Review and Proposal for the Japanese Social Security System, Mainly Focusing on the Possible Reform Proposals for the Pension System

Jun-ichi Ozawa
Director, Biophilia Rehabilitation Academy

Abstract
The social security system was originally established in the feudal period of Tokugawa for helping low-income groups, followed by the pension system for the defense groups prepared by the Meiji government. This system was developed for the government officer and later for the private sector in the 1960s. During the early stage of the modern period, thanks to rapid economic growth, no financial problem was found fortunately. This situation has completely reversed recently due to several reasons; stagnation in economic growth, growth of elder groups, lack of proper financial strategy, organizational problems in the enforcement of the social system, and uneasiness among the nation. This paper was prepared to show a brief outline of the recent history of the social system in Japan and proposes some alternatives to be taken by the government.

Keywords: Social security system, Pension system, Japan, Reform proposal, Population pyramid, Revenue and expenditure

1. Introduction
More than 100 years of history of the social security system in Japan shows that it developed gradually under the influence of the western system. Its origin goes back to more than 1,000 years ago when low income groups were supported by the rulers who respected the doctrine of Buddhism. Its modern system was developed at the beginning of Meiji Era (100 years ago) as a pension system for soldiers and government officials. Then, target of the pension system was gradually expanded to other groups (e.g. officers and workers of private companies, and normal citizens).

The other social systems, such as the health care system, poor law and support program for the handicapped, etc were prepared along with it. The social security system as a whole showed its modern style in the 1960s. The system has faced incremental changes since then. In this process, we learned that the system is closely and directly related with macroeconomic development of the country and political factors; rapid economic growth from 1960s to 1980s, partly coupled with population growth, favorably supported the sound development of the system and left no problem with its financial management.

Politicians also supported the development of the system, especially when the Socialist Party took office. Thanks to this social and economic environment, additional support programs were prepared for the system by increasing pension payment. As was expected, their actions increased the financial burden of the nation and ineffectiveness. No later than 1990s, this fact was publicly recognized and since then, reform and restructure of the system have been an inevitable issue. In this short paper, the development of the system is briefly overviewed and, some issues within the system are raised with a few proposals for improvement of the system.

2. Beginning of Social Security System in Japan
During the Tokugawa period (some hundred years ago), the poor law was formally established, and the pension program was prepared only for soldiers and government officers later during the Meiji era (100 years ago). The pension system, health care and other programs were gradually expanded. The system showed its complete form in the early 1960s, when the national insurance system finally

Received 20 September, 2012
covered all the citizens and when a new pension system was prepared to cover SMEs and normal citizens. Then the social security system became a more comprehensive system for a modern country. The system is now composed mainly of the following programs.

1) pension system  
2) health care program  
3) public assistance policy

The Japanese system, influenced also by European and U.S. systems, is now completely in compliance with the international criteria adopted by the ILO, including the following key categories; i) elderly, ii) bereaved family, iii) handicapped, iv) industrial accident, v) medical care, vi) family, vii) unemployment, viii) house and ix) public assistance.

3. Importance of the Ideal Population Structure and Economic Growth

A sound pension system will be maintained on the condition that there is a continual and growing economic development and at least proper population growth. Japan experienced economic growth after WWII. In the 21st century, it unexpectedly experienced decreasing domestic demand and sub-prime loan crisis originated in U.S.A. These effects accelerated national financial debt now amounting to 800 trillion yen and the government continues to issue national bonds to cover the deficit.

Population structure is more important factor in maintaining the social security system. The system is properly managed with a triangular population pyramid. The ideal structure was seen for a while after WWII. But when a big senior group (or Baby boomer generation) born between 1947–49 took large share and population of the following generations did not increase as was expected, the population pyramid was distorted. It continues to change its ideal structure towards 2055 shown in Fig. 1 based on national, statistical data.

Population is already decreasing in Japan with a birth rate of 1.3 and the number is estimated as 90 million in 2055 when only 1.2 persons in the working generation, on average, will to support 1 retired person. This well-known estimation gives unfairness to a young generation who has to pay for the retired generation and might not get a return in their own retirement. Unfairness between senior and youth, rich and poor, urban citizens and rural population, and handicapped and non-handicapped
does exist in these days. Population is now a key factor that affects the social security system and economic conditions in Japan.

4. Key Issues

Based on the macroscopic observation restricting the social system, it is useful to raise the key factors and issues for further discussion. Obligation of the pension payment was additionally applied to younger generations of 20-22 year-olds in the 1990s. The measure was taken to consider that there were already working youth doing this obligation. But most of 20-22 year-olds are undergraduates or non-working groups and thus the new measure increased the numbers of non-payment. According to recent statistical data, the number of non-payment population has not improved and more than 50% of the 20-22 year-olds population does not make necessary payments. This negative effect to the system is one of the new topics to deteriorate the fairness. There are also other key issues in the system which deteriorates the fairness in the nation. Those, such as national financial policy, system management, fund management and other important issues are raised in this section.

