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

by

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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)

1999: 3.95
2000: 2.08
2001: -0.70
2002: -0.61
2003: -2.84

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

Assets

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

Liabilities

- Excess Liabilities: 530 trillion yen
- Contributions: 1170 trillion yen
- Transfers (GR): 280 trillion yen
- F. Reserve: 170 trillion yen
- Total Liabilities: 2150 trillion 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

(1170) Contributions

180 Transfers (GR)

1430 Liabilities

0 200 400 600 800 1,000 1,200 1,400 1,600
(trillion yen) Assets Liabilities
Pension Liabilities Accrued from **PAST** Contributions

**Balance Sheet of the KNH (Part 2)**

(as at the 31st MAR 2000)

**Excess Liabilities**: 450 tr. yen

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

- **Liabilities**: 720

(trillion yen)
Which Is More, SS Contributions or Tax Revenues?
FY 2003 National Budget, Japan

SS Contributions (trillion yen) vs. Tax (Central Gov.t) (trillion yen)

- SS Contributions: 55.6 trillion yen
- Tax: 43.9 trillion yen
Main Income Sources of Japan’s Central Government

FY 2003 National Budget, Japan

(trillion yen)

<table>
<thead>
<tr>
<th>Income Source</th>
<th>Amount</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

SS Pension Benefits 78%

Interest and Dividends 5%
Wages and Salaries 6%
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

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 or 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