

# Incorporating changes now : the Japanese public pension system stands the test of time

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# INCORPORATING CHANGES NOW – THE JAPANESE PUBLIC PENSION SYSTEM STANDS THE TEST OF TIME

Kathrin Köster, Erlangen

## 1. Japanese Society Ages

As the title of this essay suggests, the Japanese society faces major changes. As the latest headlines of *The Nikkei Weekly* (1997:3;6) indicate, “Japan’s aging population [is] projected to decline to 67 million by 2100” and “Latest population forecast should be a call to action”. One of these changes lies in the shifting age structure leading to a problem all industrialized countries are confronted with: How to finance pensions<sup>1</sup> for the growing number of senior citizens?

This question has to be answered very quickly in Japan, where the aging of the society is progressing extremely fast,<sup>2</sup> a phenomenon called *overaging* or *kōreika*. The main reasons for this development: 1) falling birth rate;<sup>3</sup> 2) rising life expectancy – in Japan it is one of the highest in the world. Due to these factors the population of Japan is expected to age rapidly over the next few decades. The Ministry of Health and Welfare (Kōseishō) estimates that Japan’s population will start to decline after

- 1 The expression “pension” implies pensions for old-age, disability and surviving dependants. In this essay, the word pensions is only used in the sense of old-age pensions.
- 2 In Germany, the rise in the percentage of the over-65s from 7 percent to 14 percent took about 45 years whereas in Japan only 24 years (TSUJI 1996: 4).
- 3 In 1994 the fertility rate (the average number of children women give birth to in their lifetime) amounted to 1,5 (SUZUKI 1996: 58). In order to prevent the population from decreasing a rate of 2,08 is necessary (SHIMADA 1996: 30). The following points illustrate why the fertility rate has plummeted:
  - 1) Rise of average age at marriage (*bankonka*), i.e. increasing proportion of unmarried women between 20 and 35.
  - 2) Growing financial independency of women because of continued employment after marriage. A study of the Ministry of Labour conducted in 1993 reported 20.09 million working women and 15.95 million full-time housewives (SHIMADA 1996: 32).
  - 3) High costs for education. According to statistics of the Ministry of Health and Welfare education for one child from kindergarden on until graduating from university costs an average of 20 million yen (SHIMADA 1996: 32-33).

peaking at 130 million in 2011. The number of people between 15 and 64, i.e. most of Japan's work force, has been falling since 1995. But the number of people over 65 will have doubled to 32 million by 2020. In that year, the over-65s will make up around 25 percent of Japan's entire population, the highest proportion in the world, and 5.2 million people will be in need of care (Suzuki 1995:58; Anzai 1996:78). The Japanese refer to this as *hyper-overaging* or *chō-kōreika*<sup>4</sup> (see appendixes diagram 1).

Consequently, an increasing number of the non-employed population has to be financed by a decreasing number of the employed population. Continuous hikes in premiums will be inevitable: The Ministry of Health and Welfare expects premiums to double by 2025 up to 29.8 percent<sup>5</sup> of the gross income (Kawakita 1996:19).<sup>6</sup> Thus, the younger generation is forced to transfer an increasing share of its income to the elderly. But, with a rapidly graying society the young people are unlikely to see the annuities they themselves expect after retirement.

This scenario so far regarded as a horror-projection by the Ministry of Health and Welfare already has become reality in parts of the Japanese public pension system: In spite of continuous premium hikes parts of the pension fund are used up due to a rising proportion of annuities to contributors. This applies to the pension funds of the public corporations<sup>7</sup> Japanese National Railways JNR and Japan Tobacco and Salt JTS, both

4 According to official estimates hyper-overaging will peak by 2050. That year the proportion of people aged 65 or older will make up 28.2 percent, whereas people between 0 and 14 will count for 15.7 percent (KŌSEISHŌ DAIJINKANBŌ TŌKEI JŌHŌBU 1996: 19). That means that the work force makes up slightly more than half of the entire population.

5 50 percent of the premium are paid by the employee, 50 percent have to be covered by the employer.

6 Following an OECD report (1993: 110), premiums for the public pension fund will even more than double if the current age at which people are entitled to draw a pension, i.e. 60, is upheld. Under this premise premiums will amount to 35 percent of gross salary by 2025 in order to prevent the public pension fund from showing a deficit.

7 JTS was privatized in 1985, JNR followed in 1987. In these cases privatization means restructuring into a private-law company. Temporarily, the shares of these companies remain in the possession of the state. In Japan, this corporate form is called limited company by special law or *tokushu gaisha* (KÖSTER 1996: 167; 185). In 1996 a block of shares was sold to private shareholders.

organized as mutual benefit associations (*kyōsai kumiai*)<sup>8</sup> and part of the public pension system of Japan's public sector. The financial situation of the mutual benefit association for agriculture, forestry and fishery<sup>9</sup> is also expected to deteriorate because of projected rationalization measures (Konno 1996:15). Thus the mutual benefit associations mentioned here represent the beginning of acute problems with financing pensions. These difficulties, however, are not limited to pension systems of the public sector. They also appear in the public pension fund for all Japanese nationals, providing a form of basic pension. The fund has accumulated deficits since 1983. Moreover, the financial crisis not only affects public pension funds but also corporate pension funds. We can observe a growing number of bankruptcies of corporate pension funds starting with the collapse of an Ōsaka-based pension fund in 1994 (Suzuki 1995:58). This means that corporate pensions which are usually granted to Japanese employees and which, in addition to the payments of the public pension system, play an important role in financing the elderly, are endangered, as well.<sup>10</sup> The main reason for the financial crisis lies in an overaging population; other factors contribute to worsen the financial results of all pension funds, public and private: poor investment performance, use of funds for purposes other than financing pensions and rigid regulation of fund management by the Ministry of Health and Welfare and the Ministry of Finance (Ōkurashō).

The situation described above shows that steps have to be taken in order to respond to the changes brought by an aging society. Reforms have to be implemented to stabilize the pension system and thus to ensure

8 The Japanese expression *kyōsai kumiai* originally means association for mutual aid (*sai* is translated in the meaning of *sukuu*). In English this organization is referred to as mutual benefit association or mutual aid association.

9 One single association is responsible for all of the three sectors.

10 In comparison with Germany, the public pension system is of less importance in Japan where corporate pensions, mostly paid as lump sums (*taishokukin*, *ichijikin*) amounting to 3 or 4 yearly incomes, play an important role. This essay, however, includes the corporate pension system in the analysis only as far as it is important 1. for the understanding of the structure of the public pension system and 2. for an assessment of a possible solution of the public pension problem, i.e. cuts in public pensions combined with the promotion of annuity insurances.

financial security for the older generation dependent on pensions – now and in the future.

