

# **A Balance Sheet Approach to Reforming Social Security Pensions in Japan: Is NDC the Answer?**

**by**

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# Organization

**Brief Outline of Current Provisions**

**Demography**

**Basic Facts:**

**Identifying Main JPN Problems**

**Is NDC the Answer?**

**Conclusion**

# Brief Outline of Current Provisions

**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

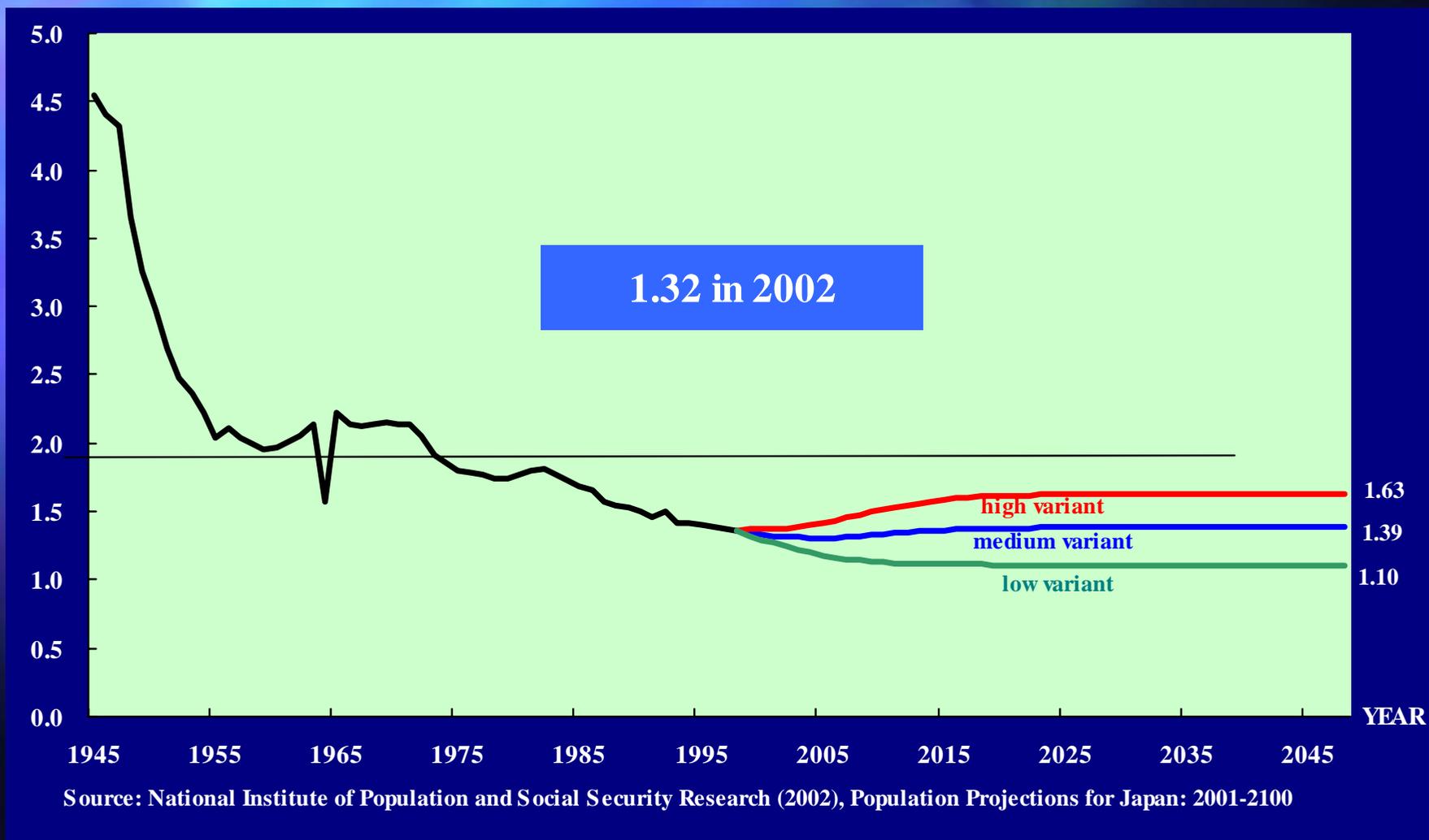
