

# Declining Labor Force

—Need for Reduction in the Equilibrium Unemployment Rate

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Japan's unemployment rate (seasonally adjusted) stood at 3.3% in April 2015, the lowest level since April 1988, and it appears to be approaching the equilibrium unemployment rate. The “Diffusion index of ‘Excessive employment,’ minus ‘Insufficient employment’ continues to be negative (implying an excess of “insufficient” responses), and, in some cases, there are acute shortages of labor. Since labor market conditions are on an improving trend along with recovery in the economy, at present, the supply/demand balance for labor is tightening. This may rekindle concerns expressed in the mid-2000s that the shortage of labor will cause supply constraints.

The potential growth rate is determined by [Change in labor input + Change in capital input + Change in total factor productivity]. Labor input is equal to [Labor force population × working hours per person]. The decline in the labor force population is expected to be unavoidable, even if the participation of women and seniors in the labor force increases. In addition, the number of working hours worked is expected to decrease as the number of non-regular workers continues to rise and restraints are placed on long working hours. Also, there is a strong possibility that the rise in labor productivity will be moderate going forward.

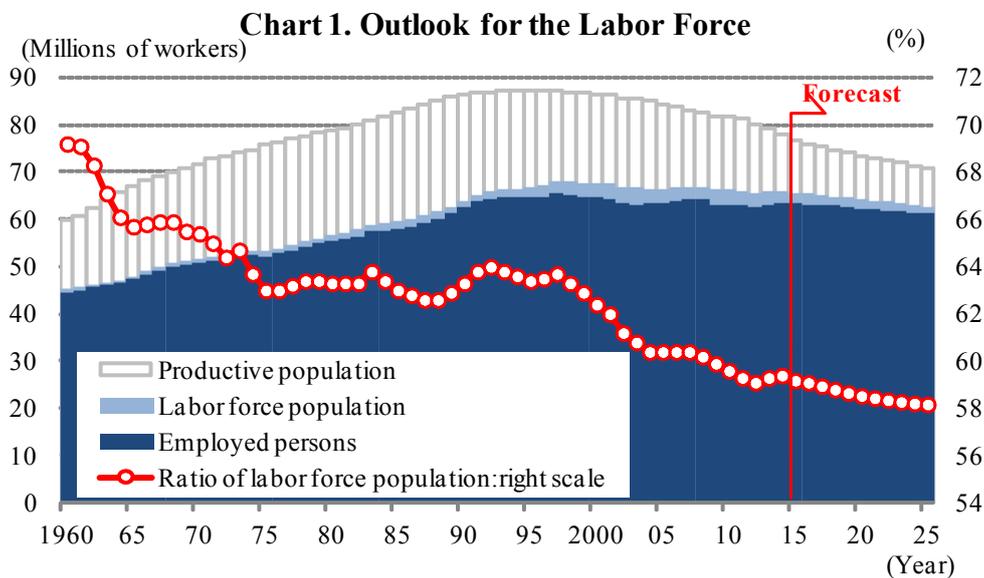
Over the long term, as the population has stopped expanding, the rate of growth in real GDP has gradually declined. The decline in the labor force population has an impact not only on the supply side but also on the demand side. At present, not only is the pace of expansion in demand rapid, but also severe labor shortages concentrated in some sectors have emerged. Therefore, it seems likely that the previously existing issue of weakness of growth in demand has not been addressed.

As the labor market has moved toward equilibrium at a lower level, the buffer in the market has diminished, and mismatching is more likely to occur. For this reason, the labor situation is now more prone to short-term fluctuations. If the economy shows sudden improvement, as is occurring now, not only will serious labor shortages emerge, but also, if the economy moves into even a minor downturn, labor market conditions may deteriorate substantially and unemployment may rise sharply.