In general, there are different methods to solve the financial problems of public pension funds caused by an overaging population (OECD 1996:81-83):

- 1) Rise of age at which a person is entitled to receive a pension, e.g. up to 70.
- 2) Restriction of payment of public pensions to persons of moderate means private annuity insurance for persons with higher income.
- 3) Drastic increase of premiums.

This essay aims at analyzing changes in the Japanese public pension system, from its establishment and extension up to the present restructuring phase leading to reductions. As most senior citizens are dependent on pension payments and as the number of the over-65s increases, finding long-term solutions for old-age insurance has become a central issue in the Japanese society and economy.

The next chapters will show the process of change, shed light on the reforms realized so far and analyze the need for and implications of further changes for the Japanese society and economy.

## 2. Historical Development of the Japanese Public Pension System

The establishment of a central state in 1886 (Meiji restoration, *Meiji isshin*) brought in its wake the foundation of a loyal army and obedient civil servants. In order to secure their loyalty the state granted special incentives to those who had to retire from public service due to advanced age. In 1875 a pension fund was created for members of the navy. The following year a similar fund was established for army-members. In 1884 civil servants were granted public pensions (Shimada 1996:40). Those pensions (*onkyū*), however, differed from the present pension system in as much as the beneficiaries did not have to pay premiums. They simply received a reward from the state for their loyal service.

The first *real* social security system in Japan was established in 1907 and was set up as the mutual aid association of the Japanese state-owned railway (*Teikoku tetsudōchō gengyōin kyūsai kumiai*)<sup>11</sup> (*Nihon Kokuyū*

11 At that time the character for help (*sukuu*, *kyū*) was used in the association's name that confirms the translation in note 8.

*Tetsudō* 1958:549).<sup>12</sup> Originally being an accident-, disability- and surviving dependents insurance for blue-collar workers (*Nihon Kokuyū Tetsudō Kōseikyoku* 1958:30), the mutual aid association was extended in 1916 to include a general health insurance. Because of the rice riots in 1918, caused by severe famine, the railway added co-op-shops to its social security system. These special shops provided railway staff and their families with the daily necessities of life. In 1920 the mutual aid association once again was enlarged by introducing an old-age insurance for white-collar workers employed by the railway.<sup>13</sup> Thus, the foundation was laid for the structures of the present JNR mutual benefit association and in 1956 a law was passed making it official (*Nihon Kokuyū Tetsudō* 1958:549).

As the mutual benefit association of the state-owned railway was a prototype for this form of a social security system a detailed description of its origins is appropriate. Following this model, several other mutual aid associations came into existence. To mention only a few: In 1908 the mutual aid association of the monopoly bureau for salt and tobacco (*senbaikyoku*) was founded, followed by the association for workers in the field of telecommunication (telephone and telegraph), created in 1909 and

12 In the 1890s, a German economic theory called historical school with its dominant figures Gustav von Schmoller and Adolf Wagner, strongly influenced the political debate in Japan. Especially Kanai Noboru (1865-1933) deserves particular mention as he introduced this approach in Japan after having spent some years in Germany. The historical school considered economic problems to be closely related to social ones, it incorporated the human psyche into economic analysis and it regarded protection of the weak as a task of the state in order to secure social stability. Following Kanai, the state was obliged to create a basis for continuous economic growth. Thus, he called for the introduction of a factory law, effective as of 1911, in order to improve working conditions. There were other economists besides Kanai also supporting the historical school. Following the German model, they founded an association called Verein für Socialpolitik (Shakai Seisaku Gakkai) in 1896. Opposing *laissez faire* and socialism the association worked for the prevention of class struggles and the promotion of social harmony. Those goals were to be achieved by applying a form of social policy similar to that introduced in Germany by Bismarck, i.e. laws covering social security. In Japan, the first step in this direction was taken by establishing the Japanese railway's mutual aid association (SCHMÖLDERS 1988: 109-121; MORRIS-SUZUKI 1989: 62-65).

13 The state-owned railway also employed civil servant who received old-age pensions according to an imperial order (*kanri onkyū rei*) promulgated in 1884 (*kanri onkyū rei*) (NIHON KOKUYŪ TETSUDŌ KŌSEIKYOKU 1958: 18).

by the association of forestry workers, established in 1919 (*Nihon Kokuyū Tetsudō Kōseikyoku* 1958:1363-1365).

In 1938, for the first time in Japanese history, an independent ministry entrusted with sociopolitical tasks was established: the Ministry of Health and Welfare (Kōseishō), already mentioned in chapter 1. Up to that time, public pension funds only existed in the public sector. In 1939, however, they were extended to the private sector, i.e. a public pension fund for seamen (*sen'in hoken*) was established. During the war, sailors especially bore high risks of disability and death. In order to ensure transport by ship, i.e. to have enough seamen available, a particular incentive was offered, consisting of a public pension system. In 1942, the predecessor of the present welfare pension system (*kōsei nenkin seido*),<sup>14</sup> the public pension fund for blue-collar workers in the private sector (*rōdōsha nenkin hoken*), was set up. All male blue-collar workers in companies with more than 10 employees were contributors. In 1944 this fund was renamed welfare pension insurance (*kōsei nenkin hoken*) and extended to male and female white-collar workers. Moreover, employees of companies with more than 5 persons employed became subject to compulsory insurance.<sup>15</sup> Compared to Germany, the establishment of an public pension fund for all employees working in the private sector occurred relatively late, i.e. not until the Second World War. The official explanation for the introduction of the welfare pension system was as follows: for the soldiers at the industrial front-line (*sangyō senshi*) similar conditions should apply as for the members of the army and for civil servants receiving pensions since the Meiji era. In fact, however, the Government needed the capital accumulated in the pension fund to finance the expensive war (Shimada 1996:40-41).

- 14 The expression welfare pension became common as a translation for *kōsei nenkin*, eventually leading to misunderstandings as it might suggest an implication of public relief. The Japanese expression *kōsei*, although translated with support of public welfare, does not mean support without return service. Rather on the contrary, the welfare pension system aims at compulsorily insure the majority of employees and thus secure their living after retirement. This means support of public welfare.
- 15 At the end of 1944 the number of employees contributing to the public welfare fund totalled 8.32 million, of this total the number of women was 2.24 million (SHIMADA 1996: 41).

The present public pension system is based on the Japanese constitution promulgated in 1946/47. According to Article 25, the state is obliged to promote and augment public welfare (Thränhardt 1994:426). As this commitment is not suable, the article only has the function of providing a guideline for politics.

