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Restructuring the Social Security System in Japan: An Overview

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Abstract

Japan's social security system has been highly evaluated by the standards of European and North American countries, so far as its economic or fiscal performance is concerned. However, we are forced today to restructure our social security system in response to a far more rapid aging of our population and a far deeper decline in our economic growth than has been expected. In this paper, we seek to examine issues on the existing social security programs in Japan, and to suggest a way to reform the programs by taking projected demographic and economic changes into consideration. In conclusion, we place special emphasis on the necessity for coordination among social insurance schemes and for privatizing social welfare services.

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Introduction

The social security system in Japan is, in fact, composed of over twenty separately-administered programs, of which major programs are Employees' Pension Insurance, National Pension Insurance, Health Insurance, National Health Insurance, Health and Medical Services for the Aged, Employment Insurance, Workmen's Accident Compensation Insurance, Public Assistance, Social Welfare and Child (Family) Allowance.

Thus, the National Institute of Population and Social Security Research classifies an annual expenditure and revenue for the social security into three major categories: "medical care", "pensions" and "others", on the basis of the ILO (International Labour Organization) standards for international comparison. Using these data, we begin by looking roughly at the feature of Japan's social security system in two respects: its structure and size.

Figure 1 shows that "pensions" have the largest share, about 50 percent in recent years, which is in striking contrast to the smallest share, about 10 percent, held the "others" category (this includes various welfare services and family or child allowances). The figure also tells us that the ratio of expenditures for the aged (i.e., retirement pensions, and medical care and welfare services for the aged) to the total rises to over 60 percent today.

We indicate in **Figure 2** that both the ratio of total social security expenditure and that of total social security revenue (social security contribution, in particular) to national income have been rising recently. This is partly caused by a slowdown of economic growth, although the former ratio remained nearly stable at around 14 percent, and the latter remained almost unchanged at about 16 percent in the 1980s.

When we turn our concern toward an international comparison of the social security system, Japan's system has been highly evaluated up to now by the standards of Western European and North American countries, so far as its economic or fiscal performance as a whole is concerned.

This is due to the fact that the proportion of social security transfers to GDP (gross domestic product) has remained at around 11 ~ 12 percent, the lowest among the advanced industrial countries (see **Figure 3**), and the ratio of fiscal balance of the social security fund to GDP has been constantly around 3 percent, the highest among these countries (see **Figure 4**). However, the ratio of the aged (65 years old and over) in Japan to the population has gone up by 5.5 percentage points (from 9.1 percent in 1980 to 14.6 percent in 1995), the most rapid aging among advanced industrial countries.

We are forced today, however, to restructure our social security system in response to a far more rapid aging of our population and a far deeper decline in our economic growth than has been expected. It is very difficult or impossible to meet the growing needs for social security, caused primarily by this rapid aging, under stringent budgetary constraints imposed by the slowdown of our economic growth. Furthermore, it is generally argued that a sharp expansion of the social security system has adverse effects on both macroeconomic and microeconomic performance.

In this brief paper, we seek to examine issues facing the existing social security programs in Japan, and to suggest a way to restructure the programs by taking projected demographic and economic changes into consideration. The rest of this paper is composed of three sections.

Section 1 of this paper describes projected remarkable changes in the age-structure of our population, the household structure of families, and the socio-economic role of women. It also considers the impact of these future demographic changes on benefits and financing of social security programs.

Section 2 of this paper begins by explaining projected rigorous economic and budgetary constraints on social security programs based on the latest projection of economic growth and of the fiscal condition, including social security funds, of all levels of government. Then, it examines the impact of a rapidly aging population and its social security system on economic performance.

Section 3, the final section of this paper, suggests an aim and guidelines for restructuring our social security system, and proposes several reform plans. In this section, we place special emphasis on the necessity for coordination among social insurance schemes and for privatizing the provision of social welfare services.

1. Impact of Demographic Changes on Social Security

Acceleration of Population Aging

Although Japan has been considered the youngest nation among the advanced industrial countries so far, we must renounce such a generally accepted view. The proportion of the aged (65 years old and over) to the population reached 15 percent by the year 1996, nearly equal to that of Germany and France, and there is a definite tendency toward acceleration of this trend.

