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**An Evaluation of the Ministry of Health, Labour and Welfare
Proposal for Pension Reform and the Issues it Raises**

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**An Evaluation of "Towards the Building" and the Issues it Raises
(General Remarks)**

In terms of (i) redressing the generation gap (i.e. reducing the burden on future generations), (ii) redressing the gaps within generations, (e.g. the third insured party problem), (iii) preventing the hollowing out of the national pension system, and (iv) the handling of pension reserves, the Ministry of Health, Labour and Welfare's pension reform proposal *Jizoku-Kano na Anshin Dekiru Nenkin Seido no Kochiku ni Mukete* ["Towards the Building of a Sustainable and Secure Pension System"] (hereafter "Towards the Building") can be evaluated as follows.

The greatest difference between the *Hokosei to Ronten* ["Directions and Issues"] document of December 2002 and "Towards the Building" relates to pension reserves. The proposal that pension reserves should be dismantled, based on a tentative proposal by Minister for Health, Labour and Welfare Chikara Sakaguchi, is praiseworthy. "Towards the Building" also proposes a review of the basic pension portfolio, but whether this review will actually take place depends on future discussion.

The next greatest change relates to the correction of the generation gap. "Towards the Building" makes a number of improvements to the system of macroeconomic indexation proposed in "Directions and Issues" as a means of curbing pension payments. For instance, the period of grace before for macroeconomic indexation was originally to last until fiscal 2032, but in "Towards the Building" it has been substantially shortened and is to end in fiscal 2013 (medium estimate case in both documents).

"Directions and Issues" did almost nothing to correct the gap between the present approach (maintaining the level of payments) and the reform proposal, but in "Towards the Building", improvements to the macroeconomic indexation system and the adoption of a limited balancing approach have raised the expected settlement of the income substitution rate to 54.7% (some 2.7 points higher than in "Directions and Issues"). There is room for discussion of the scale of increase required, but the effort is commendable. ASK

On the burden side, the proposal made in "Towards the Building" of raising the rate of contribution to employees' pension schemes, by stages, from 13.58% to 20%, is the same as that made in "Directions and Issues", and leaves a number of issues to be resolved.

The schedule for raising the contribution rate by stages over a period of 19 years is the principal reason for the generation gap and also presents a risk of political intervention during the raising process. Moreover it is not clear whether the final level of 20% is compatible with the future trend of the economy and, given the probable impact on the macroeconomy and employment, further efforts to reduce it, by a variety of means, are likely to be required.

"Towards the Building" does virtually nothing to redress the gaps within generations.

"Towards the Building" appears to lack any sense of the hollowing out of the national pension system being a problem. Hollowing out not only endangers the livelihood in old age of those who do not contribute but also places an excessive share of the fiscal burden on those who do pay their contributions, and on their

employers, and it is a matter of great concern that this document fails even to touch on basic pension contributions, which are the area of the system responsible for the imbalance. The prescription it offers constitutes no more than a palliative remedy.

Moreover, although "Towards the Building" does not go into the matter of systemic reform, the second chapter does mention the fact that systemic reforms are under discussion, hinting at a more flexible approach to future debate on this issue.

Overall, "Towards the Building" presents many improvements on "Directions and Issues". However, it does virtually nothing to address the hollowing out of the national pension system or the third insured party problem, and (i) as there is only so much that can be done to address these problems while the structure of the present system remains in place, and (ii) as the task of finding a solution to the third insured party problem has once again been put off, it would seem that the conventional approach to the discussion of pension reform itself has limitations.

As pointed out in the second chapter of "Towards the Building", it is important that the discussion of systemic reform continue. It is vital that Japan establish an effective forum for debate, separate from the actuarial re-evaluations that take place only once every five years.