In order to realize the goal of promoting public welfare and of restructuring the public pension system which has developed on historical lines leading to separate branches of associations, the Japanese Government took the following steps after the Second World War:

In 1948 a law was passed aiming at unifying the several mutual benefit associations in the public sector. The result was the formation of the present mutual benefit association for central Government officials (*kokka kōmuin kyōsai kumiai*) (*Nihon Kokuyū Tetsudō Kōseikyoku* 1958:1374).<sup>16</sup> In fact, however, each association continued to be independent. In 1956 a new law (*kōkyō kigyōtai shokuinra kyōsai kumiai hō*) was enacted providing a common legal basis for the associations of the three public corporations (*kōsha*) Japanese National Railways JNR, Nippon Telegraph and Telephone NTT and Japan Tobacco and Salt JTS. Three years later the pension system (*onkyū*) for army members was incorporated into the association for central Government officials.<sup>17</sup> In contrast to the aim of unifying the public pension system, the local authorities officials set up their own association (*chihō kōmuin kyōsai kumiai*) in 1962 (Shiono et al. 1995:572). By doing so they followed the employees in the sector of private education and the employees working in the fields of agriculture, forestry and fishery, who left the welfare pension system to establish their own mutual benefit associations (*shiritsu gakkō kyōshokuin kyōsai kumiai* and *nōringyo-gyō dantai shokuin kyōsai kumiai*) in 1953 and 1958 respectively. Employees were motivated to leave the welfare pension system in view of the prospect of receiving higher insurance benefits compared to the welfare pensions if they managed the fund themselves (see chapter 3) (Shimada 1996:42).

16 This name also subsumes the mutual benefit associations of the JNR, NTT and JTS. Until the reform of 1985/86, however, each association had an independent administration.

17 During the period of US-occupation the Americans enforced the abolishment of the public pensions (*onkyū*) for members of the army. The system, however, was reintroduced in 1953 (SHIMADA 1996: 42).



The public pension system for employees of the private sector, founded during the Second World War, was fundamentally reorganized in 1954: pensions were separated into a fixed amount (*teigaku bubun*) and into an amount dependent on income (*hōshū hirei bubun*). The family of beneficiaries was granted an additional pension. The age at which a person is entitled to receive a pension was set to 60.

In spite of this reform, there were 27.39 million Japanese aged 20 to 49 left not being subject to any public pension system in 1955. This mainly applies to self-employed, employees of very small companies (with less than 5 persons employed) and full-time housewives who did not have an insurance claim of their own but who merely were jointly insured with their husbands.

In order to realize the above mentioned aim of promoting public welfare, the Government decided to extend the public pension system to the entire population by introducing the so-called national pension (*kokumin nenkin*) in 1961. All Japanese between 20 and 59 who were not a member of an existing public pension fund had to enter the national pension system. At the same time the Government created a form of public assistance called welfare pension (*fukushi nenkin*)<sup>18</sup> for those persons born before 1911 because they were too old to profit from the national pension system. As the amount paid monthly did not exceed 1000 Yen,<sup>19</sup> the welfare pension was also called pension for sweets (*amedama nenkin*), an allusion to allowances given to children to enable them to buy some sweets. Of course, it was far too little to cover costs for living (Shimada 1996:43).

This chronology of the development of the public pension system in Japan elucidates the background and circumstances leading to the present public old-age insurance. The next chapter deals with its present structure and the measures to adapt these structures to altered conditions (i.e. overaged population) in order to create and maintain a stable financial basis for the elderly and the younger generations.

18 This form of public assistance must not be confused with the welfare pension system (*kōsei nenkin seido*), i.e. the public pension fund for employees of the private sector.

19 By 1994, the allowance increased to 33,533 Yen monthly (SHIMADA 1996: 43).

### 3. Structure and Restructuring of the Japanese Public Pension System

#### 3.1 Overview of the Public Pension System and its Reforms

56 percent of the entire population, i.e. 69.55 million Japanese joined the public pension system in 1994. All blue-collar workers, white-collar workers and self-employed are subject to compulsory insurance.

Slightly less than half of the insurants, 30.98 million,<sup>20</sup> are members of the national pension system. In 1985/86 this system was restructured because of growing financial difficulties.<sup>21</sup> In order to secure solvency the national pension system was enlarged to a so-called basic pension (*rōrei kiso nenkin*) which insurants of all funds had to join (Shimada 1996:44, 46). Consequently, members of the funds of the welfare pension and the mutual benefit associations had to pay a part of their premiums into the national pension fund. Thus, everybody subject to compulsory old-age insurance automatically became a member of the national pension system which reached a total of 69.55 million contributors in 1994.

Some branches of the mutual benefit associations<sup>22</sup> suffered from the same financial difficulties as the national pension fund. The two main factors responsible for the situation were: 1) rationalization measures resulting in a distorted age structure of the employees of the affected (public) corporations, i.e. of the association concerned; 2) a level of benefits exceeding by far the level of the welfare pension system, i.e. financial privileges for the members of the mutual benefit associations.

20 Of these 30.98 million persons only 36,000 are non-compulsory members (OHARA 1994: 150).

21 As mentioned in chapter 1 the national pension fund has shown a deficit since 1983. After the deficit of the fund of the JNR mutual benefit association dating back to 1976 it was the second public pension fund to run into financial trouble. To cover expenses the fund had to fall back on accumulated capital reserves which had shrunk to the amount of pension payments of a single year (SHIMADA 1996: 67-68).

22 Besides paying old-age pensions the mutual benefit associations carry out the following functions (due to their historical origins): 1.) health insurance 2.) social welfare of their members, i.e. providing and maintaining hospitals, housing, resorts etc. The essay only refers to the associations in their function as public pension system.

Since the '60s some companies with mutual benefit associations, in particular the Japanese National Railways JNR, continued to dismiss workers and thus reduced the proportion of contributors to beneficiaries. For the first time, the JNR's pension fund showed a deficit of 8.9 billion yen in 1976 which rose to 36.3 billion yen the following fiscal year. Premium hikes from 12.7 to 14.7 percent could not prevent the deficit from growing (*Kōtsū Shinbun* 27.8.1996:1). Since 1985 the accumulated capital of the fund has been exhausted, i.e. the fund was bankrupt.

