

The United States Is *Not* the Next Japan

Attempts to draw a parallel between the bubble in the Japanese stock market in the early 1980s and its long secular decline since to recent developments in our equity markets abound. One of the latest examples is a 62-page report from the Board of Governors of the Federal Reserve System, ominously titled "Preventing Deflation: Lessons from Japan's Experience in the 1990s."

Japan: Long history of low birth rates, token immigration

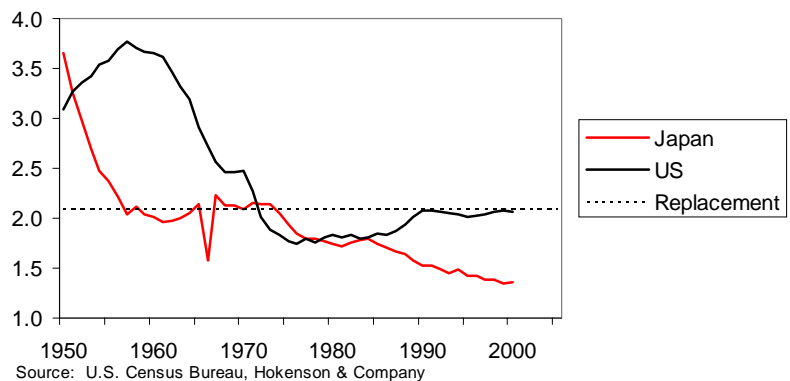
In our view, a glaring and critical omission from any of these discussions is any mention of the vast demographic differences between Japan and the United States. If we view chronic deflation as being symptomatic of insufficient demand, the Japanese problem is easily understood in the context of that country's very long history of low birth rates and its unwillingness to accept more than a token number of immigrants. Japan's situation is not, however, hopeless even in the immediate future. Genuine opportunities exist for Japan to increase domestic demand significantly by accepting a greatly increased economic contribution on the part of Japanese women. But aside from a few token measures, this potential remains largely untapped. Until and unless that changes, we maintain our zero weighting on the Japanese equity market, a view that we have held since the early 1990s.

U.S.: Highest birth rates in developed world, open to immigrants

Emphatically, demographics show that the United States is not Japan. U.S. birth rates are the highest in the already developed world, and America remains open to immigrants. That openness has been tested and retested in the post 9/11 environment. Immigration appears to have slowed somewhat, but that appears to be more a function of the domestic economic difficulties than any fundamental alteration in immigration policies. This is an issue that can change, and we will continue to monitor it. Barring any significant alterations, we retain our positive outlook on the U.S. economy and U.S. equity markets.

Chart 1

Total Fertility Rate: Japan vs US



Japan's total fertility rate is well short of what is needed to replace a generation

America's Natural Advantage – More Babies

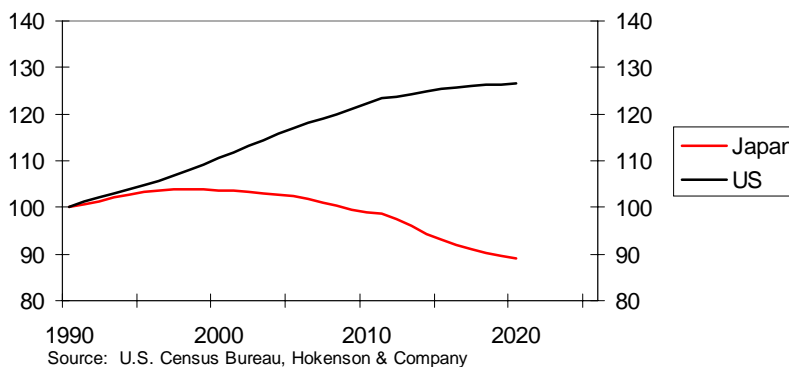
Populations change in size for three reasons: changes in births, changes in deaths, or changes in net migration (inflows minus outflows). Chart 1 (on page 1) displays the sizable birth advantage enjoyed by the United States. The total fertility rate (lifetime births per woman) in Japan fell sharply during the 1950s, reaching replacement level of 2.1 by 1960. Aside from the precipitous decline in 1966, the year of hinoe uma (fire-yang-horse), it remained roughly constant for slightly more than a decade, then began its long-term secular decline. At current levels of around 1.35, total fertility in Japan is well short of what is needed to replace a generation. It is worth noting that Japan does not have the lowest birth rate in the world. That honor, dubious as it may be, is shared by Spain and Italy at 1.18. That is why current United Nations population projections show those countries to be the oldest by the year 2050. But the entrance of Spain and Italy into very low fertility is of fairly recent origin. Their "demographic" problems are still ahead of them.

