The Japanese Public Pension System: What Went Wrong and What Reform Measures We Have

by

Noriyuki Takayama

Professor of Economics, Hitotsubashi University
takayama@ier.hit-u.ac.jp
http://www.ier.hit-u.ac.jp/~takayama/

International Conference on Japan and Italy: Economic Performances and Policies Compared, Bocconi University, Milano, 9-10 October 2003
Organization

- Demography
- Basic Facts:
  - Identifying Main JPN Problems
- Future Policy Options
- Concluding Remarks

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

- Basic Flat-rate Benefits (PM, PP)
  66,400 yen = Euro 516

- Earnings-related Benefits (40Yrs)
  28.5% of Career Average Monthly Real Earnings

- Replacement Rate (One-earner Couple)
  Around 60% Net (230,000 yen = Euro 1,780)

- CPI Indexation
Contributions/Transfer from GR

- Contributions
  - 13.58% of Annual Wages
    - 13,300 yen = Euro 103 (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 = Euro 341 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)

- 3.95 in 1999
- 2.08 in 2000
- -0.70 in 2001
- -0.61 in 2002
- -2.84 in 2003 (YEAR)
### Balance Sheet of the KNH

(as at the 31st MAR 2000)

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1170</td>
<td>2150</td>
</tr>
<tr>
<td>280 Transfers (GR)</td>
<td></td>
</tr>
<tr>
<td>170 F. Reserve</td>
<td></td>
</tr>
<tr>
<td>Contributions</td>
<td>1170</td>
</tr>
</tbody>
</table>

**Excess Liabilities: 530 tr. yen**
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

180 Transfers (GR)

1170

1430
Balance Sheet of the KNH (Part 2)

Pension Liabilities Accrued from PAST Contributions

Excess Liabilities: 450 tr. yen

Assets Liabilities

<table>
<thead>
<tr>
<th>(trillion yen)</th>
</tr>
</thead>
<tbody>
<tr>
<td>800</td>
</tr>
<tr>
<td>700</td>
</tr>
<tr>
<td>600</td>
</tr>
<tr>
<td>500</td>
</tr>
<tr>
<td>400</td>
</tr>
<tr>
<td>300</td>
</tr>
<tr>
<td>200</td>
</tr>
<tr>
<td>100</td>
</tr>
<tr>
<td>0</td>
</tr>
</tbody>
</table>

Assets
- 100 Transfers (GR)
- 170 F. Reserve

Liabilities
- 720
Which Is More, SS Contributions or Tax Revenues?

FY 2003 National Budget, Japan

<table>
<thead>
<tr>
<th>SS Contributions</th>
<th>Tax (Central Gov.t)</th>
</tr>
</thead>
<tbody>
<tr>
<td>55.6 trillion yen</td>
<td>43.9 trillion yen</td>
</tr>
</tbody>
</table>
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

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


15 20 25 30 35 40

37.2
Future Policy Options

- Is NDC the Answer?
- Other Policy Concerns
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 \( \div \) 1/2) or Guaranteed Pensions or Legacy Pensions?

What Funding Source:

Consumption Tax or Income Tax or Cutting Other Public Expenditure?
Other Policy Concerns

- Relaxing the Earnings-test
- Earnings-split between Husband & Wife
- Extending Coverage to Part-time Employees
- Non-Employees:
  - Shift to Income-related Contributions
- Strengthening Private Initiatives
Concluding Remarks

- Options Vary among Different Ministries
- No Concrete Proposals, Yet, from Political Parties
- Government reform plan may be fixed by the end of DEC 2003