Encouraging Informed Debate on the 2004 Pension Reform (A Summary)

by the NLI Research Institute Pension Forum

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1. Public Pension Reform of 2004

Ahead of the periodic reform (conducted every five years) of the public pension system in 2004, the Pension Subcommittee of the Social Security Council convened in January 2002, and released a report last December entitled, *Directions and Issues Regarding the Framework for Pension Reform* (referred to below as *Directions and Issues*). According to the reform schedule, the subcommittee will pursue debate on reforms and formulate specific reform measures this fall, based on which the Ministry of Health, Labor and Welfare will draft a reform bill, which will be submitted to the regular Diet session next year (Figure 1).

Figure 1 Pension Reform Schedule

Reform stage	Previous reform	Present reform
Council convenes	May 1997	January 2002
Council reports on issues	December 1997	December2002
MHLW presents tentative proposals	December 1997	December 2002
Council releases opinion paper	October 1998	Fall 2003 *
MHLW presents draft bill	Octoctober 1998	Fall 2003 *
LDP presents pension reform proposal	December 1998	Winter 2003 *
Bill is presented in Diet	July 1999	2004 regular Diet *
Diet passes bill	March 2000	2004 regular Diet *
Reform is implemented	April 2000	April 2005 *

* Schedule after July 2003 is predicted.

Directions and Issues reviews the last reform and subsequent discussions, presents the points at issue on a wide variety of topics, and explains the opinions of the MHLW (Figure 2). However, the report contains glaring gaps in that key issues are omitted or inadequately addressed.

To conduct advanced and intensive research on public pension issues—one of the most critical challenges in the era of aging and decline in number of children—NLI Research Institute assembled a panel of experts called the Pension Forum in April 2000. The Forum seeks to explore public pension issues in depth by inviting leading authorities from diverse fields. Ahead of the 2004 public pension reform, the Pension Forum recently compiled a report with the aim of contributing to the ongoing public pension debate. This paper summarizes the Pension Forum's findings.

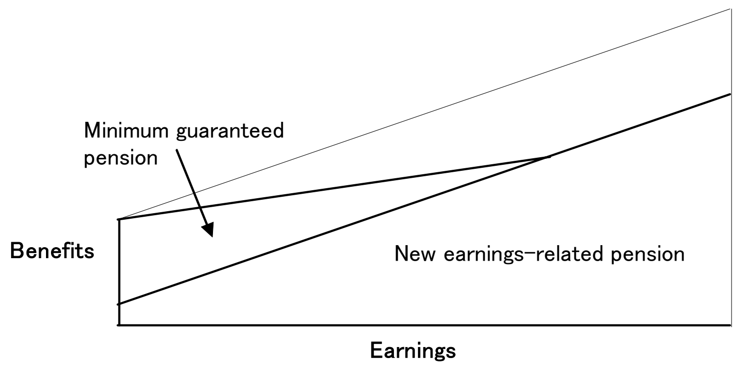
Figure 2 Summary of *Directions and Issues*

Item	issues & proposals
● Pension system structure	
Pension system structure	Maintain current structure; fund basic pension with tax revenue; eliminate earnings-related pension; create uniform earnings-related pension
Current funding method, maintenance of current reserve level	Maintain partial funding method; shift from defined benefit to defined contribution plan
● Benefits and contributions	
Benefit level	Determine relationship to cost of living; identify role of basic pension
Contribution level	Lift freeze; determine government's burden; determine final premium; consider plans to increase premium
Revision of benefits and contributions	Consider conventional defined benefit vs. notional defined contribution (fixed premium method); adjust benefits & contributions and minimum benefits
Treatment of current pension benefits	Adjust benefits & contributions and minimum benefits; fund pension with tax revenue
Enhancement & growth of private pensions	Consider ways to combine public and private pension plans
● Clear linkage of benefits & contributions	Provide information;consider point-based benefit system; shift from defined benefit to defined contribution plan
● Decline in children, women in society, change in forms in employment	
Pension's role in supporting and nurturing coming generation	Consider measures for child-raising period; scholarships
Scheme to increase participants	Extend participation to part-time workers, working elderly
Women and pensions	Consider separability of pension rights (between husband & spouse), adjustment of premiums an d benefits, and reducing number of tertiary insured (non-working spouses)
● Enhance collection of national pension premium	
● Promote uniform public pension	
● Adopt a comprehensive approach to social security	

2. Toward a Uniform Earnings-Related Pension

Two sections of the report are devoted to reviewing the overall pension reform proposal and discussing its main points. In "A Private Opinion of *Directions and Issues Regarding the Framework for Pension Reform* and the Future of the Public Pension System," Yoshifumi Fushimi (professor of sociology, Ryukoku University) addresses the lack of confidence in the public pension as a major problem, and looks at how the reform measures might help correct the problem. Specifically, he points out that the fiscal stabilizing function of the fixed premium method proposed in *Directions and Issues* is inadequate, and argues for the need to reduce earnings-related pension benefits. To do so, he recommends implementing a Swedish-type minimum guaranteed pension (Figure 3), and making self-employed persons and part-time workers participate in a new earnings-related pension plan. The government's funding burden should focus on the minimum guaranteed pension, which would be considerably higher than the livelihood protection allowance.

