

A Comment on
Noriyuki Takayama
“Pension Issues in Japan: How Can We Cope with the Declining Population?”

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Takayama’s chapter describes pension reforms and financial performance of pension systems in Japan. The chapter explains details of pension reform in 2004 assuming that readers have some background on the Japanese pension system and contemporary disputes on the reforms. It is worth clarifying the pension system in Japan as it is unique and helps readers understand this chapter easily. Therefore, in this comment, we will elaborate more on pension systems in Japan and discuss on policy options.

For social security (pension and health care) administrative purpose, residents of Japan aged between 20 and 60 are grouped into three categories as follows.

- Category I: self-employed, students and all registered residents aged 20-60 years excluding categories II and III. About 30 percent of insured population are in this category.
- Category II: Salaried employees in private sector, central and local government employees, and private school teachers and employees in private schools. Over 50 percent of insured population are in this category.
- Category III: dependent spouse of category II (aged 20-60).

Japan also has a separate occupation based on social insurance system for seaman because they do not fall into these three categories.

The public pension system in Japan can be characterized as a universal and defined benefit system. Pension is composed of **basic pension** (or National Pension) and **income-related pension**.

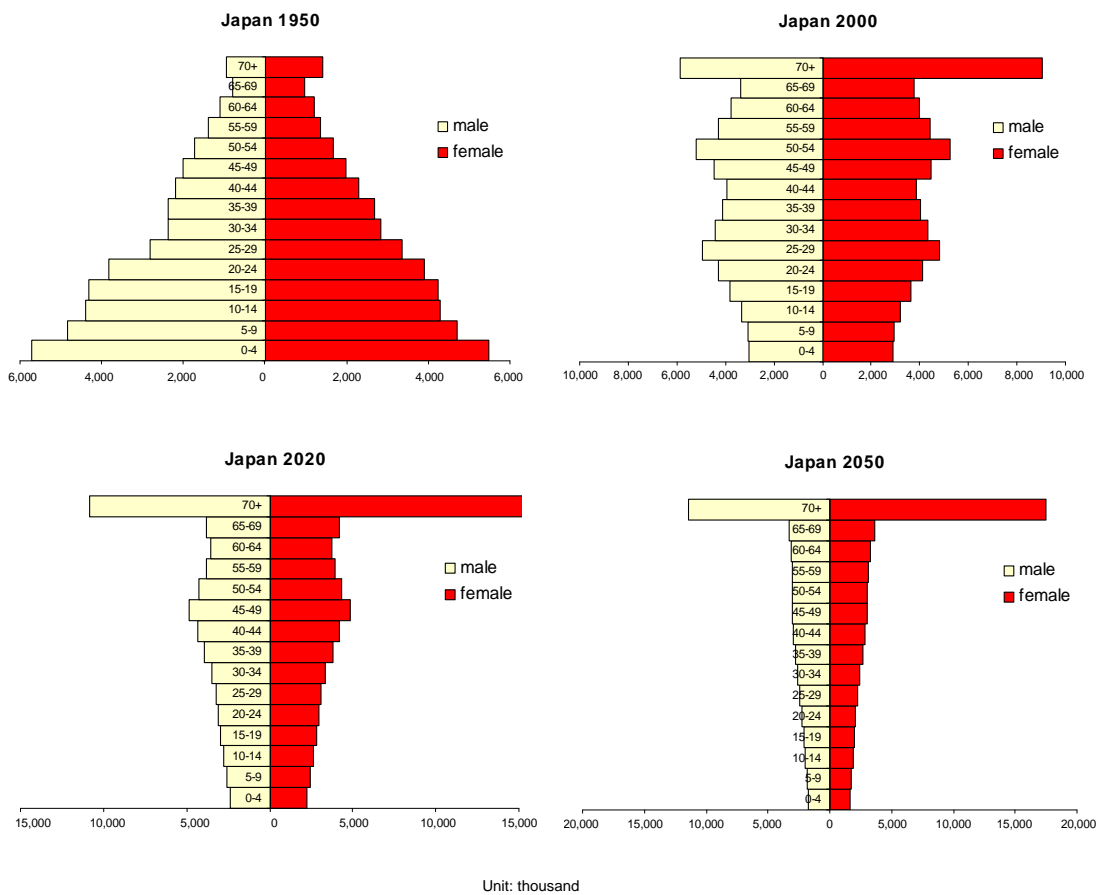
National Pension (Kokumin Nenkin) is operated by municipalities and is called a regional based pension. Everybody is entitled to basic pension required that they have paid premium for a certain period. The system is so-called a Pay-As-You-Go flat rate benefit system. The pension includes five types of benefits: old-age, disability, survivor, widow, and death benefit. Those who receive disability basic pension or public assistance are exempted from paying contribution. Students and low income workers can postpone their contribution for some periods. An important issue of the Nation Pension is its coverage. Because of aging population, a number of working age population distrusted the public pension system has increased. In 2002, the number of delinquent contributor rose by 8.3 million. The system could include only 62.8 percent of eligible population in the program. In other words, the delinquency ratio was 37.2 percent (in Figure 1 of this chapter). The ratio dropped by a few percentage points after that year. The situation was improved by a few more percentage points after the 2004 reform.

