

Towards a Long-term Vision of Japan's Social Security System

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Why There Is a Need for Social Security System Reform

1. What has been lacking in past discussions

On social security system reform, it is said that swift reform is required by 2025 when all of those from the baby boom generation (born between 1947 and 1949 after World War II when around 2,700,000 babies were born each year) reach 75 years of age or older. While various discussions have been conducted, there has been a lack of discussions in some areas, and therefore not only is the real need for reform not understood, but the content of such reform has been limited. To be more precise, there are four main aspects to this issue.

First, the reason for the need to reform is too skewed towards the financial aspect. In other words, it is asserted that the content of social security has to be reduced because the required financial resources cannot be secured. This fits the basic principle of households and corporations to “consider expenditure according to income”, and is thus very easy to understand. But when discussions on reform begin with this reasoning, they then lead on to which areas of social security should be reduced, and tend to end up in a zero-sum discussion to protect vested interests. Today's social security is entirely different from the relief of the poor in the past, and it has shifted to become the basis of *res publica* in Japan with the aim of securing decent livelihoods for all. Therefore, discussions should first begin by determining what type of social security is needed for Japan today, and then consider how to secure the necessary financial resources, or “consider income based on necessary expenditure”.

Second, concerns are also skewed towards the decrease in total population and increase in elderly citizens. Of course, the population estimate is highly accurate, and full consideration needs to be taken of future projections which show Japan's current (2018) total population of 126.44 million decreasing to less than 120 million in 2029 and to less than 100 million in 2053, while the number of elderly citizens aged 65 or above will continue to rise from 35.58 million (28.1%) in 2018 to reach a peak in 2042 at 39.35 million (36.1%). But if the decrease in total population and increase in elderly citizens attract too much attention, discussions tend to lead towards how to reduce pensions or medical expenses for elderly citizens and how to bear that cost, leading again to a zero-sum discussion between the elderly and other generations, or among elderly citizens themselves.

The above two are important issues, but bear the challenge of

being biased to one aspect of the discussion. In addition, there are two other issues that, although important, are considered less so when discussing social security reform. These are the issue of enhanced consumption and revitalization of the economy through social security, and the issue of maintaining regional communities.

The following explains these four points in more detail.

2. Financial restrictions

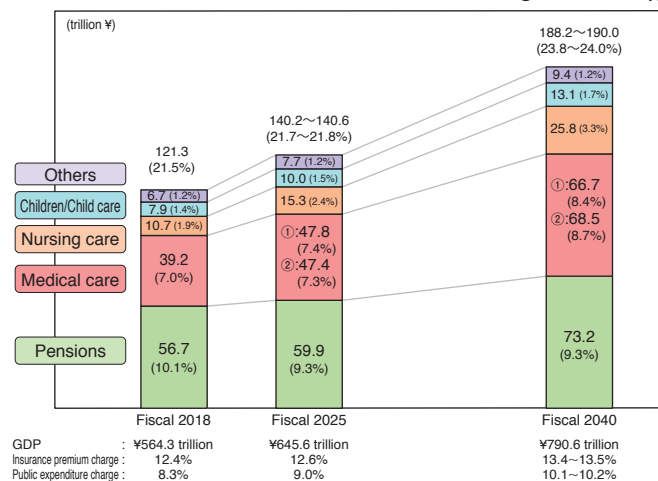
(1) Massive expenditure continues to be required in the future (Chart 1):

Although the reason for the need to reform is biased towards financial restrictions, the size of current social security is massive, at ¥121.3 trillion for fiscal 2018, which is 21.5% of nominal GDP. This will continue to increase as the aging population continues to progress. Looking ahead, the “Future Outlook for the Social Security System Towards 2040 (Material for Discussion)” was compiled jointly by the Cabinet Secretariat, the Cabinet Office, the Ministry of Finance, and the Ministry of Health, Labour and Welfare and presented to the Council on Economic and Fiscal Policy on May 21, 2018. According to an estimation conducted under set assumptions, social security as a percentage of GDP for fiscal 2040 is forecasted to be around 24%, which is a 2.5% increase from the current

CHART 1

Future outlook for social security benefit costs

Percentage of GDP in ()



Source: Extracts from the “Future Outlook for the Social Security System Towards 2040”, submitted by the Ministry of Health, Labour and Welfare to the Council on Economic and Fiscal Policy on May 21, 2018

percentage. This appears small at a first glance, because this percentage represents a share of GDP which includes the assumed growth in nominal GDP for the future years (around 2% until 2027 and 1.3% after 2028), but the monetary value for fiscal 2040 was an increase of roughly ¥70 trillion from the current value to around ¥190 trillion, which is 1.56 times the current size. The breakdown is 1.3 times for pensions, 1.8 times for medical care, and 2.4 times for nursing care, and it shows that the extension of average life expectancy as well as development in medical and pharmaceutical technologies have contributed to greater growth in medical care and nursing care compared to growth in pensions.