Figure 3 Proposal to Combine Earnings-Related/Minimum Guaranteed Pension (Fushimi)



In "The Path of Pension Reform in Japan—Pension Reform Without Postponement," Shuji Tanaka (NLI Research Institute) compares pension reforms in various countries. Regarding the funding method, he argues for maintaining the social insurance premium method because the contributory principle, which is indispensable to the public pension, is lost with funding from tax revenue (particularly the consumption tax). Moreover, he is guarded about introducing individual pension accounts as in Sweden, England and Germany, and currently under consideration in the U.S., because funded finance is not necessarily better than pay-as-you-go finance in an aging society, and even less attractive given the current economic environment. However, from the perspective of operating transparency, notional individual accounts are a necessity. In particular, by recording the contributions of individuals, employers and government, the system becomes understandable to all participants. Moreover, the government, by paying generous contributions on behalf of low-income earners, can conduct fiscal spending more efficiently (Figure 4).

Figure 4 Contribution Structure that Favors Low-Income Earners (Tanaka)

Annual scheduled cash earnings	¥ 650,000	¥ 1,000,000	¥ 5,000,000	¥ 10,000,000	¥ 15,000,000
Total premium	32.0% ¥ 208,000	24.0% ¥ 240,000	17.6% ¥ 880,000	16.8% ¥ 1,680,000	16.5% ¥ 2,480,000
Employee's share	8.0% ¥ 52,000	8.0% ¥ 80,000	8.0% ¥ 400,000	8.0% ¥ 800,000	8.0% ¥ 1,200,000
Employer's share	8.0% ¥ 52,000	8.0% ¥ 80,000	8.0% ¥ 400,000	8.0% ¥ 800,000	8.0% ¥ 1,200,000
Government's share	16.0% ¥ 104,000	8.0% ¥ 80,000	1.6% ¥ 80,000	0.8% ¥ 80,000	0.5% ¥ 80,000

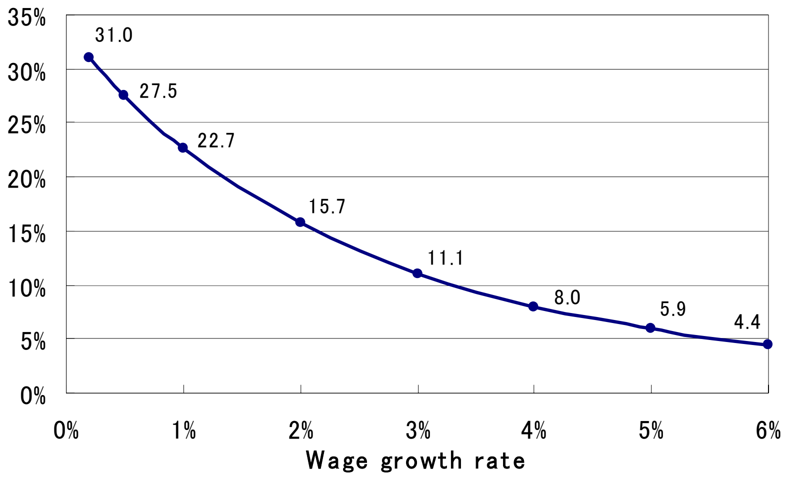
Note: For each income level, top number is premium rate, bottom number is amount.

Tanaka criticizes the fixed premium method of *Directions and Issues* as an attempt to postpone the underfunding problem with a step-up contribution method covering a 20-year period, and suggests an alternative. Basically, similar to Fushimi, he proposes integrating the current national pension and employees' pension system into a new uniform earnings-related pension plan. Moreover, as a countermeasure to the declining number of children, he proposes offering favorable premium rates to households with many children; to strengthen pension finances and invigorate the economy, he recommends promoting employment of women and elderly persons by enacting an anti-age discrimination law as in the U.S.

3. In-Depth Look at Key Issues

In "Funding Requirements for the Public Pension," Masaaki Ono (Mizuho Pension Research Institute) points out problems with the current pension finance method from an actuarial perspective, and cites the need to impose restrictions under the fixed premium method. First, he explains that the current partial funding method is characterized by a reserve ratio that fluctuates with the inflation rate and investment yield (Figure 5). The problem is that unlike corporate pension plans, which can boost a low reserve ratio by having the parent company pay special premiums, the public pension system cannot adjust expenditures as flexibly under the current pension finance method.

Figure 5　Funded Ratio and the Wage Growth Rate (Ono)



Regarding the fixed premium method, Ono cites three problems: (1) financial conditions are not reflected in the benefit adjustment system called the macroeconomic slide, (2) reserves cannot be maintained at a fixed level, and (3) there are no rules to prevent the depletion of reserves. Thus Ono proposes introducing the funding discipline necessary for the fixed premium method by referring to the case of Sweden (Figure 6).