# Demography

**TFR**

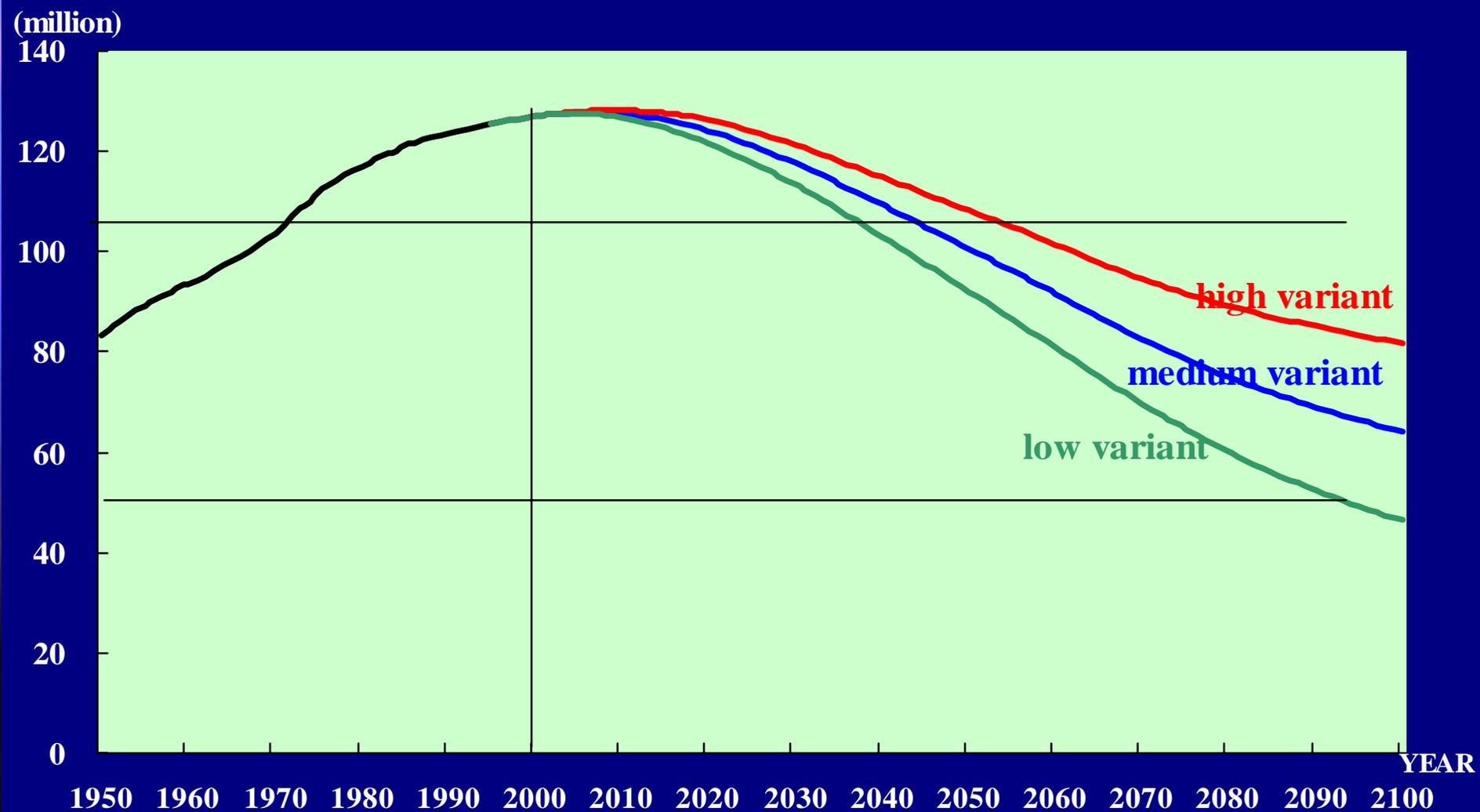
**Total No. of Populations**

**Proportion of 65+**

# Trends in the Total Fertility Rate of Japan

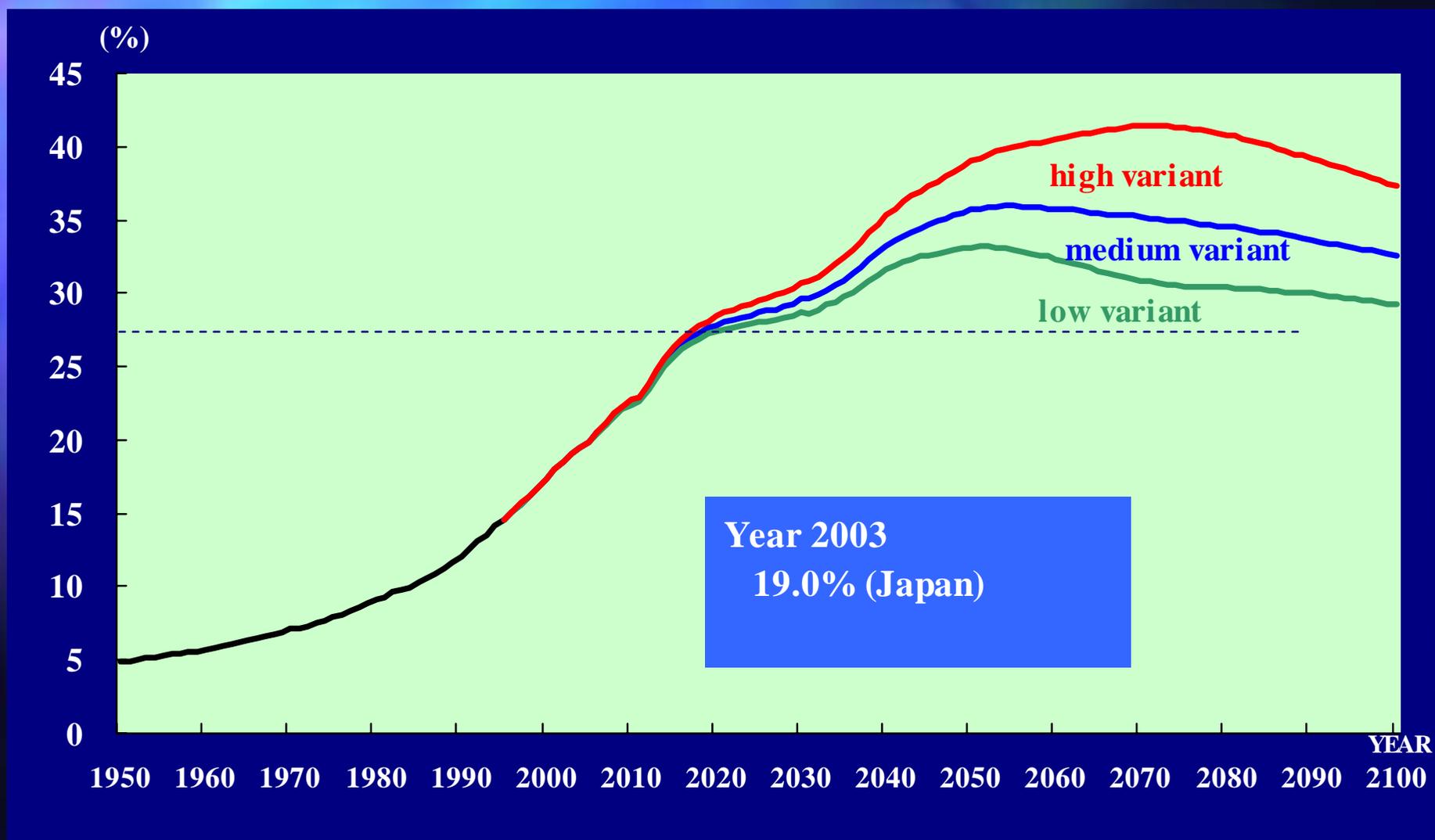


# Actual and Projected Population of Japan



Source: National Institute of Population and Social Security Research (2002), *Population Projections for Japan: 2001-2100*

# Proportion of the Elderly (+65) in Japan



Source: National Institute of Population and