The 1994 Reform Bill for public pensions in Japan: Its main contents and related discussion

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In March 1994 the Japanese government submitted a bill to the National Diet to reform the public pension system. It proposes to increase the normal retirement age for the flat-rate basic benefits for employees from 60 to 65 years of age by stages (between 2001 and 2013 for men), while guaranteeing to pay the earnings-related benefits for them from age 60 without any reduction. It also proposes a much more generous earnings-test and an introduction of old-age employment benefits, both to encourage later retirement. Another main proposal is to switch the benefits indexation from a gross to a net wage basis. This paper gives a detailed explanation of the bill, discussing why such a reform bill is submitted, whether or not it can manage to control the cost of social security in the long term, and whether or not the reform measures can effectively generate jobs for the elderly. Pensions for women, as well as some measures to support both childbirth and childrearing, are also explored.

In March 1994 the Japanese government submitted a bill to the National Diet to reform the public pension system. Major changes in the system have thus far been made roughly once every 10 years. Because the last overhaul was proposed in 1984 — a decade ago — the chances are that 1994 will become another year of pension reform.

In the past, management and labour often clashed fiercely over public pensions, and their fights generally spilled over into the legislature, where the ruling and opposition parties would trade blows over reform proposals. Indeed, pensions tended to become convenient ammunition for political wars. This time, however, the old pattern may not repeat itself. The reason is that the Liberal Democratic Party, which together with its conservative predecessors had been ruling Japan ever since the end of the Second World War, fell from power in summer 1993. It was replaced by a coalition of opposition parties (excluding the Japanese Communist Party), and it is this coalition that has prepared the current legislation.

The labour alliance *Rengo* (Japan Trade Union Confederation), which serves as an umbrella organization for most of the country's unions, announced a basic change in its stance in the spring of 1993, endorsing a switch to what is known as "net indexation". Whereas pension benefits for retirees have thus far been tied to active workers' gross wages — before tax payments and social security contributions are taken out — the switch will tie them to net wages, and they will slide up only when this take-home pay rises. Labour's new stance brought it closer to management, permitting work to get started on a compromise plan that both sides can accept. Another pending issue is the age at which benefit payments should commence, and here as well progress has been made. A project team working under the coalition government tackled this question, and it came up with an answer in its final report, released on 20 December 1993. Thanks to these developments, it seems likely that the deliberations will for the first time be characterized by cooperation between labour and management and unity between the ruling and opposition parties.

The next section explains the main contents of the proposed reform legislation. The subsequent four sections explore the commencement age, net indexation, promotion of later retirement, hikes in pension contributions, and long-term financial performance. The penultimate section discusses public pensions for women, and the concluding section refers to the remaining problems.

Contents of the Reform Bill

The main measures the government has placed before the Diet can be summed up in 13 points.

1. Japan has a two-tiered system of basic benefits for everyone on tier 1 and earnings-related benefits for employees on tier 2. In principle, payments of benefits begin at the age of 65, but there is a legal provision allowing employees to receive "special old-age benefits" corresponding to the full amounts on both tiers starting from age 60. The proposed legislation guarantees that the tier-2 benefits for retired employees between 60 and 64 years of age will be paid without any reduction.

2. The tier-1 benefits for this age group are phased out by stages (between 2001 and 2013 for men), and eventually no one under 65 will receive full basic benefits. In exchange, employees between 60 and 64 will become eligible for advance payments at a reduced rate from the Basic Pension (*Kiso Nenkin*), a fixed-amount plan that ordinarily begins paying benefits at age 65, as is currently the case for non-employees.

3. The earnings test for special old-age benefits and the newly proposed tier-2 benefits (partial pensions) for people between age 60 and 64 will be adjusted in a manner promoting employment.

4. The Employment Insurance Law will be amended so as to encourage later retirement. The main proposal is the introduction of new employment benefits to older workers.

5. The index consulted when setting benefit levels will be switched from the growth rate of gross wages to the growth rate of net wages.

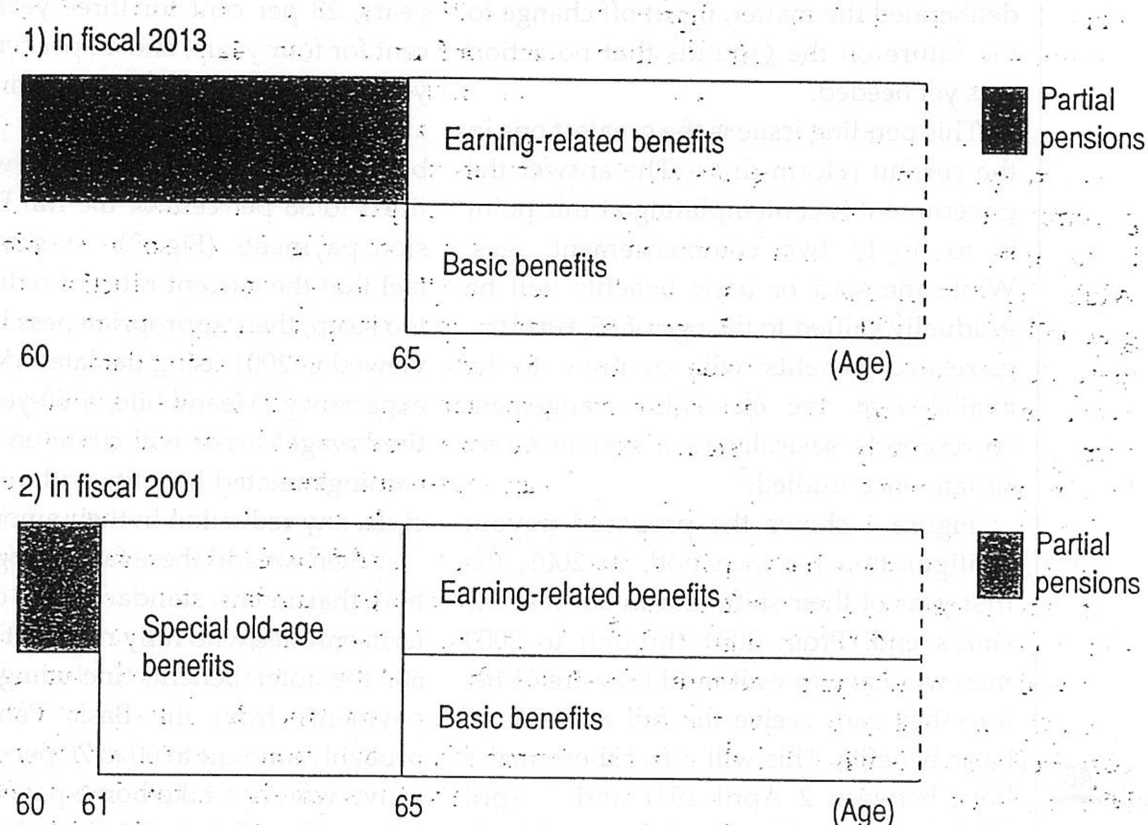
6. People receiving unemployment compensation will cease to be eligible for pension benefits.

7. Contributions will be deducted not just from monthly wages but also from bonuses. The rate to be applied is 1 per cent of the bonuses, with employees and their employers each contributing half this amount.

8. Survivors' pensions for dual-income families are to be made more generous.

9. The individual's share of contribution payments will be waived while he or she is on child-care leave.

Figure 1. *Adjustment in the commencement age*



10. Increases in contribution rates are to be somewhat larger than they have been.

11. A repayment system will be introduced for short-term foreign residents who leave Japan, and the amounts repaid will correspond to their contributions.

12. Qualified groups are permitted to contract out the tier-2 part of pensions by setting up an Employees' Pension Fund (*Kosei Nenkin Kikin*); this allows them to contribute to the state-run programme at a reduced rate. Thus far only one reduced rate has been applied, but multiple rates (from 3.2 per cent to 3.8 per cent) are to be introduced.

13. The investment restrictions on the money accumulating in the Employees' Pensions Funds are to be relaxed. Fund managers will be allowed to take independent decisions on up to one-third of not just their "new money" but also their "old money."

Adjustments in the commencement age

As noted, salaried workers receive both basic benefits and supplementary payments linked to their wages.[1] For some time now the government has been insisting that payments should not begin until people reach the age of 65. When a reform was being debated in 1989, government officials pressed strongly for an elevation of the eligibility age for benefits from 60 to 65. Mainly with financial management of pensions in mind, they argued that this change was the key to the system's long-term financial health, and they managed to secure the cabinet's approval. But when the Diet deliberated the matter, it put off change to the future on the grounds that no action was yet needed.