By 2020, Japan's working age population will be 10% smaller than it was in 1990

Japan has been dealing with such problems for more than a decade. Considering that Japan's firmly entrenched history with below replacement fertility began in the early 1970s, it is not coincidental that the country's special brand of economic malaise began in the 1990s. It would take that long for the increasingly smaller birth cohorts of the 1970s to reach working age. The persistence of low fertility implies that it gets worse the further out you go. By the year 2020, Japan's population of working age (persons aged 20 to 64 years old) will have shrunk by more than 10% compared to where it was in 1990 (see Chart 2).

Chart 2

**Working Age Population: Japan vs US
(Index, 1990=100)**



By 2020, the U.S. population of working age is expected to be 30% larger

In contrast, the population of working age in the United States in the year 2020 is expected to be 30% higher than it was in 1990. If anything, that estimate may be too low. The principal surprise of the 2000 Census was the discovery of an additional 6.115 million residents in America. Based on the prior census conducted in 1990, the U.S. Census Bureau had estimated that the resident population in April 2000 would be 275,308,000 persons. Instead, 281,421,906 residents were counted. Compared to the prior estimate, the resident population

**Surprises in the 2000 Census:
2.22% more Americans than
expected – nearly all in
younger age groups**

in the United States is higher by 2.22%. But the intriguing and positive issue that is germane to this discussion is that nearly all of the entire higher count was concentrated in younger age groups. The median age, originally estimated to be 35.8 years, came in at 35.3. A six-month improvement in the median age may not sound like much, but it is, in fact, quite noteworthy.

Chart 3 displays the numerical difference between prior and actual estimates of the U.S. resident population on April 1, 2000. Chart 4, which displays the percentage differences, provides the more significant comparison. The overall percentage difference was 2.22%. For persons aged 25-34, however, the percentage difference is 6.55%, or nearly triple the “national” average. Three other “young” age groups also had percentage differences greater than the average: 5-9, 10-14 and 20-24.

Chart 3

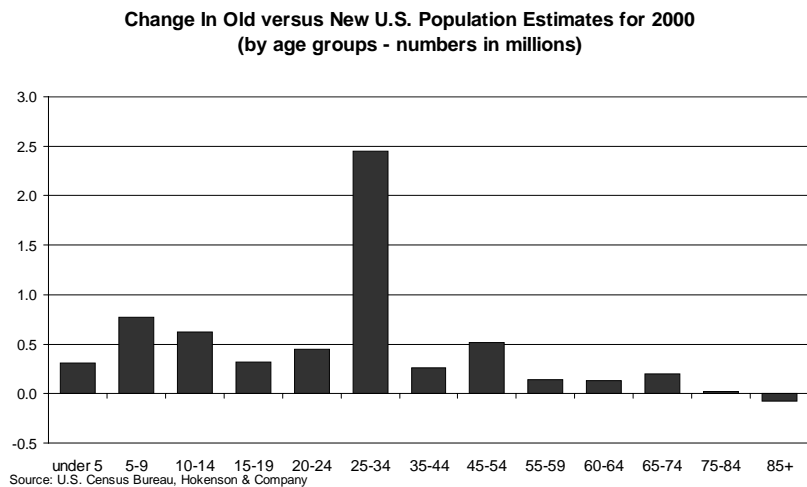
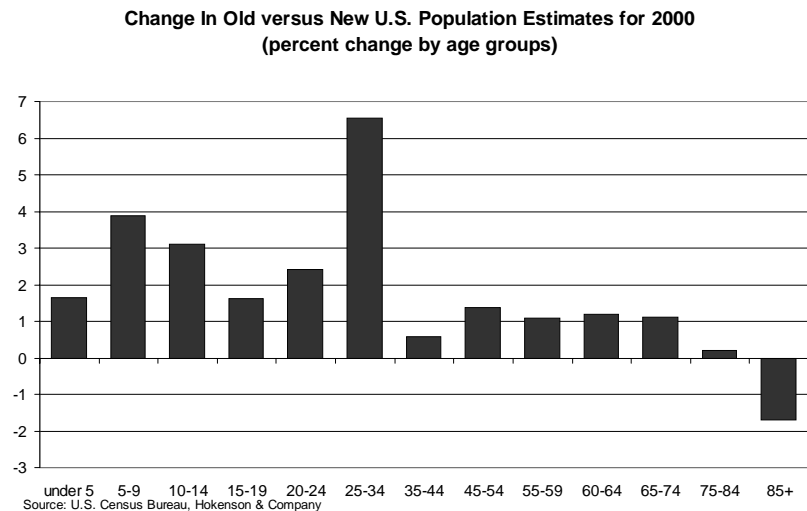


