Sustaining Old Age Security in Japan : Toward a New Public-Private Pension Mix

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1 INTRODUCTION

Until about 10 to 15 years ago broad consensus existed among the informed around the globe that post-war Japan's political and economic performance had been outstanding by most standards. Beginning in the late 19th century and gaining momentum after the Second World War, Japan as an industrial latecomer pursued highly successful policies to try and catch-up. As a result, as early as 1968 the country ranked third in terms of GDP after the United States and the Soviet Union. However, after the burst of the so-called "bubble economy", the implosion of the speculative asset and real estate bubble at the beginning of the 1990s, Japan and its policies have lost much of their lustre, although the country is still the world's second largest economy in GDP terms. After more than 10 years of a lingering recession, few foreign observers believe that there is much to learn from this country's economic policies.

This paper aims to demonstrate that Japan's pension policy, although not a good example of best-practices solutions, does in fact provide an interesting case study for other countries. One important reason to look closer at Japan's experiences is the fact that it remains *the* industrialized country with the largest and most quickly increasing concentration of people aged 65 and older. The constant decline of death and birth rates is likely to bring about an increase of the ratio of the population older than 65 years from currently 17.2 to 32.3% in 2050. As a result of this demographic shift, the population is likely to decrease from 126.9 million to 100.5 million in the year 2050, and possibly to 67.4 million in the year 2100.[1] Since Japan's public pension schemes today are predominantly financed on a "pay-as-you-go" basis, similar to those of many western European countries, the ageing of society constitutes a formidable challenge to today's policy makers. How Japan deals with these challenges will be described and evaluated in this paper. Japan is also an interesting case because it seeks to counterbalance public benefit cuts by promoting private old age provisions; policies which have been adopted in other western countries, too.

This paper begins with an overview of the history and structure of the Japanese pension system. A short discussion of the economic situation of elderly households then follows, after which the latest reforms of public (1999) and occupational pension (2001) schemes are discussed in more detail. The analysis of these reforms centers on issues of financial sustainability, distributional effects, minimum income adequacy of the basic pension and the question of how recent reforms are likely to reshape the public-private pension mix over the coming years.

II. PENSION REFORMS IN JAPAN: PAST AND PRESENT

As mentioned above, Japan was still an industrial latecomer when it ended its more than 200 years of national seclusion in the late 19th century. What was true for industrial achievement was even more so in the field of social policy. However, as in industrial matters, the country embarked on a rapid course to modernize its institutions. Studying and adapting foreign, especially German, models of social policy, Japan established its first public pension systems during the Second World War. These systems were, however, still highly fragmented and their finances were misused for the war effort and eventually eroded by post-war inflation.

The years after the war and up to the mid-1980s saw a steady improvement in terms of coverage and benefits. By 1961 most parts of the population were insured in at least one kind of public pension scheme, although entitlements were still minimal. In marked

1 See SÔMUCHÔ TÔKEIKYOKU (2001) 33.

contrast to other western industrialized countries, where the elderly received already fairly high pay-as-you-go financed benefits during the 1970s, Japan at that time still largely relied on a tax-financed means-tested welfare pension for people aged over 70.[2] On the other hand, the core public pension schemes, namely the Employees Pension Insurance (reinstated in 1954) and the National Pension Insurance (established in 1961), were originally designed as capital-funded systems. Nevertheless, several amendments to the pension law during the 1960s and 1970s resulted in a quick increase in future benefit levels of these schemes, whereas contribution hikes were much lower than what would have been prudent from an actuarial point of view. Thus, these insurances changed to become subsequently pay-as-you-go systems.

Alarmed by a slow deterioration of the pension finances and gloomy scenarios about necessary future contribution hikes to levels of almost 40%,[3] Japanese policy makers have passed several pension reforms since the mid-1980s, with which they intended the eventual shift from an expansive policy to one that has sought to curtail future expenses. The pension reforms of 1985 and 1994 consisted of various parametric reform measures in the sense that they sought to curtail pension payments by an adjustment of parameters such as age of entitlement, benefit level or financing mode. In this respect, the last public pension reform of 1999 was no exception. It slashed aggregate pension benefits by another 20% by the year 2025.[4] Recent reforms must also be seen against the background of the adoption of neo-liberal ideas by the Japanese government. Since the mid-1990s, the officially expressed opinion on this point has been that the state should provide only a moderate level of benefits, and that whatever additional benefits are necessary should be covered by private provisions in the future.[5] Thus, the occupational pension reform of 2001 is of special significance for the future of the public-private pension mix in Japan, because the hope is that occupational provisions will play a bigger role in the future so that public benefits cuts can be compensated for.[6] Before discussing the actual amendments and the implications of the recent public and occupational pension reforms in closer detail, the next section provides an overview about the structure of the Japanese pension system in its current form.

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2 For a more detailed analysis of early pension policies in Japan, see CONRAD (2000a) 89-129.
3 See KÔSEISHÔ (1983) 85-87.
4 See Nihon Keizai Shinbun (22 March, 2000).
5 See KÔSEISHO DAIJIN KANBÔ SEISAKUKA (1994).
6 See NENKIN SHINGIKAI (1998).

III. THE STRUCTURE OF THE JAPANESE PENSION SYSTEM

1. The Public Pension System

The Japanese system of old-age income security consists of public, occupational and personal pension provisions. The first public tier is the Basic (*kiso nenkin*) or National Pension Insurance (NPI) (*kokumin nenkin*).[7] In principle, all residents in Japan between the ages of 20 and 59 are eligible, and are required to become subscribers to this scheme. Currently this system has 70.1 million members (see FIGURE 1). There are three types of insured persons:

"Type 1 insured persons" includes all residents in Japan between ages 20 and 59 regardless of their nationality. These are mainly the self-employed, farmers and non-employees. In principle, they are required to pay a fixed contribution of ¥ 13,300 per month (2002). However, low-income earners (about 17% of all Type 1 insured persons) are currently exempt from paying premiums.[8]

"Type 2 insured persons" are all employees in private industrial or commercial enterprises that regularly employ one or more workers.[9]

In contrast to Type 1 insured persons, Type 2 insured persons are automatically enrolled in the NPI when they become a member of the Employees Pension Insurance (EPI) (*kôsei nenkin*) or a mutual aid association (*kyôsai nenkin*),[10] which both provide second-tier earnings-related benefits. The premiums for these second-tier insurance systems include the premium to the NPI.

Currently, the EPI premium is 13.58% of the employee's yearly gross earnings (including overtime earnings, travel and family allowances including bonuses) divided equally between employee and employer.

