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**Note:** The table is in Japanese and contains additional information that is not translated.
A Balance Sheet Approach to Reforming Social Security Pensions in Japan: Is NDC the Answer?

by

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World Bank & RFV Conference on NDC Pension Schemes
Sandhamn, Sweden, 29-30 September 2003
Organization

- Demography
- Basic Facts:
  - Identifying Main JPN Problems
- Is NDC the Answer?
- Conclusion

- 2-tier Benefits
- Contributions
- The Biggest Business
Two-tier Benefits (DB)

- Basic Flat-rate Benefits (PM, PP)
  
  66,400 yen = USD 580

- Earnings-related Benefits (40Yrs)

  28.5% of Career Average Monthly Real Earnings

- Replacement Rate (One-earner Couple)

  Around 60% Net (230,000 yen = USD 2,000)

- CPI Indexation
Contributions/Transfer from GR

- **Contributions**
  - 13.58% of **Annual Wages**
  - 13,300 yen = USD 117 (PM, PP)

- **Subsidy from General Revenue**
  - 1/3 of Flat-rate Basic Benefits

- **Mainly PAYG, but**
  - with Partial Prefunding
The Biggest Business in Japan

- Aggregate SS Pension Benefits
  44 tr. Yen = USD 386 billion in 2003
  (12% of National Income)

  cf. The Automobile Industry
  40 tr. Yen (Domestic Output in 2000)

- Rapidly Growing
Demography

- TFR
- Total No. of Populations
- Proportion of 65+
Trends in the Total Fertility Rate of Japan

Actual and Projected Population of Japan

Proportion of the Elderly (+65) in Japan

Year 2003
19.0% (Japan)

Basic Facts

- Deficit in Current Account
- Balance Sheet:
  - Huge Excess Liabilities
- SS Pension Contributions:
  - Heavy Burdens Outstanding
- Too Much Income Transfers between Generations
- Increasing Drop-out
Current Account of the KNH

<table>
<thead>
<tr>
<th>YEAR</th>
<th>Current Account (trillion yen)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>3.95</td>
</tr>
<tr>
<td>2000</td>
<td>2.08</td>
</tr>
<tr>
<td>2001</td>
<td>-0.70</td>
</tr>
<tr>
<td>2002</td>
<td>-0.61</td>
</tr>
<tr>
<td>2003</td>
<td>-2.84</td>
</tr>
</tbody>
</table>
Balance Sheet of the KNH
(as at the 31st MAR 2000)

Assets

Contributions 1170
F. Reserve 170
Transfers (GR) 280

Liabilities

Excess Liabilities: 530 tr. yen

Contributions

Excess Liabilities: 530 tr. yen

Assets

Liabilities
Balance Sheet of the KNH (Part 1)
(as at the 31st MAR 2000)

Pension Liabilities Accrued from FUTURE Contributions

Excess Liabilities: 80 tr. yen

- Contributions: 1170
- Transfers (GR): 180
- Liabilities: 1430
- Assets: 1200

(trillion yen)
Balance Sheet of the KNH (Part 2)

(As at the 31st Mar 2000)

Pension Liabilities Accrued from PAST Contributions

Excess Liabilities: 450 tr. yen

Assets

- 100 Transfers (GR)
- 170 F. Reserve

Liabilities

720
Which Is More, SS Contributions or Tax Revenues?

FY 2003 National Budget, Japan

SS Contributions = 55.6 trillion yen
Tax (Central Gov.t) = 43.9 trillion yen
Main Income Sources of Japan’s Central Government

FY 2003 National Budget, Japan

(trillion yen)

Consumption Tax: 11.9
Personal Income Tax: 13.8
SS Pension Contributions: 29.0
SS Health Care Contributions: 17.5
Corporate Income Tax: 9.1
Per-capita Income by Age in Japan

SS pension benefits are the major source of retirement income

SS Pension Benefits 78%

Wages and Salaries 6%

Interest and Dividends 5%

Others 11%

median income: 3.38 million yen

Source: The 1989 NSFIE (elderly couples: median income group)
Drop-out from SS Pensions (Non-employees)
Delinquency in Paying Pension Contributions

% 40
35
30
25
20
15


37.2
Is NDC the Answer?

- How Helpful?
- Any JPN-specific Problems Remaining?
- Politically Feasible?
Strengthening Incentive-Compatibility

- Direct Link between Contributions and Pension Benefits
  “Every Penny Counts”
- Increased Credibility
JPN-specific Problems

- Income Reporting Reliable?
- Legacy Pensions
  - Huge Excess Liabilities
- Reducing EL:
  - Several Options
Option 1: Reducing Benefits

- Deflation-Indexing
- A Clawback System
- “Macroeconomic Indexation”
- Increasing the NRA to 67
- Deducting Contributions for Health Care
- More Taxes on Benefits
Option 2: Increasing Contributions

- Incentive-compatible?
  - What Matters is Taste of Pie

- Penalties on Employment
  Non-neutral & Regressive

- Income Tax Revenues
Option 3: Increasing Subsidies

- **Where to Go:**
  - Flat-rate Basic Benefits (1/3 ÷ 1/2) or Guaranteed Pensions or Legacy Pensions?

- **What Funding Source:**
  - Consumption Tax or Income Tax or Cutting Other Public Expenditure?
Politically Feasible?

- Strong Interest Already Shown
- No Concrete Proposals, Yet
- Options Still Vary among Different Ministries
- Gov’t Reform Plan:
  May be Fixed by the End of DEC 2003
Conclusion

- **Switch to NDC:**
  Very Much Helpful for Strengthening Incentive-Compatibility

- **Handling Legacy Pensions Still Remains**

- **Politically Feasible, but Unclear When to Switch**