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Tokita, Tadahiko, Theturo Chino, Hideeaki Kitaki, Izumi Yamamoto, and Mitsuyoshi Miyagi. 1997. The present and future national medical expenditure in Japan. *Economic Analysis* 152 (September): 1–68.

## Comment

Epictetus Patalinghug

### Introduction

This chapter estimates the quantitative magnitude of implementing a prefunding scheme to finance Japan's future health and long-term care costs. It starts by arguing that Japan's social security benefits will grow at a double-digit rate, and a growing component of these benefits is the benefit due to health insurance and long-term care insurance. The authors argue that the burden of workers will steadily increase and it will create intergenerational imbalance of burdens if the health and long-term care insurances are continued to be financed under the current pay-as-you-go system. In estimating the general magnitude of the prefunding burden, the authors provided an alternative projection of the labor force (assuming less optimistic labor-participation rates), projected health and long-term care benefits, and conducted sensitivity analysis of contribution rates under a prefunding scheme. The chapter concluded that the prefunding scheme will significantly increase the appropriate contribution rate, but it will likewise reduce the intergenerational inequity of burdens. The analysis of the chapter is consistent with the findings of Takayama and Kitamura (1999), which looked at the impact on generational imbalance of fiscal policy. In this study, the authors also suggested the use of the prefunding scheme as a way of restoring equity in the social insurance program in Japan. The chapter is very timely because Japanese policymakers are currently contemplating on economic policy reforms to ensure the sustainability of its fiscal and social security programs.

### Analysis and Findings

The efforts of the authors are to be lauded. However, the authors need to address some gaps in their work. Economists argue that political feasibility is a crucial element in the formulation of policy. The authors do not address the issue of how a change to a prefunding scheme that would alter the redistributive burdens can be more palatable to those adversely affected. The chapter does not explicitly take into account the response of individuals and firms to changes in the health and long-term care insurance system.

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The chapter seems to imply that the burdens of financing social security systems in Japan rely solely on private contributions and government subsidies. If taxes are inadequate to finance benefits, the solution is either to increase taxes or to lower benefits. The authors argue that the latter is not politically feasible because health care and long-term care services are considered basic services by Japanese people.

The chapter needs to provide estimates of the deadweight loss of the higher taxes that would be needed to finance the social insurance system under the pay-as-you-go tax system compared to the prefunding scheme (see Feldstein 1999). The chapter likewise argues that higher interest rates can reduce the burden considerably. However, there is no explanation in the chapter on how the trust fund of the prefunding scheme is invested to produce higher returns and improve its financial condition.

The authors suggest that the recent poor performance of Japanese asset prices precluded using interest rates approaching the U.S. level. This is a relevant point but they could have demonstrated if there are advantages in investing some of the health and long-term insurance fund in private securities. Diamond (1997) has demonstrated that investing some of the trust fund in high-yielding equity may lessen tax increases but significant intergenerational redistribution remains.

Though the chapter has analytically and graphically illustrated the intergenerational consequences of shifting from the pay-as-you-go system to the prefunding system, it needs to measure its distributional consequences. What happens to disposable income of low- and middle-income workers under each scheme? Feldstein and Samwick (1997) had estimated the impact of prefunding Medicare in the United States on the growth of capital stock and the level of national income. Doing such kind of analysis on estimating the impact of prefunding the cost of Japanese health and long-term care insurance on its capital stock and its level of national income would have given a broader insight.

## Conclusion

I commend the authors for doing a pioneering study that looks at the intergenerational impact of prefunding both the health and long-term care costs in Japan.

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## Comment

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Many governments now provide large-scale social insurance and pension programs as a safety net for the elderly. As populations age, these programs have led to rapidly growing fiscal obligations that governments must meet. However, under current tax policies, most governments will collect far less revenue than the total amount of benefits they have promised to elderly citizens in the future. Generational accounts show that the magnitude of the fiscal imbalance is very large for most developed countries (Auerbach, Kotlikoff, and Leibfritz 1999).

Japan is no exception to this problem. According to calculations by Takayama, Kitamura, and Yoshida (1999), Japan faces one of the largest fiscal imbalances, owing largely to its rapidly aging population and longevity of the elderly. Takayama et al.'s generational accounts imply that future generations will have to bear 2.7 to 4.4 times the fiscal burden that current generations do, meaning that sharp increases in tax rates are needed to sustain fiscal balance.

These generational accounts rely on detailed assumptions about the trajectory of the economy and demographics over a long horizon. The accuracy of the underlying assumptions is thus critical in obtaining reliable projections of fiscal imbalances.

In this chapter, Tadashi Fukui and Yasushi Iwamoto focus on the assumptions underlying one aspect of the generational imbalance problem in Japan: the fiscal burden of health and long-term care costs. Fukui and Iwamoto take issue with the *structural* forecasting methods used by the Japanese government to make projections about economic activity over the next century. Their primary criticism is that these methods are quite opaque and make many implicit assumptions that are hard for the user to decipher. They instead advocate a reduced-form or *mechanical* approach that does not rely on this complex structure. Fukui and Iwamoto's projections are based on transparent statistical extrapolations that do not rely on a specific economic model.

The author's mechanical method yields significantly less pessimistic estimates of the degree of fiscal imbalance due to health care costs. This is

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