Financial difficulties were aggravated by the high level of benefits, e.g. compared to the welfare pension system, which differed from the latter in following points (*Nenkin Kenkyūkai* 1996:163-165; Saitō 1996:5):

- 1) Pension age at 55. Up to 1981 the members of the mutual benefit associations had a pension claim at the age of 55 years whereas the members of the welfare pension were entitled to a pension only at the age of 60.
- 2) Basis for pension assessment in final year before retirement. In contrast, the welfare pension payments are based on the average salary the insurant earned during the period of contribution resulting in lower pensions due to the principle of seniority (*nenkō joretsu*).
- 3) Possibility of early retirement with slightly reduced payments (*genkaku taishoku nenkin*) which welfare pension system did not provide.
- 4) Payment of an additional benefit (*shokuiki nenkin*).

In order to secure solvency, funds of mutual benefit associations with a financial bolster had to support deficit associations, e.g. the JNR's association.<sup>23</sup> Between 1985 and 1989 the associations of NTT, JT<sup>24</sup> and central Government officials paid a total of 46.6 billion yen to the association of JNR (*Kōtsū Shinbun* 27.8.1996:1). Though easing the financial crisis of the JNR's association for the time being, this solution endangered the financial stability of other mutual benefit associations in the long run. This applies particularly to associations of (public) corporations affected by rationalization measures (e.g. the JNR) and resulting in a

23 In February 1984 the cabinet debated and decided on the integration of the mutual benefit associations into the public welfare system (*ichigenka*) and the procedure of adjustment payments to give financial relief to the mutual benefit association of the JNR, JT etc. (*KŌTSŪ SHINBUN* 27.8.1996). Based on this cabinet decision the Parliament passed the law relating pensions (*nenkin kankei hō*) in 1989 (*KŌTSŪ SHINBUN* 22.8.1996: 1).

24 After privatization in 1985 the public corporation JTS was renamed JT.

distorted age structure of the employees. The mutual benefit association of JT is at the edge of bankruptcy as well.

In spite of extensive adjustment payments out of other public pension funds deficits increased by 1995/96: the deficit of the association of the JR peaked at 201 billion yen, the deficit of JT's association amounted to 10 billion yen (Hayashi 1996:9).<sup>25</sup>

In view of this development the Japanese Government was compelled to enforce a reform program already conceptualized after the Second World War, i.e. the unification and systematization of the public pension funds (see chapter 2).<sup>26</sup>

The reform of 1985/86 was the first step in this direction: It consisted of two major parts: 1) cut of benefits; 2) institutional unification aiming at distributing the financial burden of some public pension funds to all funds in order to improve the overall financial situation.

As mentioned before, one step towards institutional unification was the extension of the national pension fund by restructuring this pension as a basic pension compulsory for everyone. Another step is the integration of the mutual benefit associations of the JR, NTT and JT into the welfare pension system by 1997. The term *ichigenka* (unification) is applied to describe this process in Japan. Though the associations of JNR, NTT and JT had to pay 2.5 trillion yen to the welfare pension fund in order to join it (Hayashi 1996:9), the welfare pension system as well as the associations which are not yet integrated into the welfare pension fund, will have to continue their financial support to cover the deficit now integrated into the welfare pension fund: starting in 1997 they will have to discharge 4 trillion yen over a period of 40 years (for a scheme of the new structure see diagram 2) (Hayashi 1996:9; Konno 1996:15).

25 139 billion yen of this deficit were covered by the Japanese state. The rest was paid out of other public pension funds.

26 In spite of the early recognition of the financial problems connected with the overaging society and in spite of the early conceptualization of countermeasures, the realization of reforms took place relatively late. The cause for this is rooted in strong self-interests of the organizations in question. For fear of losing their privileges the members of the mutual benefit associations opposed reforms. The public pension funds with an age structure guaranteeing financial stability, even in the far future, to the extent of that offered by the welfare pension system, also objected to reforms because they were afraid of losing their sound financial basis if they had to pay the deficits of other funds.

Integration of the different funds on the one hand led to secure solvency of the national pension's fund and the associations' funds already at the edge of bankruptcy. On the other hand, it assured more fairness concerning pension claims by pledging to a sole pension claim. Insurants who by then had two or more pension claims had to opt for a single claim (Thränhardt 1994:438).<sup>27</sup>

As the integration of the public pension system did not sufficiently stabilize the financial situation of the public pension funds in the long run, the reform of 1985/86 also provided extensive benefit cuts:

- 1) The age at which members of the mutual benefit associations are entitled to a pension was raised to 65 years.
- 2) As mentioned above the possibility of receiving pensions from different funds at the same time was strongly restricted.
- 3) Abolishment of the possibility of early retirement for members of the mutual benefit associations.

Summarizing the public pension reform of 1985/86 we can state that the main target was to lower the high level of benefits mutual benefit associations had been able to provide and to restrict them in their independence. That means that employees of the public sector lost their privileges in the field of old-age pension. Additionally, the reform aimed at restructuring the national pension system.

The reform, however, did not seem to sufficiently secure the financial stability of all funds. Costs for pension payments increased from 14.7 trillion yen in 1985 to 27 trillion yen in 1993 (Shimada 1996:65). That is why a second reform became inevitable. It took place in 1994 and had the main goal of cutting costs, i.e. lowering the level of benefits (Shimada 1996:26, 64):

- 1) Pension age of the welfare pension members was raised from 60 to 65 years. That measure will have to be realized in several steps between 2001 and 2013.

27 The existence of multiple pension claims is due to the Japanese employment system forcing employees to retire at an average age of 57. Most of the employees concerned look for other employment after retiring, most accept a decline in salary. According to statistics of the Ministry of Labour 76.9 percent of the people aged between 55 and 69 years are employed full-time. 70 percent of those employees have to keep on working to earn their living (THRÄNHARDT 1994: 438). From the second or third employment after the age of 55 can result additional pension claims.

2) Coupling the pensions to the development of prices (*bukka suraido sei*) was replaced by calculating pensions according to the available income (*kashobun shotoku sei*), resulting actually in a pension reduction.

In response to the overaging Japanese population the public pension system has been reformed twice so far (in 1985/86 and in 1994) aiming at securing old-age pension for the elderly of today and of the future. The restructured system had characteristics shown in table 1 (see appendixes).

Besides giving an insight into the historical development (rise and decline) of the public pension funds and their benefit level, the following provides some background information on the administration and management of public pensions.

### 3.2 Fund Management

The Ministry of Health and Welfare is responsible for controlling all parts of the public pension system.<sup>28</sup> To express it more concretely, a public corporation (*tokushu hōjin*) called Pension Welfare Service Public Corporation (Nenkin Fukushi Jigyōdan) manages a small part of the pension fund.<sup>29</sup> The major part of the fund for national pensions or basic pensions is managed by the Ministry of Finance, i.e. by the Trust Fund Bureau (Shikin Un'yō-bu). Based on the principle of capitalization the means of the fund bear interest and are used within the scope of the Fiscal

28 Corporate pension funds (tax-qualified pension) pay lump sums to employees when they retire and are not connected with the public pension system. They are controlled by the Ministry of Finance (SUZUKI 1996: 4).