Of course, limiting the increase in individual social security payouts is necessary. Raising the starting age for pension payouts as average life expectancy rises is inevitable, and there are many reforms that will contribute to improving the quality of life for each individual and there are those that will lessen medical and nursing expenses, such as disease prevention, nursing care prevention, and promotion of health data. However, the important aspect is that social security expenditure is different from discretionary expenditures such as public works and defense in that it is directly related to people's lives and daily lifestyles, and thus there is a limit to how much can be reduced regardless of the availability of financial resources.

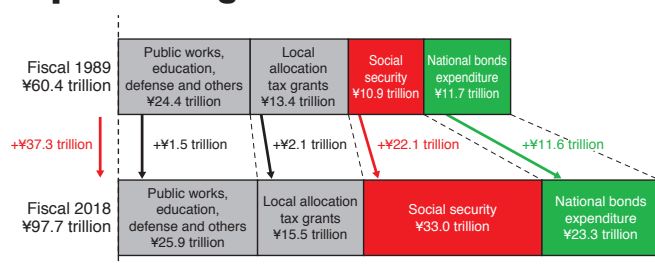
(2) Largest factor of increase in Japan's expenditure is social security (Chart 2):

Year after year, enormous effort and time has been put into creating government budgets, and the 30 years of the Heisei period (fiscal 1989 to fiscal 2018) could be condensed in one sentence such as: "Japan was unable to cover expanding social security expenditures with tax revenues, a phenomenon which came with an expanding aging society, and thus saw an increase in issuance of government bonds."

Of the major items of expenditure, growth in social security expenditure is striking. The ¥10.89 trillion recorded in fiscal 1989 increased by three times to ¥32.97 trillion in fiscal 2018, but considering that the number of elderly citizens increased by 2.5 times during that period, it was unavoidable.

The second-largest growth was in bond expenditure, which

CHART 2
Trends in expenditure items in Japan's budget



Note: Initial budget basis

Source: Compiled by the author

accompanies the increase in the balance of government bonds. The ¥11.66 trillion of fiscal 1989 doubled to ¥23.30 trillion in fiscal 2018.

There was no major change to other expenditures aside from social security expenditure and national bond expenditure. There has been small growth in defense expenditure (¥3.92 trillion to ¥5.19 trillion) and science and technology expenditure (¥448 billion to ¥1.32 trillion), but other expenditures such as public works (¥6.20 trillion to ¥5.98 trillion), ODA, and education have gone down.

Expenditures in the 30 years of Heisei have increased by ¥37 trillion from ¥60.41 trillion to ¥97.71 trillion, but the majority of the increase can be attributed to the increase in social security by ¥22 trillion and in national bonds by ¥12 trillion.

(3) There are limits to reductions in expenditure and an increase in revenues is required

In contrast, tax revenues increased by only ¥8 trillion from ¥51.1 trillion to ¥59.79 trillion. Thus, the size of bond issuance has increased by five times from ¥6.64 trillion to ¥33.69 trillion, and the ratio of bond dependency expanded from 10.1% to 34.5%.

The balance of government bonds has expanded from ¥161 trillion, or 39% of nominal GDP, to ¥833 trillion, 158% of GDP. Social security expenditure, an expenditure which inevitably expands with an aging population, increased by ¥22 trillion in the 30 years of Heisei, but if tax revenues only increased by ¥8 trillion, how can the fiscal deficit be resolved? "Tax hikes for much needed social security" is an issue which has thus far been considered taboo, but we must face this issue.

In addition, social security expenditures such as medical care, pensions, nursing care and livelihood protection must be covered privately for the most part if they are not covered through public means. These are also expenditures that all of us are likely to make during our lifetime. If that is the case, why can they not be collected as taxes? Even if collected from the people, such expenditures do go back to the people, and there is a need to expand tax revenues and restore "a mechanism where everyone supports everyone". The entire tax system must be considered to determine which tax items to increase – not just the consumption tax, but also income tax, corporate tax, asset tax, inheritance tax, etc.

3. Decreasing birth rate and aging population

The issue around population is more about changes in the structure of the population rather than the decrease in total number. In other words, the number of citizens older than 65 years of age will increase, but the productive-age population between ages 15 and 64 and juvenile population under 14 will decline.