Figure 6　Restrictions Required Under the Fixed Premium Method (Ono)

① Immediately implement planned 5% benefit cut and starting-age increase to 65

② Specialize in old-age benefit and its government-funded complements: survivor's pension and disability pension

③ Adjust benefit levels based on funding conditions

In "Issues in the Public Pension Tax System," Masaharu Usuki and Kunio Nakashima (NLI Research Institute) simulate the effects of preferential measures in the pension tax system, and argue for a pension tax system that encompasses private pensions. The public pension system currently enjoys a double deduction—a public pension deduction for benefits (accounting for a ¥1.2 trillion tax revenue loss in 2000), and an insurance premium deduction for contributions (accounting for a ¥3.4 trillion tax revenue loss; Figure 7). Two problems arise at the benefit stage: (1) the public pension deduction is higher for persons age 65 and over than for working persons who receive a payroll deduction, and (2) deductions increase with income level. Even if this inequity is corrected by reducing all deductions to the payroll deduction level, tax revenue would increase by only about ¥130 billion. The revenue increase for 2025 would be ¥200 billion.

Figure 7 Simulated Tax Revenue Loss (Usuki and Nakashima)

(¥ trillion)

	2000	2025
■ Public pension deduction		
Current deduction	1.20	1.20
Reduce deduction for age 65+ (to payroll deduction level)	1.07	1.00
Implement a ¥1 million fixed deduction	1.07	1.02
■ Deduction for social insurance premium (for public pension)		
Current full deduction for public pension premium	3.4	4.3
Set a ¥1.5 million maximum deduction (public pension only)	3.4	3.9
Set a ¥1.5 million uniform deduction (with private pension)	6.2 max	5.5 max

Note: Assumes fixed premium method for 2025.

On the other hand, at the contribution stage, the tax revenue loss amounts to ¥3.4 trillion in 2000 and ¥4.3 trillion in 2025. The problems that arise here are: (1) among private pensions, only the Employees' Pension Fund and National Pension Fund are eligible for the social insurance premium deduction, (2) the maximum deduction is not determined based on the contribution level necessary to provide for an appropriate retirement income, and (3) the deduction increases with income level. To correct these problems, we need to set the maximum deduction based on the required contribution level, and integrate other private pension plans into the insurance premium deduction. However, in doing so we also need to clarify whether the public pension's role is to prepare individuals for retirement life, or to ensure intergenerational support.

4. Expansion of Issues Under Debate

In "Memorandum on Pension Policymaking," Kenichiro Naganuma (assistant professor, faculty of social welfare, Nihon Fukushi University) focuses on the rarely discussed area of policymaking. Two basic types of policymaking processes are compared—confrontational and consensual. The confrontational process is exemplified by England, where two major political parties champion opposing policies, leaving the ultimate decision to a public vote. This process generates public interest and prevents policymaking behind closed doors. In the consensual process, exemplified by Sweden and the U.S., a nonpartisan panel of experts makes and implements policies based on its findings, enabling design and management of the system from a long-term perspective.

Judging from Japan's peculiar circumstances and characteristics pension policy, the confrontational process appears unlikely to succeed here. Intertwined with this matter is the problem of whether bureaucrats or politicians are put in charge of policymaking. Bureaucrats are limited by vertically segregated jurisdictions, while politicians are easily swayed by prevailing political winds. In either case, major risks arise when policymaking is done based on an all-or-nothing approach.

In “Changes in Japan’s Economy and the Significance of Pension Reform,” Yoshihiro Kaneko (Department of Empirical Social Security Research, National Institute of Population and Social Security Research) focuses on expanding the pension to part-time workers, who are considered a prime candidate for inclusion in an expanded pension system, and estimates the impact on the economy and on pension finances using a macroeconomic model. His results suggest that expanded participation could boost the real growth rate and stabilize pension finances in the long term.

Next, he simulates funding alternatives for the Employees’ Pension Fund by applying a dynamic model with overlapping generations. Aging and the decline in children not only impact economic growth through the supply side by reducing the labor force, but the demand side as well through changes in consumption and savings patterns. Thus we must also take into account the economic consequences of pension financing alternatives. Kaneko compares three alternatives for increasing the government’s financing burden: (1) a comprehensive tax on wages and interest, (2) tax on wages, and (3) consumption tax. According to the results, the consumption tax would increase national income but expand the intra-generational income disparity; the wage tax would limit the intra-generational income disparity but increase the intergenerational income disparity; and the comprehensive tax on wages and interest would be less economically efficient, but better alleviate intergenerational disparity. Kaneko calls on the government to disclose that none of the choices can satisfy both goals of enhancing economic efficiency and reducing all income disparities.

5. Toward Further Debate

Since everyone in the public participates in the public pension system, no pension reform can hope to fully satisfy the diverse demands of each generation, income group, and employment type. The government as well as researchers must strive to make this point clear, and to generate greater public understanding and acceptance of reforms. We hope that our report reaches as many people interested in pension reform as possible, and contributes to enhancing the quality of the debate on public pension reform.