Meeting Japan’s intertwined challenges of population ageing and high government debt

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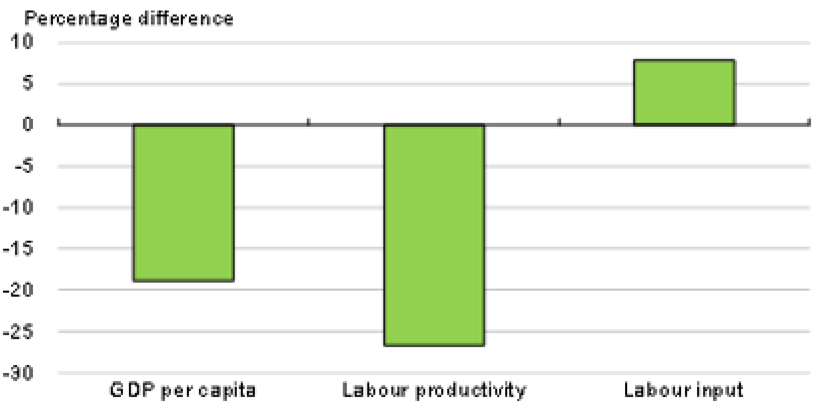
With faster growth in the past six years, Japan’s real GDP growth in per capita terms has converged toward the OECD average and job creation has been strong. However, labour productivity and per capita income are well below leading OECD economies (Figure 1), while Japan faces challenges of rapid population ageing and high government debt. The 2019 *OECD Economic Survey of Japan* explores ways to address those challenges.

Figure 1. Labour productivity is low in Japan and labour inputs are high

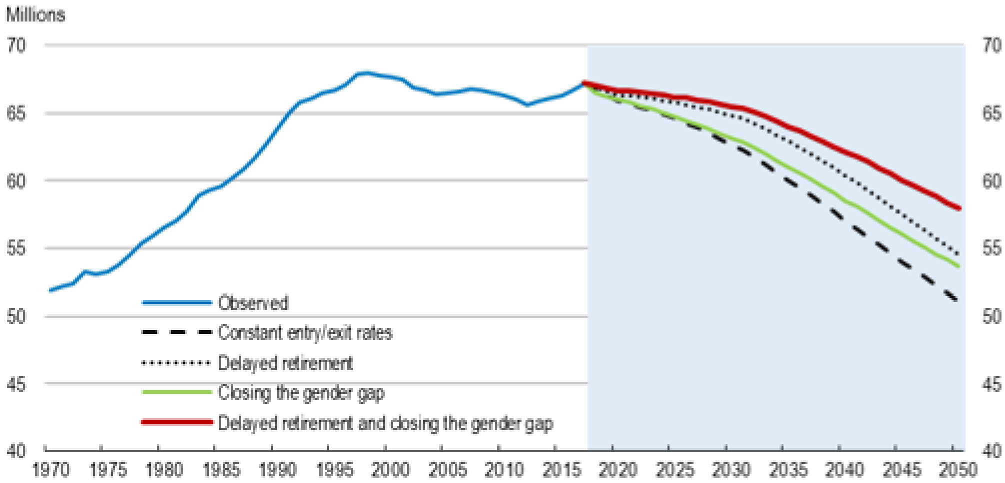
Japan relative to the top half of OECD countries in 2017



Source: OECD (2019).

Japan’s population is projected to decline by one-fifth to around 100 million by 2050, while the elderly population will reach 79% of working-age population, remaining the highest in the OECD. One important challenge of the demographic change is a shrinking labour force. Assuming constant labour market entry and exit rates, Japan’s labour force would drop by a quarter from 67 million to 51 million by 2050 (Figure 2). Reforms of labour policies and practices to remove obstacles and disincentives to work for men and women of all ages would limit the decline in the labour force.

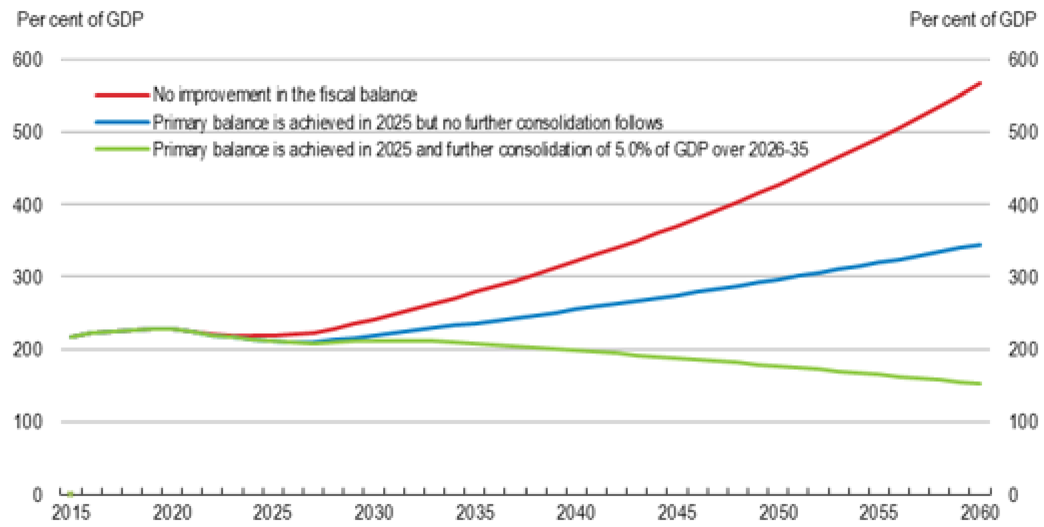
Figure 2. Japan's labour force faces a significant decline



Note: The baseline assumes constant labour market entry and exit rates by gender for each five-year age group. In the "delayed retirement scenario", exit rates are reduced for both men and women by 10% for each five-year age group between the ages 55 and 74. In the "closing the gender gap" scenario, the participation rates for women converge to those for men in each five-year age group.
Source: OECD (2019).

Demographic change is also having a big impact on the fiscal situation. Public social spending doubled from 11% of GDP in 1991 to 22% in 2018, surpassing the OECD average. Twenty-seven consecutive years of budget deficits have driven up gross public debt from 60% of GDP to 226%, the highest ever recorded in the OECD area. Population ageing is projected to raise social spending by another 4.7% of GDP over 2020-60. An illustrative analysis indicates that fiscal consolidation beyond the government's FY 2025 primary surplus target is necessary to stabilise government debt (Figure 3).

Figure 3. Fiscal consolidation beyond 2025 is necessary to stabilise the government debt ratio



Source: OECD (2019).

Those challenges are intertwined. Weak economic growth, due to low productivity and declining labour force, makes it difficult to ensure fiscal sustainability. Distortions in tax and benefit systems impede employment, particularly of women and the elderly. Against this backdrop, the main messages of this *Survey* are:

- Bold structural reforms, including improved corporate governance and policies to make small and medium-sized enterprises more dynamic, are needed to boost productivity and promote inclusive growth as labour inputs decline.
- Fundamental labour market reform is a priority to enable Japan to make full use of its human resources, thereby mitigating the impact of a shrinking labour force.
- Achieving fiscal sustainability requires a detailed consolidation plan that includes measures to control spending in the face of rapid population ageing and gradual hikes in

revenue, beginning with
the 2019 consumption tax hike.

Further reading:

OECD (2019), *OECD Economic Surveys: Japan 2019*, OECD Publishing, Paris.