Some often say that a decreasing population is nothing to worry about because the Japanese population in 1948 after World War II was 80 million; but since the population in 1967 during the period of high economic growth was 100 million, Japan is only going back to its recent past. However, although the number of 100 million is the same, the structure of the population by age group is completely different. For the 100 million in 1967, those under 14 years of age were 24.4%, those aged 15 to 64 totaled 69%, and those over 65 were 6.6%. But in 2052 when the population will be about 100

million, those under 14 will be 10.5%, those 15 to 64 will be 51.6%, and those over 65 will be 37.9%, and the productive population of 10.4 persons supporting one elderly citizen in 1967, will become only 1.4 persons supporting one elderly citizen in 2052.

Hence, while measures against the decreasing birth rate are required in social security reform in an effort to increase the future productive population as much as possible, at the same time work-style reforms will also become more important to enable the current productive age population and younger elderly citizens to work to their full extent.

4. Satisfactory consumption and revitalization of the economy

About 60% of Japan's GDP is personal consumption, and to revitalize the economy substantial consumption is vital. Social security reform can contribute to this in two respects.

First, as often said, at the root of today's low consumption in Japan is the fact that the younger and mature generations are opting to prioritize savings rather than consumption due to their vague fears about the future, and allaying their concerns through social security reform will have a great impact on consumption.

Second, in a society where elderly citizens are increasing, social security sectors such as medical care and nursing care have the potential to become a large core of a growing industry. According to economic census, the sales value of the medical and nursing industry in 2015 was ¥111 trillion, higher than the ¥108 trillion in the construction industry and about 30% of the ¥396 trillion in the manufacturing industry. Room for market expansion is extensive with new technologies such as IT, new drugs and medical equipment which utilize advances in medical science, new medical treatment systems, and so forth. It is an area in which two birds can be killed with one stone, with revitalization of the economy also contributing to the promotion of people's health.

5. Maintaining local communities

The social security system greatly impacts local communities. The decreasing birth rate and aging society directly hit local communities, especially small-scale municipalities. People who are considering relocating from large metropolitan areas to regional areas are said to focus on three points: employment opportunities, educational institutions for children, and medical facilities.

Employment opportunities in regional areas used to be in the manufacturing and construction industries, besides agricultural, forestry or fisheries. But as previously mentioned, sales in the medical welfare industry now exceed those of the construction industry. As society in Japan continues to face a decreasing population, this viewpoint must be emphasized in order to maintain regional communities when undertaking social security system reform.

Need for Long-term Vision

1. Unresolved fears about the future

As stated above, in thinking about the future of the social security system, social welfare must not be considered in isolation, but the

inter-dependent relationships between other important issues such as finance, economy, and regional society need to be fully taken into account. In other words, consideration from a comprehensive and systematic viewpoint and a long-term vision is necessary.

A long-term vision is also necessary for a more fundamental reason. Of all the fears about the future that prevail in Japan today, the biggest is that the population will decline as the decreasing birth rate and aging society continue. Various projections, including private ones, have been presented on the population decline and its effects, but the government has yet to indicate any comprehensive measures or policies to address this.

However, even though various forecasts and recommendations focusing on the decreasing population have been presented, our fears and anxieties about the future cannot be resolved that easily.

For one thing, many recommendations remain forecasts and solutions to specific areas, and so there is no clear holistic view on how to address a society with a decreasing population.

Second, although estimations on the impact of the population decline have become more detailed, the recommended measures are not well-developed, and thus doubts remain about their effect. It is not clear where the financial resources will be raised, and that raises questions about feasibility.

Third, although these are long-term forecasts, possible catastrophic natural disasters, such as earthquakes, have hardly been considered.

To address these fears of the Japanese people, once forecasts have been obtained based on a long-term perspective of 30 to 50 years, it is vital to formulate a long-term vision which covers various sectors such as social security, economy and infrastructure .

2. Reviving economic plans and national land plans cannot address the issue

Then there are those who suggest reviving long-term economic plans as represented by the "National Income Doubling Plan" or "Comprehensive National Development Plan" which indicate long-term national land maintenance, but these cannot address the issue.

Population is a given in economic planning and land planning, and although it is an important pre-condition when formulating policies, it does not fluctuate with policies. In order to address the current challenge that Japan is facing, policies need to change with the population itself, such as total population and age composition. In addition, the policy targets of economic planning and land planning are in tangible areas such as hard infrastructure development and macro-economic areas such as macro-economic indicators for the entire nation, but in an era of decreasing population "people" themselves become soft and the micro-aspects are the policy targets.

Japan, which has the world's most rapidly declining population, needs to formulate comprehensive forecasts of the impact of the decreasing population on various sectors and on the entire country. At the same time, it needs to systematically formulate measures that are consistent with these forecasts. Since impacts of catastrophic disasters largely consist of uncertain factors, these can be inserted as multiple scenarios during the formulation process.