Income-related pension is mandatory for employees in companies with five or more employees, public employees, and teachers and employees in private schools. Basic pension and income-related pension for private employees are jointly operated (called

Employees' Pension Insurance, Kose Nenkin Hoken or KNH) and a single contribution rate is paid by employee and employer. The Employees' Pension Insurance covers employees and spouse (insured persons in categories II and III). The joint basic pension and income-related pension for public employees and teachers and employees in private schools are operated by the National Government Employees' Mutual Aid Association, Local Government Employees' Mutual Aid Association and Private School Teachers and Employees' Mutual Aid Association. Pension schemes for private employees, public employees and private school teachers are unified. As described by the author, this public pension system currently faces many challenges: a persistent deficit in the income statement, huge excess liabilities in the balance sheet, and heavy burden of contribution.

Population forecast by Japan's National Institute for Population and Social Security Research (IPSS) implies that the Japanese pension systems will become more seriously unhealthy. The figure below shows that each of young Japanese will have to bear the burden from at least one elderly in 2050. The government will no longer commit an expansion of the old-age pension benefit. Moreover, they have to seriously show that the system will be financially sustained.

Japan's Population by Age Group



Source: IPSS (www.ipss.go.jp/site-ad/TopPageData/p_age2.xls, accessed January 30, 2007)

The author mentions five policy options that have been discussed in Japan: privatization of earning-related pension, a move to a fully-funded plan, the use of tax revenue to finance basic pension, a move to notional defined contribution, and an introduction of a minimum guaranteed pension. It should be noted that, extension of retirement age beyond 65 is not an option although life expectancy among Japanese is longer than other nations. Moreover, the option of taxing pension income has been overlooked.

From the discussion, it is not quite clear which part of pension schemes should be changed to fully-funded, the basic pension or the earning-related pension or both. It makes sense to change the earning-related pension to fully-funded defined contribution system and the basic pension to the minimum guaranteed pension. This means that the options do not have to be mutually exclusive.

It is quite interesting to see that an earmarked consumption tax has been proposed to be an alternative source for financing basic pension. If financed by general tax revenue, the basic pension holds the principle of income redistribution. Consumption tax is regressive in nature. It hurts the poor more than the rich. Additional consumption tax increase may increase the number of poor old-age in Japan. Then, the new social issues will be arisen.

The Japanese pension reform is all about the intergeneration share of “pie”. Looking at the balance sheet, we learn that the piece of pie the old will have is getting smaller and smaller. But, the number of old will be larger. The young will have to share their pie with the old. This is not easy since the author shows that the 2004 reform made the present value of future benefits account for only 80 percent of the present value of future contribution. The question is how to make the young willing to share their pie with the old when they are not sure that the number of their offspring will not be large enough to make a big pie that is shareable?