29 The Pension Welfare Service Public Corporation was established in 1961 and is responsible for the following tasks: 1.) financing of housing for members of the public pension system; 2.) granting credits to insurants in order to enable them to finance their home; the credit is secured by expectant pension claims; 3.) financing facilities promoting public welfare, e.g. centers for medical care.

Capital flows are as follows: the contributors to the pension funds pay their premiums to a special budget (*tokubetsu kaikei*) of the central Government. The total amount of insurance rates then is transferred to a shadow budget, the Fiscal Investment and Loan Program FILP (*zaisei toyūshi keikaku*). The Pension Welfare Service Public Corporation borrows the sum of money it was entitled to handle by the Ministry of Health and Welfare from the FILP and manages this borrowed money by investing it as profitably as possible. One part of the profit flows back to the FILP for interest payments. The remaining profit is used as subsidies for the members of the public pension insurance (FUJIOKA 1995: 84-85).

Investment and Loan Program (*zaisei toyūshi keikaku*) (Shimada 1996:57).<sup>30</sup> The funds of the welfare pension and the mutual benefit associations, i.e. that part remaining after the separation of the capital flowing into the national pension fund (see basic pension) are managed by the companies or industries the respective insureds work with. The Ministry of Health and Welfare controls these funds: on the one hand there is the rule that managing the funds has to result into an interest yield of 5.5 percent. On the other hand there are limitations as to how much capital may be invested in shares, real estate etc.<sup>31</sup> For an overview of the fund management, see diagram 2 (appendixes).

### 3.3 Financing the Public Pension System

The system does not have a fully funded basis but operates on a so-called pay-as-you-go-basis. Most of the capital is provided by premiums.<sup>32</sup> 50

30 A simplified explanation of the Fiscal Investment and Loan Program: capital comes from profits made by investing postal saving deposits (*yūbin chokin*) and public pension premiums on the capital market (for further explanations see NAKAGAWA / KAWAI/HARADA 1994: 1-47). In fiscal 1993 FILP made up approx. two thirds of the regular budget. Presently, it serves to finance projects to increase the quality of life (improvement of housing and infrastructure), to support small and medium sized enterprises etc. (see IPMS GURŪPU 1994: 104).

31 In spite of this strict regulation concerning the management of the pension funds the Ministry could not prevent the funds from containing so-called bad loans (*furyō saiken*), i.e. loans that cannot be repaid. It is still unknown, though, how high the loss suffered was. This regulation is not only applied to public pension funds but also to corporate pension funds (see chapter one). Since 1991 the average interest rate has been below 5.5 percent, constituting a major problem for the companies. In 1995 interest rate reached a bottom of 3.52 percent. As companies have to make up for the losses emerging from the difference between rates they increased pressure on the Ministry for Health and Welfare and the Ministry of Finance and demanded deregulation of fund management. Actually, deregulation is in progress: Starting in April 1997 the 5.5%-rule will be loosened to allow for a 2%-corridor (down and up). The limit, however, is the interest rate of long-term public loans. Moreover, companies will have the option of cutting pensions. They will need the approval of the employees concerned, though (NIKKEI 1996: 1).

32 The basis of assessment of the premiums is the monthly gross salary minus bonus payments (*shōyo*). In Japan, these boni are paid twice a year and amount to approximately 3 to 5 monthly basic salaries. Since April 1995, however, the employee has to pay 0.5 percent of the boni payments as premium for the public pension fund. The employer has to discharge 0.5 percent as well (TSUJI 1996: 4).

percent of the insurance rate is paid by the employee, 50 percent by the employer. Moreover, the Japanese Government subsidizes the public pension funds: in fiscal 1993 it spent about 5.47 trillion Yen, in 1994 subsidies amounted to 5.51 trillion Yen. All subsidies are financed by the regular budget (*ippan kaikei*) (Ohara 1994:148).

### 3.4 Pension Payments and the Role of Public Pensions

In general, the amount received positively correlates with the average total lifetime working income and the period of contribution. Up to 1994 it was coupled with the development of prices (*jidō bukka suraido sei*). Since then it is linked up with the available income (*kashobun shotoku suraido* or *netto suraido*) (Shimada 1996:52-53). As the basis for assessment depends on the kind of pension fund a detailed description cannot be given here because of the brevity of this essay. In general, however, we can state that the average Japanese public pension is relatively high. In 1992 the average proportion of pensions to salaries ran up to 40.9 percent compared to 34.4 percent in Germany. Besides, income-related benefits of an insurant with a contribution period of 35 years amount to 68 percent, i.e. are about 8 percent higher than standards laid down by the International Labour Office ILO (OECD 1993:111). Table 2 (see appendixes) indicates the average pension payments per month according to the different pension funds.

To give an idea of the value of these amounts: According to a study of the Ministry of Health and Welfare in 1994 married couples aged 65 and older had a monthly available income of 266,667 yen on the average. The public pension share is only 54.9 percent of this amount and not sufficient to cover one's living costs, especially in agglomeration areas.<sup>33</sup> The remaining share of 55.1 percent mainly consists of income from work (self-employed or employed) and invested capital (Shimada 1996:35). This

33 Average costs for living of a married couple receiving pensions amounts to 241,559 yen. Housing costs are assessed at 15,367 yen. This is an underestimation due to the high proportion of house owners being of the order of 80 percent in the age group between 60 and 80. Compared to the average costs for living pensions of the welfare fund and of the mutual benefit association funds seem to be sufficient. However, following categories of elderly face financial difficulties: old people who do not own a house, i.e. who have to pay rents; men and women who only draw national pension; widows who have to live on the pension for surviving dependants amounting to roughly a mere third of the husband's pension.



means that the elderly depend on employment even after having reached the age at which they are entitled to benefits. Of course, there are motives other than financial necessity that make people continue to work even after retiring (see chapter 4).

#### 4. Results and Future Developments

##### 4.1 Specific Features of the Japanese Public Pension System and the Characteristics of its Reform

In comparison to other industrialized countries, public pension systems were established relatively late in Japan resulting in the following characteristics:

###### *High Importance of Self-Responsibility*

In Japan the awareness of having the vested right to be supported by the state at old-age, i.e. the attitude of protection of vested rights in the field of public retirement pensions is not so common as for example in Germany where most people take it for granted that the state is responsible for them to the rest of their days an attitude which is hard to revise.

