



JRI news release

The Crisis in the Debate on Pension Reform

- 1. The Dangers of "Macroeconomic Indexation"**
- 2. The Need to Go Back to an "In the First Place" Discussion**

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Overview

The debate on the pension reforms proposed for fiscal 2004 is in a critical state. First, there has been no critical examination of the reform proposal put forward by the Ministry of Health, Labour and Welfare (MHLW), which is the only option that the government has so far put to the general public and goes into far greater detail than other proposals. Second, there has been no discussion of how the various proposals were arrived at in the first place.

In December 2002, MHLW published a document entitled *Directions for and Issues Relating to a Framework for Pension Reform*, which effectively constitutes a reform proposal.

In this document, MHLW proposes a method whereby the level of pension payments would be automatically adjusted in line with social and economic changes, which it refers to as "macroeconomic indexation". However, contrary to the impression conveyed by MHLW's explanation that this method involves automatic adjustment of payments and is an adapted version of the Swedish approach, "macroeconomic indexation" presents hidden dangers. It would appear that these dangers are not fully realized.

Macroeconomic indexation is a formula for cutting the level of payments similar but not identical to the Swedish method of automatic balancing of payments. This point should first be made clear.

The main burden of the cuts in the level of payments is placed on later generations, without any rational justification. The justification for postponing cuts in the level of payments should be reexamined.

However, macroeconomic indexation is unreliable as a method of effecting cuts. More reliable, fairer means of effecting cuts, such as cutting the payment multiple rate should be considered.

It is highly likely that the explanation that the income substitution rate will fall from 59% to 52% is optimistic. Ongoing population aging and failure to achieve reserve balances will cause the income substitution rate for later generations to fall still further, and that the rate may fall below the level of 45% suggested at the time of the low estimate.

These dangers are veiled by pseudo-scientific jargon such as "automatic adjustment", and are not fully realized by the general public. The public should, properly, be made aware of all possible dangers.

Another missing element is a fundamental discussion of the proper role of public pensions. There should also be a discussion of how the various arguments were arrived at in the first place.

However, as typified by the proposal of raising the state contribution to the basic pension to 50%, the discussion is being stunted by that fact that it assumes the continuation of the present system. Raising the state contribution to 50% will do nothing to resolve the problem.

To facilitate discussion at a fundamental level, the government should take steps to make the relevant information, at present concentrated in the hands of MHLW, more widely available, and to secure data relating to the hollowing out of public pensions and other areas in which the situation is unclear.

MHLW acknowledges the mood of distrust and anxiety among the younger generations. However, it denies the arguments on generation gaps. The government should reconfirm the purpose and methods of reform.

Political parties that have no proposals for reform have no *raison d'etre*. Concrete proposals for reform should be put to the people of Japan. Moreover, there is no need to insist on reforms being implemented during 2004. Instead, the government should aim to promote the kind of discussion that will truly eliminate distrust of the public pension system.