This pending issue is the greatest one in the current reform drive. The answer the government is contemplating at this point is to apply two commencement ages. While the start or basic benefits will be gradually shifted to the age of 65, earnings-related benefits will continue to be available at age 60. This arrangement corresponds basically to a system Great Britain once studied.[2]

Figure 1 shows the proposed payout configuration for men both in 2001, the first year of their shift, and in 2013, at the shift's end. From 2001 through to 2003 men will have to wait until they are 61 before they can receive the full amounts of basic benefits. This will affect those males born between 2 April 1941 and 1 April 1943 (Table 1). The phasing out of basic benefits for female employees will be delayed five years behind the schedule for male employees, starting only in 2006. Eventually, retired workers under the age of 65 will not receive any of the special benefits now available for enrollees in the 60- to 64- age bracket, though they will still be eligible for full amounts of the earnings-related benefits on tier 2.

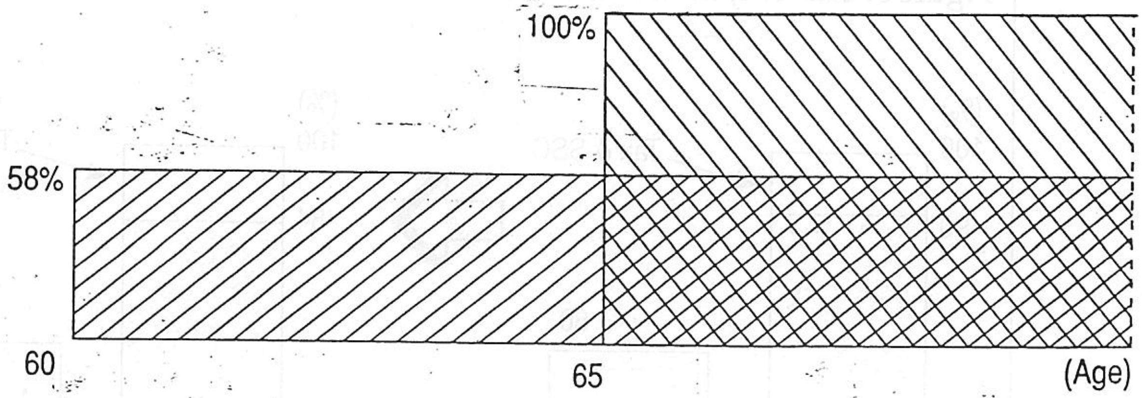
Those in this age bracket can also receive advance payments at a reduced rate from the Basic Pension on tier 1. At present, non-salaried workers can already take advantage of this system, and at the start of the twenty-first century, salaried workers will gain the same right. The advance payments are to be handled by paying out Basic Pension benefits at a reduced rate until the end of the pensioner's life. The size of the reduction now being applied rises from 11 per cent for one year of advance payments to 20 per cent for two years, 28 per cent for three years, 35 per cent for four years, and 42 per cent for five years. If the same schedule continues to be applied, a man who begins receiving benefits in 2013 at the age of 60 will be entitled to 58 per cent of the full Basic Pension payments (Fig. 2). As some people feel that the current rates of reduction are too steep, their appropriateness is to be reviewed in 2001 using the latest data on life expectancy. Meanwhile, a 60-year-old retired wage earner will continue to receive earnings-related benefits without, in principle, any reduction in their amounts.

When we add these factors together, we find that in the standard case of a long-term enrollee who fully retires at the age of 60, the total benefits including advance payments from the Basic Pension will probably amount to 60 to 70 per cent of the active worker's take-home pay. This level is in no way inferior to that in the West's industrially advanced countries. When the income of the pensioner is set at 100, the after-tax wages of the active worker lie between 143 to 167. If one takes into account the differences between the households they typically have — one with an old-aged couple, the other with four household members — this does not seem an unreasonable balance.

How should benefit levels be set?

Recognizing that the time has come to ensure a sound balance between the benefits received by pensioners and the contributions paid by active workers, the government is proposing that a change be made in the way benefits are calculated. Thus far it has adjusted benefits upwards in line with the hikes in gross wages, but as was stated above, it now wants to use net

Figure 2. *Advance payement of basic benefits at age 60*



wages as its index. This reform promises to be a meaningful one. While it will not in itself affect benefit levels, it should stabilize the balance between benefits and take-home pay over the long run.

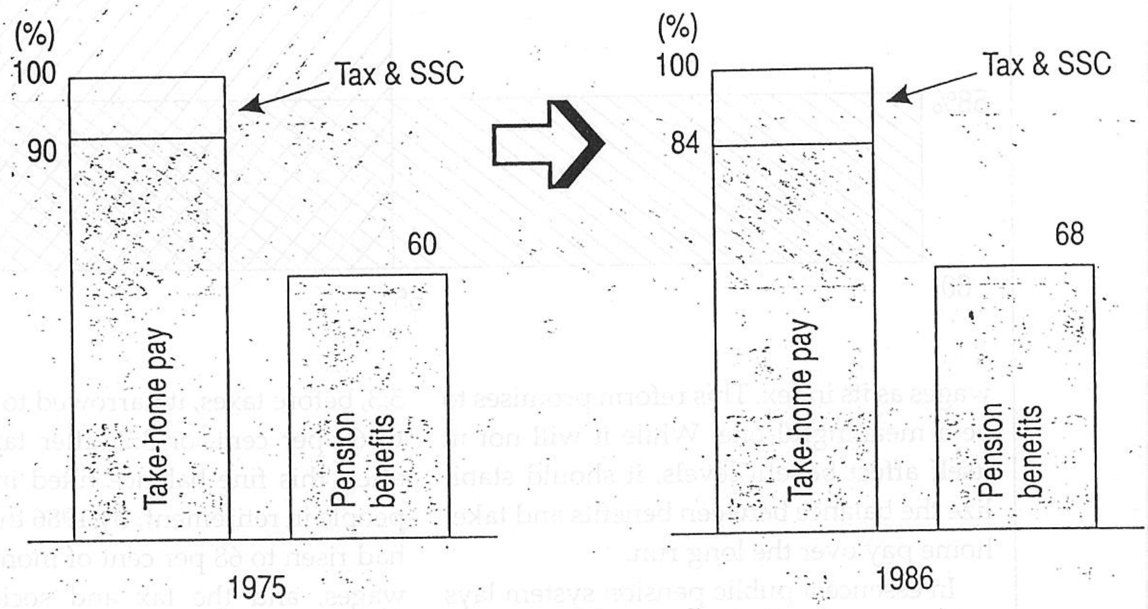
In essence a public pension system lays down rules for dividing the economic pie between people in old age and the working generation. Retirees should be able to maintain their dignity, while workers should be adequately rewarded for their labours. It is the pension system that prescribes the rules for satisfying these two needs.

From this perspective, the old rules were lacking. They were giving pensioners a gradually growing portion of the pie with each step towards an old-aged society. In the case of the Employees' Pension Fund — the main plan for private-sector wage earners — around 1975 the standard benefits came to roughly 60 per cent of active male workers' average monthly wages before taxes (Fig. 3). In those days, national and local income taxes and social security contributions reduced wage earners' monthly paychecks by about 10 per cent on the average, while the same burden on retirees was quite light. Thus while the ratio of monthly wages to benefits was 100 per cent to 60 per cent, or 5:3, before taxes, it narrowed to 90 per cent to 60 per cent, or 3:2, after taxes. Thereafter, this fine balance tilted in favour of people in retirement. By 1986 their benefits had risen to 68 per cent of monthly pretax wages, and the tax and social security burden on workers had grown to 16 per cent, reducing their net wages to 84 per cent of the gross amount. This works out to a 5:4 ratio between net wages and benefits.[3]

The greying of Japanese society will be continuing apace, and inevitably the tax and social security burden will grow much heavier. Take-home pay is likely to decline eventually to 75 per cent or even 70 per cent of the pretax amount. In the absence of reform, old-age benefits will then be virtually the same size as the worker's monthly paycheck. Seen from the pension system's inherent objective of having one generation give a helping hand to another, this would be a strange balance.

To hold the net-income balance between the two generations constant, debate on benefit levels must take net wages as its departure point. We must rectify our deeply ingrained habit of examining benefits only in relation to gross wages, before taxes and social security contributions are deducted. The ratio on a net basis is

Figure 3. *Balance of net income between active and retired workers.*



SSC: Social security contributions

now in the vicinity of 5:4, and if we like it there, all we need to do is to agree on maintaining it. A consensus on this point alone will keep benefits pegged to a fixed share of net wages no matter how far the ageing process goes, and each pensioner's slice of the pie will remain constant until death. Compared with the way the pie is now being divided, this would be much fairer.