As the statistics on income structure of the elderly showed (see chapter 3), public pensions make up around 50 percent of the income, i.e. dependence on payments by the state is relatively low. The main reason is that pensioners continue to work. There are two probable courses for that: First, there are a number of old people in Japan who are excluded from the public pension system due to its late establishment. They have no claim for a pension or the benefits they receive do not exceed pocket money, a fact forcing them to work until old-age in order to earn their living.<sup>34</sup> Second, a proportion of senior citizens receive sufficient benefits to cover the cost of living, they prefer, however, to continue working even after they have reached age. One reason for this might be the above mentioned attitude of

34 Moreover there are numerous elderly who do have a full pension claim. Nevertheless, they have to continue to work after retirement because public pension is insufficient to cover the living costs. This can be the case in particular with beneficiaries of the national pension system.

self-responsibility.<sup>35</sup> The statistics (see table 3, appendixes) seem to confirm the fact that Japan's older population shows a high proportion of employment.

The structural characteristic of the Japanese society described above could facilitate the realization of further benefit cuts or the reduction in the scale of the public pension system. Focussing on further reductions of benefits corresponds to the third method the OECD offers to solve the financial crisis of the public pension system (see chapter 1). The most extreme outcome of this method is the restriction of public pension claims to persons of moderate means.

However, a major barrier for the realization of this approach lies in the economic depression dating back to the beginning of the '90s leading to job reductions, i.e. it is harder for older people to find employment. Moreover, deregulation measures contribute to a job loss for the elderly, e.g. in the retail business. Here, conflicting aims of economic policy appear: on the one hand the promotion of deregulation and liberalization as macro-economic requirements, on the other hand the necessity of restructuring the public old-age insurance.

Another conflict arises if the financial crisis of the public pension system is solved by the introduction of a very moderate basic pension for everybody (entitled to a public pension) that is not sufficient to cover the costs of living. On the assumption that the number of jobs for elderly cannot be increased to such a degree that would be necessary in order to compensate for the reduced public pension payments by income from employment, the available income of the elderly will sink. With an increasing proportion of over-65s this means a decrease in domestic demand.<sup>36</sup> Thus, the reform of the public pension system would counteract the policy Japan adopted, partly responding to US-pressure (*gaiatsu*) since the beginning of the 90's, i.e. launching huge economic stimulation programs aiming at augmenting domestic demand.

35 Other factors like the atmosphere at home also influence the determination to continue to work up to a high age.

36 Of course, overaging also leads to a change in consumption behaviour. On the assumption that available income of the elderly will not go down a change in demand may result in the creation of new industries, as well. In this respect, overaging can be regarded as a chance to restructure industries and create new jobs.

These will be the difficulties emerging if the approach of cutting benefits or restricting the public pension system to certain categories of persons is implemented, although it will be easier to realize in Japan than in other industrialized countries because of the above mentioned structural characteristics. Before chapter 4.2 will again address this issue another consequence of the late establishment of Japan's social security system needs to be pointed to.

### *Economic-Political Role of the Public Pension Funds*

Another consequence of the late foundation of public pension funds, coupled with a late start of an overaging society (compared to European countries) is the fact that the public pension funds, especially the welfare pension fund, showed high surpluses up to the 90s.

Within the structure of the Fiscal Investment and Loan Program FILP, the (interest) income earned by investing this (surplus) capital was used to finance economic policy measures. In the 60s/70s stress was laid on industrial policy, whereas the 80s, especially in the second half after the publication of the Maekawa-Report, saw a shift to the promotion of projects enhancing the quality of life, particularly housing and social infrastructure. We can thus consider FILP to be an important economic-political allocative instrument financed to a large extent by the surpluses of the public pension funds. Overaging, however, results in accumulated capital melting fast and endangering the basic concept of the FILP.<sup>37</sup> Therefore, the deterioration of the financial situation of the public pension system not only forces the restructuring of an old-age insurance but also the reform of an important allocative instrument to implement economic policy.

### *Approaches so far Realized to Solve the Financial Difficulties of the Public Pension Insurance*

In view of the complexity a reform of financing the elderly is linked with, we can understand that no radical approaches like those proposed by the

37 Moreover, survival of the FILP is questioned by another factor: In the course of liberalization of the capital market politicians discuss the privatization of the postal insurance system, also largely contributing to finance the FILP.

OECD (see chapter 1) have been implemented so far. Instead the following characteristics define reform approach:

- 1) *Cuts in benefits*<sup>38</sup>
- 2) *Standardization* of the different systems aiming at integrating the deficit-ridden funds into those funds (still) supplied with sufficient capital. If this integration is not coupled with extensive belt-tightening measures it will only slow down the financial crisis of the public pension systems. In view of the dramatic change in age structure, bankruptcy will be inevitable, though.
- 3) Although a problem of top priority the reform process to secure solvency of the public pension funds, i.e. to ensure the financial support of the elderly, is very *slow*. To give an example: the integration of the three mutual benefit associations of the JR, NTT and JT into the welfare pension system. It took the Government 13 years from the cabinet decision in 1984 to realize the standardization of a part of the funds in 1997. Considering the high speed of overaging, future solutions have to be conceptualized and realized much faster than implemented so far. Given the example above, however, we cannot expect very quick solutions.

## 4.2 Future Developments

In spite of diverse difficulties in its wake as described in the preceding chapter, the Japanese decision makers seem to focus on quantitative methods (cutting benefits and increasing premiums) in order to secure solvency of the public pension funds.

According to Kawakita (1996:19) welfare pension premiums will increase to 19.5<sup>39</sup> percent by 1999. Starting that year there will be a premium hike of 2.5 percent every 5 years. In spite of the constant increase in insurance rates drastic benefit cuts would be inevitable.

This statement seems to be confirmed by a report recently released by a commission of the Ministry of International Trade and Industry MITI (Tsūsanshō). Demanding a basic reform of the social insurance system, especially the public pension insurance, the commission is in favour of a cut of average monthly pension payments from 230,000 yen<sup>40</sup> to 165,000

38 Especially the benefit levels of the mutual benefit associations and the welfare pension were higher than international standards.

39 This percentage includes the employer's and the employee's proportion.

40 This amount seems to be too high (see table 2).

yen. In addition, they call for a general reduction of public pension systems in favour of private old-age insurances (Ishizawa 1996:3).