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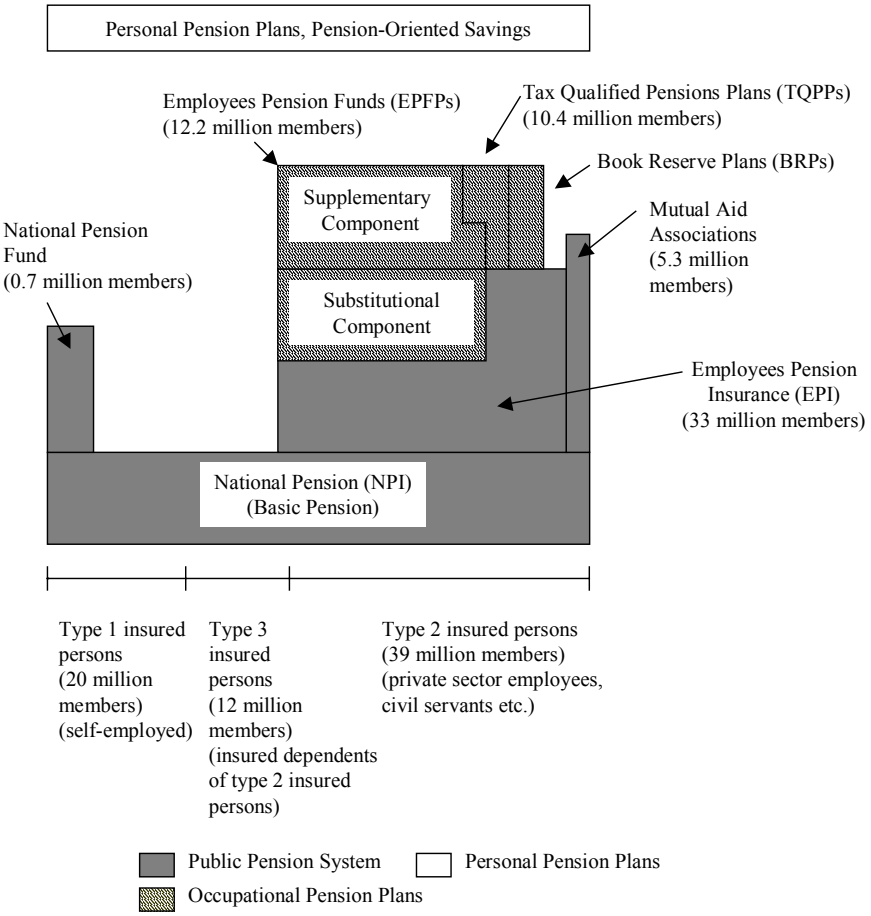
7 National Pension Insurance *(kokumin nenkin)* is the institutional name, whereas Basic Pension Insurance *(kiso nenkin)* refers to its function. The confusion about the wording results from the fact that until 1985 the National Pension Insurance was the sole pension system for the self-employed. In 1985 this system was reformed to create a non-income-related basic pension system for all residents. In this way, the National Pension Insurance became the Basic Pension Insurance. However, for the self-employed the National Pension Insurance is still the only regular public pension, so that for this group the usage of the term "Basic Pension" does not seem to be suitable. For this reason, this paper refers to the pension mostly by its institutional name, *i.e.* "National Pension Insurance" (NPI).

8 See KÔSEI TÔKEI KYÔKAI (2001).

9 If the enterprise is owned by an individual, as opposed to a corporate body (a judicial person in Japanese legal parlance), coverage is only compulsory if the firm regularly hires five or more workers.

10 This paper deals mainly with the National and Employees Pension Insurance. The regulations of the mutual aid associations are, in principle, similar to the Employees Pension Insurance, although the former tends to pay higher earnings-related benefits.

FIGURE 1 : The Structure of the Japanese Pension System



Source: Based on KÔSEISHÔ NENKINKYOKU (1998) 23.

At the time of pension pay-out, the EPI or the mutual aid associations transfer a part of their collected premiums to the NPI to cover the basic pension benefits. Whereas the benefits of the NPI are non-income-related and depend solely on length of participation, the benefits of the EPI and the mutual aid associations are earnings-related.

TABLE 1 : The Japanese Pension Market (1997)

Main Segments	Capital in Trillion ¥	Number of Insured in Millions
PUBLIC PENSION SCHEMES	170.0	70.3
National Pension Insurance (NPI)	8.5	70.3
Employees Pension Insurance (EPI)	125.7	33.4
OCCUPATIONAL PENSION SCHEMES	94.0	--
Book Reserve Plans (BRPs)*	13.6	n.a.
Employees Pension Fund Plans (EPFPs)	44.9	12.1
Tax Qualified Pension Plans (TQPPs)	18.5	10.3
PERSONAL PENSION SCHEMES	45.0	--
Private Insurers	15.3	13.4
Gojo Nenkin	10.0	--
Kanpo	10.0	4.5
OTHERS	12.6	--
ALL	321.6	--

*1996 estimate.

Notes: 1. The numbers indicate capital-funds only. They do not indicate the total amount of all pension entitlements.
2. The available data allow meaningful comparisons for the year 1997 only.

Sources: CURUBY & COMPANY (1998) 13-27; WATANABE (1998) 8; LIFE DESIGN KENKYÛJO (2000) 17 u. 23.

According to the NPI, "Type 3 insured persons" are non-working spouses of Type 2 insured persons. They are automatically insured through their working spouses and are not required to pay their own premiums.[11]

Current NPI benefits are paid out of currently collected premiums, but one-third of the benefit expenditure is subsidized out of the general budget of the government. According to the 1999 reform, the government's share is projected to rise to one-half of

11 In the case of divorce, the non-working spouse is only entitled to basic pension provisions. However, in contrast with, for example, Germany's *Versorgungsausgleich,* the non-working spouse is not entitled to the income-related benefits of the EPI or the mutual aid associations.

expenditure by the year 2004. EPI and mutual aid association benefits are 100% financed by contributions.

The monthly "model pension" of a "standard" couple (employed husband who has paid 40 years of contributions based on an income which equals the average employee's income during this entire period, and a full-time housewife) is currently ¥ 238,125. This amount provides a replacement rate – in relation to the average net income (including bonuses) of currently active male employees – of 59%. This model pension consists of ¥ 104,092 EPI pension and ¥ 67,017 NPI pension each for both husband and wife. The self-employed, as "type 1 insured persons", are only entitled to the NPI pension, which has a maximum amount of ¥ 67,017 after 40 years of contribution.

As TABLE 1 reveals, the Japanese public pension schemes still control enormous capital funds of ¥ 170 trillion (= 33.4% of GDP). However, as will be shown later, this does not mean that these systems are for the most part still capital-funded because there are already high entitlements which will be paid out over the coming years. Accordingly, the capital funds will slowly be melted down in the future to prevent a fast increase in contribution rates.

2. The Occupational Pension Plans

With regard to the number of participants and the amount of assets, three kinds of defined benefit schemes currently dominate the occupational pension market in Japan, namely, the Book Reserve Plans (BRPs), the Employees Pension Fund Plans (EPFPs) and the Tax Qualified Pension Plans (TQPPs). Defined contribution schemes have attracted only a small number of participants and they only control a comparatively small amount of assets.[12] Several reasons for the limited importance of these types of plans can be identified. There has been a broad consensus in the past on the part of Japanese employers that pension benefits were a "reward for effort"; employees considered pension benefits a form of deferred wages. Because of these perceptions it was natural to set up employer-sponsored plans that would pay a specified sum to qualified employees. The other important reason for the limited success of these plans is that authorities encouraged the founding of defined benefit plans by creating a comparatively favorable tax framework.

The perception of occupational pensions as a reward or as deferred wages explains why Book Reserve Plans (BRPs) for severance lump-sum benefits have always played a comparatively large role in the Japanese retirement context. These severance payments, paid to employees for faithful service, existed well before the introduction of corporate-type business entities in the Meiji period (1868-1912). The lump-sum benefits paid by BRPs depend on a number of variables such as the size of the company, the total length of employment, sex, level of education, and reason for leaving the company. Benefits

12 For the smaller defined contribution plans, see CONRAD (2001b) 37.

increase proportionally with the length of continuous employment; an early withdrawal from a company results in higher rebates.[13] BRPs receive preferential tax treatment under corporate tax law, which allows employers tax deductions for an amount equal to 40% of the accrued voluntary retirement lump sum benefits.[14]

Employees Pension Fund Plans (EPFPs) were first introduced in 1966. To establish an EPFP a firm must have 500 or more employees for a single-employer plan or 3000 or more employees for a multi-employer plan. Company unions and the Ministry of Health, Labor and Welfare must approve the establishment of a plan. EPFPs are used to contract-out the earnings-related part of the public EPI in return for lower social security contributions with the rebate rate. The benefits of an EPFP consist of two components. The substitutional component *(daikô bubun)* is directly linked to the remuneration-proportional part of the public EPI. In exchange for lower social security contributions, the EPFP assumes responsibility for paying this part of the EPI. Meanwhile, the EPI bears the costs for price and wage indexation. The difference between the regular social security contribution rate and the rate for participants in EPFP goes to finance the earnings-related, contracted-out benefits, which are now paid by the EPFP. Contributions to the substitutional component are shared equally by the worker and the firm. Employer contributions are treated as business expenses and are deductible from corporate income tax. Employees' contributions to the EPFP are completely exempt from income tax in the same manner as contributions for public social insurance programs. EPFP benefits are usually paid as annuities.

