

# Balance Sheet Describes One Side But Misses The Essence

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# Why do social security pensions exist?

- ❁ **Poverty problems under the capitalism**
- ❁ **Human wisdom to control the contingencies**
  - **mandatory social insurance**
  - **benefits in virtue of definite legal rights**



# What do social security pensions compensate?

❁ **Inability to make provisions for retirement or other contingencies for oneself in the free market economy**

**- Life longevity is unknowable.**

**> future improvement of mortality**

**- Future economic and financial conditions are unknowable.**

**> changes in price or wage levels**

**> future level of investment return**



# Goals of Social Security Pensions

- ❁ **To prevent individuals from being impoverished by:**
  - retirement
  - disability
  - death of the bread-winner
- ❁ **The real value of the benefits has, more or less, to be maintained.**



# Characteristics of Social Security Pensions

- ❁ **Compulsory coverage**
- ❁ **Intergenerational income transfer**



# Social Security Financing

❁ **Pay-as-you-go**

❁ **Level contribution**

- It is sometimes called the funding method in the context of social security financing.
- When the demographic structure is stable and there is no accumulated reserve fund, it coincides with the pay-as-you-go contribution rate.

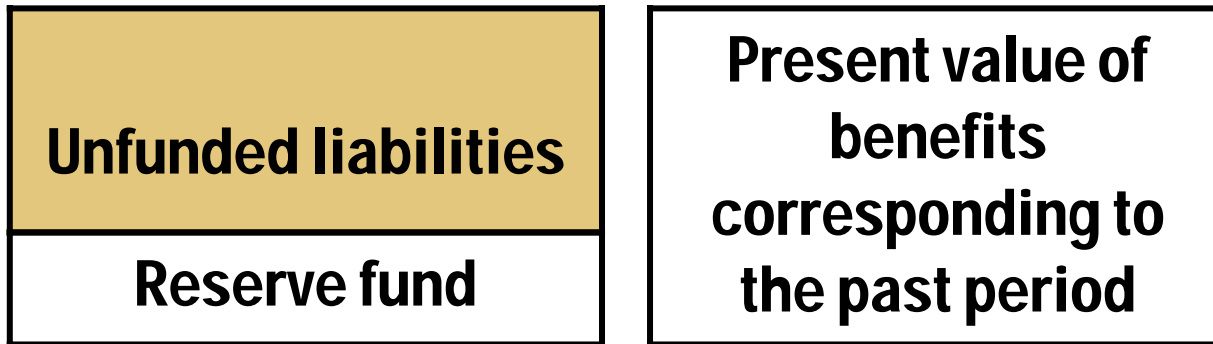
❁ **Advance funding has never been adopted for social security financing.**

- It is for corporate pension plans.



# Balance sheet describes the scheme from the viewpoint of advance funding.

## ❁ Unfunded liabilities



❁ The financing method that accumulates reserve fund corresponding to the past period is called advance funding method.

❁ To neutralize the implication, it is called the unfunded obligations in the context of social security pensions.



# Unfunded Obligations

- ❁ **Should they be amortized in a finite number of years?**
- ❁ **Under the intergenerational income transfer, looking into the scheme sustainability is much more important than evaluating the unfunded obligations.**
  - **Intergenerational equity might be preferable, but, actually can it be measured taking all aspects of the human life?**

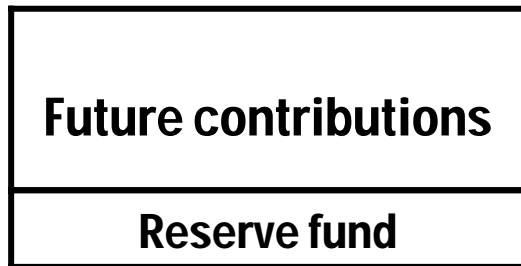




# The 2004 Reform in Japan

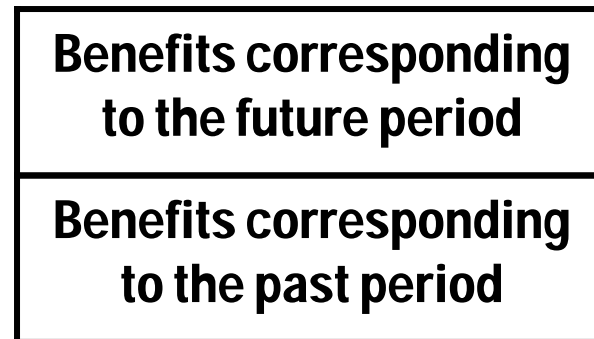
- ✿ **Modified indexation**

- ✿ **Every five years we look into the balance, and if the scheme is not financially balanced for 95 years' period of equilibrium, we continue the modified indexation.**



<present value of contributions  
for the next 95 years>

vs

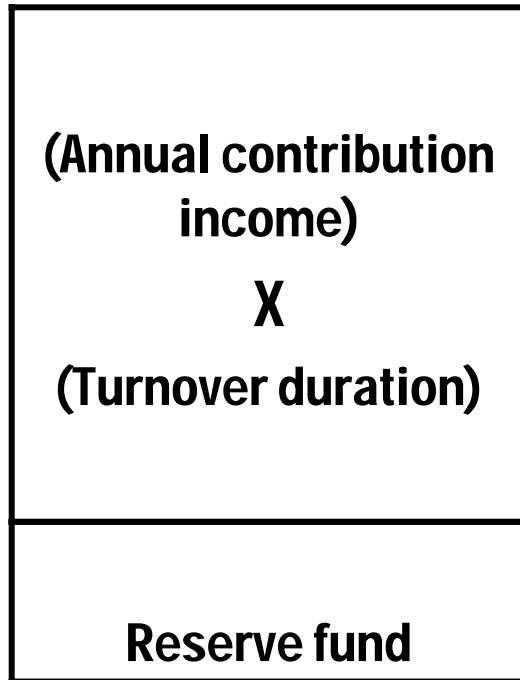


<present value of benefits  
for the next 95 years>

**NB In this case the benefits are indexed  
to the normal indexation.**



# Reform in Sweden



vs