The problem is the decline in the labor force population as such, but it seems that a factor that is making the shortage of labor more serious in the near term is that there are many instances of mismatching between regular and non-regular employment, job types, age-groups, etc., in the

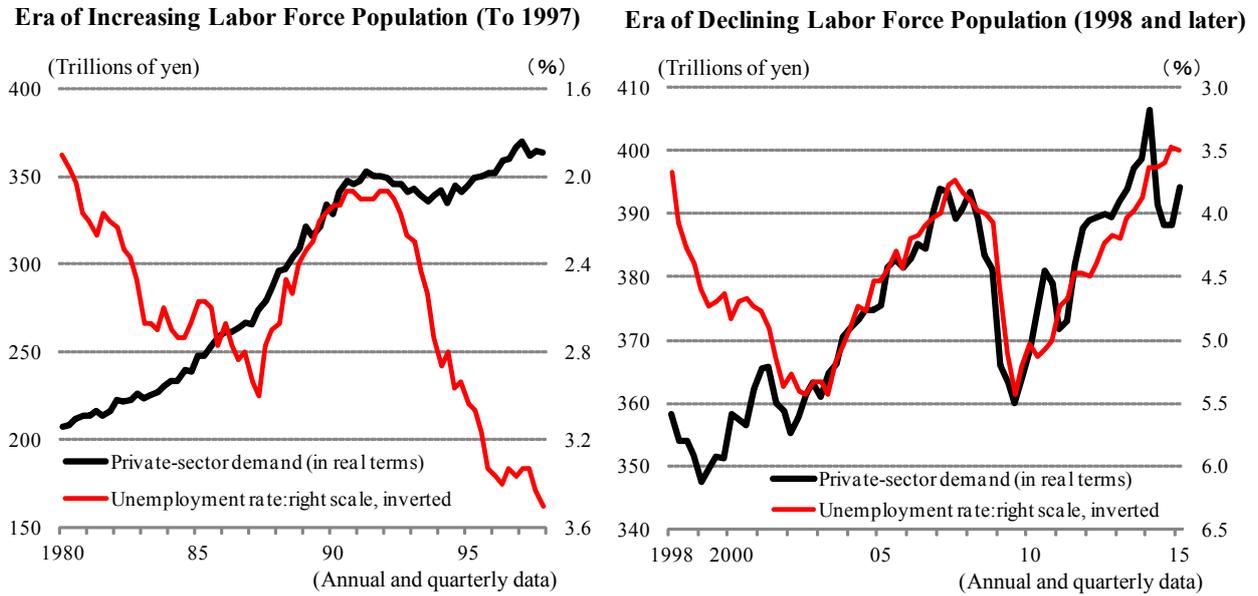
labor market. As a result of this mismatching, some persons are not able to participate in the labor force. Thus, in addition to the decrease in the unemployment rate due to the expansion in demand, a new issue to be addressed is the decline in the equilibrium unemployment rate through eliminating labor mismatching.

The elimination of mismatching is becoming more important, and, for this reason, it will be necessary to increase liquidity in the labor market. One way of doing this would be to relax restrictions on the dismissal of employees, but, unless frameworks are put into place that will enable dismissed employees to find new jobs, this could cause labor market instability.



Note: Figures for 2015 and later years are MURC estimates.  
 Figures for productive population are as of October 1 each year.  
 Sources: Ministry of Internal Affairs and Communications,  
 National Population Census, Population Estimates, and Labor Force Survey;  
 National Institute of Population and Social Security Research,  
 Population Projections for Japan (Estimates as of January 2012)

**Chart 2. Private-Sector Demand and the Labor DIs**



Note: Seasonally adjusted data  
 Sources: Cabinet Office, Preliminary Quarterly GDP Statistics; Ministry of Internal Affairs and Communications, Labor Force Survey

\*This is an English-language summary of a report originally published on June 15, 2015. The full report is available only in Japanese, but the author will answer questions regarding the topic by e-mail.

\*The information and the views contained herein are subject to change without notice.