs. And Japan's top companies such as **Toyota Motor** Corp. are shifting their operations overseas in search of more-vigorous growth.

These worrisome developments are an overlooked factor contributing to Japan's decade-long economic crisis. Population pressures will continue to sap the country even if it shakes off its deep banking crisis and a crippling bout of price deflation. "People have rational expectations for the future, and their behavior today is affected," says Naohiro Yashiro, president of the Japan Center for Economic Research. "The aging society is not only a matter of the future, but a matter of the present."

A decade from now, some economists say Japan could even slip into semipermanent recession because of the

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COMPANIES

Dow Jones, Reuters

Matsushita Electric Industrial Co. ADS (MC)

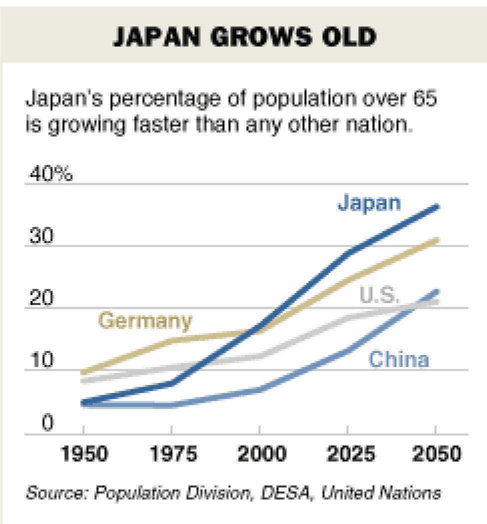
PRICE	9.70
CHANGE	-0.20
U.S. dollars	12:39 p.m.

* At Market Close

declining working population, and its national pension system could collapse.

How Japan copes with its unfolding demographic crisis has crucial lessons for other countries facing similar trends. With the world's longest life expectancy -- 85 for women, 78 for men -- Japan's society is aging faster than any other now. But by midcentury, the populations of Italy and Russia are expected to have declined even more drastically. Even China, the world's emerging economic powerhouse and most populous nation, will age rapidly starting in 2010, with the elderly making up 22.7% of the population by 2050, up from 6.9% now, according to the United Nations Population Division.

Such jumps in age, coupled with declines in fertility in virtually every country, have led at least one expert to predict that, after zooming ahead in the next 50 years, the world's population could begin to decline. That marks a reversal of long-held predictions of unsustainable population explosions.



"Japan is like a laboratory -- a canary in the coal mine," says Koichi Akaishi, a fellow at the Research Institute of Economy, Trade and Industry, a government-affiliated think tank.

Japan's corporations say they have started preparing for demographic change, in ways that bode ill for their home-country economy. The country's top car makers, Toyota, **Honda Motor** Co. and **Nissan Motor** Co., haven't opened an assembly plant in Japan for over a decade, and are shifting their focus to the U.S., where the population is expected to keep growing. Nissan has shuttered three assembly plants in Japan recently, while it plans to expand North American production by 53% to 1.3 million units in 2004, from 850,000 last year. Japanese videogame maker **Sega** Corp., facing a shrinking youth market at home, is putting more emphasis on sports games popular in the U.S.

One immediate solution to the shrinking work force would be large-scale immigration. But Japanese leaders remain adamantly opposed to this, and foreigners still account for just 1.4% of the country's population.

Mr. Isshiki, who worked as a chemical engineer at a gas company and has generated numerous patents, is relatively prosperous. He has a house in the Tokyo suburbs, has paid off his mortgage, and received a lump sum of more than $170,000 from his company on retiring. On top of that, his national pension pays him between $2,100 and $2,500 a month.

Still, he won't dare splurge, especially after a recent class on Japan's aging society he took at a school called the Senior Citizen's College. If he or his wife, Teiko, became ill, for example, the nation's public medical and nursing-care insurance systems would only cover a portion of the costs.

"If we go and spend all our money, who would look after us?" says 66-year-old Teiko Isshiki, sitting around a heated table with her husband one recent evening, eating sukiyaki. The Isshikis use all their monthly pension money and cash Mr. Isshiki earns on part-time consulting, but they haven't touched their retirement lump sum. It is in the bank earning next to no interest. They drive a 10-year-old Toyota Corolla.

Anxiety about the future is one reason Japan's savings rate remains stubbornly high -- currently around 10%, compared with 1% in the U.S. For many years, that helped finance Japanese industry and enabled a high level of investment. Still, economists had expected the savings rate to plummet as Japan's population aged, producing a large number of retirees who spent from their savings. This spending, economists once assumed, would buoy consumption and overall growth. One study around 1990 predicted that Japan's savings rate would fall to around 5% in 2002, and then go negative around 2007. The economists got it wrong.

"The savings rate should be declining a lot, but it's hardly going down at all," says Wataru Miyanaga, an Assistant Director in the Economic and Industrial Research Department of the Development Bank of Japan. Other reasons for the high savings: concerns over rising unemployment and a bulge in the thrifty middle-age population.

