International Workshop on
The Balance Sheet of Social Security Pensions

Balance Sheet Describes One Side But Misses the Essence

by

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Thank you Prof. Takayama for giving me the chance to discuss the subject at this workshop.

My discussion may be grinding to some participants, but as a social security actuary involved in the social security pension matters for a long time, I feel a bit strange tone in analyzing the financial conditions of social security pensions by balance sheet. Balance sheet itself is a very useful instrument to get a sort of transparency of the current conditions of companies or any other entities of economic activities. I think, however, that, once you apply it to social security pensions, you will lose sight of their essence. I would like to explain what I mean.

Social security pensions have evolved out of the bitter experiences under the capitalism after the industrial revolution. The poverty problem in the urban area was so serious that every government could not help taking various measures. Even some undertook experiment of communism. After a while, human wisdom hit upon an idea of supporting the retired by society as a whole. That dramatically reduced the number of impoverished old people. Until then, the government only gave assistance to the impoverished people, but after the invention, people came to receive benefits in virtue of a definite legal right. The invention was the social security pensions.

Supporting the retired people by society means that the rule should be introduced to direct some portion of what the active people produce to the retired people. In the free market economy, people cannot make provisions for retirement or other contingencies for oneself because you cannot foresee the future improvement of mortality or the future changes in price, standard of living or level of investment return. The rule should more or less overcome the inability, and that necessitates the intergenerational income transfer.

Now let’s turn our attention to social security financing. The wide practice is by PAYGO method. It may also be financed by level contribution method as was done at the start of the EPI (or KNH) scheme. Please note here that advance funding has never been adopted for social security financing. It is for corporate pension plans.

The problem of applying balance sheet to social security pensions is that it describes the social security pensions from the viewpoint of advance funding. Personal pensions or corporate pensions base their financing on the advance funding principle, but history tells that the principle cannot solve the poverty problem, and it is the very reason why the social security pensions have come into existence. To keep pace with the price or the standard of living always entails the unfunded liabilities.

The unfunded obligations cannot be the trigger to act on the social security pension schemes because it does not tell the real problem of the schemes. Looking into the sustainability is far more important than calculating the unfunded obligations.

Some people talk about the problem of intergenerational equity. From this viewpoint, they say that amortizing the unfunded obligations is the symbol of unfairness among generations. But that way of thinking is only viewing the social security pensions as one form of the private pensions that could not solve the poverty problem under the capitalism. How do you amortize the unfunded liabilities given rise to by the improvement of mortality? How do you amortize the unfunded liabilities caused by indexation to, for example, price?

Concluding my speech, I would like to add that Japan and Sweden are using balance sheet for their automatic balancing mechanism. This usage of balance sheet is useful to social security pensions as well.

Thank you for your attention.

Rejoinder by Noriyuki Takayama

Thank you, Mr. Sakamoto.

I agree with Mr. Sakamoto's statement that social security pensions have widely been financed by the PAYGO method and that advance funding has never been adopted for social security financing.

Mr. Sakamoto seems to misunderstand the balance sheet, however, when he says that it describes the social security pensions from the viewpoint of advance funding. Sweden, for instance, uses the balance sheet to automatically adjust their PAYGO social security pension benefits to respond to changing demographic and economic conditions. Its use is not for a change into advance funding.

One reason for his misunderstanding may be that he only sees Part One of the balance sheet (Figure 1). I am asking to look at both Part One and Part Two of the balance sheet combined, thereby checking the financial sustainability of social security pensions. This is the essential problem of the pension schemes, as Mr. Sakamoto asserts.

Thank you.