Actually Japan is not the only country that has been studying net indexation. Germany recently pushed through just such a reform, and its net indexation went into effect in 1992. If Japan's reform proceeds on schedule, it will follow suit in October 1994.[4]

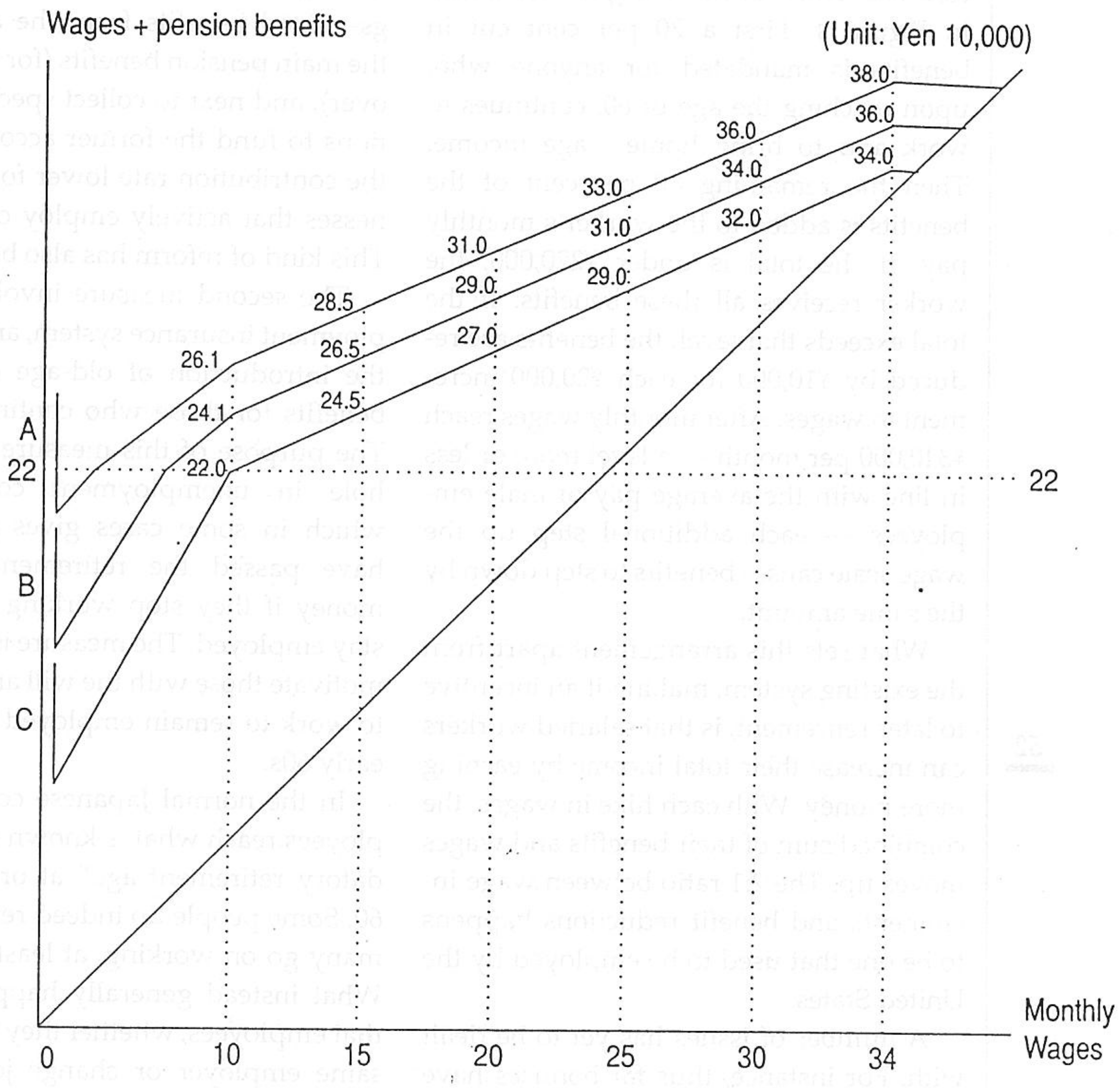
Promoting later retirement

Between the last reform drive and the current one, the government shifted its stance on the handling of benefits around the time of the commencement age. Upon deliberating the directions in which Japan's society and economy will be evolving from now into the twenty-first century, the authorities came to the conclusion that labour is likely to be in short supply, and this led them to stress the importance of keeping older people in the work force. They are now arguing persuasively that the pension system needs modification to promote employment of the elderly.

The changes proposed affect workers in the 60- to 64- age bracket. Currently these people are being encouraged to retire early at age 60 by the special old-age benefits and by the earnings test. In a major step forward, the thrust of the pension system in this respect is to be reversed.

A word is needed here on how the design of pensions can motivate people either to stay employed or to retire. Thus far those in their early 60s who continue working have had a strict earnings test ap-

Figure 4. *Earnings test introduced*



Note: A, B, and C indicate actual pension benefits under the proposed earnings test in cases of ¥ 250,000, ¥200,000, and ¥150,000 as the full amount of pension benefits.

plied to their benefits. They receive no benefits at all if their monthly wage income is ¥250,000[5] or more, and if they suffer benefit cuts ranging from 20 per cent to 80 per cent for income levels under that. This system is virtually structured so that with each increase in wages, benefits decrease by the same amount. It is as if a marginal income tax of 100 per cent has been imposed on wage hikes. The rationale is that the purpose of pensions is only to guarantee the payment of livelihood expenses. Since people cannot expect to add to their income by securing a raise — as their benefits would then be cut, leaving the total of wages and benefits constant — they tend to conclude they might just as well stop working.

This philosophy is now to be turned in the opposite direction. Two basic measures have been devised to encourage later retirement, as explained in the following.

The first measure is a change within the pension system — a change in the earnings test. The nature of the change is illustrated in Figure 4. First a 20 per cent cut in benefits is mandated for anyone who, upon reaching the age of 60, continues to work and to bring home wage income. Then the remaining 80 per cent of the benefits is added to the worker's monthly pay. If the total is under ¥220,000, the worker receives all these benefits. If the total exceeds that level, the benefits are reduced by ¥10,000 for each ¥20,000 increment in wages. After monthly wages reach ¥340,000 per month — a level more or less in line with the average pay of male employees — each additional step up the wage scale causes benefits to step down by the same amount.

What sets this arrangement apart from the existing system, making it an incentive to later retirement, is that salaried workers can increase their total income by earning more money. With each hike in wages, the combined sum of their benefits and wages moves up. The 2:1 ratio between wage increments and benefit reductions happens to be one that used to be employed by the United States.

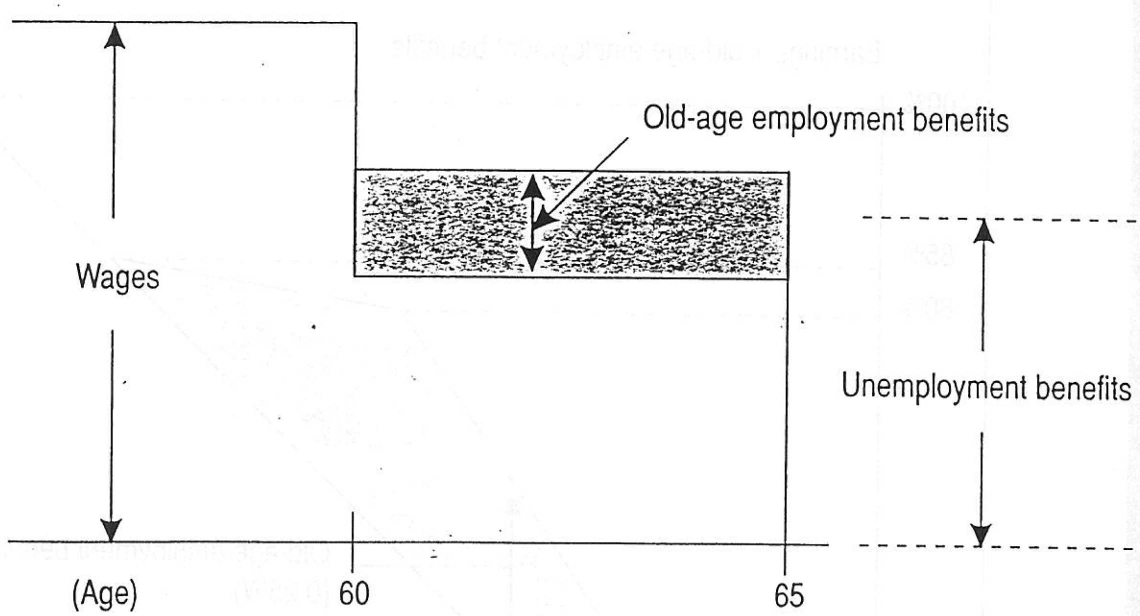
A number of issues has yet to be dealt with. For instance, thus far bonuses have not been considered in the earnings test. Again, the reform will not affect the practice of awarding full benefits to those who continue to receive wage income but who work fewer that 33 hours per week, as in the case of part-time advisors and people working on commission. Furthermore, once a private-sector wage earner reaches the age of 65, the full pension becomes payable regardless of whether he or she is earning a high salary.

It should be noted that many experts favour an additional reform to promote employment among those in the 60- to 64-age bracket. Their idea is first to separate the financial accounts for this group's earnings-related benefits from the accounts for the main pension benefits (for those 65 and over), and next to collect special contributions to fund the former accounts, setting the contribution rate lower for those businesses that actively employ older people. This kind of reform has also been put off.