Chart 4



Immigration – America’s Secret Weapon

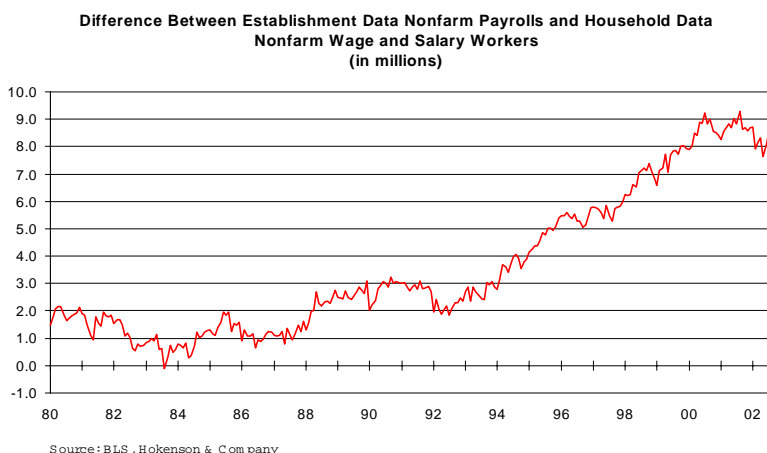
Japan’s long experience with chronic deflation and economic malaise has not escaped the eye of observers, some of whom appear to be at least cognizant of Japan’s demographic difficulties. Every six months or so, a newspaper article appears suggesting that Japan become more open to foreign residents. Inasmuch as migrants from abroad cannot move their housing, this could create the demand so desperately needed. It is, however, the least likely outcome.

Xenophobia vs border control

Asia in general and Japan particularly are the most xenophobic regions of the world. I have visited Japan every year for the past 14 years. Several years ago, there was an article in the Tokyo press that expressed great concern about the possibility of 30,000 undocumented workers (illegals) in the greater Tokyo metropolitan area (total population in excess of 24 million). In Dallas a month later, I related that story to clients. One of them speculated that there were probably 30,000 illegals within a square mile of where we were having lunch. And to the best of my knowledge, there had not been any articles in the local press expressing any concern. This was, of course, pre 9/11. In the immediate aftermath of that terrible tragedy, there were more than several instances of concern bordering on hysteria about illegal aliens. And more than one politician introduced legislation that could have effectively shut the borders. Fortunately, that hysteria has greatly subsided, essentially replaced by the recognition of more effective border control but not to the extreme of closing the borders.

Some of the positive aspects of the openness of America to illegal as well as legal immigrants are discussed in the results of the 2000 Census above. A more timely proxy for tracking illegal immigration that has been developed is shown in Chart 5. It simply recognizes the fact that illegal workers are likely to be counted in the establishment survey but unlikely to be counted or found in the separate survey on households.

Chart 5



Another “jobless” recovery?