Social Security Research (2002), Population Projections for Japan: 2001-2100

# 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

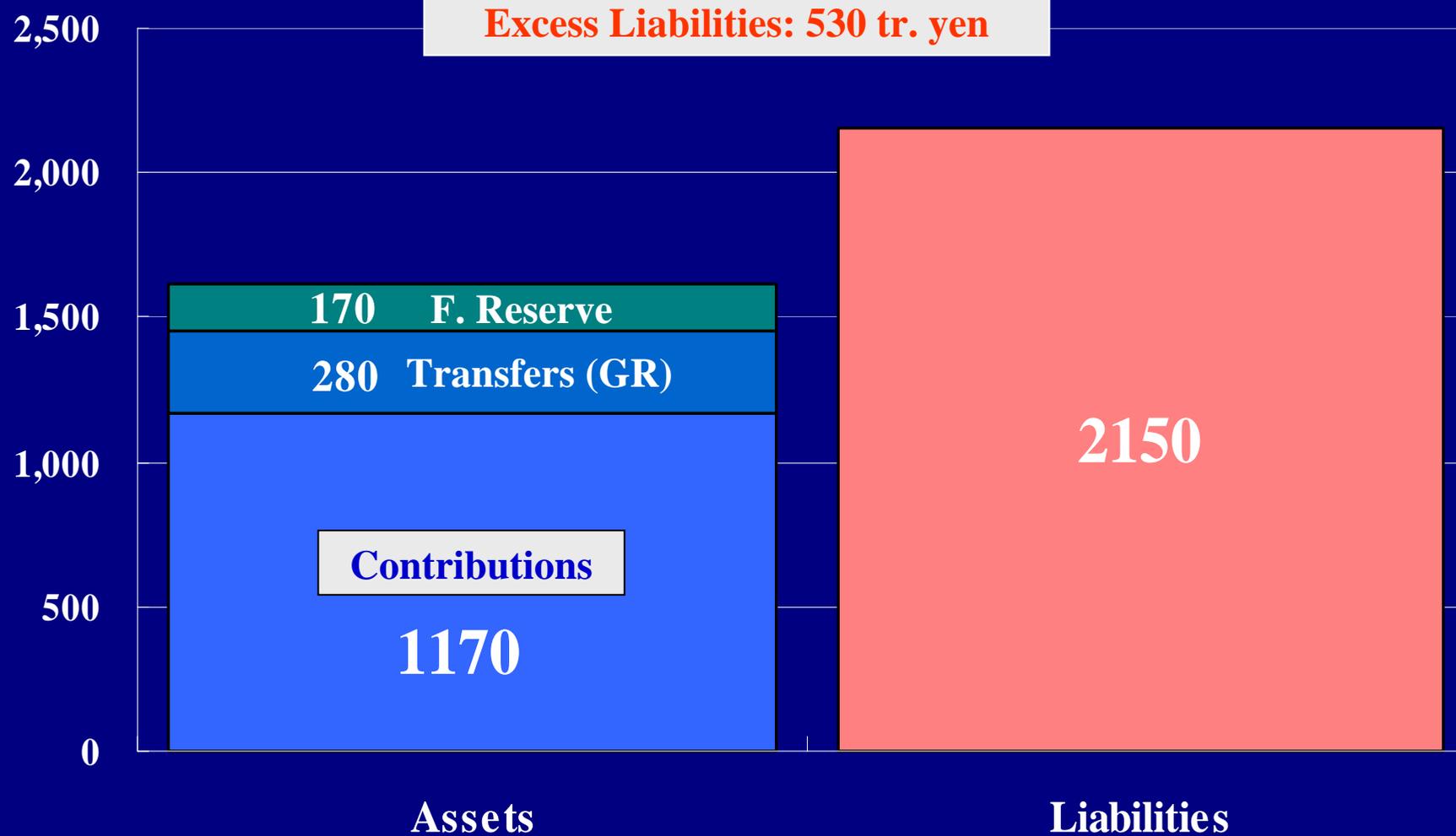
(trillion yen)



# Balance Sheet of the KNH

(as at the 31<sup>st</sup> MAR 2000)

(trillion yen)



# Balance Sheet of the KNH (Part 1)

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(as at the 31st MAR 2000)

Pension Liabilities Accrued from **FUTURE** Contributions

(trillion yen)