4.1. Revenue and expenditure

Social expenditure now amounts to about 100 trillion yen in a year and continues to increase with no hope of ceiling, as shown in Fig.2.

<table>
<thead>
<tr>
<th>Year</th>
<th>National income A</th>
<th>Total expenditure B</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>61.0</td>
<td>3.5 (100%)</td>
</tr>
<tr>
<td>1980</td>
<td>203.9</td>
<td>24.8 (100%)</td>
</tr>
<tr>
<td>1990</td>
<td>346.9</td>
<td>47.2 (100%)</td>
</tr>
<tr>
<td>2000</td>
<td>371.8</td>
<td>78.1 (100%)</td>
</tr>
<tr>
<td>2011</td>
<td>351.1</td>
<td>107.8 (100%)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension</td>
<td>0.9 (24.3%)</td>
<td>10.5 (42.2%)</td>
<td>24 (50.9%)</td>
<td>41.2 (52.7%)</td>
<td>53.6 (49.7%)</td>
</tr>
<tr>
<td>Medical care</td>
<td>2.1 (58.9%)</td>
<td>10.7 (43.3%)</td>
<td>18.4 (38.9%)</td>
<td>26 (33.3%)</td>
<td>33.6 (31.2%)</td>
</tr>
<tr>
<td>Welfare</td>
<td>0.6 (16.8%)</td>
<td>3.6 (14.5%)</td>
<td>4.8 (10.2%)</td>
<td>10.9 (14.0%)</td>
<td>20.6 (19.1%)</td>
</tr>
<tr>
<td>B/A</td>
<td>5.77%</td>
<td>12.15%</td>
<td>13.61%</td>
<td>21.01%</td>
<td>30.70%</td>
</tr>
</tbody>
</table>

Fig. 2. Annual expenditure for Social Security System since 1950
(Source: Data of the Ministry of Finance)

The main reason for the increase is the growing expenditure for pension service and medical care for the senior generation. The expenditure is mainly covered by the social insurance income of about 55 trillion yen evenly paid by the working people (mainly between 20-64 years old) and by private companies. Until recently, income level was enough for necessary social expenditure. In the 21st century, the insurance income stopped to increase and kept about 50 trillion yen. On the contrary, expenditure shows a constant increase to 100 trillion yen in 2009. (Fig.3) The government is now forced to support the growing gap or balance of about 50 trillion yen with its tax revenue and other financial supports of the almost same level of the annual tax revenue in total. (40 trillion yen, recently)
The large contribution by the government financial system gives us two big issues. One is growth level. If the social expenditure continues to increase, how should the government compensate the gap? It is now required to do more cost-effective management of the system and to make use of the Government Fund with 100 trillion yen, partly appearing in Fig. 4.

Second is the national investment policy. Under the growing burden of the social expenditure, the government cannot afford to buy a preferable investment policy for infrastructure, economic development, SMEs and education, for example. This situation will affect the Japanese development in the middle and long term.

4.2. Incident of a former government agency (Social insurance agency incident)

In parallel with the increasing concern over the social security system recently, it was revealed that the important executing government agency, "the Social Insurance Agency" under the Ministry of Health, conducted its management improperly. The Agency could not properly keep the pensioners' records partly, did ineffective duties and wasted public money. Thus the government had to force to
abolish this Agency later. It was curious that, in spite of this decision, it was replaced to a new quasi-governmental body as the Japan Pension Service. The new body succeeded the same duties with tens of thousands of staff members. The body only added a new service to send citizens private information on regular basis. This incident also attracted a lot of politicians and led to heated policy discussions between political parties. The author would say that after the incident, the Financial Ministry might have a big say to the Ministry of Welfare over the management of the Pension System.

4.3. A step towards improvement of the system

Within the pension system, there are three different types of services according to types of citizens; mutual-aid service provided for government officers, employees’ pension service for workers, and national pension service for all citizens. The three services were historically arranged in this order, and their detail is different accordingly. Non-payment groups and different gains from pension services are important problems to keep fairness. Moreover, mutual-aid service is regarded to be more favorable and so government officers are better off. That is why the government is preparing to start a new policy to unify the services and to provide fairness to citizens.

Another issue for further measure for streamlining the system is related to management of pension income. In Japan, the pension system is managed by a “pay-as-you-go” system paid from the then working generation to the retired generation. This method is imposing a bigger burden on the younger generation, when its number is decreasing and that of the senior pensioners is increasing. The ratio of population of 65 years+ to that between 20-64 years old was smaller than 1:5.1 before 1990, but the ration increased annually and is estimated to reach 1:1.2 in 2055. (Fig.1) It is arguable to continue this management system with further modification or to take a different type of “funded pension plan” taken in other countries.

