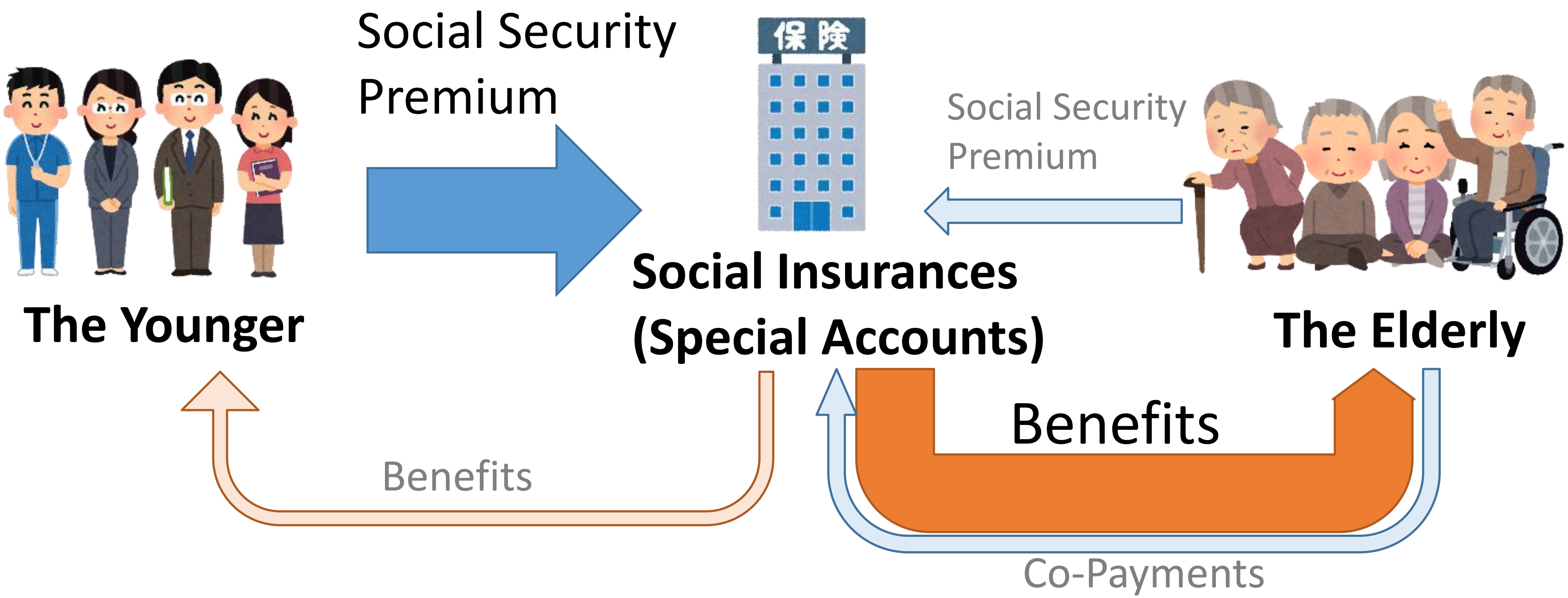
Financing the Social Security in Japan

Takashi Unayama
(Hitotsubashi University)