1,600

1,400

1,200

1,000

800

600

400

200

0

**Excess Liabilities: 80 tr. yen**

**180** Transfers (GR)

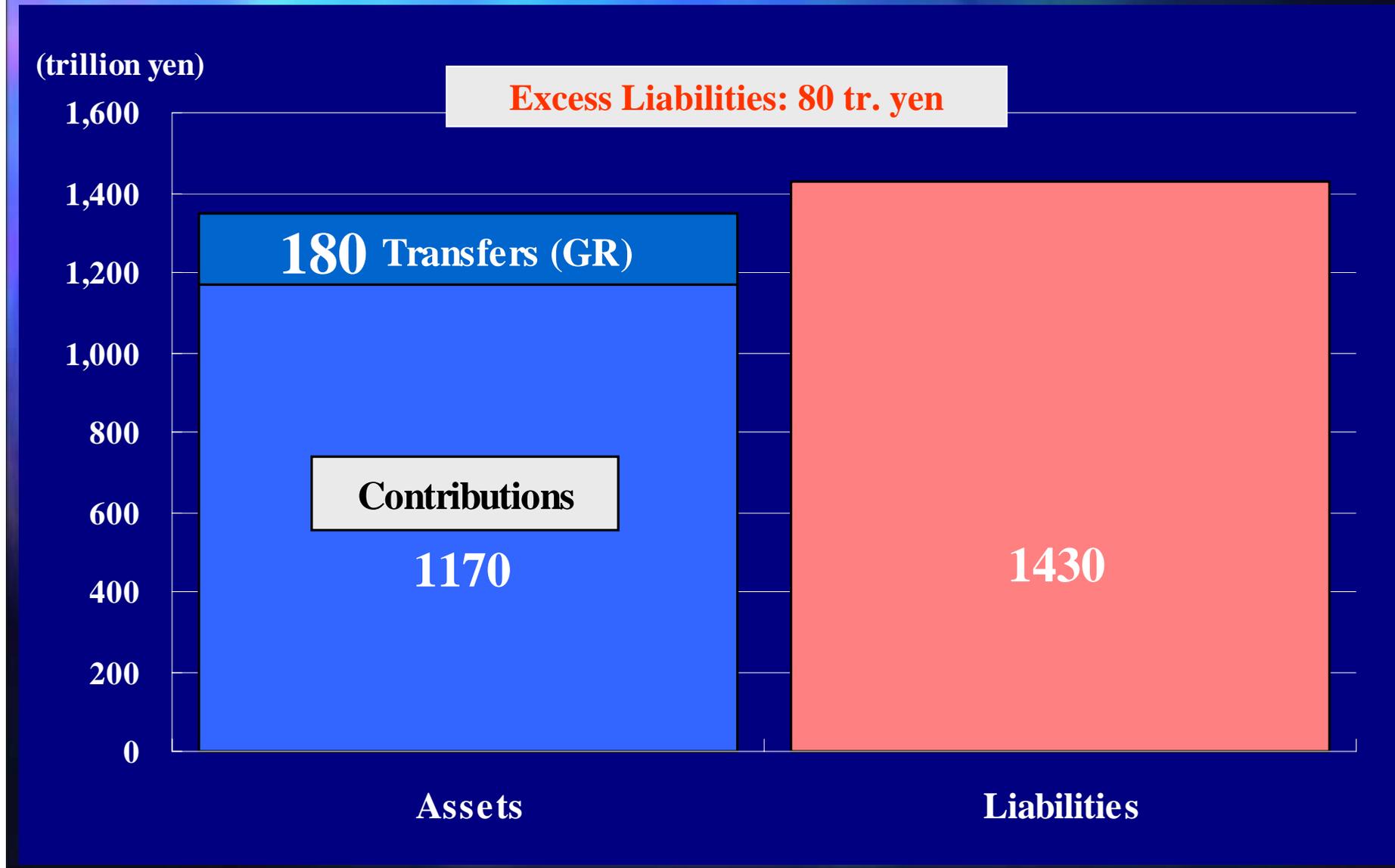
**Contributions**

**1170**

**1430**

**Assets**

**Liabilities**



# Balance Sheet of the KNH (Part 2)

(as at the 31<sup>st</sup> MAR 2000)

Pension Liabilities Accrued from **PAST** Contributions

(trillion yen)