In addition to the substitutional component, the EPFPs are required to pay a supplementary component (*fuka bubun* or *purasu arufa*), which must not be less than 30% of the substitutional EPI benefits accrued while working for a firm. The supplementary component is an incentive tool used by employers to attract employees, and therefore the main reason for an employer to set up such a plan. Accordingly, most companies pay 100% of the contributions to finance this component. There are three types of EPFPs which differ according to how they calculate their benefits.[15] The most common type (85% of all plans) pays a so-called additional component *(kasan bubun)* on top of the substitutional and supplementary component.[16]

Tax Qualified Pension Plans (TQPPs) were first introduced 1962. Until then employees who reached retirement age would only receive lump-sum benefits paid by BRPs. TQPPs have been adopted mainly by small to medium-sized employers with 15 or more workers. The establishment of TQPPs requires approval from the Ministry of Finance which also oversees these plans. Theoretically, contributions have to be borne equally by employers and employees; however, 96.8% of the companies actually

13 See YAMAGUCHI (1999) 73-75.
14 See WATANABE (1996) 127.
15 For further details, see CONRAD (2000b) 256-257.
16 See KIGYÔ NENKIN KENKYÛJO (1998) 27.

pay the full amount of the contributions.[17] Employer contributions are treated as business expenses and are therefore deductible in corporate income tax liability. The funds are invested with life insurance companies, trust banks and/or investment management companies. The benefits are treated as retirement income and taxed in the miscellaneous income category of the personal income tax. Benefits can either be drawn as lump-sum payments or as annuities. However, most workers choose payment as a lump-sum benefit because this results in preferential tax treatment.

Whereas investment regulations for TQPPs and EPFPs have been fairly restrictive, since around 1997 these plans have been relatively free to invest their funds with life insurance companies, trust banks and/or investment management companies.

3. The Personal Pension Plans

As Table 1 indicates, personal pension-oriented savings are also an important source of income for Japan's elderly. However, a problem of definition arises because it is not entirely clear which forms of personal assets should be considered as earmarked for old-age provision. If we follow the official "Family Savings Survey" *(Chochiku Dôkô Chôsa)*, only 4% of personal savings are personal pension-oriented assets. In 1997, these assets amounted to ¥ 45 trillion. The pension adviser *Curuby & Company* estimates, however, that personal plans could soon total 10% of a projected US$ 18,000 billion of personal savings.[18]

The issue of definition is of paramount importance because the considerable capital funds in public and occupational pension schemes are tiny in comparison with the entire private financial assets of Japanese households, which reached ¥ 1,385 trillion in March 2001).[19] If we do not consider distributional and property issues, which are of course vital, we could arrive at the mistaken conclusion that the current financial problems relating to public and occupational pension schemes, which will be discussed later, could easily be overcome by drawing on these financial assets.

If we follow a narrow definition of personal pension-oriented assets, private insurers with 13.4 million pension insurance policies have a market share of roughly 30%. About 22% of all personal pension-oriented assets are invested with an association, called *gojo nenkin,* formed to manage the post-retirement assets of public employees. Many retirees who opt for lump sum payment of their pension benefits roll them over into *gojo nenkin*, which invests them mainly in loan trusts with trust banks. Another 22% of the pension-oriented assets are invested with the postal insurance *(kanpo),* as well as regional agricultural co-operative insurance organizations which offer personal pension products.

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17 See MURAKAMI (1997) 111-112.
18 See CURUBY & COMPANY (1998) 23.
19 See The Nikkei Weekly (2 July, 2001).

IV. THE ECONOMIC SITUATION OF ELDERLY HOUSEHOLDS IN JAPAN

Unfortunately, available statistics do not allow us to draw a comprehensive picture of the economic situation of elderly households in Japan. Issues of income and wealth distribution are still treated rather secretly in Japan and access to micro data, which might shed more light on these issues, has frequently been denied on the grounds of a possible breach of privacy. Thus, we can make only some general comments on this issue.

In general, the economic situation of the elderly in Japan can be described as favorable. In the 1990s the disposable income of the population aged between 65 to 70 years was about 90% of those aged 18 and over.[20] In terms of financial and housing wealth the position of the elderly was even better than those of younger generations. In 1995, the average savings of people aged over 65 were ¥ 24.9 million, well above the population average of ¥ 16 million. The rate of homeownership for people aged over 65 was 85.7%, which is higher than the rate of homeownership of all households that totals almost 60%.[21]

Of all households with people aged over 65 years, 96.6% receive some kind of public pension (1998). For 58% of those households, public pension income constitutes 100% of their total income, for 21% it makes up less than 60% of their total income.[22]

Working income constitutes a large share of the overall income of people aged 65 and over. In the lower (1st-3rd deciles) and middle income (4th-7th deciles) groups, working income makes up between about 24 to 45% of the overall disposable income. Capital income, including such from private pensions is under 5% in the lower and middle income groups, whereas net social transfers (including public pensions) to these groups constitute between 70% and just under 50% of the total disposable income.[23] Of all males aged between 65 to 69 years, 12.8% are beneficiaries of private pensions.[24]

The economic situation of Japanese elderly is also closely connected to their living arrangements. In fact, after the age of 60 there is a significant increase in the rate of cohabitation with their children. At the age of 65, slightly less than 50% of elderly live in households with three or more members.[25] Living in larger households in Japan is not indicative of low income levels and the consequent need to rely upon working income from working children. Nonetheless, high housing prices and rents as well as caregiving considerations are important factors for these arrangements.

Although the elderly in Japan enjoy on average a high standard of material well-being, the situation of elderly people living alone is, as in many other industrialized

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20 See OECD (2001) 27.
21 See SÔMUCHÔ CHÔKAN KANKYOKU KÔREISHAKAI TAISAKU SHITSU (1997) 113 u. 214.
22 See SHAKAI HOKEN KENKYÛJO (1999) 142.
23 See OECD (2001) 29.
24 See OECD (2001) 172.
25 See OECD (2001) 32-33.

countries, often associated with poorer economic conditions. For example, 20% of non-working women aged over 60 who live alone receive means-tested public assistance benefits.[26]

V. Recent Public and Occupational Pension Reforms: An Overview

Japan has recently enacted two important pension reforms which are likely to have far-reaching effects on the public-private pension mix in the coming years. First, the public pension reform, which was passed in 1999 and which became for the most parts effective in April 2000, and secondly, the occupational pension reform, which was passed in two separate laws in summer 2001 and which came into effect in October 2001 and April 2002.

Table 2 lists the most important measures of the public pension reform. Three measures are especially noteworthy. First, the complete gradual increase in the entitlement age for regular pension benefits to 65. By the year 2025, the partial pension, which was introduced with the 1994 pension reform, will be phased out. Second, a 5% cut of earnings-related benefits to newly commenced pensions (a grace period worked into the bill will delay the actual reduction until the fiscal year 2004). Third, the abolition of wage indexation for all pensions after commencement of payment (including those currently being paid) to people aged 65 and over. These pensions will only be indexed to the consumer price index in the future. As mentioned above, these measures combined will slash aggregate pension benefits by about 20% by the year 2025.

First, since April 2002, pensioners between the ages of 65 and 69 and who have additional working income are subject to an earnings test. The first-tier basic benefits are fully paid regardless of salary and wage earnings, but if the total amount of pension benefits and additional earnings exceeds ¥ 370,000, the earnings-related pension benefits are reduced by ¥ 10,000 for each ¥ 20,000 increment in wages. *Takayama* reckons that this earnings test may induce earlier retirement for those still working in their late 60s.[27]

Second, starting in April 2003, the calculation base for social security contributions changed. In addition to the normal social insurance premium charged on monthly earnings, the 1994 pension reform had introduced an additional contribution rate of 1% on bonuses. If we consider that the average bonus is 20% of an industrial worker's yearly salary,[28] then this was an important measure to increase pension revenues.