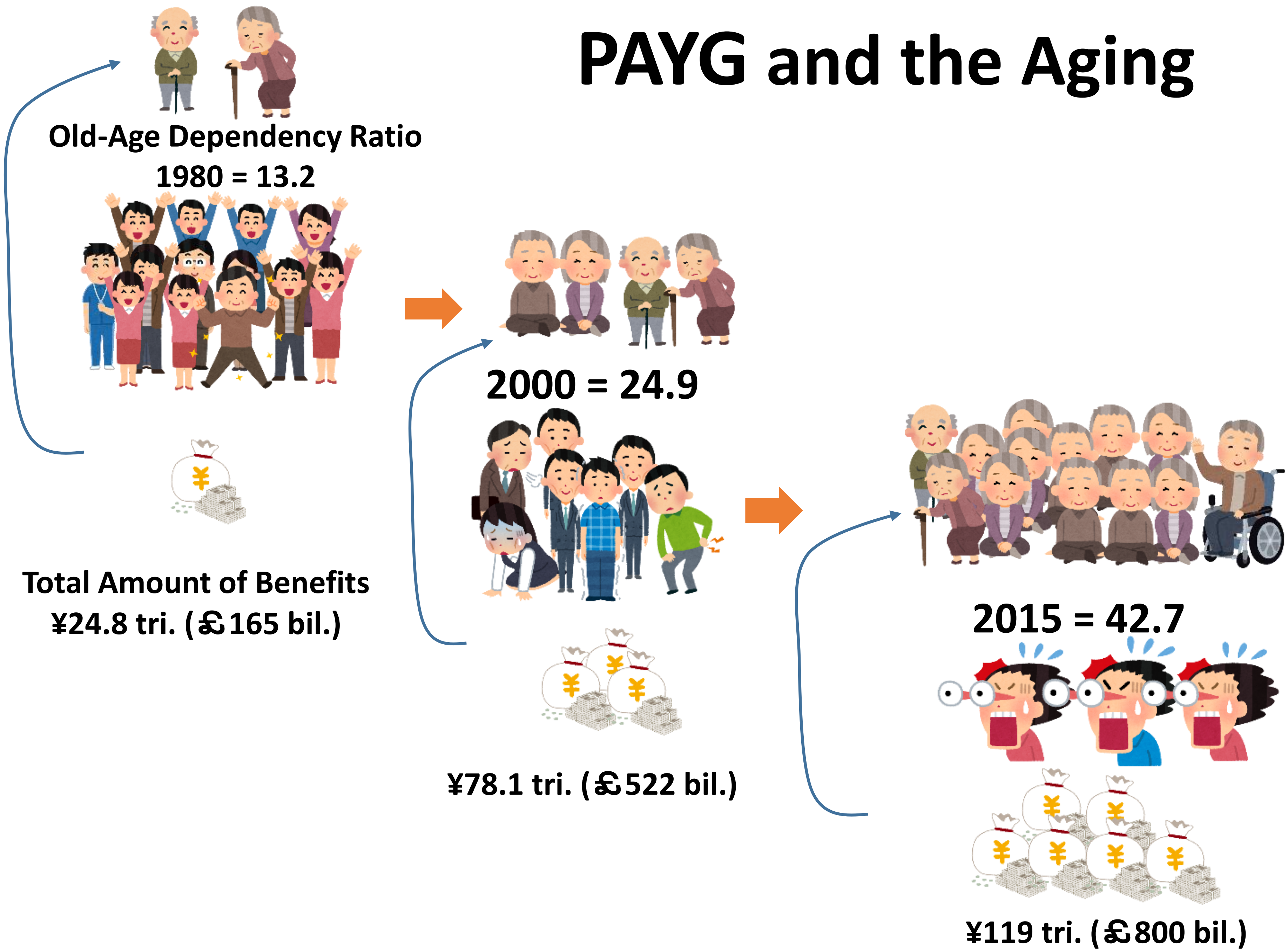
Features of the Social Security System in Japan

- **Social insurance scheme**
  - Financially independent from government's general accounts
  - Each program has their own fund managed by the government
    - No private insurance company is involved
  - Benefits depend on contributions
    - Unlike tax based system in which benefits are independent from tax payment, the government makes a contract with a participants
- **Programs are different according to its purpose and coverage**
  - Public pension for employees/non-employees
  - Health insurance for employees/non-employees
  - Long-time-care for age under 65/age 65 and over
- **Universal**
  - All Japanese residents must enroll
- **Pay-as-you-go (PAYG) financing**
  - Most of benefits paid now is financed with contributions paid now
    - Future benefits are partially funded
  - The government subsidizes them (from the general account).

