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)

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>170 F. Reserve</td>
<td>2150</td>
</tr>
<tr>
<td>280 Transfers (GR)</td>
<td></td>
</tr>
<tr>
<td>Contributions</td>
<td></td>
</tr>
<tr>
<td>1170</td>
<td></td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>Liabilities</strong></td>
</tr>
<tr>
<td><strong>2,000</strong></td>
<td><strong>2,500</strong></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

<table>
<thead>
<tr>
<th>(trillion yen)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,600</td>
</tr>
<tr>
<td>1,400</td>
</tr>
<tr>
<td>1,200</td>
</tr>
<tr>
<td>1,000</td>
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<tr>
<td>800</td>
</tr>
<tr>
<td>600</td>
</tr>
<tr>
<td>400</td>
</tr>
<tr>
<td>200</td>
</tr>
<tr>
<td>0</td>
</tr>
</tbody>
</table>

**Excess Liabilities: 80 tr. yen**

- **Contributions**: 1170
- **Transfers (GR)**: 180
- **Liabilities**: 1430

**Assets**

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

(as at the 31st MAR 2000)

Pension Liabilities Accrued from PAST Contributions

Excess Liabilities: 450 tr. yen
Which Is More, SS Contributions or Tax Revenues?

FY 2003 National Budget, Japan

SS Contributions (trillion yen) 55.6
Tax (Central Gov.t) 43.9
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

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 or 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**