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26 See Takayama and Arita (1996) 150.
27 See Takayama (2001b) 3.
28 See Rôdôshô Seisaku Chôsabu (1994) 30.

TABLE 2 : Important Measures of the 1999 Public Pension Reform (enacted in April 2000)

Reform Measures	Effective by
EMPLOYEES PENSION INSURANCE (EPI)	
Contributions	
• During child-care leave employers are exempted from paying contributions (Hitherto only employees were exempted from contributions). When benefits are calculated today, it is regarded as if contributions had been paid.	April 2000
• Pensioners aged between 65 and 69 who have additional working income are subject to paying contributions.	April 2002
• Introduction of the new contribution base "annual earnings".	April 2003
Benefits	
• 5% cut to benefits of newly commenced pensions (grace period worked into the bill will delay the actual reduction until the fiscal year 2004).	April 2000
• Abolition of wage indexation after commencement of pension payment of people aged 65 and over. From now on indexation to consumer price index only.	April 2000
• Benefit cuts for pensioners with working income aged between 65 and 69.	April 2002
• Gradual increase of the eligibility age for remuneration-proportional benefits from 60 to 65 years. This results in abolition of the partial pension and the total increase of the normal entitlement age to 65 by the year 2025.	starting in April 2013
NATIONAL PENSION INSURANCE (NPI)	
Contributions	
• Up to 10 years postponement of students' contribution payments (if contributions are not paid retroactively, this is only counted as qualifying period).	April 2000
• Low income earners shall pay only half the normal contributions.	April 2002
• Increase of government's share of expenditures from one-third to one-half.	By 2004
Benefits	
• Abolition of wage indexation. The benefit level of NPI pensions will be decided every five years, at which point the development of the consumer price index in the previous five years is taken into account.	April 2000
PENSION RESERVE FUND MANAGEMENT	
• The pension reserve fund is to be gradually managed independently by the Ministry of Health and Welfare.	April 2001

Sources: SHAKAI HOKEN KENKYÛJO (1999); Nihon Keizai Shinbun (22 March, 2000) 1; In addition to the reform measures on the benefit side, the 1999 reform also introduced four important measures on the financing side.

However, this system was also highly unfair because these contributions were not taken into account when calculating the remuneration-proportional benefits; in this sense these contributions were similar to a 100% tax. In April 2003, the contribution base shifted from monthly earnings to annual earnings, including half-yearly bonuses. This widening of the calculation base means that a lower overall contribution rate will suffice to raise the same amount of contribution revenues. For this reason, the contribution rate was lowered from 17.35 to 13.58% in 2003.[29]

However, the rate will have to be raised gradually in future to finance increasing benefit expenditures over the coming years. TABLE 3 shows the latest official contribution hike schedule as it has been projected by the Ministry of Health, Labor and Welfare.

TABLE 3 : Officially projected contribution rates of the Employees and National Pension Insurances (May 2002)

Fiscal Year	**Employees Pension Insurance***			**National Pension Insurance**		
	State subsidy 1/3		State subsidy 1/2	State subsidy 1/3		State subsidy 1/2
2003**	17.35 (13.58)		17.35 (13.58)	¥ 13,300		¥ 13,300
2005	19.85 (15.50)		18,65 (14.58)	¥ 13,200		¥ 10,000
2010	22.35 (17.42)		20,96 (16.35)	¥ 17,200		¥ 13,000
2015	24.84 (19.34)		23,26 (18.12)	¥ 21,200		¥ 16,000
2020	27.34 (21.26)		25,56 (19.89)	¥ 25,200		¥ 19,000
After 2025	High proj. ***	29.4 (22.8)	26.5 (20.6)	High proj. ***	¥ 27,100	¥ 19,000
	Middle proj.	31.9 (24.8)	28.8 (22.4)	Middle proj.	¥ 29,600	¥ 21,600
	Low proj.	35.4 (27.5)	32.0 (24.8)	Low proj.	¥ 33,000	¥ 24,000

Notes:
* Contribution rates of employee's monthly gross earnings excluding bonuses; Numbers in brackets show contribution rates of employee's yearly gross earnings including bonuses.
** Data for 2003 show actual premiums, thereafter projected;
*** Assumptions of future birth rates: high: 1,63; middle: 1,39; low: 1,10.
Source: KÔSEIRÔDÔSHÔ (2002).

29 See TAKAYAMA (2001b) 7.

Before the last reform the maximum contribution rate to the EPI was projected to rise to 34.3% of monthly earnings (with a state-subsidy of one-third), now it is supposed to top at 31.9% (middle projection) in the year 2025.

The third important aspect of the 1999 reform is that it alters future revenue streams. In 2004, general revenues flowing into the NPI are to be boosted, with the state subsidy rising from one-third to one-half of the NPI's annual cost. Under this assumption the future contribution rates of EPI and NPI will be markedly lower as can be seen in TABLE 3. Yet, at the time of publication of this paper it is still unclear where the necessary tax revenues for the increase of the state-subsidy will come from.

The fourth area that will attract attention in the future is the shift in the management of the pension reserve fund which started in April 2001. Up until then, the Trust Fund Bureau of the Ministry of Finance managed the pension fund reserves on behalf of the Social Security Agency. The Trust Fund Bureau used this money as part of the Fiscal Investment and Loan Program. In overall terms, this program is a huge public financial institution whose main purpose is to provide long-term loans to public finance corporations, public corporations and agencies, local authorities and private companies. Now the pension fund reserves are to be managed independently by the Ministry of Health and Welfare. Over a period of seven years, funds amounting to ¥ 150 trillion, currently invested in the FILP program, will be transferred to the Ministry of Health, Labor and Welfare).[30] The use of the pension fund finances within the Fiscal Investment and Loan Program was hitherto highly problematic because the money was frequently used for politically motivated projects where the return on investment was lower than what could have been realized had the money been invested in a mixed portfolio in the capital market. However, it remains to be seen whether the Ministry will actually be able to invest the money efficiently and without political interference.[31]

Next, we will discuss the 2001 legislation of the occupational pension plans. The first law, effective since October 2001, concerns the introduction of defined contribution plans modeled on the U.S.'s so-called 401(k) plans.[32] The other law, effective since April 2002, concerns the regulations of defined benefit plans.

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30 See Nihon Keizai Shinbun (29 March, 2000).