This system of comprehensive estimates and measures can be described as a national grand design to address a decreasing population society, or a national strategy, but since it is a policy system based on highly accurate estimates of future population, the term “long-term vision” must be used.

For the methodology of long-term vision formulation, there is a need to collect the views of both the public and the private sectors, rather than just have the government engage in a centralized formulation process. Formulation entities should not only include a wide range of private sector actors such as academics, businesses, journalists, and NPOs, but also private think-tanks, and universities and graduate schools of policy science. From the government also, in addition to policy departments, policy institutions of each ministry will also participate. If it is meaningful to have a national discussion about a decreasing population society, then it will be important to spend considerable time, such as three years, to conduct discussions.

Since it is the most crucial issue facing the nation, it should be formulated under the responsibility of the Cabinet. To be more specific, permanent services that span the long term, such as formulation, promotion, follow-up and revision – a permanent institution, not a time-bound secretariat – should be put in charge. For example, this could be conducted under the Council on Economic and Fiscal Policy. As the legal authority, this council will also be able to address issues beyond the important matters of economic and financial policies, and address issues outside economics.

In addition, once the long-term vision has been formulated, in order to promote systematic policy accurately and effectively, a permanent institution will be essential. What will be useful references are two examples by the Cabinet Office taking responsibility for conducting not only formulation but also implementation of a policy system. These are the “Committee for Promoting the Integrated Economic and Fiscal Reforms” under the Council on Economic and Fiscal Policy and the “Council for Promotion Regulatory Reform”.

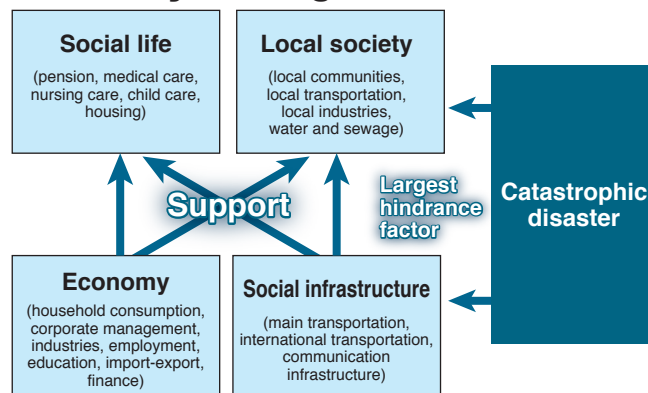
For example, the Economic and Fiscal Reform Promotion Committee is in charge of formulating detailed working plans for reform for each sector in order to ensure the economic and fiscal revitalization action program is implemented as indicated in the “Basic Policy”, monitor the progress of the working plan, assess intermediate indices, and when not achieved, investigate the cause.

3. System for long-term vision (Chart 3):

A system for a long-term vision will be formulated based on future population estimates for the entire country, by individual prefectures and by municipalities for the next 50 years, and it will be based on the National Census conducted every five years. In addition, future estimates will be conducted for all sectors that population has an impact on. When doing so, it is imperative that the estimates show interdependent relationships between each sector and that they are consistent. Estimates can have width and there can be multiple estimates. The following five are considered to be the main sectors.

CHART 3

Relationship of the 5 sectors necessary for long-term vision



Source: Compiled by the author

- i. “social life” (pensions, medical care, nursing care, child care, housing)
- ii. “local society” (local communities, local transportation, local industries, water and sewage)
- iii. “economy” (household consumption, corporate management, industries, employment, education, import-export, finance)
- iv. “social infrastructure” (main transportation, international transportation, communication infrastructure)
- v. “disaster prevention” (personal damage, material damage, economic damage, capital function damage)

The relationship between these five sectors will be based on the economy and social infrastructure, and support social life and local society, while disaster prevention is the largest hindrance to the other four sectors. “Social life” roughly corresponds to the social security sector.

Required financial resources (tax, national bonds, etc.) will be provided depending on the nature of the various policies. For example, policies that address the wide general public will be sourced from the consumption tax, while policies related to regional areas will be from local taxes, and policies related to increased income will come from income tax or corporate tax.

The important aspect is to conduct follow-up studies on the status of progress every year. A rolling method, which makes the necessary revisions based on a Detailed National Census conducted every 10 years, is being considered. In addition, if a long-term vision based on a prefectural basis or municipality basis is formulated in light of the national long-term vision, then a distinctive outlook reflecting the various regional characteristics can be drawn up. By formulating a long-term vision and sharing it with the nation, a society which is led by fear can turn course.

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