800

700

600

500

400

300

200

100

0

**Excess Liabilities: 450 tr. yen**

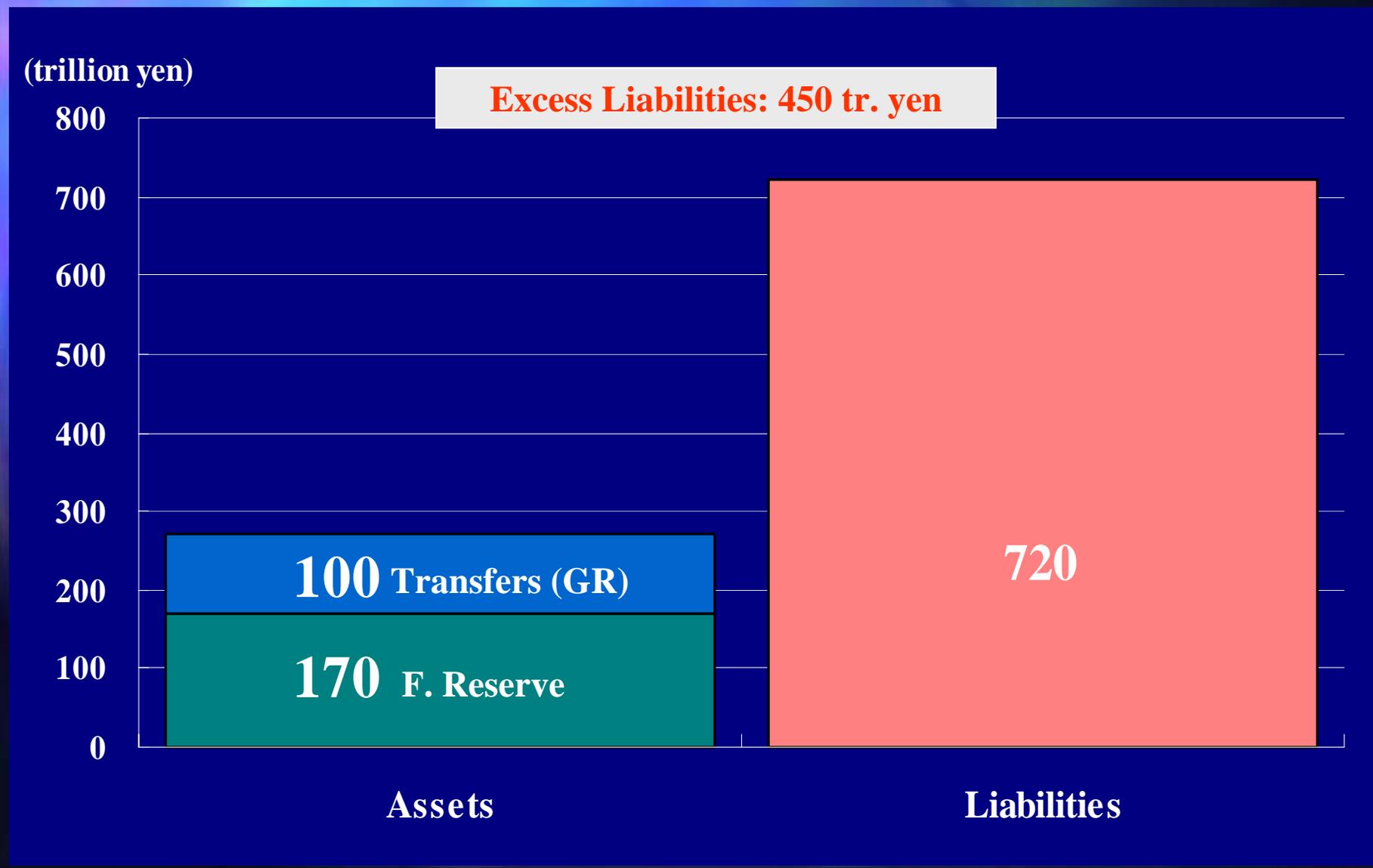
**100** Transfers (GR)

