A Balance Sheet Approach to Reforming Social Security Pensions in Japan: Is NDC the Answer?

by

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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

(trillion yen)

<table>
<thead>
<tr>
<th>Year</th>
<th>Value</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)

Excess Liabilities: 530 tr. yen

Assets

- Contributions: 1170 tr. yen
- F. Reserve: 170 tr. yen
- Transfers (GR): 280 tr. yen

Liabilities

- 2150 tr. yen

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

Pension Liabilities Accrued from FUTURE Contributions

Assets Liabilities
(trillion yen)

Excess Liabilities: 80 tr. yen

1170

Contributions

180 Transfers (GR)

1430
Balance Sheet of the KNH (Part 2)

(Part 2 )

(as at the 31st MAR 2000)

Pension Liabilities Accrued from PAST Contributions

Excess Liabilities: 450 tr. yen

Assets | Liabilities
--- | ---
100 Transfers (GR) | 720
170 F. Reserve |

(trillion yen)
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)

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount (trillion yen)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumption Tax</td>
<td>11.9</td>
</tr>
<tr>
<td>Personal Income Tax</td>
<td>13.8</td>
</tr>
<tr>
<td>SS Pension Contributions</td>
<td>29.0</td>
</tr>
<tr>
<td>SS Health Care Contributions</td>
<td>17.5</td>
</tr>
<tr>
<td>Corporate Income Tax</td>
<td>9.1</td>
</tr>
</tbody>
</table>
Per-capita Income by Age in Japan

SS pension benefits are the major source of retirement income

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

YEAR

%
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 \(\frac{1}{3} \text{ or } \frac{1}{2}\) 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**