The second measure involves the employment insurance system, and it features the introduction of old-age employment benefits for those who continue to work. The purpose of this measure is to plug a hole in unemployment compensation, which in some cases gives people who have passed the retirement age more money if they stop working than if they stay employed. The measure is designed to motivate those with the will and the ability to work to remain employed during their early 60s.

In the normal Japanese company, employees reach what is known as the "mandatory retirement age" at or around age 60. Some people do indeed retire then, but many go on working, at least for a while. What instead generally happens at 60 is that employees, whether they stay with the same employer or change jobs, suffer a large salary cut, and at that point the unemployment compensation they are entitled to may be larger than their new wages. The second measure rectifies this problem by hereafter treating those who have a sharp decline in wages as quasi-unemployed; specifically, these people are to be provided benefits amounting to 25 per cent of their new wages. These benefits, when combined with wage income, will give many of those in the 60- to 64-age group more money than they could receive from employment insurance alone (Fig. 5). The 25 per cent benefit rate begins

Figure 5. *Old-age employment benefits*



to drop at the point where workers are still receiving 64 per cent of their former salary, and for those who receive 85 per cent or more of their former salary, the rate reaches zero and no benefits are provided (Fig. 6).

Shown in Figure 7 is the net income of a worker receiving both these old-age employment benefits and the old-age benefits paid by the pension system. To balance the employment benefits, the pensions of such workers are to be cut by an amount equivalent to 10 per cent of their new monthly salary.[6]

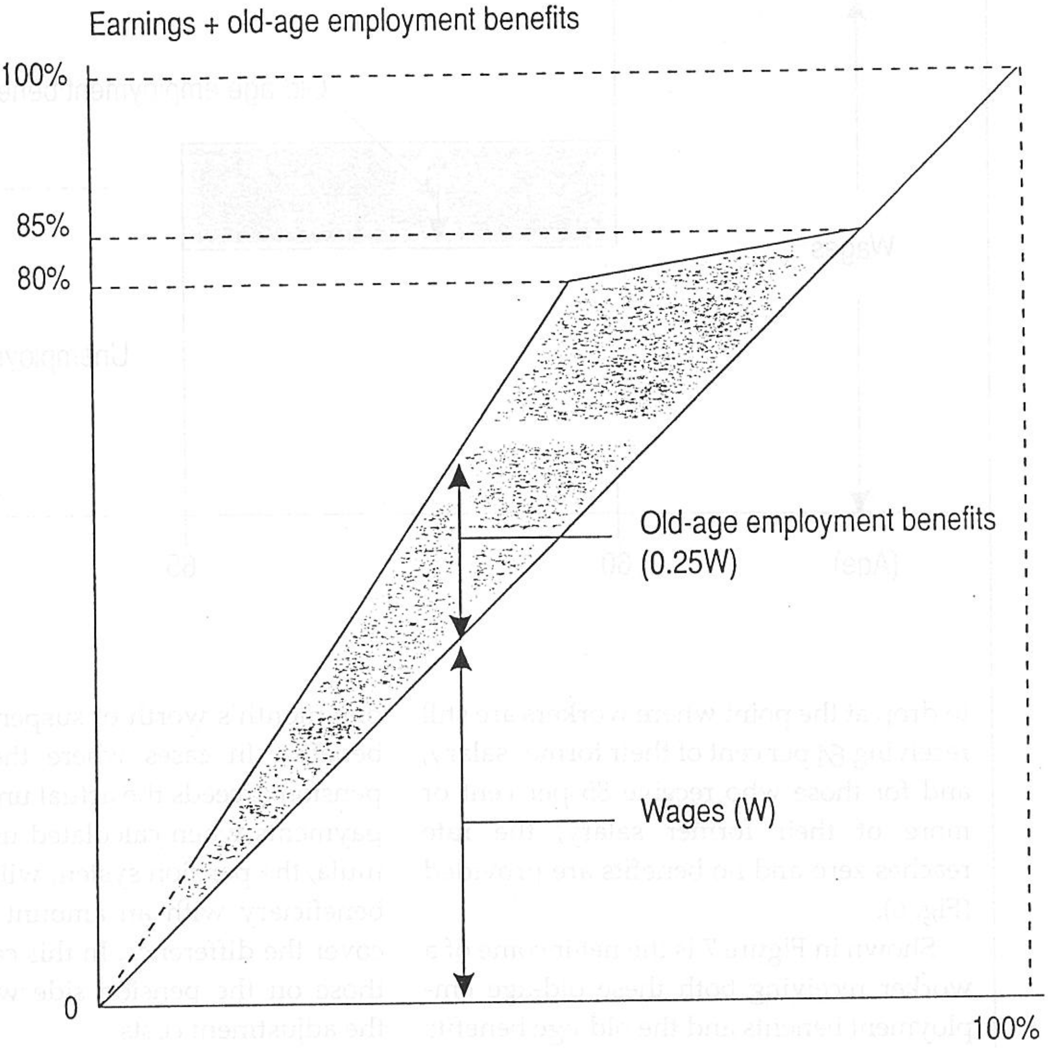
If the reform proceeds as planned, people will no longer be able to collect both unemployment compensation and old-age benefits. The plan now being studied is to give unemployment compensation to the jobless for as long as their coverage lasts, after which they will receive pension payments. In a later adjustment, each 30 days of the basic unemployment allowance will be treated as the equivalent of one month's worth of suspended pension benefits. In cases where the suspended pension exceeds the actual unemployment payments when calculated using this formula, the pension system will provide the beneficiary with an amount sufficient to cover the difference. In this case, it will be those on the pension side who shoulder the adjustment costs.

As can be appreciated, the linkage between pensions and employment will be made somewhat more complicated by these fine-tuning measures. The limitations of a compartmentalized bureaucracy cannot be denied. In the end, the response from employers will determine whether or not the reform measures can effectively generate jobs for the elderly.

Hikes in contribution rates

In principle, upward revisions in contribution rates for the Employees' Pension Fund are decided upon once every five years.

Figure 6. *Old-age employment benefits*



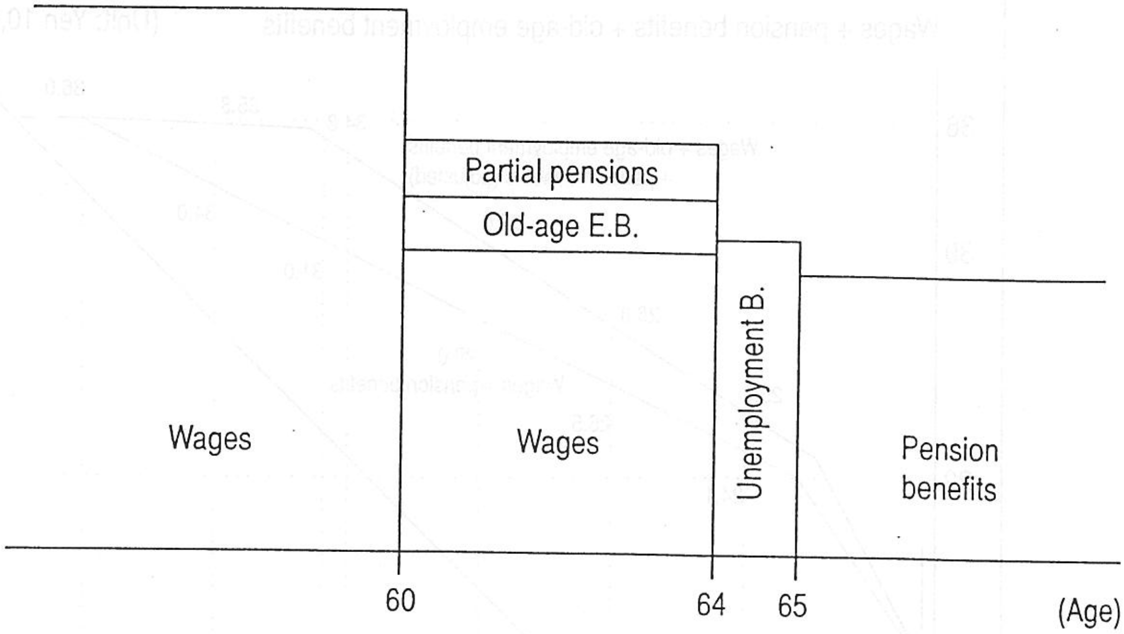
Note: The 100% line of wages means the wage level just before the mandatory retirement age.

The current rate (as of April 1994) is 14.5 per cent, and employees and employers split the contributions equally between them. The government intends to raise the rate to 16.5 per cent in November 1994 and to follow this with a further hike to 17.35 per cent in Octoberber 1996. The average increase for the five-year period between November 1994 and September 1999 is to be 2.5 percentage points.