**170** F. Reserve

**720**

Assets

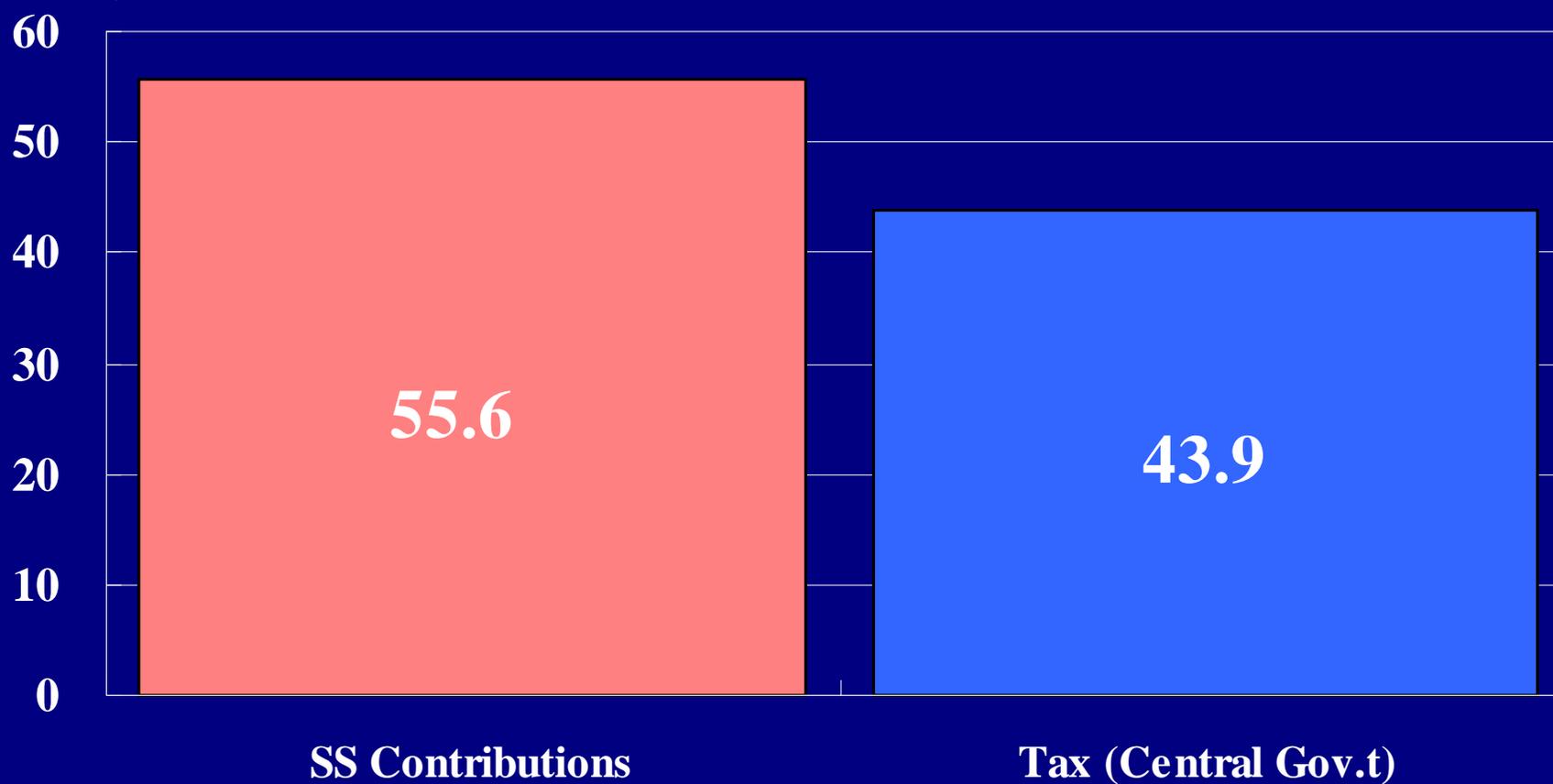
Liabilities



# Which Is More, SS Contributions or Tax Revenues?

FY 2003 National Budget, Japan

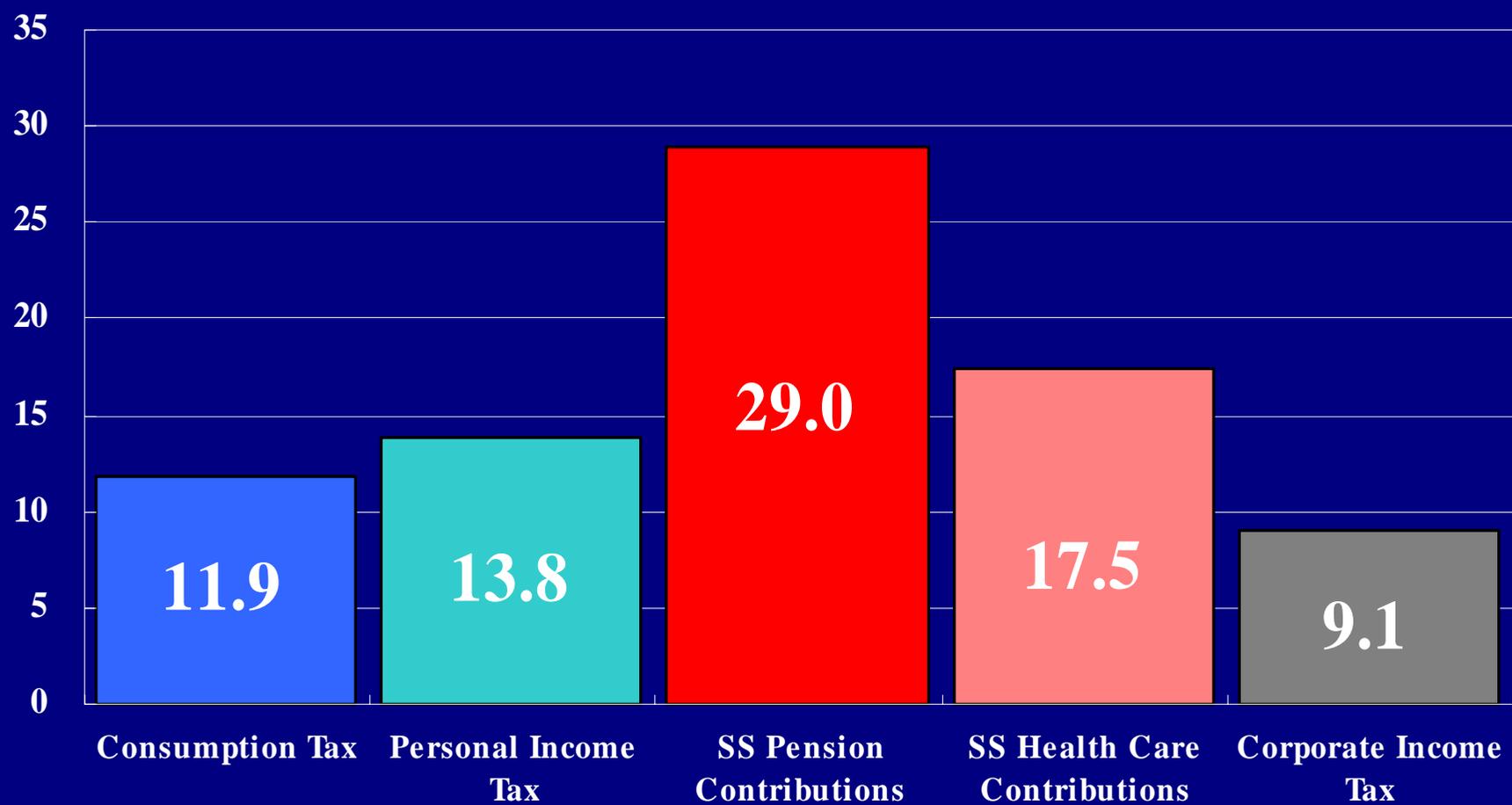
(trillion yen)