Following the above mentioned statements, decision makers regard further premium hikes and benefit cuts as major future approaches to solve the crisis in the wake of financing the older population. However, there are limits to these approaches. As referred to in chapter 4.1, those limits consist of conflicts emerging between different economic-political goals. Besides, premium hikes correspond to augmented nonwage labour costs. Japanese corporations face very high pressure to reduce costs, anyhow. Therefore, the danger is high that Japanese companies will respond to any cost increase by migrating (*kudōka*) to Asian neighbour countries where social insurance costs are lower than in Japan (Kawakita 1996:19; Tsuji 1996:4). Moreover, the young generation probably will not sympathize with a policy leading to premium hikes coupled with benefit cuts (Kawakita 1996:19). Two consequences are possible:

- 1) Politicians promoting such a policy run the risk of not being reelected.
- 2) The moral of the younger workforce forced to pay more in order to get less will deteriorate, reducing the efficiency of human capital.

Keeping in mind the limits of the above listed quantitative approaches we once again want to refer to the proposal of the MITI-commission, i.e. the promotion of private old-age protection. As shown in chapter 4.1, in Japan an attitude of non-impairment of vested rights in the sector of social security is not yet so common as Europe. Besides, people (still) are used to working even beyond the retirement age (partly due to financial necessity). Based on these characteristics, Japanese decision makers could extend the quantitative-orientated approach to a more qualitative-orientated one, thus softening the disadvantages discussed of mere quantitative solutions.

#### *Possible Further Changes*

In order to secure solvency of the public pension funds in the long run and thus guarantee public assistance for the elderly of the present and the following generations the institutional organization of the public old-age insurance and social structures in Japan have to be incorporated into a comprehensive approach of reform and change.

First, there has to be a change in the management of the public pension funds. As shown in chapter 3, the Ministry of Health and Welfare

is charged with the task of controlling the system, and the Ministry of Finance carries out the concrete management of the funds. In view of the increasing public deficit of the Japanese state the funds run the risk of being used for purposes other than to finance public pensions by the Ministry of Finance.<sup>41</sup> A definite assignment of responsibility for managing the capital of the public pension insurance is extremely important in order to prevent the funds of turning into self-service-shops of the Ministry of Finance. The Ministry of Health and Welfare has to be clearly assigned responsibility to independently manage the funds. To protect the funds from misuse the Board of Audit (Kaikei Kensa'in) should regularly inspect and control the management of the public pension fund. Additionally, the Ministry of Health and Welfare should be obliged to publish all figures concerned in order to augment transparency. Moreover, the same regulations applied to the management of the corporate pension funds should be valid for the management of public pension funds. As chapter 3 pointed out, however, those regulations have to be loosened to a certain degree. Such an institutional arrangement could prevent the use of the public pension funds for purposes other than financing public pensions and thus avert the risk of a further deterioration of the financial situation of the funds.

Second, Japanese decision makers have to take into account policies aiming at altering social conditions. As mentioned before, employment at old-age is (still) relatively wide-spread in Japan. Thus, there is no fundamental barrier to extend old-age employment. Of course, we have the difficulty of creating appropriate jobs for the elderly. In view of the good health of many people between 60 and 75, especially women, there might be a chance of employing them in the booming service sector, thus increasing their income from employment and decreasing their dependence on public pensions. The benefit level could be lowered in the long run to reduce costs. However, other expenses will emerge connected with the employment policy for elderly, e.g. incentives for companies to create new, appropriate jobs.

41 Recently, the Ministry of Finance was accused of withdrawing capital from the public pension funds in order to redeem the fast growing deficit of the public settlement corporation JNRSC that assumed the debts of the former Japanese National Railways JNR in 1987 (SATŌ 1996: 4).

Moreover, a policy has to be applied in order to maintain the balance between the workforce and the people not employed. A major step in this direction is a policy allowing women to bring up children without interrupting employment. Connected with this approach are the efforts of the Ministry of Health and Welfare to establish more facilities for babies between ages 1 and 3 to facilitate continued employment of mothers. Although this measure has to be financed as well, it offers two advantages to secure the public pension system: 1) preventing the birth rate from declining sharply; 2) increasing the number of women who contribute to the public pension funds, the latter being a short-term advantage as those women will have their own pension claims, though. Another step to stabilize the balance between the active and passive population could be the liberalization of immigration policy.<sup>42</sup>

Finally, we can summarize that there is a close interaction between altering social conditions such as the overaging of the population and changes in the economic policy and the economic structure. The challenge overaging poses need not only lead to a necessary restructuring of the public pension system but, furthermore, to changes in the entire society and eventually to a change in values.

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42 In 1994, foreigners living in Japan made up around 965,000 persons corresponding to less than 1 percent of the entire population (YOSHIMUNE 1995: 48).