In 1989, the government proposed that every five years the rate be moved 2.2 points higher, but now it is saying that a larger increase of 2.5 points is needed. What prompted this revision, the authorities inform us, is a bigger drop in the birth rate than had been anticipated; this will be making the financing of public pensions that much more difficult. (The latest population projection is shown in Fig. 8.)

The long-term financial projections the government has prepared for the future envisage further 2.5-point hikes every five

Figure 7.1. *Wages and benefits for employees in their early sixties (an image diagram)*



Unemployment B. = unemployment benefits; old-age E. B. = old-age employment benefits

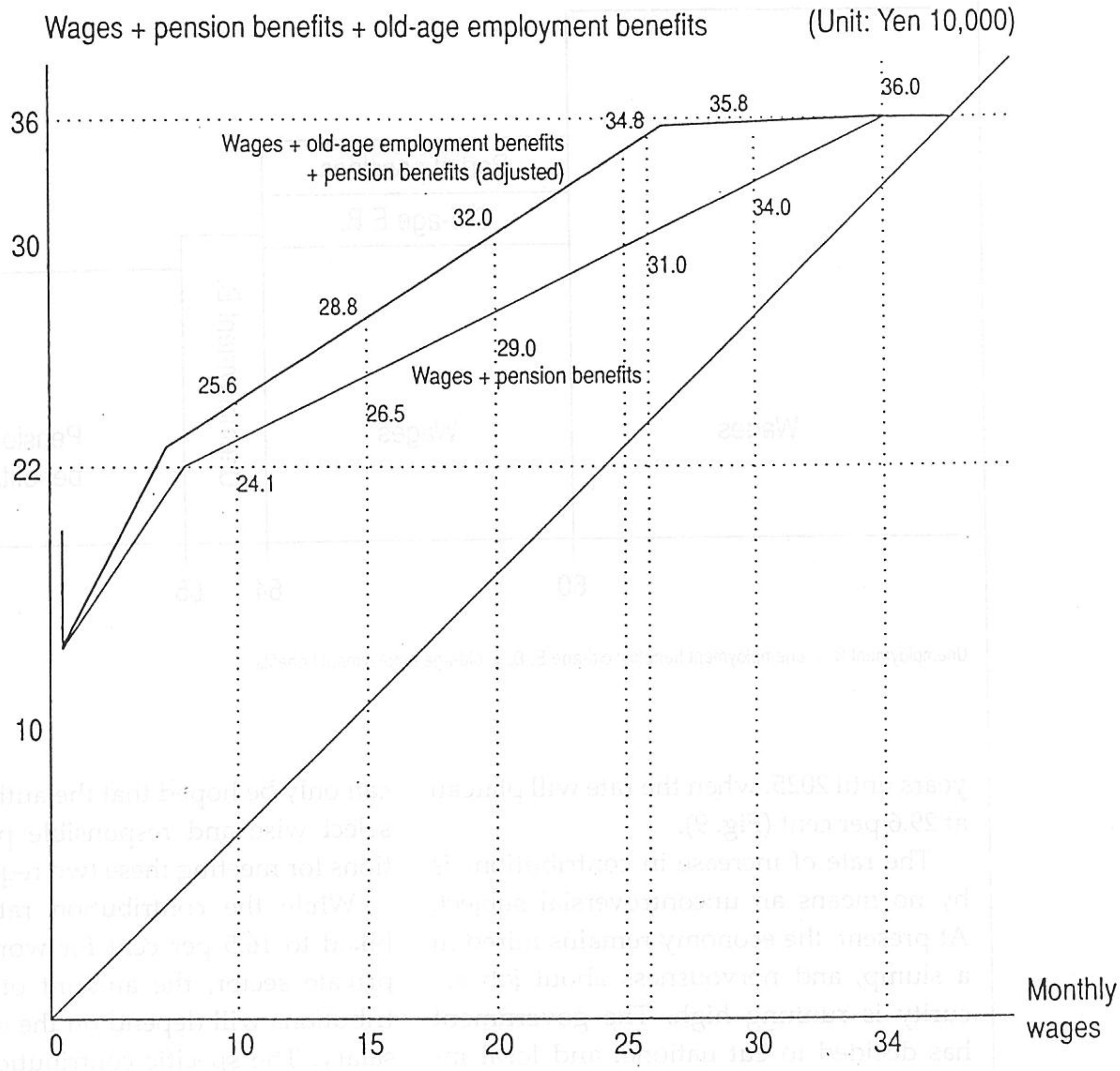
years until 2025, when the rate will plateau at 29.6 per cent (Fig. 9).

The rate of increase in contributions is by no means an uncontroversial subject. At present, the economy remains mired in a slump, and nervousness about job security is running high. The government has decided to cut national and local income taxes by ¥5.47 trillion in 1994 to give the economy a boost, but some say that the impact of this relief will be largely offset by the higher contributions, which annually will add ¥3.8 trillion to pension funds. If the government's leaders are to form a united front for the economy's management, one idea they should consider is a steady series of contribution rate hikes by 0.5 points each year. On the one hand, there is a long-term need to keep pension administration in good health, and on the other, there is a short-term need to respond to swings in the business cycle. It can only be hoped that the authorities will select wise and responsible political options for meeting these two requirements.

While the contribution rate is to be hiked to 16.5 per cent for workers in the private sector, the amount of their contributions will depend on the size of their salary. The specific contribution is determined by consulting a schedule of monthly earnings, and this schedule is also to be revised in November 1994. The lowest salary level is to be raised from ¥80,000 to ¥92,000, and the highest is to be raised from ¥530,000 to ¥590,000.

As noted above, one feature of the reform package is that contributions are for the first time to be taken out of bonuses, which are usually paid twice each year and account for a substantial portion of many employees' income. This assessment will begin in April 1995 at a 1 per cent rate split between employees and employers,

Figure 7.2. *Wages and benefits for employees in their early sixties*



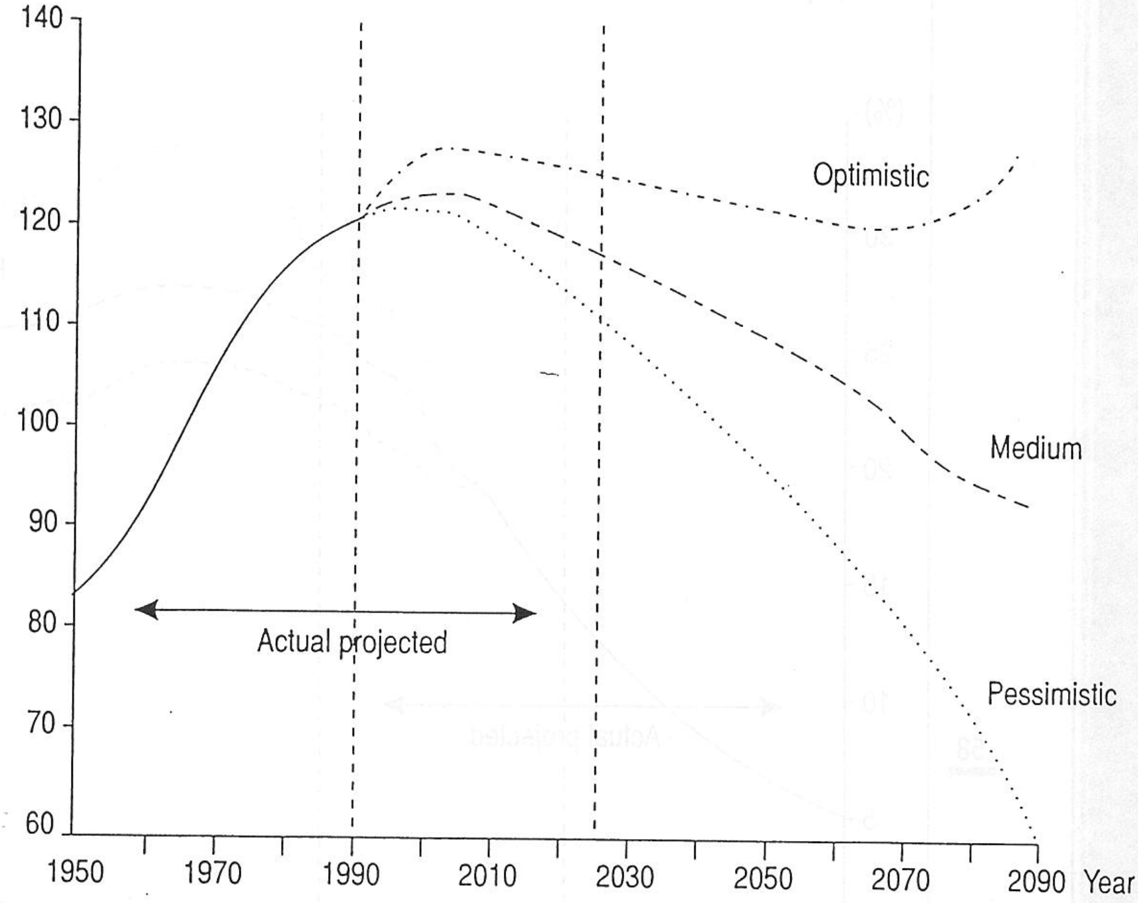
Note: The amount of monthly wages just before mandatory retirement is assumed to be ¥ 400,000. The full amount of monthly pension benefits is assumed to be ¥ 200,000.

and it will apply to bonuses without any ceiling. Pension experts tend to feel quite strongly that contributions ought to be assessed on total remuneration including bonuses. Probably the government has come to the same conclusion and, bearing the reaction of the business community in mind, is ready to take the first step towards this kind of system.[7]

The contribution rates for the fixed-sum pensions for those other than employees are also to be raised. The monthly payment, which was ¥10,500 in April 1993, was just increased to ¥11,100 in April 1994, and it will go up further to ¥11,700 in April 1995 (Fig. 10). Thereafter the government plans to tack on ¥500 (in 1994 prices) each year until 2015, when the monthly sum will be ¥21,700 (in 1994 prices).