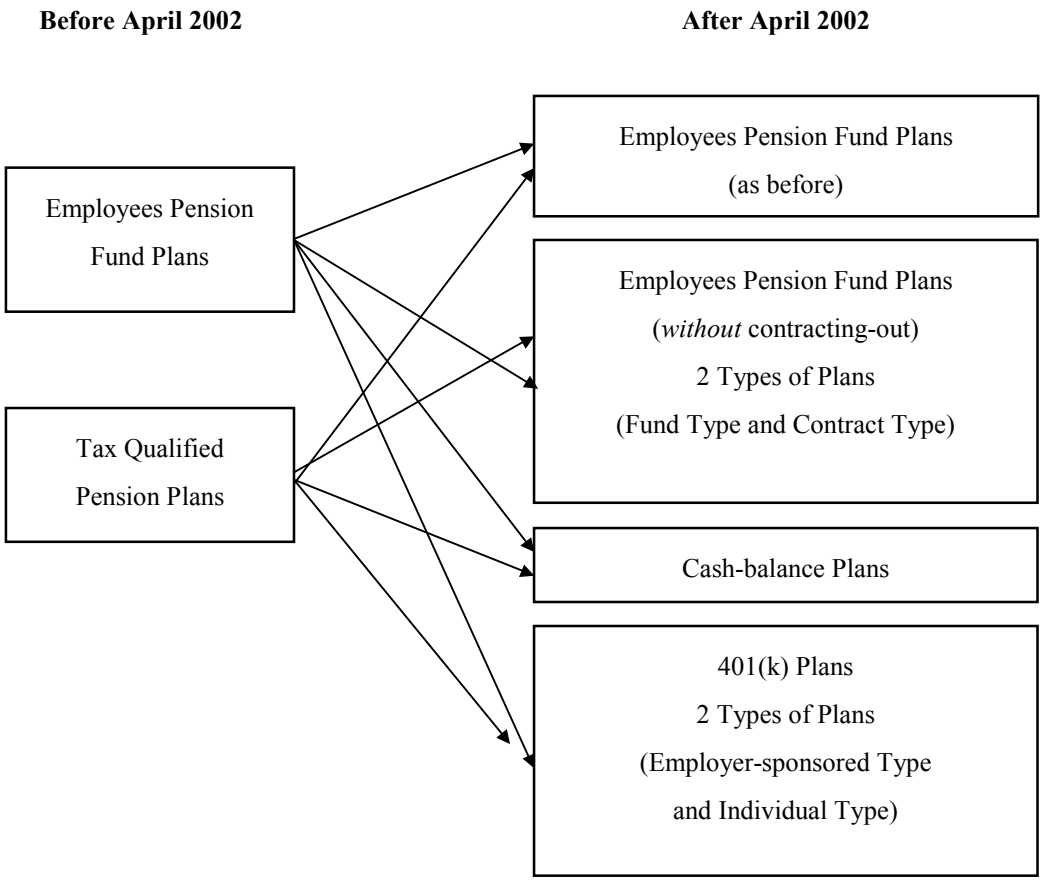
31 For a more detailed analysis of this issue, see CONRAD (2000b) and CONRAD (2001b) 77-82.

32 401 (k) plans in the USA are constituted as mutual fund-type investment vehicles designed to attract pension assets. In contrast to defined benefit plans these schemes do not guarantee a definite benefit level dependent on former contribution payments and qualifying times. Instead, the benefits are dependent solely on the investment returns yielded by contribution payments. Contributions to these plans are tax-deductible. In general, the employees make their own contributions, but in most cases the employers match these contributions. The employee can choose investment strategies according to his own risk adversity. Should the employee change his workplace, he has full control over his own contribution payments and their investment earnings (portability). In accordance with employee's service time in the company, he gradually becomes the owner of the employer's contributions and investment earnings (vesting). See KATZEFF (1996) 1-11, 108.

The key elements of the occupational pension reform are as follows:[33]

First, companies are given greater choices in terms of plan design. As FIGURE 2 indicates, companies can now transfer their current schemes to a number of new plans.

FIGURE 2 : The 2001 Occupational Pension Reform



Source: Own representation

33 See TAKAYAMA (2001a) (2001b); W.M. MERCER (2001).

Second, employers offering EPFPs will be permitted to divest themselves of the contracted-out substitutional component of their plan. This will permit plan sponsors to gain relief from paying that portion of the government earnings-related pension by transferring a lump sum of assets to the government. However, participants in these newly constituted defined benefit plans, called "Fund Type" *(kikinkei),* will no longer be granted an exemption from the asset tax of 1.173% that had been imposed only on TQPPs. The specific rules governing this restructuring of old EPFPs into the new type of EPFPs remain to be clarified. The Pension Fund Investment Fund will manage these assets and be responsible for paying the previously contracted out benefits.[34]

Third, companies offering TQPPs will be required to terminate them by March 2012.[35] The new legislation creates another new defined benefit scheme of the so-called "Contract Type" *(keiyakukei)* to replace existing TQPPs. Unlike the new defined benefit plans of the "Fund Type", setting up these schemes does not require a pension entity separate from the employer.[36]

Fourth, after employers and employees have worked out a set of rules agreeable to both parties, companies can set up defined contribution 401(k) plans of the "Employer-sponsored Type" *(kigyôkei).* Entitlements for existing defined benefit plans may be transferred into these new schemes. If the employer does not have a contracted-out EPFP or a TQPP, an annual tax-qualified contribution of up to ¥ 432,000 per employee is permitted. If the employer already runs a defined benefit scheme, only ¥ 216,000 per year can be put into the 401(k) plan. No matching employee contributions are allowed.

Fifth, self-employed and non-salaried workers can contribute to a new type of 401(k) plan of the "Individual Type" *(kojinkei).* The tax-qualified ceiling is ¥ 816,000 per year. Employees whose company does not have an occupational pension scheme (excluding BRPs) can also contribute up to ¥ 180,000 a year to such a personal "Individual Type" 401(k) scheme.

Sixth, participants must be provided with at least three investment choices for their money invested in the new type of 401(k) plans. The employer contributions vest in three years and are portable if the worker changes companies. 401(k) plan pay-outs may be taken as a lump-sum or annuity as early as age 60 and pay-outs must commence by age 70.

Seventh, for all types of plans, stricter rules with regard to minimum capital, fiduciary duty and disclosure standards apply.

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34 See CERULLI ASSOCIATES (2001).
35 See LIFE DESIGN KENKYÛJO (2001) 24.
36 See TAKAYAMA (2001a), (2001b).

VI. Implications of Recent Reforms

1. Financial Sustainability

As pointed out in section III, Japan's public pension schemes still manage immense capital funds. In the cases of EPI and NPI – the most important public schemes – the ratios of pension fund reserves to yearly expenditures *(tsumitate doai)* are 6.1 and 3.3 respectively (2000).[37] On the other hand, large pension entitlements shall be paid out in the coming years so that these reserves will have to be melted down slowly to prevent high immediate increases of contribution rates.[38]

When judging the impact of the last pension reform on the financial sustainability of the public pension finances, official projections of the Ministry of Health, Labor and Welfare are not very helpful, because their underlying assumptions have proven to be too optimistic, especially with respect to the development of the birth rate. Neither the calculation methods nor the results of the five yearly actuarial reviews are disclosed in detail.[39] Moreover the financial projection, which was the base for the 1999 reform, assumed a rise in the birth rate to 1.61 by 2050, although the actual birth rate has been sinking for years. In 2000 the birth rate was 1.35.[40] Because there are no significant new family policy measures that would allow a positive assessment of the development in the birth rate, official statistics should be regarded with caution.

In some earlier papers, this author based his judgement regarding this issue on projections which were published by a group of well-known Japanese economists in 1997.[41] These projections differ from the official calculations in that they specify assumptions which are more realistic and up-to-date; they include the interaction of macroeconomic variables, and they simulate the effects of different reform measures. Although the reform measures tested by the researchers and the actual amendments of the 1999 reform differ in various aspects, this author has argued that we can nevertheless reasonably assume that the 1999 reform measures will considerably improve the finances of the EPI and safeguard its financial sustainability.[42] This positive evaluation has now been supported by latest calculations by *Katô* (2001) and *Oguchi* and *Hatta* (2001) who demonstrate that the EPI is not likely to run any deficits in the projection period up to the year 2050.[43]

This positive evaluation with regard to financial sustainability of the EPI does not mean, however, that contribution hikes will not be required in the future. In fact, the above named calculations are all undertaken under the assumption of an increase of the

37 See Shakai Hoken Kenkyûjo (1999) 205-209.
38 See Conrad (2000a) 155-161.
39 See Conrad (2000a) 170-173.
40 See Nihon Keizai Shinbun (09 August, 2001).
41 See Keizei Kikakuchô Keizai Kenkyûjo (1997).
42 See Conrad (2001b) 56–60.
43 See Kato (2001) and Oguchi and Hatta (2001).