It is certainly conceivable that some of the recent flattening and weakness in illegal immigration is attributable to post 9/11 concerns. But there was a similar decline back in 1992 when the United States was in the early stages of what was then labeled the “jobless

recovery". Aside from the 9/11 issues, the receptiveness to illegal workers is also clearly inversely correlated with the state of domestic labor markets. When labor markets are tight (unemployment low) as it was for much of the latter half of the 1990s, the tolerance for illegals is much higher. And it is the converse when labor markets are loose and unemployment is higher. We continue to be optimistic that the United States will remain open to immigration. Time will tell whether there is a break from the recent past or whether this is a function of the current economic funk that will disappear when the economy picks up. It is an issue that we will continue to monitor and report on going forward.

Is There Any Hope for Japan?

Demographically, the United States has an enormous advantage compared to Japan. Birth rates here are higher, and America remains much more open to immigration. Moreover, there is very little that Japan can do about its own demographic fortunes. It is a demographic reality that no one is born as an adult worker. Even if Japan could somehow engineer a major birth boom near term, it would take the better part of 20 years for that to begin to have a material impact on the country's economy. There are some who still believe that Japan will become more open to foreigners. It is not a belief that we share.

Japanese women could play a much larger role

The as yet unrealized potential that does exist today for Japan is the role of women in the Japanese economy. Chart 6 (on page 6) illustrates the basic problem. In terms of the utilization of women in the economy, Japan has gone nowhere for the past 50 years. The percentage of women in the paid labor force has remained stuck at around 50% since 1950. In contrast, the United States (also here as a proxy for the United Kingdom and most of northern Europe), has seen a fairly steady increase in the percentage of women working from about 3 in 10 in 1950 to now close to 6 in 10. At first glance, it appears that Japan has gone from first to last in the latter half of the 20th Century. But appearances are deceiving. Even as late as 1960, more than one-third of the Japanese population still lived on farms. Thus, Japan's apparent position of being first in terms of accepting the economic contribution of women greatly understates the country's resistance since many of the women counted in the paid labor force back then were wives of farmers. If we could properly account for this rural/urban shift, it would show that Japan began at a much lower percentage.

Glass ceilings are still very thick

By 1980, of course, the rural/urban shift was about complete in Japan. The essential flatness since then continues to reflect informal barriers to employment that women face once they are married and/or start families. Japan has the highest participation rates in the world for women who are not married. But the notion that the place of employment is the place to find a husband is endemic. On a recent trip, we were told by a client that 60% of Japanese male managers marry someone whom they meet at work. Once a woman marries, she is expected to leave the workforce to take care of her husband. As a former colleague used to remark, getting married is strike one. Strike two is starting a family. The social pressure on women is tremendous. It is no surprise that Japanese women who are married and/or have families are much more likely to work for non-Japanese firms. And we have lost count of the number of Japanese women who are graduates

of the most prestigious universities in Japan who are now working in New York or London. Simply put, glass ceilings are still very thick in Japan. As shown in Chart 7, not only is Japan way behind the United States in terms of educated women in the workforce, it lags Turkey and Mexico as well.

Chart 6

Female Labor Force Participation: US vs Japan

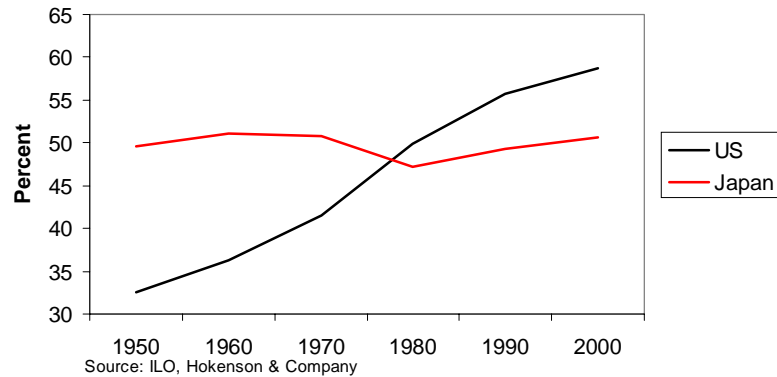
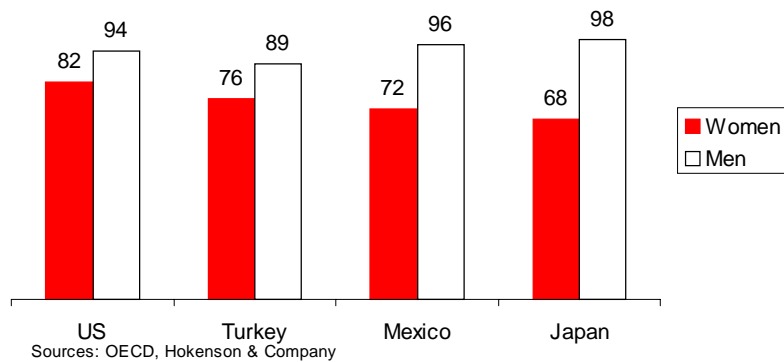