# Main Income Sources of Japan's Central Government

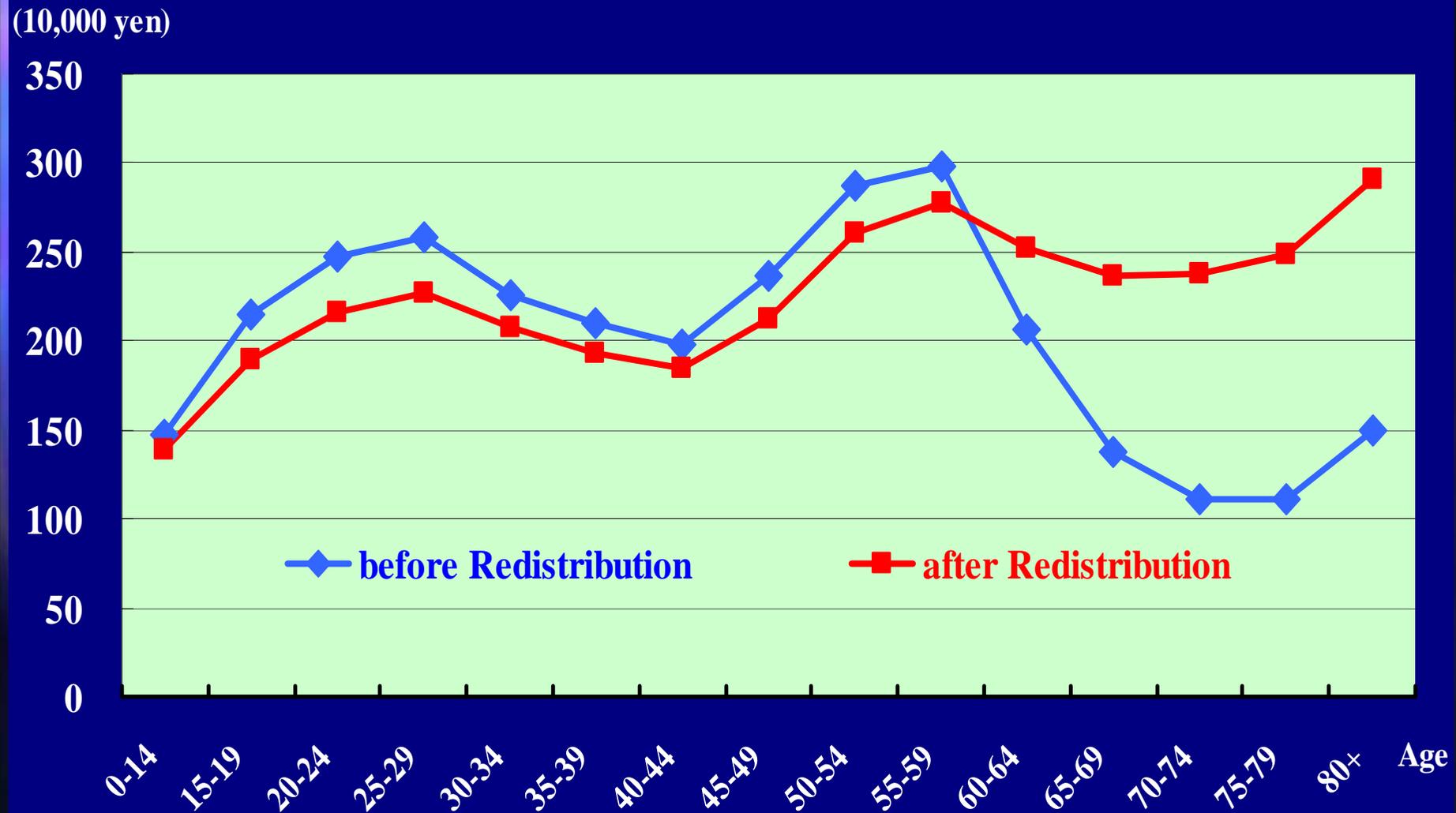
FY 2003 National Budget, Japan

(trillion yen)