Looking at a series of projections of population trends made in 1976, 1981, 1986, 1992 and 1997 by the Ministry of Health and Welfare (the National Institute of Population and Social Security Research), we find that the ratio of the aged to the population projected for the year 2025 had to be revised upward in every projection from 18.1 percent in 1976 to 21.3 percent, 23.4 percent, 25.8 percent, and finally 27.4 percent in 1997 (see **Figure 5**).

Interestingly, the latest projection made in 1997 tells us that the first country in the world whose ratio of the aged to the total population will exceed 20 percent before the year 2010 will not be Sweden or Italy, as expected. It will be Japan.

Unlike other advanced industrial countries, changes in the age structure of the population in Japan is determined completely by trends in fertility and mortality rates, since the factor of international migration can be left out of consideration.

In this respect, while the population has been aging faster primarily due to the more rapid than expected long-term decline in total fertility rates (from 2.23 in 1967 to 1.42 in 1995, as **Figure 6** shows), the remarkable increase in average life expectancy at birth has also been an important factor (from 69.3 years for men and 74.7 years for women in 1965 to 76.4 years for men and 82.8 years for women in 1995 respectively, as **Figure 7** shows).

Changes in Family Structure and Female Status

It goes without saying that a rapid aging of the population has been usually accompanied by considerable changes in family structure, and hence in the family's socio-economic function. This is exactly true of Japan's family structure.

First of all, the proportion of the so-called extended family, which was the traditional family structure in Japan, has been decreasing markedly, even though it is relatively high today in comparison with European countries and the U.S. In other words, the proportion of the so-called nuclear family has been increasing sharply.

As a result, the size of the family has decreased, and the number of the aged living alone or living only with their spouse has increased, partly because of the diffusion of old-age pension schemes. Measured as a proportion of the aged population (65 years old and over), the aged living alone has increased from 8.5 percent in 1980 to 12.0 percent in 1994, and the aged living only with their spouse has increased from 19.6 percent in 1980 to 29.0 percent in 1994 (see **Figure 8**).

Second, the social and economic status of women, who have long been responsible for raising children and nursing the frail elderly at home, has changed remarkably. The percentage of women who enter college, for example, increased sharply from 17.7 percent in 1970 to 47.6 percent in 1995.

The percentage of women who participate in the labour force in the 25-29 year-old range increased markedly by more than 20 percentage points from 1970 to 1995 (see **Figure 9**).

These changes, which have occurred since the 1970s, are dominant factors in lowering the total fertility rate, and consequently in accelerating the aging process of our population. In more specific terms, we believe that a continuous rise in the average age of women when they first marry in demographic terms (see **Figure 10**), and a steady increase in the so-called "opportunity cost" of time-consuming childcare for women in economic terms are responsible for lowering the total fertility rate.

Demographic Changes and Social Security Programs

Demographic and related changes, described above, will have serious impact on social security programs in the future by both enhancing social needs for the programs and restraining revenue sources of the programs. The impact on social insurance schemes involving an intergenerational transfer scheme in particular, such as the Old-age Basic (National) Pension Insurance, the Employees' Pension Insurance, and the Health and Medical Services for the Aged, will certainly be more serious.

In addition to reforming these programs, we will have to expand current childcare assistance programs to prevent fertility rates from declining, and to introduce a new program for long-term care in order to keep up with the sharply growing number of the very old (75 year old and over), whose probability of requiring long-term care services is well known to be by far higher than that of the elderly aged under 75.

More specifically, we examine briefly the major social security reforms that have been taken so far or are now under deliberation in response to the demographic and related changes.

In the first place, important reforms were made in 1994 concerning the Old-Age Employees' Pension Scheme, which is an earnings-related pension scheme for employees nearly based on a pay-as-you-go financing principle. For example, the age for full pension benefits was phased up from 60 years to 65 years, and the revaluation rate of the past earnings was changed from a gross-earnings basis to a net-earnings basis (after income taxes and social insurance contributions on earnings paid by the employee).