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Appendixes

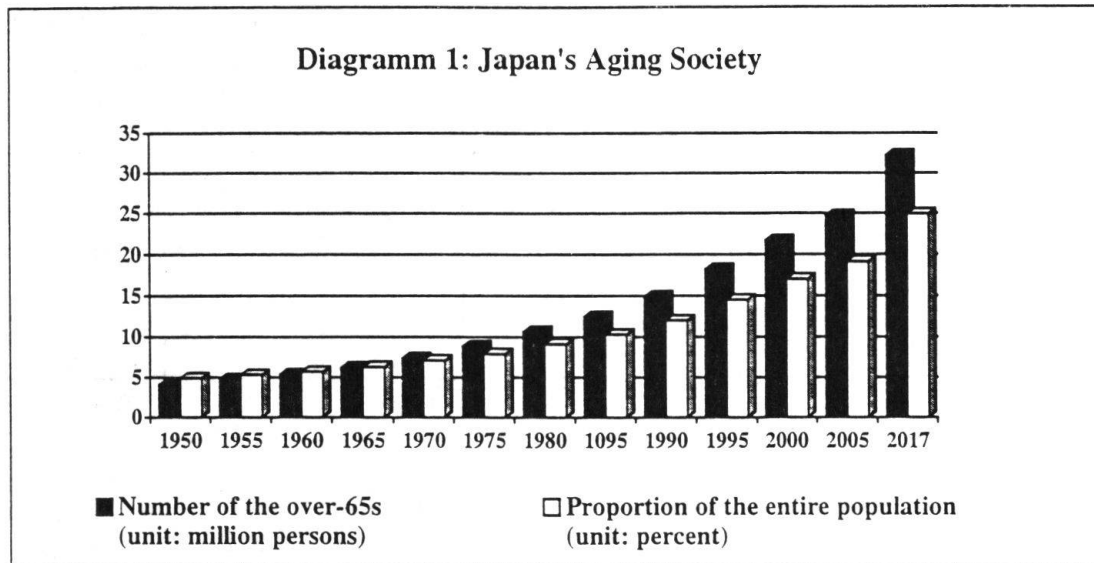
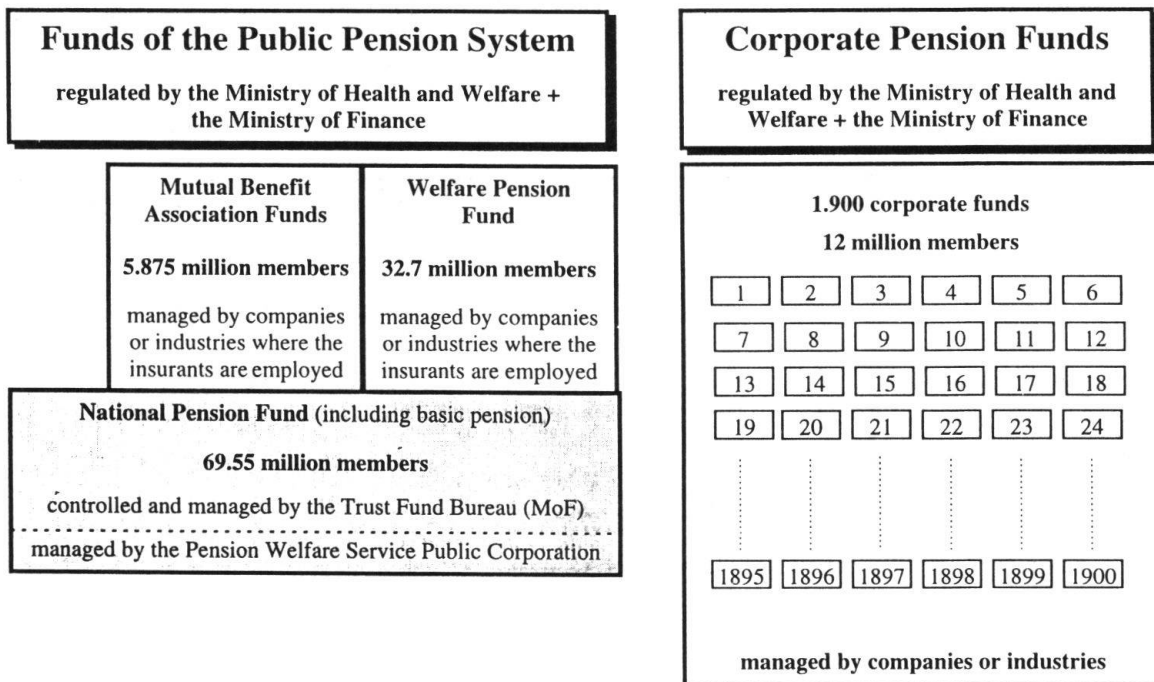


Diagram 2: The Management of Pension Funds



**Table 1: Structure of the Public Pension System after the Reform in 1994**

public pension system	Number of contributors (A) by 1994	Number of beneficiaries (B) by 1994	(B/A)	premium (in %) April '94 (April '96)	categories of persons entitled to receive pensions
MB-Association of JR	200,000	440,000	2.2	9.6 (9.78)	employees of former <i>kôsha</i> , central Government officials
MB-Association of NTT	250,000	160,000	0.64	7.0 (8.13)	
MB-Association of JT	25,000	32,000	1.28	8.5 (9.54)	
MB-Association of central Government officials	1.12 million	750,000	0.66	7.6 (8.72)	
mutual benefit association of local authorities officials	3.35 million	1.65 million	0.49	7.08 (7.92)	employees of local government etc.
mutual benefit association of teaching staff at private schools	420,000	150,000	0.35	5.9 (6.4)	teaching staff at private schools etc.
mutual benefit association of persons employed in the field of agriculture, fishery and forestry	510,000	250,000	0.49	8.15 (9.27)	persons employed in the field of agriculture, fishery and forestry
welfare pension ( <i>kôsei nenkin</i> )	32.7 million	13.27 million	0.41	7.25 (8.25)	employees of private sector
national pension ( <i>kokumin nenkin</i> )	69.55 million	14.31 million	—	11,100 ¥ 12,300 ¥	nationals between 20 and 60

Source: compiled from KÔTSÛ SHINBUN 22.8.1996: 1; OHARA 1994: 150-151; KONNO 1996: 15.

Notes:

(B/A) shows how many beneficiaries (B) have to be financed by a single contributor (A).

MB-Association stands for mutual benefit association.

The welfare pension system has two exceptions: In 1996, employees of the mining industry had to pay a premium of 9.15 percent. The same is true for seamen who had to pay the same percentage. Since October 1996 total premiums (employers' and employees' shares) have increased to 17.35 percent (TSUJI 1996: 44).

The premium for the national pension is a fixed premium all contributors to the national pension fund have to pay regardless of their income.

**Table 2: Overview of Monthly Pension Payments after 25 Years or more of Contribution (as of March 1995)**

name of pension fund	amount of monthly pension payments in yen
national pension	65,458
welfare pension	168,000
mutual benefit association for central Government officials	215,000
mutual benefit association for JR	195,000
mutual benefit association for NTT	206,000
mutual benefit association for JT	199,000
mutual benefit association for local authorities officials	231,000
mutual benefit association for teaching personal at private schools	212,000
mutual benefit association for persons being employed in the field of agriculture, fishery and forestry	172,000

Source: KONNO 1996: 15; SHIMADA 1996: 53.

Notes:

As the welfare pension and the mutual benefit association pensions cover (extremely low) benefits for wives, the above listed pension amounts do not apply for a single person but for a married couple. If, however, the wife is additionally member of the national pension fund she has an independent pension claim. The monthly pension amount of the national pension system applies to a single person.

According to the exchange rate of that time 200,000 yen were equivalent to about 3,100 German Marks.

Due to the late establishment of the national pension fund the minimum contribution period to be entitled to get a pension depends on the year of birth. Being equated it lies between a period of 25 and 40 years. A full pension claim, however, is only possible after a contribution period of 40 years.

**Table 3: Proportion of Old People Being Employed or Wanting to be Employed**

unit: %	persons between 60 and 64		persons between 65 and 69	
	male	female	male	female
Japan	75.6	40.1	55.3	28.0
US	54.9	37.4	25.8	16.0
UK	52.2	24.7	13.1	8.0
Germany	34.9	11.9	8.0	4.0
France	18.1	15.1	4.5	3.2

Source: based on KIYOË 1996: 33, according to statistics of the International Labour Office ILO

Note: As no details are given about the method of the registration of people who want to be employed, doubts about the correctness of these figures seem to be justified.