contribution rate as projected by the Ministry of Health, Labor and Welfare (see TABLE 3). With the introduction of annual earnings, including half-yearly bonuses as the new contribution base in 2003, the contribution rate was lowered to 13.58% so that the absolute burden remains the same. Following this, however, the contribution rate will be raised gradually to meet increasing expenditures. The officially projected contribution rate (after the increase of the state-subsidy to the NPI from one-third to one-half of the expenditures and the adoption of the new contribution base "annual earnings") is estimated to top at 22.4% of total compensation in 2025 (see TABLE 3). However, given the unreliability of such projections and the over optimistic assumptions of the official calculations, we should rather expect the future contribution rate to be a few percentage points higher than that. The ratio of EPI fund reserves to the expenditures is supposed to sink from the current 6.1 to 4.0 in 2025 (in the case of a state subsidy of a half of NPI expenditures.[44]

The financial situation of the NPI is much more difficult to assess. Hitherto NPI benefit levels depended largely on political decisions, but were frequently raised in line with changes in the net wages of the working population and the development of the consumer price index. The 1999 pension reform stipulates that starting from April 2000 the benefit level of NPI pensions will be decided every five years, at which point the development of the consumer price index in the previous five years will be taken into consideration.[45] One reason, which makes it hard to judge the sustainability of the NPI finances is the fact that this scheme faces a serious problem with people who are not paying their contributions, although they are in principle obliged to do so. According to *Oguchi* and *Hatta*, the percentage of the population, which does not pay NPI contributions has been rising steadily and reached almost 40% in 1999.[46] This problem of contribution evasion might become even more pronounced if the contributions, but not the benefits, are raised in the future. Another factor which makes it hard to assess the future of the NPI is the question of how the government is going to finance the increase of the state subsidy from one-third to one-half by 2004[47] and how this will influence future contributions. Although the official projection indicates that, given a state subsidy of one-half of the benefits, the contributions only need to rise to ¥ 21,600 by the year 2025 – instead of ¥ 29,600 in the case of a state subsidy of one-third –, this calculation should nevertheless be regarded with some caution. Following assessments made by *Oguchi* and *Hatta*, it seems reasonable to argue that the 1999 reform has considerably improved the financial position of the NPI. However, since most of this improvement is due to the planned increase of the state subsidy, the real net improvement might be rather small.

44 See SHAKAI HOKEN KENKYÛJO (1999) 205.
45 See SHAKAI HOKEN KÔHÔSHA (2000) 2.
46 See OGUCHI and HATTA (2001).
47 See The Nikkei Weekly (3 April, 2000) 7.

2. Distributive Effects and the Role of the Basic Pension

This section discusses shortly the influence of the 1999 pension reform on issues of inter- and intra-generational distribution and the role of the basic pension.

Inter-generational distributive effects are inherent to all pay-as-you go systems because initial age cohorts receive benefits without having paid equivalent contributions. Since benefit formulas and contribution rates change over time, the benefits and contributions of public pension schemes vary between generations. These effects have caught the attention of many Japanese economists and there are a number of so-called "money's worth calculations"[48], which have calculated the "internal rate of return" or the "benefit-tax-ratio" of the Employees Pension Insurance for different age cohorts.

Although these calculations are sometimes problematic in the sense that they tend to focus only on old age benefits, neglecting widow/widower's and disability benefits, they unanimously demonstrate that today's pensioners receive benefits several times greater than what they paid as contributions and what they would have received had the money been invested in similarly safe investments. On the other hand, birth cohorts since the beginning of the 1960s will receive negative net-returns in the future.[49]

The results of these calculations have strongly influenced the public debate on pension reform and "re-establishing" inter-generational fairness was named as one of the main objectives of the latest reform.[50]

How then, do the 1999 reform measures influence this pattern of inter-generational redistribution in the future? A tentative answer to this question can be given even without exhaustive calculations, if we consider to what extent the reform measures reduce the benefits (increase the contributions) of current or soon to be retirees without reducing the benefits (increasing the contributions) of future pensioners. It can be shown, for example, that immediately increasing the contribution rate to a sustainable level would improve inter-generational equity, because age cohorts that are close to retirement age have to bear a relatively larger burden. The same is true for a temporary abolition of net-wage indexation.[51]

However, the 1999 reform probably did not improve inter-generational equity. On the contrary, a recent calculation by Katô suggests that the gradual increases of contribution rates and entitlement age in the future will result in a relatively higher burden for younger age cohorts.[52] The very gradual increase of the normal entitlement age to 65 until the year 2025, as part of the 1994 and 1999 reform measures, will only partly

48 See for example HONMA ET AL. (1984); UEDA, IWAI and HASHIMOTO (1987); TAKAYAMA ET AL. (1990); ASO (1992).

49 For a more detailed discussion of these issues, see CONRAD (2000a) 220-231 and CONRAD (2001b) 67-74.

50 See SHAKAI HOKEN KENKYÛJO (2000) 13.

51 See HATTA (1998).

52 See KATO (2001) 73-89.

effect the post-war baby boom generation, who is still to receive comparatively high benefits. The new 5% benefit cut concerns only newly awarded pensions; current retirees do not have to shoulder a heavier burden. Finally, the abolition of net-wage indexation will lower pension benefits for all generations in the same way, and thus does not improve the relative position of younger cohorts. Consequently, although the improvement of inter-generational equity is frequently named as one of the major objectives of reforms, the 1999 measures have in fact not improved the position of younger age cohorts. One reason for this outcome might be due to the fact that alienating older voters would prove to be a risky strategy for the Liberal Democratic Party, which has been in power for a greater part of the post-war period, since older voters tend to vote in greater numbers and constitute a core group of supporters for this party.[53]

How will the 1999 reform influence intra-generational distribution of the public pension system?

Although it is frequently argued that any targeted vertical income position can be better achieved through a progressive (income) tax system and social assistance benefits, in most countries, including Japan, public pension systems still count a re-distributive function as a part of their goals.

In principal, the Japanese pension system is designed as a multi-pillar system in which the NPI fulfills the minimum income and redistributive function and the EPI performs the savings function. Thus, to a certain extent the system follows the philosophy of functional differentiation as it has been promoted by the *World Bank*.[54] In general, such a functional differentiation is able to minimize the trade-off between social and individual equity aspects and can lead to higher "target efficiency".[55]

As described above, the NPI insures three types of participants. Whereas the fixed contributions and benefits of the "Type 1 insured persons" (mainly the self-employed) are closely related, this kind of equivalence principle does not hold for "Type 2 insured persons" (employees). Employees do not pay fixed contributions to the EPI, but a ratio of their working income – currently 13.58%. The remuneration-proportional benefits of the EPI increase in accord with higher contributions. In contrast, the benefits from the basic pension (NPI) are not related to contributions; they depend solely on the length of participation. "Type 3 insured persons" (non-working spouses of Type 2 insured perons) benefit directly from a redistribution because they are entitled to NPI benefits without paying contributions. On the other hand, non-working spouses of the self-employed are required to pay full contributions to the NPI. This system becomes even more complicated if we consider the different financing sources for this scheme, currently two-thirds participant contributions and one-third state subsidies.

