

## The Future of Japan in Ascending, but Aging East Asia

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Japan's politics and society appear to be sinking deeper into turmoil and lethargy. Numerous signs abound: politicians intent on deposing each other rather than engaging in policy discourse; a sadistic bent by some of the media; diplomacy carried out on an ad hoc basis; a budget-cutting panel (*shiwake*) by populist politicians that shrinks long term social investment and innovative initiatives; indifference toward expansion of opportunities for the young generation and women.

Can we stand by and accept this plight at the time when Japan moves toward becoming a society of an unprecedented mature population (evident in its aging demographic and low birth rate). Is it not that what is required at this very moment are a proactive stance and the will to fabricate together a vision for the direction Japan should pursue based on a reconfirmation of Japan's historic and international position?

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The aggregate total of real GDP (on purchasing power parity basis) for China, Japan, Korea, Taiwan, Hong Kong, and Singapore has risen to \$ 15.8 trillion in 2009 (IMF estimate). This is comparable to \$ 15.5 trillion of the U.S. and Canada (\$17.0 trillion for NAFTA including Mexico), and it has overtaken the EU's \$ 14.8 trillion. How will these East Asian economies that have turned into a major economic region progress in the future? Will China continue its rapid economic growth and grasp regional hegemony? Is Japan's presence fated to become increasingly less relevant?

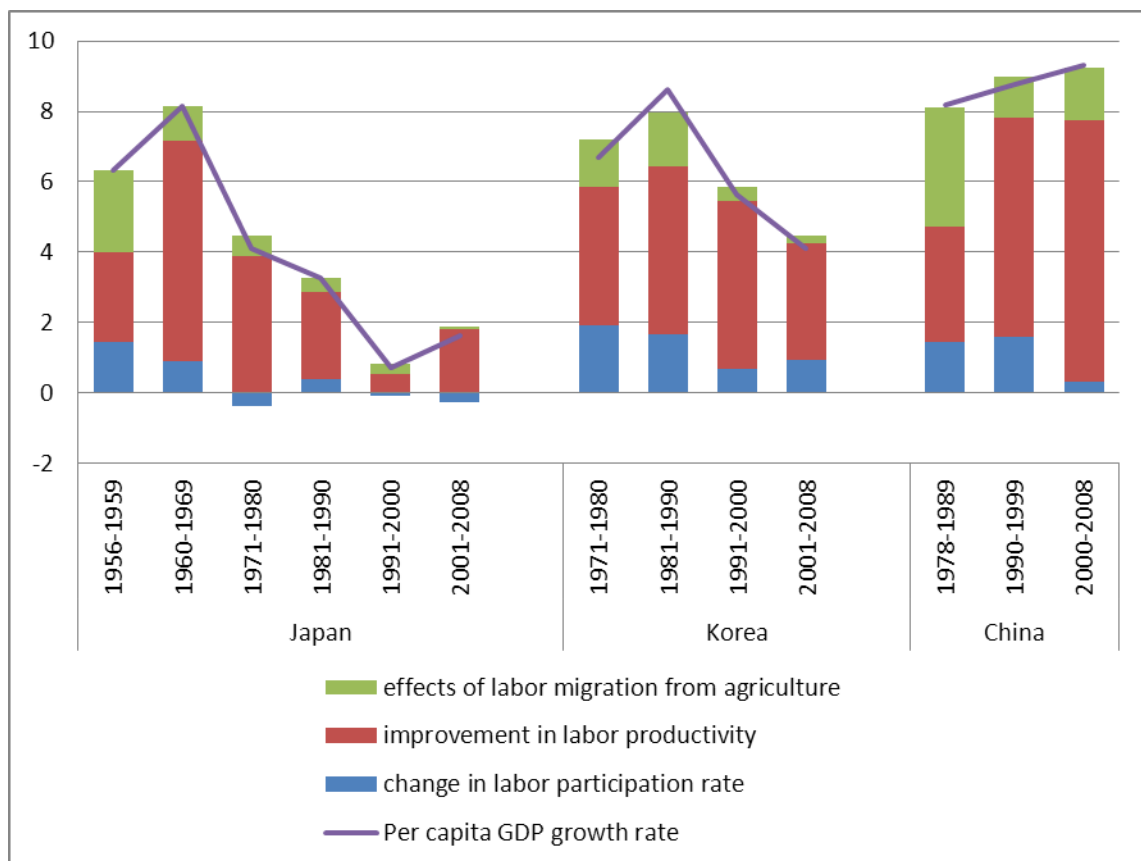
The size of GNP of a country matters in terms of her abilities to have impacts on global markets, to invest in public goods including defense and so on. However, let us focus here on per capita income as a proxy measure of economic development and individual economic welfare. Using official data from Japan, China, and Korea, I analyzed the sources of growth of per capita GDP and have presented the results in the accompanying chart I. There are striking similarities in the high growth patterns of Japan from 1956 to 1969, Korea from 1971 to 1990, and China from 1978 to 2008. In all three cases shift of agricultural employment to more efficient industrial and service sectors, combined with a "demographic bonus" (that is, production growth due to an labor force increase brought about by a high birth rate in the previous period), were major contributing factors. Currently, the per capita GDP of China's coastal region indeed approaches Japan's toward the end of the 1970s and Korea's of the mid-1980s; but coastal China's agricultural employment rate at 28% still remains high (48% for inland region) .

During the following period—1971–1990 in Japan and 1991–2008 in Korea—the effects of the expansion of the labor force and the migration of agricultural workers receded while the autonomous rise in industrial labor productivity maintained the growth of per capita GDP. Sooner or later, China, which reached its peak in the ratio of its labor force to population last year, will enter this phase. There is still room for a shift of employment from the agricultural sector, but even here conditions are beginning to forecast a turning point. This is apparent in the wage increase among the population that

has flowed from the rural areas to urban areas whose official residential registration remains in rural villages.

