Interview

“Should consumption tax fund basic pensions? Absolutely. Burdens must be shared by everyone.”

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Is the pension system collapsing?

Middle-aged subscribers harbor increasing doubts about whether they will be paid as much by the pension system as their parents were. Young subscribers are afraid of getting the short end of the stick--- higher contributions with fewer benefits.

In recent years, widespread concern over the financial difficulties facing this country’s state-run pension plan have given rise to debate about a proposal to avert the crisis through a new revenue source--- the consumption tax.

The Daily Yomiuri: What kind of role do you expect to see the consumption tax play in funding the basic pension plan?

Noriyuki Takayama: First of all, my argument does not accept the current two-tier formula as a given. This means I’m not insisting on using revenues from the consumption tax to finance the lower first tier, which covers flat-rate basic pension benefits to all subscribers to the system. Instead, my proposal seeks to accomplish two purposes.

Could you be more specific?

First, revenues from some sources unrelated to pension contributions--- chiefly those from the consumption tax--- should be used to redress the lack of financial resources needed to give elderly and middle-aged subscribers, mostly postwar baby boomers, their dues promised in the past, but still unfunded by the government.

Second, such revenues should be used to implement a plan to replace the current basic pension plan with a notional defined contribution system (NDC), popularly known as the Swedish formula. This would be tantamount to a “scrap-and-rebuild” reform of the lower first tier.

What is the rationale behind your reform plan?

The fundamental question is whether the state-run pension system will be able to survive in the future.

In other words?

The most formidable challenge facing this country’s pension plan is how to remove a growing distrust felt by younger generations about the system. This is best shown by the increasing number of young people who refuse to pay pension contributions.

They may have good reason. As circumstances stand today, young subscribers to the system would be able to receive almost as much as they had paid in contributions, if they reach the pensionable age.

What makes them unwilling to pay contributions then?

Promised but unfunded future pension benefits to corporate employees total about 450 trillion yen, which is almost equivalent to the nation's annual gross domestic product. To raise funds for such benefits, the government and the ruling parties are seeking to increase pension contributions and reduce benefits in the future. This means that younger generations would have to pay greater contributions to enable current and soon-to-be pensioners, including baby boomers, to receive as much as promised in the past.

Is this a typical example of the inequality felt by subscribers in different age brackets?

Precisely.

It often has been argued that the sharp drop in the birthrate and the rapid graying of the population, combined with unsuccessful investments of pension funds, have contributed to the depleted coffers of the system. Is this the case?

Hardly. Such a line of argument is commonly accepted, but unfounded. The major reason for the crisis is past governments' promises of too generous pension benefits that do not match the contributions subscribers have paid.

The question is what should be done to redress the lack of funds for already promised, but still unfunded, pension liabilities. One solution is to cut benefits to be paid to current and soon-to-be pension recipients. This should be complemented by a plan to use revenues largely from the consumption tax to help cover costs.

Efforts to reform the current system requires and "all Japan" approach, meaning that every subscriber to the system, young and old, should shoulder a fair share of the financial burden to keep the system going. The consumption tax is a promising answer to this.

What are the basics of your second proposal--- that is, a plan to use consumption tax revenues to finance a Japanese version of the Swedish formula?

The current basic pension plan pays the fixed amount of benefits to every subscriber, rich or poor. Two-thirds of financial resources for this scheme come from contributions paid by subscribers, with the remaining one-third from the state coffers. However, my plan would divide the system into two separate schemes under the NDC formula--- namely, one covering benefits currently funded by contributions, and the other covering benefits provided through transfers from the state finance.

How would each scheme work?

The former scheme would be transformed into a system in which individual subscribers would receive benefits in proportion to the amount of contributions they have paid according to their incomes.

The latter formula would determine the amount of benefits to individual low-income subscribers in reverse proportion to their respective means, meaning that the lower the income they earned, the bigger the pensions they would receive. Meanwhile, the scheme would reduce the amount of benefits to affluent subscribers in proportion to their individual income--- that is, the greater their income, the lower their pension benefits.

What is the biggest advantage of your plan?

It will convince young people that the contributions they have paid will surely be refunded to them in the form of future pension benefits.

Using consumption tax revenues to help fund the pension system is synonymous with an increased tax rate. Any idea about a specific increase rate?

The consumption tax rate could be raised to 15 percent plus an extra over a period of 15 to 20 years. No one would argue that an increase in consumption tax revenues through a rise in the tax rate should be entirely used to finance the basic pension plan.

In fact, some people have insisted on using such revenues to provide better educational and child care support programs, for instance. Given this, it may be reasonable to assume that one-fifth or so of revenues from the 15 percent consumption tax could be used to support the pension scheme.

What is a major hurdle to your reform plan?

An attempt to scrap the current basic pension plan needs time to thoroughly debate a proposed plan and reach a national consensus about the reform. In 1991, Sweden started debates about introducing an NDC formula. It took the country until 1999 to implement its new pension plan.

I suggest that Japan give itself at least 20 years to replace its current basic pension plan with an NDC formula in its entirety.

--- Interview by Daily Yomiuri Staff Writer Mr. Kiyotaka Shibasaki