On 22 February 1994, the pension authorities made public their 1994 revised long-term financial projections. For popu-

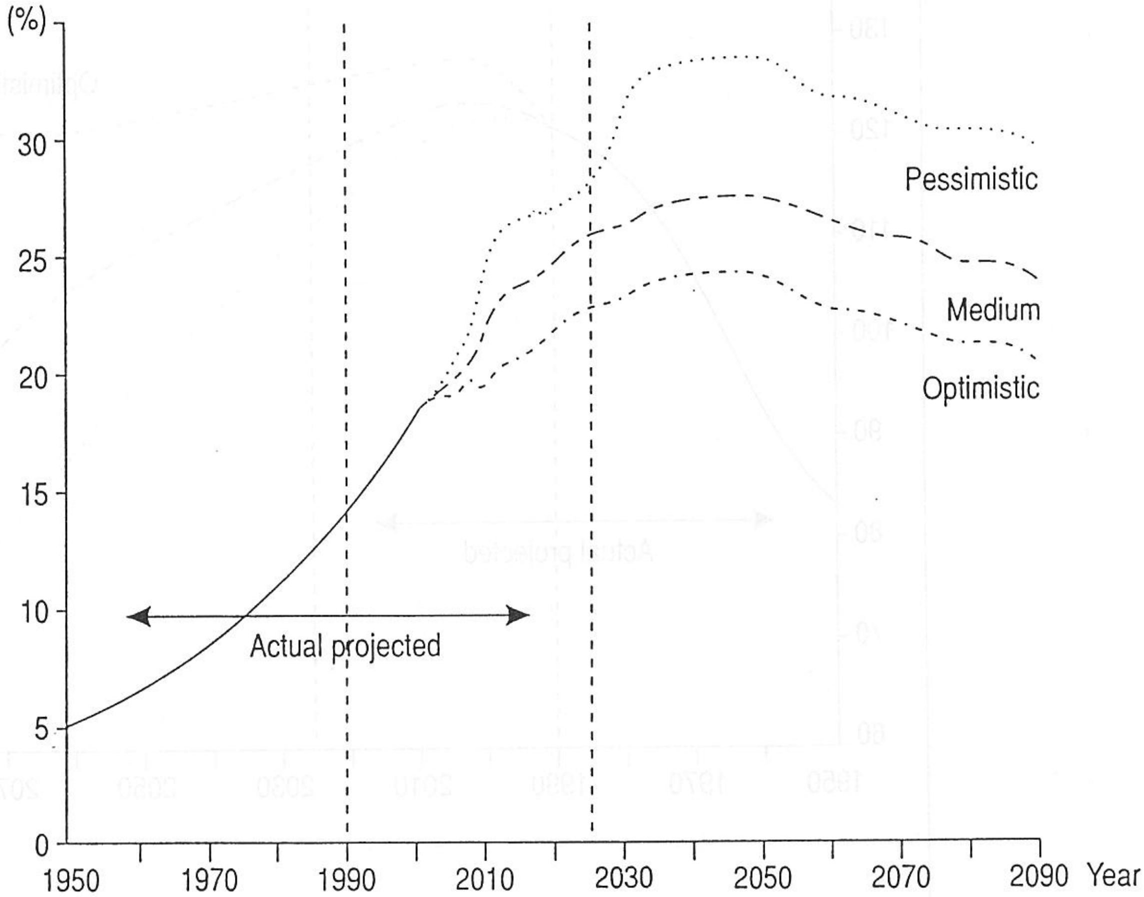
Figure 8.1. *The total population in Japan* (in millions)



lation figures, they used the medium projection in a September 1992 forecast by the Institute of Population Problems — a research organization under the Ministry of Health and Welfare — and for labour force figures, they drew on the March 1993 projection by the Ministry of Labour's Employment Security Bureau. They posited that the average nominal growth rate of salary payments (monthly earnings) would be 40 per cent per year, while that of the consumer price index would be 2.0 per cent per year. And they further assumed that the annual rate of return from the investment of pension funds would be 5.5 per cent in nominal terms.

Their projections are predicated upon successive hikes in pension contributions. In drawing up a schedule for these hikes, they made use of four conditions: (1) that at the stage of maturity contribution levels be constant and unchanging so as to permit stable pension management; (2) that the upward adjustments in rates every five years not impose an increasingly heavy burden on each succeeding generation; (3) that no deficit be recorded in the current accounts for any single fiscal year; and (4) that a certain level of fund reserves (by convention, enough to cover more than two years of benefits) be kept on hand for

Figure 8.2. *Population projections of the elderly (65 and over) as a percentage of the total population*

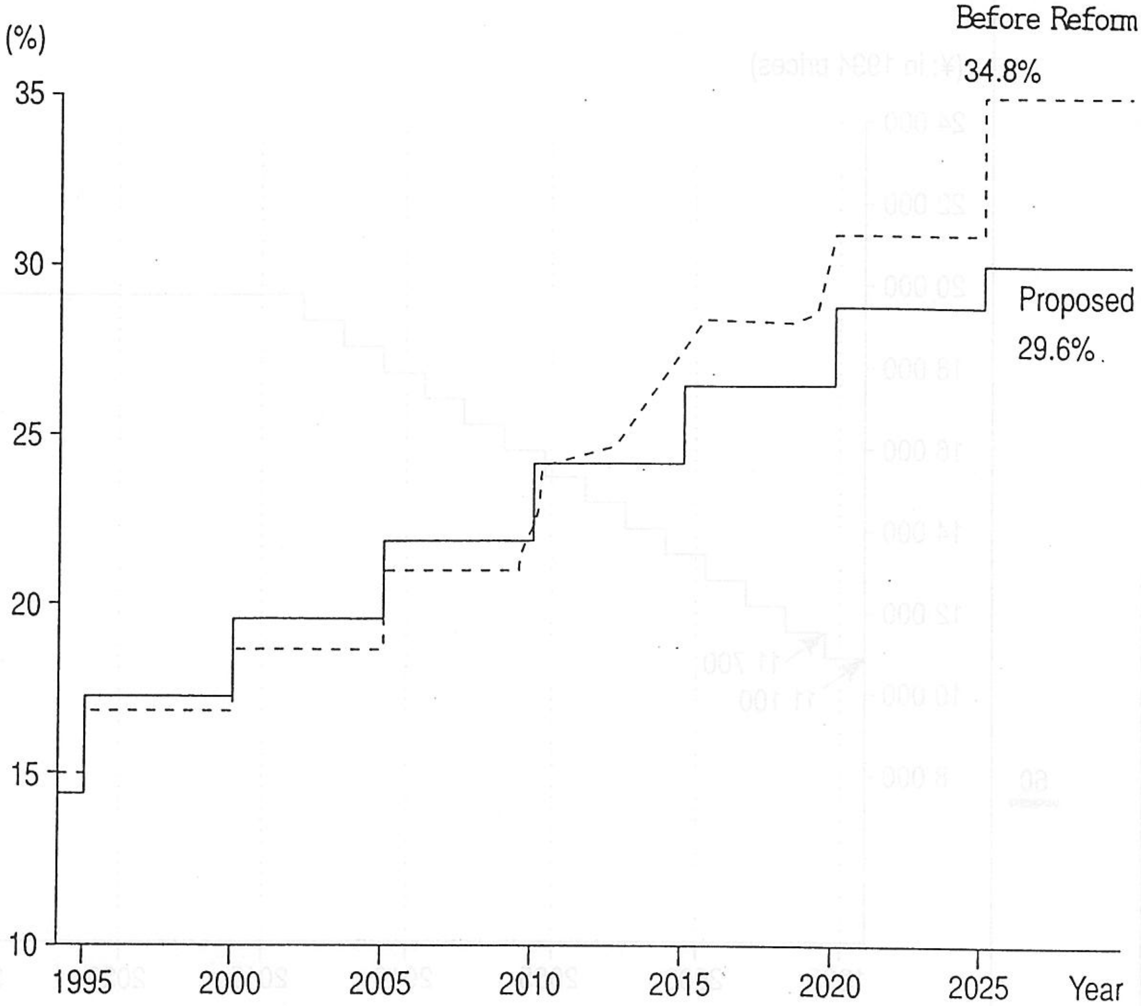


Source: Institute of Population Problems, Ministry of Health and Welfare, Japan. *Population projections for Japan: 1991-2090*, 1992.

weathering any short-term deterioration in economic conditions.