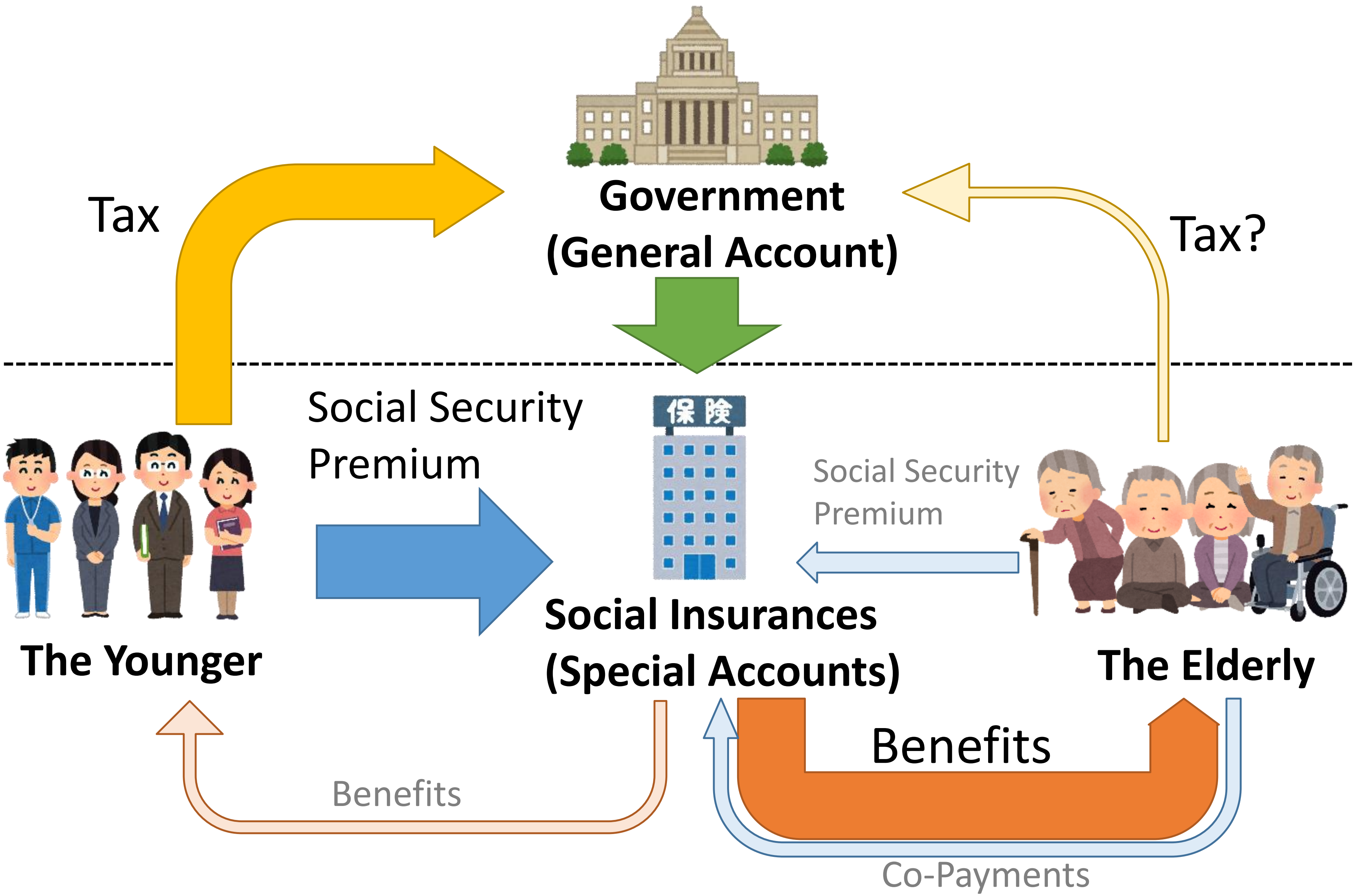
PAYG Finance System



PAYG and the Aging



PAYG Finance System and Government debt



Reforms Before Abenomics

- 2004 Public Pension reform
  - Increasing public pension premium (gradually until 2017)
  - Increasing the subsidy from the general account
  - Introducing the “Macroeconomic Slide” system
- Comprehensive Reform of Social Security and Tax (2012)
  - To simultaneously achieve two priority goals
    - Enhancement and stabilization of social security
    - Fiscal consolidation
  - As for the revenue side:
    - <u>Consumption Tax rate Increase from 5 to 10 percent</u>
    - Increase of the highest marginal individual income tax rate
    - Strengthened enforcement of Inheritance Tax
    - Public pension “cut”

PROs and CONs of “Reform” options

	Consumption Tax	Income Tax	Social Security Premium	Benefit Cut	Co-payment	Debt Finance
Size of impacts	○			Possibly		Possible?
Do the elderly pay?	○			○	○	
Do the richer pay more? (progressivity)		○		Possibly		
Not so Bad for the economy?					○	○
Politically easy?		△			△	○
Action	8% → 10% (Postponed until Oct, 2019)		2004 Public Pension Reform was completed in Sep, 2017	Extension of “macro-economic slide” system	**Discussed NOW**	Reducing the primary deficit to 1 percent of GDP

Fiscal Consolidation Policies in Abenomics

- **“Without economic revitalization, there can be no fiscal consolidation”** (経済再生なくして財政健全化なし)
  - Try to make up the deficit by “economic growth”
  - Achieving 2% inflation rate will mitigate the consolidation problem
  - ⇒ That is, they are trying to go without any serious “reform”
- Avoid negative impacts of reforms on economic growth
  - The second Consumption Tax rate increase was postponed twice in November 2014 and June 2016 (and now planned in October 2019)
  - Basic Pension cut for higher income earner, which is discussed in the “Comprehensive” reform, has been canceled

Is there any realistic scenario?

- It is not quite sure that 2% inflation can be achieved
  - Bank of Japan repeatedly extends the schedule for achieving their 2% target
- Even if the target will be achieved, still knife edge scenario
  - Higher growth usually coincides with higher interest rate
  - If interest rate increases more rapidly, government cannot pay
- So far, the primary deficit will worsen in coming years
  - The Primay Balance–GDP ratio was projected as –1.7% at FY2018 but now –2.9% according to the interim report for "Integrated Economic and Fiscal Reforms"
  - One important reason is unexpected slow growth in tax revenue
  - Not only because of postponing of Consumption Tax rate increase
- Economists are more pessimistic about the situation