In Japan what followed the period of a stable ratio of working population were the “lost two decades.” During this time the negative effects of a maturing demographic appears to start being felt in the form of declining labor productivity (as the level of employment remained rather stable); and this impact will no doubt will become more straightforwardly evident in the next ten to twenty years. Korea has managed to keep the positive effect of its second demographic bonus from 1991 to 2008; but in ten years this will have an adverse result when Korea’s aging population will increase with an unparalleled speed even faster than Japan’s case: a paradox of demographic bonua. China is no exception to the creeping population maturity; the reconsideration of its one-child policy will doubtless turn into a political controversy.

**Chart: Sources of per capita GDP growth rate**



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Wild geese fly in a V-shaped formation to improve their lifting power during their long distance migrations. In the early 1930s, Professor Kaname Akamatsu employed this metaphor to characterize the pattern of economic development in the Asian region. His was a vision of technology transfer from the lead wild goose (Japan) in turn to the following

flock of geese to allow the development of all of Asia. This vision became a popular paradigm in development economics in 1960s. Now, however, the lead goose has become aged and once-lagging China has become stronger and appears to be catching up and overtaking.

However, one can have an alternative story of the emergent phenomenon: Not only has Japan until now been ahead of other Asian nations in terms of technological development, it is also leading the way toward a society of unprecedented population maturity in modern history. This dynamic has been, and will be, accompanied by institutional change, as I will note later. Korea and China, in their own ways, will sooner or later follow this course. If we say Professor Akamatsu's vision is "Version 1.0" (and its popular version in the 1960s as "Version 1.1"), we can conceptualize the compound dynamics of East Asia's demographics, economies, and institutions as "Flying Geese Paradigm 2.0."

Suggested in this are two essential implications. The first highlights an unresolved problem essential for Japan to continue its flight toward its mature demographic phase in a stable manner. That is to say, it is no longer possible to continue the system of entitlements such as pensions and health insurance as set up in the 1970s when a ratio of active labor force to total population remained high and stable. Should the reform of these institutions be postponed, the burden will lie more heavily on members of the younger generation, sapping their incentive to work. This would mean that in the future the bars on the graph I for Japan would be dragged further down.

The overhaul of the system of entitlements by increasing still-relative low sales tax rate (7%) and allocating its total revenues for social security purposes is of critical urgency; this requires a mutual understanding and alignment of interests among three generations: the retired, the active workers, and the young (and the ones yet to be born). This necessitates a mechanism that incorporates a political vision, public mindedness, and inter-generational compassion. Such mechanism ought to differ from the formerly dominant arbitration among economic interest groups by patriarchal politicians and bureaucratic initiatives, as well as from the pursuit of small government through bureaucrat-bashing. Can we view the present political faltering as an indication of unavoidable stray in the transition to such a mature political institution?

Second, the disparity among Japan, China, and Korea flying in the flying geese paradigm with their differing phases can hold the potential for being the source of common potential benefits. The new phase that China will fly toward can stabilize as it successfully deals with the accumulated "costs of high growth" in the current phase, such as environmental destruction, inefficient energy use, rising income gaps between urban and rural areas, lack of universal public services, and urban congestion.

On the other hand, should China continue to exhibit increases in industrial labor productivity, it is neither realistic nor necessary for Japan to attempt to maintain its comparative advantages in all industries as a one set. Rather, it will become critical to diverse manufacturing basis globally, combine industrial and service strengths in innovative manners in some selected markets, further refine social and economic technology attained in the previous phase (e.g., environmental and urban management) and mobilize innovative abilities to solve issues particular to the phase of mature demographics (health, caregiving, lifelong education, scientific technology, organic-oriented agriculture, etc.).

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Under these circumstances, there arises the potential for mutual support between the strategies of an economy leading the way toward the phase of mature demographics (Japan) and an economy pursuing the way toward the phase of stable growth (China). That is, for Japan to meet the above-mentioned challenge more effectively, its reliance on China's growth in industrial productivity in terms of imports from China and direct investments in China increases. Conversely, as China deals with its accumulated "social costs of growth," the social and economic expertise that Japan has already attained and will develop further will become useful.

When the efficacy of the developmental strategies of nations in different phases of development is subject to a dependency on other nations' strategic choices, these strategies may be said mutually complementary. According to game theory analysis, when strategic complementarities are present, each country can potentially attain the momentum gained from such complementarities. There is also the danger, however, that triggered by some event, mutual distrust emerges, leading the two sides into retorts of isolationist strategies that trap them in a dismal state. For Japan to exploit potential benefits from global strategic complementarities as the lead flying goose, it must be determined to open up the nation further. To cope with shrinking workforce, it needs to relax immigration regulations, inviting possible candidates for skilled, nationalizable workers and families rather than temporary unskilled workers. It also needs to actively participate in the formation of the Trans-Pacific Partnership free trade agreement (TPP) to open its domestic markets further. A wild goose that forges ahead into unknown territory all alone will stall.

Each nation's strategy does not merely refer to its governmental policies. It consists of the vector of political choice of all its citizens based on the private benefits of various interest groups and the people's civic spirit. In order to allow a smooth transition to the coming flying geese paradigm phase, each nation needs to evolve its political framework so that it can effectively bind these factors together. Japan only has a limited time that it can put off the agreement among its generations and the wider opening of its country. When it starts to address these issues in earnest, hope will return to Japan as it leads the flight toward the as yet unknown territories of the future.

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