Among the findings from the revised projections, one is that the number of contributors for each beneficiary of the Employees' Pension will drop swiftly from 5.05 in 1995 to 2.36 in 2020, after which it will subside more slowly to 2.07 in 2045. Another projection is that the total expenditures of the Employees' Pension will swell from ¥21.8 trillion in 1995 to ¥111 trillion in 2020 and ¥277 trillion in 2045. When calculated using 1994 prices and setting the total expenditures in that year at 1.0, the spending will measure 3.1 in 2020 and 4.7 in 2045 (Tables 1 to 4.). The government's subsidies are expected to rise from ¥3.9 trillion in 1994 to ¥8.1 trillion in 2025. If the changes in population size instead follow the pessimistic projection of the Institute of Population Problems, the outlook for pension finances will be much cloudier than this analysis indicates.

Figure 9. *Contribution rates of the Employees' Pension Fund (Kosei Nenkin Hoken)*

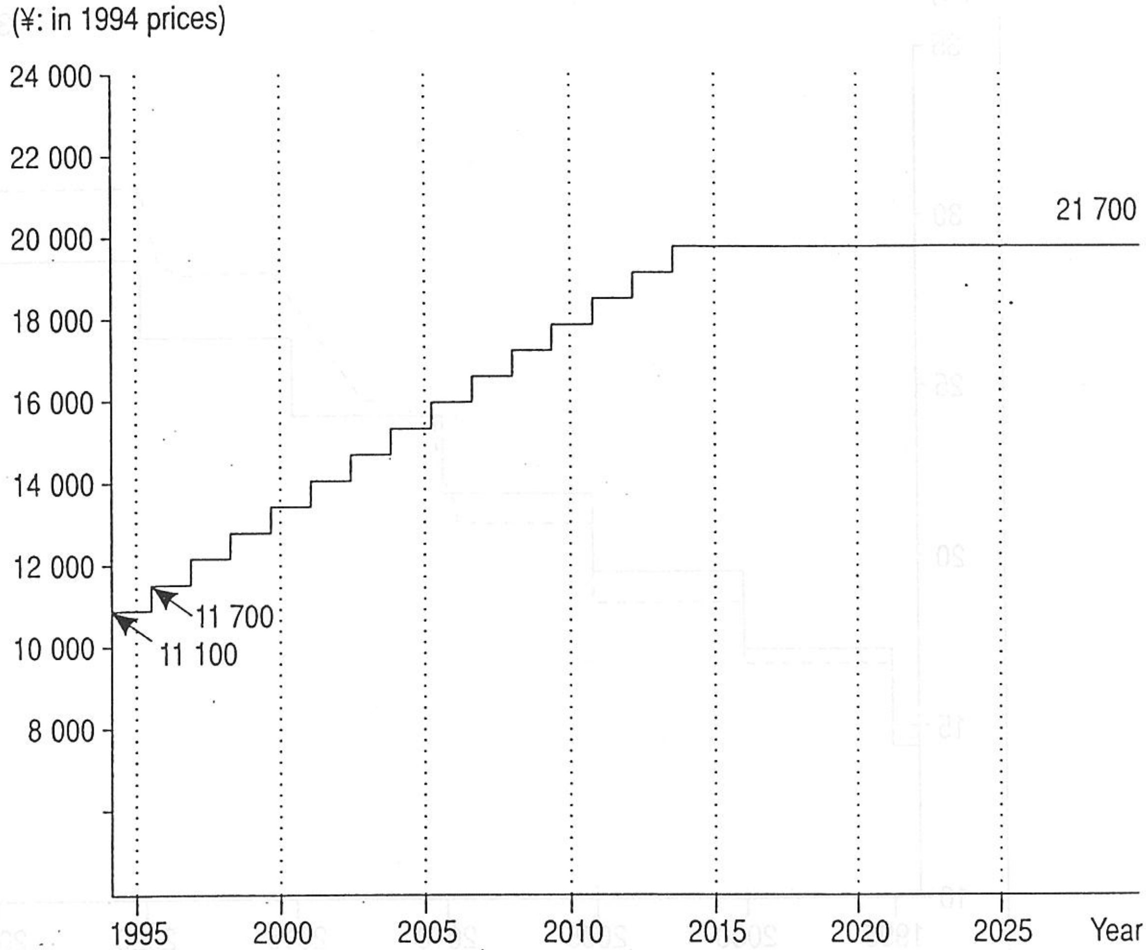


Pensions for women

There has been much debate in Japan over pensions for women. This is an issue many countries have been wrestling with, and better solutions are still being sought. The main topics in Japan's case are survivor's pensions and pension coverage for part-time workers.

In principle there is no gender discrimination in survivor's benefits. To grasp where problems arise, consider the differences in the payments to wives in single-income and dual-income families after the husband dies. In the case of couples in old age who have been receiving pensions, both the full-time housewife and the wife who had a job will continue to receive their own Basic Pension even after the husband's death; no difference occurs in this respect. Where the difference lies is in earnings-related benefits. The housewife receives three-fourths of the amount her husband had been receiving. The woman who worked has two options: either she asks to be paid the full pension for her own earnings, or she asks for three-fourths of her husband's earnings-related

Figure 10. *Monthly contributions for non-employees*



benefits, thereby getting the same pension the housewife receives.

Working women have been expressing strong dissatisfaction with this arrangement. They do not receive anything back, they complain, from the contributions they themselves make to the pension system. In response, the government has proposed a third survivor's option in its reform package: half the earnings-related benefits that result when the husband's and wife's benefits are added to together. This option is essentially identical to the earnings-split formula some Western countries are using, and it should reduce the dissatisfaction of women in dual-income families to some extent.[8]

There have also been some complaints about the fact that full-time homemakers do not themselves contribute directly to the pension system. Nonetheless, the existing "old-age" pensions have a design that treats working women and homemakers impartially. When both members of any couple are considered together, the old-age benefits they receive correspond to the contributions they make.[9]

The outlook is that the current reform will free people on child-care leave from paying their share of pension contributions as well as health and employment con-

Table 1. *Start of full basic benefits for male employees*

Date of birth	Age
Before 1 April 1941	60
Between 2 April 1941 and 1 April 1943	61
Between 2 April 1943 and 1 April 1945	62
Between 2 April 1945 and 1 April 1947	63
Between 2 April 1947 and 1 April 1949	64
After 2 April 1949	65

Table 2. *Population ageing in the Employees' Pension Fund (Kosei Nenkin Hoken)*

Fiscal year	Contributors	Beneficiaries	Beneficiaries	Contributors/beneficiaries
	(1)	(2)	(3)	(4)
1995	33.8	6.7		5.06
2000	34.5	8.5		4.06
2005	34.0	10.0	0.9	3.38
2010	32.6	11.4	3.7	2.50
2015	31.1	12.4	4.5	2.50
2020	30.4	12.9	4.9	2.36
2025	30.3	12.7	4.8	2.38
2030	29.9	12.5	5.2	2.40
2035	28.9	12.5	5.9	2.32
2040	27.5	12.8	5.2	2.14
2045	26.4	12.8	4.5	2.06
2050	26.0	12.5	4.0	2.08
2055	25.9	11.8	3.7	2.19
2060	25.9	11.0	4.1	2.35

Notes:
1. Contributors and beneficiaries are in millions.
2. Beneficiaries (column 2) include only those receiving old-age benefits, excluding those pensioners with disability and survivors' benefits.
3.Beneficiaries (column 3) are those born after 2 April 1941, receiving the tier-2 benefits in their early 60s.

Source: Ministry of Health and Welfare, Japan, 1994.

Table 3. *Long-term financial performance of the Employees' Pension Fund (Kosei Nenkin Hoken)*

Fiscal year	Contribution rate	Total expenditures	Surplus	Funded reserve	(3) / (1)
		(1)	(2)	(3)	(4)
1995	16.5	21.8	8.8	132.5(132.5)	6.1
2000	19.5	33.8	10.4	182.7(150.6)	5.4
2005	22.0	50.1	9.3	230.3(157.4)	4.6
2010	24.5	70.2	6.4	269.1(152.8)	3.8
2015	27.0	90.7	5.7	299.8(141.4)	3.3
2020	29.5	110.9	10.8	343.5(134.6)	3.1
2025	29.6	132.8	13.8	420.0(136.7)	3.2
2030	29.6	159.4	15.9	516.8(138.3)	3.2
2035	29.6	193.5	13.1	615.3(135.4)	3.2
2040	29.6	232.9	7.4	693.0(125.3)	3.0
2045	29.6	276.6	3.9	754.7(112.2)	2.7
2050	29.6	326.2	2.2	808.0(98.7)	2.5
2055	29.6	380.9	9.0	882.8(88.6)	2.3
2060	29.6	445.9	20.8	1,020.1(84.2)	2.3

Notes:

1.Figures in columns 1, 2, and 3 not in brackets are in trillion yen in *nominal* terms. Those within brackets are in trillion yen at 1994 prices.