53 See for example TALCOTT (1999).
54 WORLD BANK (1994).
55 See KLANBERG and PRINZ (1988).

Because of the system's complex setup, the distributive effects cannot be exactly quantified.[56] However, on a higher level of aggregation we can see that "Type 1 insured persons" receive benefits from the basic pension system that are altogether higher than what they pay as contributions and taxes.[57] The same is true for those insured by mutual aid associations, including their non-working spouses. On the other hand, the overall benefits of the EPI-insured (including non-working spouses) are lower than their overall financing burden.[58]

These findings illustrate the fundamental problem of the Japanese basic pension system, where redistribution depends more on the insured group than on actual neediness. Within the Type 1 group, earners of low incomes probably constitute a larger fraction than they do within the Type 2 group (although the data to support this statement is insufficient). Nonetheless, it is at least debatable whether those self-employed persons who constitute the majority of participants insured in the Type 1 group are, in general, a needy constituency worthy of income redistribution. This is definitely true for the insured of the mutual aid associations whose remuneration-proportional benefits are frequently higher than the ones paid by the EPI.[59]

The fundamental problem of the Japanese basic pension system is that, although it has a certain functional differentiation, it still aims to achieve two conflicting objectives within the basic pension pillar. Whereas the tax-financed state subsidies stress the social equity aspect (tax-transfer model), where all members of society are taxed according to their ability to pay, the contribution-based financing mode stresses the individual equity aspect by linking former contributions and later benefits.[60]

How does the 1999 reform influence this pattern of intra-generational redistribution? The increase of the state subsidy to one-half of basic pension expenditures by 2004, part of the last reform, does not fundamentally change the above assessment. Although the planned increase of the state subsidy shows that there is a growing awareness of problematic distributive effects, a parametric change will not result in higher "target efficiency". It is indeed doubtful whether a combination of contributions and tax subsidies for the basic pension makes much sense, mainly because the resulting distributive effects remain largely opaque.

In addition to the complicated distributive effects generated by the NPI system there is also the issue of the adequacy of its benefits. In fact, the NPI model pension is supposed to cover the basic costs for food, clothing and housing of a non-working, 65-year old pensioner who lives alone. Survey data show that ¥ 72,336 per month are needed to cover these expenses. However, although the current model NPI pension of ¥ 67,016 is

56 For a more detailed discussion of this issue, see CONRAD (2000a) 240-245.
57 This calculation is based on the simplified assumption that all insured shoulder the same tax burden.
58 See CONRAD (2001b) 69-73.
59 In FIGURE 1, this is indicated by a longer vertical column.
60 See THOMPSON (1983) 1436-1438.

lower than this level, the Ministry of Health, Labor and Welfare does not argue in favor of an increase of the model pension, but rather in adopting a different cost-of-living indicator.[61] Even when we disregard the rather hairsplitting argument about a suitable cost-of-living indicator, the model basic pension is definitely lower in comparison to the benefits paid by the national public assistance system. The benefit levels of the public assistance system are set nationally and vary among local municipalities according to variations in cost of living across the country. For a two-person, elderly household (male 72, female 67) this subsistence level varies between ¥ 116,120 and ¥ 149,989 among regions. For a single woman aged 70, this level ranges from ¥ 84,064 to ¥ 108,506. If the general assistance standard does not meet needs, a special standard is additionally applied to cover housing deposits, rent and necessary repair costs up to ¥ 70,000.[62] These numbers indicate that the current model basic pension for an elderly couple, ¥ 134,032 (¥ 67,016 x 2), suffices to maintain a subsistence level (without additional housing assistance) in some regions. However, the basic pension for a single-person household does not even meet the lowest subsistence level. In conclusion, the basic pension system hardly provides an adequate minimum income.

How does the 1999 reform influence this assessment? According to the reform basic pension benefits are only indexed to prices after commencement of payment in the future. Thus, the basic pension is likely to continue to lose its role as a guarantor of an adequate minimum income.

3. Changing the Public-private Mix in Pensions

After evaluating some of the more specific aspects of the latest public pension reform, we will now take a somewhat broader perspective and discuss the possible future outcome of the official reform strategy, *i.e.,* to offset recent public pension cuts by the promotion of occupational pension schemes. For various reasons the chances of success for this replacement strategy appear to be rather limited.

First, occupational pension provisions are first of all a means to motivate and attract a certain type of employee.[63] For this reason, human resource considerations are at least as important as the legal and tax environment when deciding on the implementation or modification of pension plans. Against the background of the ongoing restructuring of Japanese businesses and the resulting massive lay-offs, an expansion of occupational benefits has little place in the current primary objectives of most companies.

Second, the current diffusion of occupational pension benefits is characterized by big differences between small, medium-sized and larger companies. Whereas the core work force of bigger companies can expect generous lump-sum benefits plus occupa-

61 See KÔSEISHÔ NENKINKYOKU (1998) 179-180.
62 See KÔSEI TÔKEI KYÔKAI (1998) 99; EARDLEY ET AL. (1996) 248.
63 See LOGUE and RADER (1998) 3-13.

tional annuities, employees of smaller companies generally receive markedly lower benefits. Since public benefits are being cut for all insured in the same way, while occupational provisions are, if at all, not uniformly extended, the inequality of incomes will inevitably rise in the long-term.

Third, many occupational pension plans are currently in a dire financial situation. The current crisis of these schemes is closely related to the ailing Japanese stock market but also to obsolescent accounting and calculation practices. Until 1997, the government's actuarially mandated deferral interest rate for EPFPs and TQPPs (*i.e.,* the expected rate of return of these defined benefit schemes) was set at 5.5%. However, the yield from fund reserves has been substantially lower than this deferral interest rate for several years because of an ailing stock market and a continued monetary policy of low interest rates. As a result of rigid actuarial assumptions and a number of investment restrictions, many EPFPs and TQPPs have carried unrealized losses *(fukumi-son).* For many years, a reluctance to sell these unprofitable holdings has prevented a management of investments that is oriented toward earning returns. Even after the "deferral" interest rate was lowered for the first time in 1997, many funds kept using the old rate of 5.5% because switching to a lower rate would have made the problem of under-funding visible.[64] So far, the magnitude of the funding problem has been impossible to quantify because plan sponsors have not revealed enough financial data. New accounting rules, which came into effect in March 2002, will require all such liabilities to be disclosed in the future.[65] If we consider the fate of the 27 leading Japanese companies that reveal most of their pension finance data in the U.S. under the Generally Accepted Accounting Rules, we can already catch a glimpse of the magnitude of this problem. At the end of fiscal year 1996, these companies had, on average, an under-funding problem of ¥ 140.8 billion, which was equivalent to 15.5% of their combined shareholders' equity. Since these companies are among Japan's best companies, we can rightfully assume that the situation in the rest of the market is much worse.[66] High pension expenses arising from under-funding will negatively affect net income, price/earnings ratios, debt/equity ratios and cash flow. Since many companies fear these unpleasant revelations, they have gone ahead and recognized their pension fund deficits, shoring up their funds. In fiscal year 1998, ending in March 1999, 230 defined benefit plans received contributions from sponsoring companies to cover shortfalls.[67] In fiscal 1999, companies paid ¥ 1.01 trillion to 1800 EPFPs. Nearly every EPFP received additional funds to cover pension shortfalls. About a third of Japan's major companies contributed to their pension plans through specially designed trusts to offset unfunded liabilities. This allows them to remove contributed portfolio shares from their balance sheets,

64 See WATANABE (1998) 10.
65 See OECD (2000) 129.
66 See ASIA AGENDA INTERNATIONAL (1998) 15.
67 See SHIBATA (1999) 30.

which in turn shrinks their asset base and opens the way for more efficient use of assets.[68]

Regulations concerning EPFPs provide fairly strict protection for the vested rights of employees. This obliges the EPFPs to shore up their funding, which is not the case with TQPPs. Nevertheless, around 10% of all EPFPs had to lower their pay-outs during fiscal 2000.[69] Small and medium-sized companies, which constitute the largest share of the sponsors of TQPPs, often lack the financial resources to eliminate pension shortfalls. An increasing number of companies are therefore allowed to dissolve pension plans. In recent years, an average of 3,000 to 4,000 plans per year ceased their operations.[70]

Because of these current problems it can be expected that many companies will make use of the option to shift their defined benefit plans into defined contribution plans – thereby shifting the investment risk to the employees. However, this does not rid them of the responsibility to close existing financing gaps in the future (at least as far as EPFPs are concerned). Consequently, there will be reluctance to extend existing occupational provisions.

