

The Japanese Version of the 401(k) Plan and the Emergence of the New Species "The Aged"

By Hamano Takayoshi

The 401(k) plan, a defined contribution corporate pension scheme, has been spreading fast in the U.S. since the latter half of the 1980's. The move to introduce a similar plan in Japan has been picking up momentum. This is considered to be a way out of the ever worsening financial status of corporate pension resulting from the fast aging of society as well as the worsening of the capital investment situation due to virtually zero interest rate and low stock prices. The 401(k) plan differs from the conventional defined type. If a company just bears the installment premium of the pension, it need not take responsibility regarding the sum amount of pension payment and worry about investment results. This is a great attraction for companies.

Why is the 401(k) plan gaining popularity in the U.S.? When introduced in Japan, will it function well?

The Situation of 401(k) in the U.S.

It is said that the company pension system appeared in the U.S. in the latter half of the 19th century, but actually it became prevalent only after World War II. Most popular type was the defined payment pension contributed by employers, similar to the one in Japan. The defined payment type still accounts for about half of the company pension in the U.S. despite a rapid increase in the defined contribution pensions.

One of the reasons for the emergence of defined contribution pension in the U.S. is that the public pension system is mainly aimed at helping people who cannot make ends meet, and that the pension payment level is low and insufficient to support retirement life. On the other hand, corporate pension have continually been improved through such measures

as the introduction of tax incentives on the premiums for contributions. Americans have conceived a way of supporting their retirement lives using both public pensions and corporate pension.

One of the defined contribution pensions is the 401(k) plan which is based on the section (k) of the Internal Revenue Code introduced in 1978. One of its features is that premiums are contributed mainly by employees who have joined this scheme, but companies also contribute to premiums to a certain extent. Tax incentives are offered not only for premiums contributed by companies but also for those contributed by employees in the form of deferment of income tax. When employees switch their jobs, the 401(k) plan can be transferred without tax.

But the 401(k) plan requires employees to be responsible for the funds they have deposited.

Americans of the baby-boomer generation, born soon after the end of World War II, poured huge amounts of the money into the 401(k) plan to prepare for their retirement. The fund has rapidly expanded, \$1 trillion dollars in 1998, more than twice the total of investment trust in Japan. It is believed that quite a large amount of 401(k) funds has flowed into the stock market, helping boost stock prices above the \$10,000 level.

Pensions are an element of social security. The combination with risky stocks and investment trust raises concern among some pensioners. On the other hand, there are a large number of Americans who, in pursuit of a pleasant retirement life, are determined to increase their income through proper management of their funds if they are denied a pay raise. But, since risk is involved in such fund management, they join

investment clubs in order to forestall a possible investment fiasco.

Japan Plans Introduction of 401(k) in Fiscal 2000

The ruling Liberal Democratic Party (LDP) and government ministries concerned are continuing studies on the introduction of the 401(k) plan in Japan in fiscal 2000. Since the beginning of this year, a LDP working party on private pensions has been putting the final touches to a draft of the Japanese version of 401(k) which was worked out by the Ministry of Health and Welfare, the Ministry of Finance, the Ministry of International Trade and Industry and the Ministry of Labor. The draft is fundamentally similar in idea to the U.S. 401(k) plan and incorporates both the corporate contribution type and the individual contribution type, which self-employed individuals can also join. Individuals who are members of the public National Pension Policy will have access to the scheme. The scheme was allegedly devised so as to enable the government to trace tax dodgers via pension numbers. There are a number of problems which must be solved before the Japanese version of 401(k) takes off smoothly.

The most important question is whether it is possible to give tax incentives to premiums as in the U.S. The U.S. 401(k) scheme owes its chief attraction to tax incentive measures.

In Japan, public pensions are granted tax breaks in both contribution and operation, and deductions are also made when benefits are paid. Against such a background, the Ministry of Finance is hesitant to apply tax incentives to the proposed Japanese 401(k) scheme. Taxation in regard to 401(k) will remain a contentious issue

for the government and the LDP throughout the year.

Senior Citizens' Response to 401(k)

The Japanese population is aging very fast. Those aged 65 and above outnumbered those aged under 15 in 1997 and will account for half of the productive age group aged 15-64 in 2020.

Japanese society will face various dismal problems due to its aging, such as pension payment, nursing care and the stagnation of economic activities.

On the other hand, a new group of healthy and active aged people, is expected to emerge in the not too distant future.

This group is often referred to as the "New Aged Species," because it is different from the aged population in the past.

The term "New Aged Species" became a mass media catchword when it was used in a report compiled in early June by a working party under the director general of the Price Bureau of the Economic Planning Agency, which suggested the way Japanese people can live pleasant lives.

The report said, in part, "Baby boomers, who will be aging soon, are well-educated, brought up in an affluent society and know how to enjoy life. They are active and are more interested in self-enjoyment or in self-grooming than taking care of grandchildren. They are devoted to cars or rock music and are well versed in personal computers and e-mail.

The question is how the baby boomers would respond to corporation pensions like 401(k) which they would have to manage at their own risk.

Japanese have long been extremely safety-conscious when it comes to saving money. Even now when the interest rates are almost zero, a majority of people still stick to bank savings which guarantee principals. Most Japanese consumers are unused to taking risks in fund management, because the Japanese financial system has been protected by government



Will the "New Aged Species" try the risky 401(k) plan?

regulations. Even those experienced in stock investments and investment trust believe in safe capital investments, even though their yields are low, as they suffered a painful experience in the bursting of the bubble economy in the late 1980's.

Will the "New Aged Species" try the risky 401(k) plan?

Even in the U.S., there were not many people who preferred high-risk fund management until about 20 years ago. Only in the late 70's, when the inflation rate was more than double the interest rates of regulated banks, did Americans begin to invest their money in equities as well as in high-yield, cashable investment trusts, such as money market fund (MMF), to avoid reductions in income. The money revolution resulted from such unavoidable circumstances.

There is growing concern in Japan about a possible breakdown of both the public and corporate pension systems due to the rapid aging of

society and a decrease in the number of children.

Even so, it takes some time before most Japanese people change their mentality and venture to take a risk in investing their money.

The idea of introducing the 401(k) plan arose mainly out of corporate needs. The general public is still left in the dark about the details of the 401(k) scheme. The introduction of a new system could flop without full confirmation of the will of the public.

The proposed 401(k) plan is deeply concerned with people's daily lives. The government should provide full information about the scheme in an effort to create a mechanism suitable for Japanese society through public discussions.

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