The annual cash flow from a “pay-as-you-go” system consists of nearly 50% of total expenditure of about 100 trillion yen. It is an interesting coincidence that “Government Pension Investment Fund” now saves more than 100 trillion yen, but the exact figure is not publicly known. The Fund is established by the government to fairly utilize the saving and to properly invest the fund money. Interest from the investment is utilized for the annual expenditure of the pension system. (Fig.2) The Fund employs only 75 staff members to manage the large amount of money. It only depends on the outside trust banks or investment managers who are expected to invest in line with the authorized management policy of the Fund. It is a question that Fund money could be safely and profitably invested. An investment manager confessed the sum is too large. As is expected, the Fund sometimes wasted some money when the invested bond price fell down. The Fund withdraws about 1 trillion yen every year for the pension expenditure and plans to exhaust the Fund money within the coming 100 years according to unidentified information. The management of the pension system, its complexity and difficult management of the Fund, along with the expected increase of obligatory payment to the pension system, are long-term issues nowadays.

5. Proposals as a Summary

Ruling political parties have started to reform the system to rationalize the financial system. At present, one clear answer to this is to increase the tax rate every year imposed on both the companies and citizens for the social security system. This type of countermeasure is useful only for a short time and cannot substantially solve the problem. At the moment, the authority seems more concerned with a short-term balance sheet. Then it only will put a big burden on the future generation.

Japanese social security and especially, the pension system are giving big pressure to the financial system and the nation as a whole. As stakeholders and financial scale are too large to tackle, the policy maker has needs for subscription.

The present government reform program only makes a minor modification against facing financial deficit. It is reasonable to make an incremental reform for the existing and enormous scale of the pension system. Still, considering the importance of and difficult problems behind the social and pension system, it is necessary to prepare a radical reform program. At the final stage of the paper, it may useful to show ideas to improve the present system.
The first one is partial reform mainly focusing on the Fund management. Half of the Fund should be spent for the next year’s budget in order to decrease the government expenditure. The government can invest this money of about 50 trillion yen which is almost equal to the annual government expenditure, either to the social security system, to economic development and infrastructure, or to population problems and other purposes. The rest of the Fund would be maintained for the future system management. Decreasing the fund money would be better for fund managers, based on a discussion with another fund manager who explained difficulty with a large amount of money. Also, the Japan Pension Service, authorized organization aiming at recording pension related information of citizens, collection and payment services of the pension, should be reformed. The Service employs nearly 16,000 staff members and holds more than 300 offices. Its annual budget of 340 billion yen is completely subsidized by the government and the amount is gradually increasing within these years. As is observed, the Service often makes mistakes and shows inefficient activities. Rationalization of the Service by introducing IT, reducing number of officers and offices is also required.

The second idea is a more difficult one, but it may be more effective. It is to abolish the existing government-supported pension system, although it may cause a lot of confusion during the reform process. It includes the following systematic changes and financial reforms.

1) Systematic reform

Japanese Pension Service and other pension systems are to be abolished. Government Pension Fund should also be abolished. In return, Fund money of 100 trillion yen will promptly and fairly be returned to citizens. In average, the cash return per head would be about 1.5 million yen.

2) Financial reform

After the abolishment of the government controlled pension system, citizens don’t have to do any obligatory payment to the pension system, and they have redundant money. Instead, they may make a contract with private security services if they wish. Then, the government does not have to collect 50 trillion yen for pension service from taxpayers every year, but a part of the money may be utilized for economic development of the country. All the Fund money should be returned to the citizens, as referred above. After the abolishment of the operating bodies of the Japanese Pension Service and the Government Pension Fund, the management cost would be eliminated. Sales of their unnecessary lands and buildings will yield a positive effect within the financial system.

The proposed radical reform will be an alternative to solve the social security system and at least, in part the pension system, and it will improve the country’s financial system substantially.

References

1) Web page information of the following organization;
2) Tadashi YAMAMOTO, Consideration on the future pension system, Univ. of Ritsumeikan (1997)
3) Hisashi YAMADA, Issues on the Japanese social security system and reform proposal in comparison with Western system, Japan Research Institute, Business and Economic Review, September (2011)
4) Cabinet Decision, Comprehensive reform program on the social security system and taxation system, February 17 (2012)
5) Naoki KAMO, Japanese social security system in the late 20th century, Kyoto Women’s University Modern Research (2010)
7) Seiritsu OGURA, Social insurance burden from the point of fairness view, Policy and Research Institute, Financial Review, March (1991)
8) Toshiaki TACHIBANAKI, Social security system with reliability, Toyokeizai Inc. (2010)