Fourth, the new legislation has introduced stricter protective regulations on the fiduciary duties and disclosure standards of the new defined benefit plans (Contract Type and Fund Type), which are likely to lead to higher administration costs. Therefore, many companies might terminate their TQPPs, but without introducing new defined benefit or defined contribution schemes instead.[71]

Fifth, the new 401(k) plans have a relatively low level of tax-qualified contributions.[72] The low employer contribution ceilings reflect the government's reluctance to allow more compensation to be exempted from tax in a time of economic depression and rising fiscal deficits. This low tax-qualified cap, together with a 1.173% special annual corporate tax on pension assets, makes these plans unattractive at the moment. Although experts assume that the Japanese 401(k) market will rise to about ¥ 50 trillion in the next 10 years, the initial takeoff is expected to be rather slow because of the aforementioned problems.[73] According to a survey carried out by the Nihon Keizai Shinbun for the fiscal year 2001 which centered on stock market listed companies, only 24% of the responding companies named 401(k) plans as the pension plans they would like to introduce in the future. On the other hand, only 4% of the responding companies were considering the introduction of defined benefit EPFPs.[74]

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68 See The Nikkei Weekly (31 July, 2000) 17.
69 See Nihon Kinyû Shinbun (19 October, 2000) 10.
70 See Nihon Keizai Shinbun (18 August, 2000) 3.
71 See TAKAYAMA (2001b) 15.
72 In contrast, in the United States employee contributions may total $ 10,500 per year.
73 See Reuters (6 August, 2001).
74 See Nihon Kin'yû Shinbun (19 October, 2001).

Sixth, with the exception of the 401(k) plans of the "Individual Type", personal pension provisions are not supported by tax-qualified contributions and even the "Individual Type" private pensions have a very low tax-qualified ceiling of ¥ 180,000 per year for an employee in a private company. Unlike, for example, the newly introduced personal pensions in Germany, there are no subsidies for low income earners, so that there is a substantial risk that only those who already have sufficient savings will be able to put money into additional private provisions.

Even if some of the shortcomings of the current legislation can be addressed in the future, three tendencies support the argument that the shift in the public-private mix will eventually lead to growing inequalities among Japanese households. First, unlike most public pension schemes, private schemes usually do not include redistributive elements that would compensate for a low level of participation in the labor force during working life, low wages, or periods of non-employment. Second, occupational pension schemes frequently cover only the core workforce, while part-time workers are not included. Third, an occupational pension, where the employee bears some or all of the expense of accumulating savings, requires a certain level of income so that current consumption is not unduly restricted.

In her transnational analysis, *Behrendt*[75] confirms that private pensions (predominantly occupational pensions) have reproduced or even strengthened existing inequalities in the labor market. However, the study also shows that a high degree of inequality is not necessarily a characteristic of private pensions as such, but strongly depends on other policy factors. Regulation of private schemes can cause a large difference in distributive effects. For example, Finland and other Scandinavian countries have relatively high degrees of equality in private pension distribution, partly because private provisions are mandatory in some of these countries. Since Japan is currently not considering making private schemes mandatory, it is reasonable to expect that the pension inequality will increase in the future. How we judge this development largely depends upon our view of social equity as a moral value underlying the welfare state. Whereas some egalitarians argue for "equal opportunity", others are more concerned about "equal outcomes".[76] Followers of the latter school of thought would naturally argue that Japanese pension policy needs better regulation and presumably mandatory private provisions – either occupational or personal. Conversely, for followers of the "equal opportunity" school of thought the outcome of current pension policies is not a major concern.

75 See BEHRENDT (2000) 18-23. According to her, the study did not include Japan because of a lack of suitable data.

76 See GOODIN ET AL. (1999) 28-30.

VII. CONCLUSION

This paper has sought to discuss recent public and occupational pension reforms in Japan. It has revealed that the latest reform of the pension system had a considerable positive impact on the financial sustainability of the public pension finances. However, major problems in distributive effects and minimum income security remain. Although the government claims to have improved inter-generational fairness with the last reform (*i.e.* relieve the contribution burden of younger age cohorts and increase the burden for older cohorts), it seems likely that it resulted instead in a relatively heavier burden for younger cohorts. The last reform also fares badly with regards to improving intra-generational fairness. The fundamental problem here is that the basic pension system, although it follows a certain functional differentiation, still aims to meet two conflicting objectives by combining two financing modes. Whereas the tax-financed state subsidies stress the social equity aspect, where all members of society are taxed according to their ability to pay, the contribution-based financing mode stresses the individual equity aspect by linking former contributions and later benefits. Moreover, the basic pension system tends to favor "Type 1 insured persons", who are not, by definition, a needy group who require income redistribution. The increase of the state subsidy to one-half of basic pension expenditures by 2004, instituted as part of the last reform, does not fundamentally change this assessment.

The official replacement strategy regarding the new public-private mix in pensions is problematic because so far it lacks sufficient supportive measures such as higher tax-qualified contributions, or state subsidies for low income groups to foster the new occupational and/or personal pension plans. As a result and partly due to these problems and partly due to more general considerations, it is likely that the pension distribution will show increasing disparities in the coming years. This will further strengthen the already noticeable trend of increasing inequality in income and wealth among Japanese households.[77]

Rising economic inequality might not be a problem if only there were effective instruments to ensure an adequate minimum income for the elderly. However, with its low benefits the basic pension system in Japan does not fulfill this role. This is problematic since means-tested social assistance is still highly stigmatized and the take-up rate is low. Only 25 to 30% of those actually eligible in Japan receive these last-resort benefits.[78] Thus, it seems that both the basic pension system and the public assistance system are in need of reforms which will accompany the evolving new public-private mix in pensions.

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77 For a brief overview of the recent development in income and wealth inequality in Japan, see CONRAD 2001.

78 See ESPING-ANDERSEN (1997) 184.

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ZUSAMMENFASSUNG

Der Beitrag untersucht einige zentrale ökonomische Wirkungen jüngster japanischer Reformen der öffentlichen und betrieblichen Alterssicherung. Im Mittelpunkt der Untersuchung stehen dabei die Auswirkungen der Reformen auf die finanzielle Stabilität der öffentlichen Rentenfinanzen, die inter- und intragenerative Umverteilung, die Minimaleinkommenssicherung sowie den öffentlich-privaten Rentenmix.

Angesichts einer rapide voranschreitenden Bevölkerungsalterung stehen die sozialen Sicherungssysteme in Japan vor einem erheblichen Anpassungsdruck. Dies gilt besonders für das öffentliche Rentensystem, das wie in vielen anderen Ländern weitgehend umlagefinanziert ist – eine abnehmende Zahl von Beitragszahlern muß eine immer größer werdende Zahl von Rentenempfängern finanzieren. Die von der Regierung verfolgte Reformpolitik zielt darauf ab, die vorgenommen Leistungseinschränkungen bei der öffentlichen Rentenversicherung durch einen Ausbau der betrieblichen Alterssicherung zu kompensieren.

Die Analyse zeigt, daß sich die letzte Rentenreform sehr vorteilhaft auf die öffentlichen Rentenfinanzen auswirkt hat. Andererseits wurden bestehende Probleme im Bereich der Verteilungswirkungen und der Minimaleinkommenssicherung nicht angegangen bzw. verstärkt. Obwohl die Ausgestaltungsoptionen der betrieblichen Alterssicherung erheblich erweitert wurden, ist angesichts der aktuellen Finanzierungsprobleme der Betriebsrenten, der bisherigen Verbreitung dieser Systeme und der unzureichenden steuerlichen Rahmenbedingungen davon auszugehen, daß die Leistungskürzungen der öffentlichen Alterssicherung ohne weitere Reformen nicht kompensiert werden können. Es steht vielmehr zu erwarten, daß die Alterseinkommensverteilung in den kommenden Jahren sehr viel ungleicher ausfallen wird als heute. Um längerfristig Probleme bei den unteren Einkommensschichten zu verhindern, sind weitergehende Reformen des Grundrenten- und Sozialhilfesystems notwendig, die die „Privatisierung" der Alterssicherung sozialverträglich begleiten.