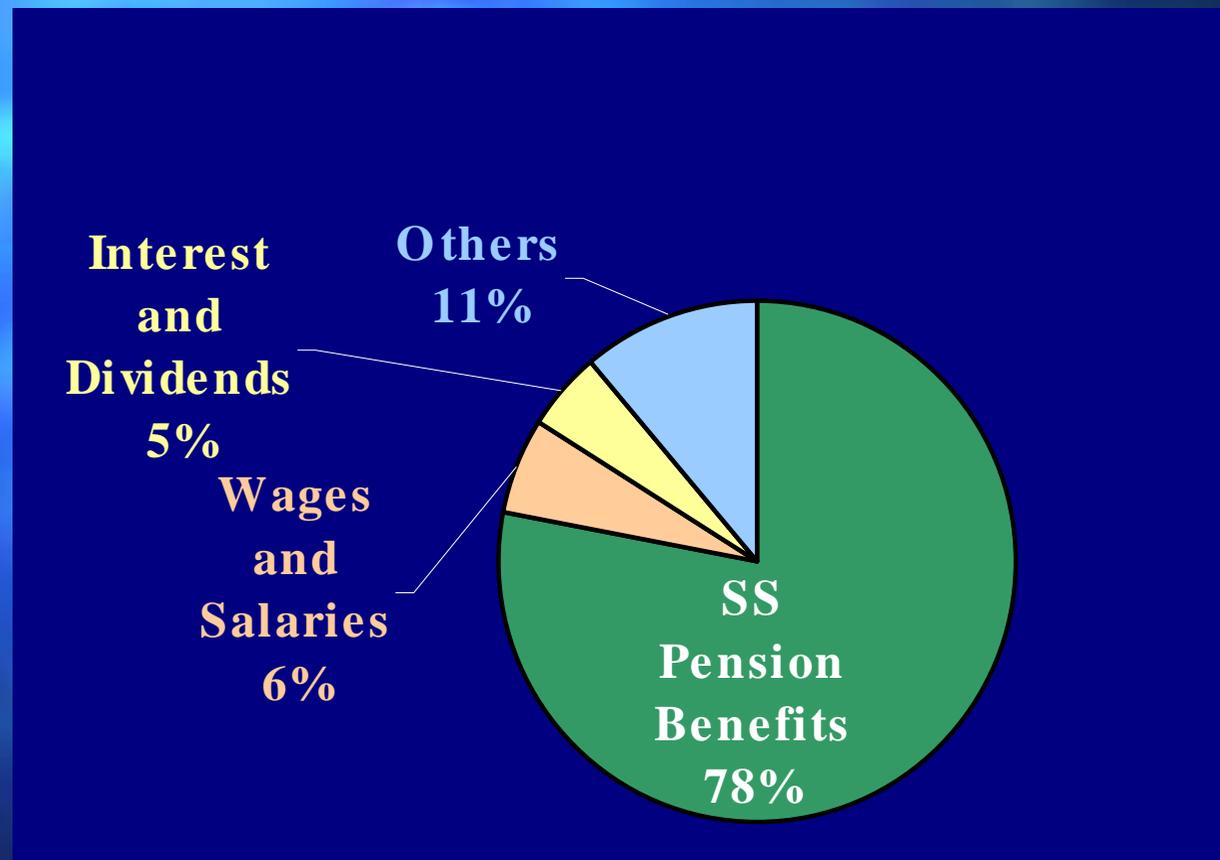
# Per-capita Income by Age in Japan

18



Source: Ministry of Health and Welfare, *The 1996 Income Redistribution Survey*

# SS pension benefits are the major source of retirement income

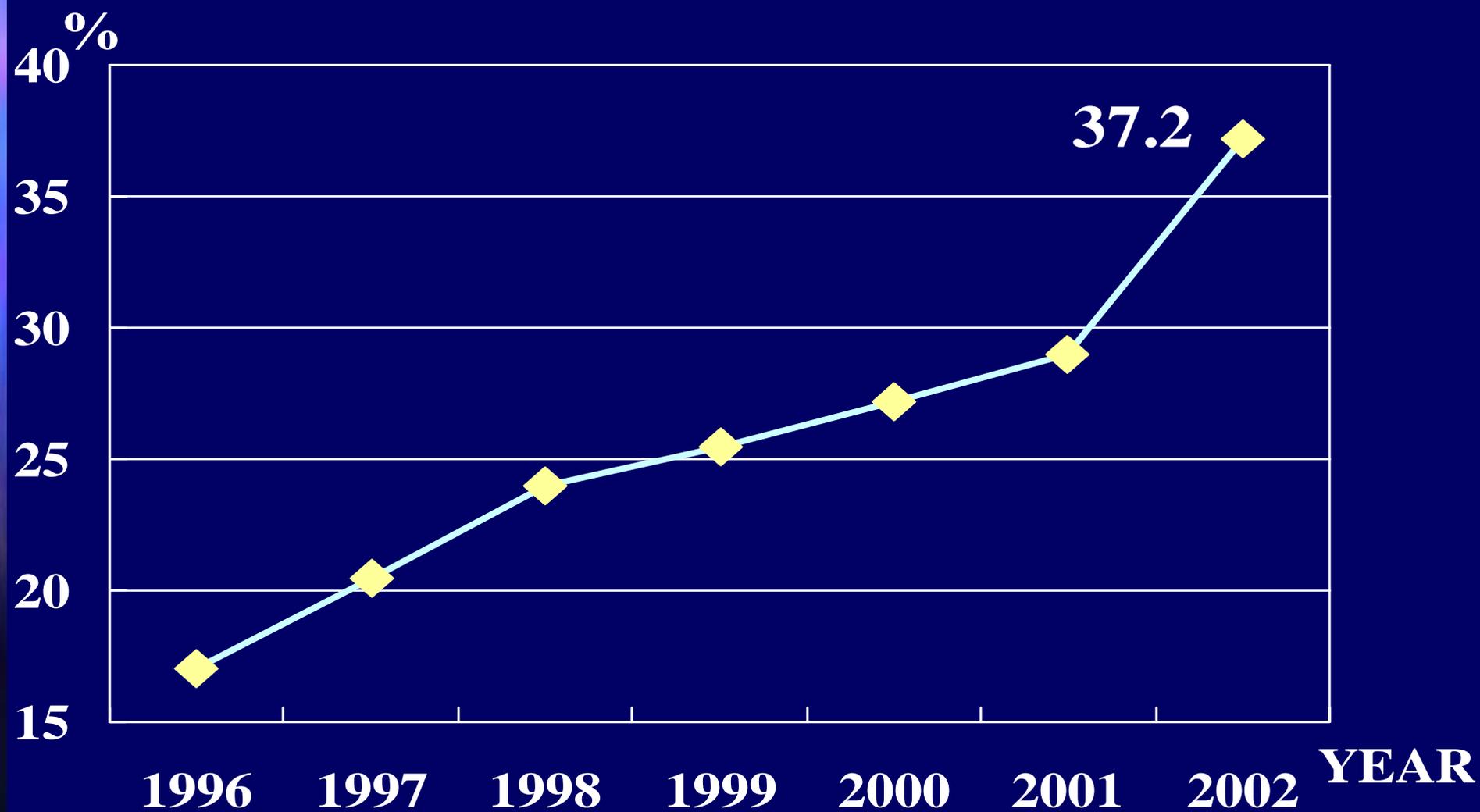


median income: 3.38 million yen

Source: *The 1989 NSFIE* (elderly couples: median income group)

# Drop-out from SS Pensions (Non-employees)

## Delinquency in Paying Pension Contributions



# 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 ( $1/3$      $1/2$ ) 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**