Rather than the boon they were once considered, such high savings have driven a steady decrease in consumption over the past 10 years -- except for a blip in 1996 ahead of an impending increase in the sales tax. And sagging private consumption, which makes up 55% of Japan's gross domestic product, has in turn dragged down real GDP growth to an average of just 1.05% a year over the past 10 years.

The dramatic implications of demographic change are even affecting the behavior of young Japanese. Shinsuke Hamada, a shaggy-haired 25-year-old who works the graveyard shift directing traffic at road works in the Tokyo area, isn't scheduled to retire for another 40 years. But most of his friends are boycotting their obligatory national pension payments, currently $113 a month.

The reason: In 2002 there were 3.6 Japanese between 20 and 64 to support each person over age 65. By 2025, when he turns 48, the ratio will fall to just 1.9, and it will still be declining. While Mr. Hamada's generation pays premiums to keep today's elderly in relative comfort, they can expect far less when they retire.

"We all said, 'We won't get anything, so we aren't paying,' " says Mr. Hamada, a budding rock drummer. "The image of the pension system is that it's just throwing money away." He was startled recently to discover that his mother was paying on his behalf, and told her it was a waste.

Such pension rebels are increasing every year. Among self-employed Japanese, who must make their own pension payments, 29% didn't pay their pension premiums in 2001, compared with just 17% in 1996. Among those aged 20 to 24, 46% didn't pay up. Some economists fear that any further rise in pension-dodging might trigger a collapse in the system unless the government gets more aggressive about collection. An official at the Ministry of Health, Labor and Welfare's pension division concedes the government has been lax about enforcement and says a plan to reform the system is in the works.

Many companies, meanwhile, are being sapped by the effects of corporate traditions such as Japan's seniority-based wage system, where pay rises according to age. The average age at electronics behemoth **Matsushita Electric Industrial** rose to 41 in 2002 from 31 in 1980. The aging trend imposes a swelling wage burden, straining companies' bottom lines. The change in age structure means that in 2000, Japanese companies -- excluding farming and forestry firms -- had to spend an annual average of $741 more on salaries for each male employee than in 1980, according to Fumikatsu Kimura, a labor-market economist at Mitsubishi Research Institute. For female employees, the extra cost was $362. For Japanese industry as a whole, that translates into $31.5 billion of additional costs -- equal to about 0.7% of Japan's annual economic output.

A few companies are exploring a way to retain older workers while keeping costs down. **Mitsukoshi** Ltd., a Tokyo department-store chain, sets the official retirement age at 60. Then, it rehires as many as three-quarters of the retirees at a much lower salary, which gets around the seniority system.

Japan's declining labor force -- the number of people age 15 and older who are employed or looking for a job -- means the domestic economy will soon have to struggle mightily to grow at all. Increases in the labor force are a prime ingredient in the growth of any country's economy, along with inputs of capital and gains in productivity. But Japan is losing one of those three pillars of growth. The nation's work force peaked in 1998 and has been shrinking slightly since 1999. Economists forecast an annual 0.1% fall in the labor force until around 2010, when the rate of decline will accelerate to 0.5% and beyond.

Of course, Japan's economy could still grow, if each worker produced more. But productivity growth has languished at under 1% for the past 10 years, a rate that would barely make up for the thinning work force.

In the long term, a boost in the birth rate could remedy the demographic impact to the economy. But so far, the government's efforts, including showering new mothers with free strollers and cash, haven't succeeded. Among the reasons: An increasing number of working women, discouraged by long hours required in the office, few day-care facilities and the high cost of children's education, are opting not to give birth, or to have just one or two children.

"It's hard to raise kids in the current environment," says Yuriko Shimizu, a 38-year-old working mother of two. "You think about a lot of problems such as the high cost of raising kids and the difficulties to get a place in a day-care center. You know it's going to be tough."

For now, Japan's best hope in defusing the demographic time bomb may be to squeeze more work and consumption out of the elderly. Hakuhodo Inc., Japan's second-largest advertising agency, set up the "Elder Business Development Division" three years ago, to create an additional advertising focus beyond the under-35 set. A spate of new products aimed at the elderly have recently hit store shelves. Travel agent JTB Corp. is offering package tours aimed at seniors, featuring events such as concerts in Vienna. **NTT DoCoMo** Inc. sells mobile phones with large buttons.

Some economists suggest raising the bar on the definition of "old." If companies extend the mandatory retirement age from the current norm of 60 to 70 later this decade and 75 around 2020, the ratio of pensioners to working-age Japanese would remain below a manageable 20%, says Dr. Yashiro, the Japan Center for Economic Research president.

Mr. Isshiki doesn't have any problem with working as long as he can. After retiring at age 60, he stayed on at his employer another five years at a reduced salary. Even now, in addition to calisthenics, study programs and extra exercise classes, he still helps write patent applications for engineers at his old company.

"When you have to do something for someone, it gives you an aim," he says. "I want to live like a spinning top -- keep going round till I drop."

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