2. Main assumptions are as follows: (a) the annual consumer price index increase is 2.0 per cent; (b) the nominal wage-rate increase is 4.0 per cent per annum; and (c) the nominal rate of return is 5.5 per cent per annum.

Source: Ministry of Health and Welfare, Japan, 1994.

tributions. In practice, this exemption should provide greater support to women in dual-income families.

Turning now to the debate over providing pension coverage to part-time workers, we find that the current system does not directly apply to those who work fewer than 33 hours per week. In principle these part-time workers are treated like full-time homemakers. But if their annual pay exceeds ¥1,300,000, they lose the right to be treated as a dependent spouse. They then become obligated to enroll in the tier-1 system of fixed-amount pensions and to shoulder these contributions by themselves. Because this arrangement tends to encourage part-time jobs that pay less than ¥1,300,000, calls are being made for the introduction of a system that part-time workers can enroll in. And to strengthen their incentive to enroll, survivor's pensions probably should be further improved.

Four other problematic points involv-

Table 4. *Population ageing in the tier-1 system*

Fiscal year	Contributors (1)	Beneficiaries (2)	Contributors / beneficiaries	Total benefits (3)
1995	71.2	16.7	4.3	11.6
2000	71.9	20.9	3.4	14.7
2005	70.5	25.3	2.8	17.5
2010	67.0	29.2	2.3	20.0
2015	64.2	32.5	2.0	22.2
2020	63.1	33.6	1.9	23.3
2025	62.8	33.3	1.9	23.4
2030	61.3	33.1	1.9	23.3
2035	58.2	33.3	1.7	23.2
2040	55.3	33.8	1.6	23.3
2045	53.3	33.2	1.6	23.0
2050	52.4	32.0	1.6	22.4
2055	52.2	30.0	1.7	21.6
2060	51.7	28.0	1.8	20.7

Note: Figures in column 3 are in trillion yen at 1994 prices.
Source: Ministry of Health and Welfare, Japan, 1994.

ing pensions for women have also been raised. First, a full-time housewife who divorces has no right to claim part of the earning-related benefits her husband accumulated while she was married. It has been suggested that the right to these benefits be divided between the two. Second, payments of survivor's pensions terminate upon remarriage, but critics say they should continue. Third, critics also find it strange that a spouse who has married after beginning to receive an old-age pension becomes entitled to claim a survivor's pension. Fourth, while a fatherless family has the right to a survivor's annuity, a motherless family does not. This, it is said, violates the equality of the sexes.

Future issues

Many other issues remain to be addressed. Above all, revenue-sharing schemes must be found to integrate the various pension plans and to handle pension administration more economically. Another pressing need is to use the system to support both childbirth (by introducing childbirth benefits) and the raising of children (by employing a child-support deduction when pension contributions are calculated). Again, a system of extra benefits should be set up for old-age pensioners who later become disabled; this will adjust the benefits to fit the needs at each stage of retirement.

As the greying process progresses, the key to Japan's future will be continued economic growth. Were the economy to fail to expand as the share of senior citizens in the population rises, the real after-tax pay of workers would decline. Younger Japanese would despair of achieving a higher standard of living than their parents, and the present level of intergenerational transfers from workers to retirees would become hard to maintain. Distrust in politics would intensify, and everyone would begin fighting for bigger slices of the pie.

For the next 20-odd years, the share of old-aged people (65 and over) will be rising by 0.5 percentage points each year on the average. But if economic growth of at least 1.0 per cent per year in real terms can be sustained, the take-home pay of the productive population should continue to rise to some extent, pushing living standards slowly but surely higher. In this light, we need to approach the question of funding from the perspective of circumventing constraints on economic growth. We must ask which of the three main revenue sources available — the income tax, social security contributions, or the consumption tax — will slow down growth the least. And the answer is the consumption tax.

Unlike income taxes, which come out of wages before they are spent, the consumption tax does not function as a direct levy on the saving and investment that powers the economy. Social security contributions, meanwhile, have a character midway between income and consumption taxes in their effect on growth. Inherently, they are fairly regressive. And because they are a component of personnel costs, their effect on corporate behaviour is not neutral. If these contributions become too onerous, companies will shift production offshore to places where personnel costs are lower, and domestic production will stagnate. In this respect as well, social security contributions are highly problematic. Over the long term, accordingly, it will make sense to fund part of the increased costs of our greying society by hiking the 3 per cent rate of the consumption tax. By selecting this option, we will also be able to lighten the extra load that young and middle-aged Japanese have to shoulder, thereby spreading burdens more evenly that at present over the respective life stages.

In the funding debate thus far, the general assumption has been that the best way to redistribute burdens is to place less emphasis on taxes and more on social security contributions. This was the conclusion that the blue-ribbon panels studying administrative reform reached, and it has guided the reform process thus far. Today, however, we need to rethink this approach, and we also need to correct the defects in the current consumption tax. Among this levy's shortcomings is that it lacks neutrality in its impact on business of different sizes and types.

Clearly Japan still has many problems awaiting solutions. We can only hope that sensible answers will present themselves in the course of a dispassionate and intelligent debate.

Notes

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1. Descriptions of the current public pension system in Japan can be found in Takayama

(1992a, 1992b) and International Social Security Association (1993).

2. See Secretary of State for social security, United Kingdom (1991).

3. The figures here ignore bonuses, which have thus far been excluded from pension calculations. It has been estimated that when bonuses are included, benefits in 1986 came to 63 per cent of net wages in the standard case.

4. See Schmähl (1993). Of course, there are some technical differences in the way the Japanese and German net indexation systems work. In Japan's case, wages over the last five years increased by 17 per cent when calculated by the old formula, but the increase rate drops slightly to 16 per cent when calculated on a net basis. It was Musgrave (1981) who proposed net wage indexation.

5. ¥10,000 = US$102.1 = UK£65.88 = DM156.3 = FFR536.0 as at 22 August 1994.

6. Faithful adherence to the thinking behind the proposed earnings test would have mandated a 12.5 per cent cut. That a smaller cut has been proposed can be taken as a sign that the pension authorities have broadened their thinking to include matters that fall in the realm of labour administration.

7. When contributions are not collected from bonuses, unfairness in the distribution of pension burdens arises in several ways. Contributions can be reduced and benefits for workers in their early 60s can be increased by shifting income from monthly wages to bonuses. These defects disappear when levies are applied to bonuses or when all wage income is aggregated for contribution assessment. But it now has become possible for high-wage workers to dodge a portion of their contributions by holding their bonuses to the minimum and shifting to an annual salary system.

8. In introducing a third option, another possibility would have been to award the survivor three-fourths of the total earnings-related benefits (up to a certain limit) of the husband and wife. This option would have given completely equal treatment to full-time homemakers and working women. Alternatively, the reform proposal could have steered clear of discrimination by reducing to one-half the surviving housewife's share of her husband's earnings-related benefits.

9. The convention in the Employees' Pension Fund has been to treat the salaried worker with a full-time homemaker as the standard model. (See Takayama, 1992a, Chapter 1; and Takayama, 1992c, in Japanese).

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Errata, issue 1/95

Social security for dependent persons in Germany and other countries

p. 19 col. 2, line 7: *for* "or does it derive rather from . . . Bismarckian philosophy" *read* "which derives from . . . Bismarckian philosophy"

p. 19 col. 2, line 16 (and in general thereafter): *for* "care" *read* "nursing care"

p. 21 col. 1, para. 2: *for* "Dependency insurance is to become a separate element" *read* "Dependency insurance is to become a separate branch"

p. 25 col. 1, line 14: *for* "provision of social benefits for those most in need is not guaranteed" *read* "targeting of social benefits for those most in need is not guaranteed"

p. 30 col. 2, para. 4, line 4: *for* "apparent at the national level" *read* "apparent at the international level"

The 1994 Reform Bill for public pensions in Japan

p. 47 col. 1, line 10: *for "Hoken" read "Kikin"*

p. 53 col. 1, line 2: *for* "80 per cent" *read* "64 per cent"

p. 57 col. 1, line 11: *for* "40 per cent" *read* "4.0 per cent"

p. 58 col. 2, line 3: *for* "2.7" *read* "4.7"

p. 61 Table 2, column 4, year 2000: *for* "4.6" *read* "4.06"

p. 62 col. 1, line 11, and col. 2, line 6: *for* "¥300,000" *read* "¥1,300,000"

Postscript: The 1994 Reform Bill was passed in the National Diet on 2 November 1994.