Chart 7

Japan's Glass Ceiling

Labor Force Participation of 25- to 64-year-olds with college education or above, 1998, percent



Growth accounting highlights the need for improvement in the status of Japanese women

The importance of dramatically increasing both the percentage of women who are working (participation) and improving the integration of women into the economic system can best be understood by remembering how economies grow. Real economic growth can be accounted for by three components: (1) growth in the labor force, (2) changes in utilization (increase in hours worked and/or higher employment), and (3) productivity. Japan already has the longest workweek in the developed world, so big changes in that component are unlikely. Current unemployment rates are high, but even a dramatic decline will not produce much beyond a cyclical acceleration. As displayed above, the population of working age is poised to decline. If participation rates do not increase sufficiently, that leaves productivity as the only driver of growth. Productivity, however, has been a drag on growth. We view this as reflecting a lack of youthful dynamism. No one can change the age distribution of Japan, but it is conceivable that increased utilization and integration of women may help to inject new dynamics.

Lies, Damn Lies and Statistics

One of the more damning charts purporting to show that the United States is already the next Japan is shown here as Chart 8. At first glance, it seems to show a nearly exact replication of the Japanese market. The fit is so good, it is eerie. But the fit is *too* good. In instances like this, we are reminded of Mark Twain's comment about lies, damn lies and statistics. The good fit results from a judicious use of scaling. The left hand scale is the Nikkei. It increased nearly eight-fold from 1982 to December 1989. The right-hand scale is the S&P 500. It increased by only four-fold from 1992 to 2000. Using the same percentage scale for each index, the fit breaks down (see Chart 9).

Chart 8



Source: Forbes.com
 (<http://www.forbes.com/2002/08/19/08/0819simons.html>)

Chart 9



Source: Hokenson & Company

Conclusions and Summary

In conclusion, demographics reassures us that ongoing concerns that the United States is the next Japan are misplaced. From that perspective, the two countries are nearly polar opposites. Of course, demographics is not the only issue separating the two countries—although we have always been fond of the remark from the Canadian demographer David Foote that demographics explains about 70% of everything. Aside from the issue about the utilization and integration of women discussed above, Japan also suffers from a lack of transparency in accounting, reporting issues regarding nonperforming loans, highly regulated markets and considerable governmental influence in corporate affairs. All those issues compound the chronic deflation in Japan. They are, however, not its cause, which is largely demographic in nature. Much of the current debate about macroeconomic policies (fiscal and/or monetary policy) for Japan misses the point – akin to looking at trees and not seeing the forest. Macroeconomic policy mistakes were made, but they did not create the current dysfunction. Nor are there macroeconomic policies that can correct Japan's problems.

Postscript: Is Housing the Next Bubble in the United States?

The other area of interest for the financial markets is trying to spot the next bubble. Within the past year a number of commentators have asserted or alluded to the possibility that housing is the next bubble. The evidence cited is home prices rising faster than the general rate of inflation and more rapidly than the rate of growth of household income (leveraging). We do not share that fear. Like anyone else, we would love to be able to point out the formation of the next bubble. The preliminary work that we have done in the housing area, however, suggests that what is occurring in the housing markets has a solid demographic base. Aside from the immigration issues discussed above (it is not possible for immigrants to move their houses here), there are enormous shifts in the social mosaic of generations that support rising homeownership (rising demand for single-family homes). It is an area that we will be commenting on in much more detail in our next report.

References

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