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

by

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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

1999: 3.95 trillion yen
2000: 2.08 trillion yen
2001: -0.70 trillion yen
2002: -0.61 trillion yen
2003: -2.84 trillion yen
Balance Sheet of the KNH
(as at the 31st MAR 2000)

Excess Liabilities: 530 tr. yen

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<th>Liabilities</th>
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<tr>
<td>1170</td>
<td>2150</td>
</tr>
<tr>
<td>0</td>
<td>2150</td>
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Contributions
Transfer (GR)
F. Reserve

(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

Contributions: 1170
Transfers (GR): 180
Assets: 1430
Liabilities: 1610
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

Liabilities

720

170 F. Reserve

100 Transfers (GR)
Which Is More, SS Contributions or Tax Revenues?
FY 2003 National Budget, Japan

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

FY 2003 National Budget, Japan

(trillion yen)

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
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<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>
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Per-capita Income by Age in Japan

SS pension benefits are the major source of retirement income

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

YEAR

%
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