It is, nevertheless, projected by the Ministry of Health and Welfare that the contribution rate of the Employees' Pension Scheme will have to be raised from 16.5 percent in 1995 to 29.8 percent in 2025 in order to maintain the financial stability of the current scheme. According to the revised projection on the basis of the latest population projections in 1997, it will have to be raised further to 34.3 percent in 2025. In the case of the National Pension Insurance, a flat-rate pension scheme for the non-employee, the number of non-participants or delinquents has been increasing as the lump-sum contribution rate has been raised.

As a result of this acceleration of population aging, there occurs a serious problem in the relationship between benefits and contributions, the so-called intergenerational inequity, under the current scheme of the Employees' Pension Insurance. **Figure 11** reveals that there exists a considerable difference by generation (by age or year of birth) in the ratio of benefits to contributions (paid by both insured persons and employers) in terms of the present discounted value.

As younger generations point out at present, we must admit that this marked difference is inequitable, even if we take into account peculiar factors introduced after the renewal of the Employees' Pension Scheme in 1954, such as the past-wages revaluation system and the inflation-adjusted benefits formula (i.e., inflation indexation), which account for a certain degree of difference by generation.

Second, reform plans are now under consideration by the Ministry of Health and Welfare in order to contain public expenditures for medical care. It is widely recognized that the main focus is on controlling medical care expenditures for the aged, since the Health and Medical Services for the Aged, introduced in 1983, is characterized by a kind of intergenerational transfer program.

Figure 12 shows that average per capping expenditure for the elderly aged 65 and over is nearly five times as high as that for the non-aged (in the case of the elderly aged 70 and over, it is almost six times as high), and **Figure 13** tells us that the proportion of medical expenditure for the aged to the total medical expenditures rose to 32 percent by 1995. In this respect, we must pay much attention to the fact that medical expenditures for the aged includes expenditures for long-term care provided by medical institutions.

Third, the introduction of a new social insurance scheme for long-term care is the most important at present among plans for social security reform. Since the current long-term care program has been operated on a means-tested or eligibility-tested basis under tight budgetary constraints, long-term care services publicly provided at home and in care institutions have been too poorly funded to meet the increasing needs caused primarily by the recent rapid aging.

As a result, according to a rough estimate by the Ministry of Health and Welfare, about four-fifths of the frail elderly requiring long-term care are obliged to depend on care services provided either by hospital staffs as medical services or by their own family members, mostly women, as unpaid household services. This miserable situation basically calls for a new social insurance scheme for long-term care of the aged.

Finally, the government has started a package of childcare support policies called the "Angel Plan", since there has been widespread concern about the continual decline of the total fertility rate. However, we have doubt about its effectiveness, partly because marriage and birth are private matters, and partly because disadvantageous circumstances for married women still exist both at work and at home. We would rather regard the Angel Plan as more effective in raising female labour force participation rates.

Anyway, it seems to us that the Angel Plan cannot pull up the current total fertility rate to a level of about 2.1, which is required to maintain a stationary population over time, even though the Angel Plan can prevent the total fertility rate from declining further. We therefore should make reform plans for social security programs and related economic and fiscal policies by regarding the rapid aging of the population as given.

2. Impact of Population Aging and Social Security on Economic Performance

Deterioration of Economic Performance ?

By the beginning of the 1990s, our economy had enjoyed a relatively high growth rate. This accounted for a relatively low level of social security transfers as a percentage of GDP, and for the relatively favorable fiscal balance of all levels of government among OECD countries, as I described earlier.

From the beginning of the 1990s, however, our economy has fallen into a recession, which we had never experienced before. The average annual growth rate of real GDP dropped markedly from 5.2 percent between FY 1987 and FY 1990 to 1.0 percent between FY 1992 and FY 1995. What is more serious is that this slowdown of economic growth is not a passing phenomenon caused by the collapse of the so-called Bubble Boom in the latter half of the 1980s.

According to the latest projections of future economic performance and government finance by the Economic Council and the Economic Planning Agency, real economic growth rate will remain at 1.6 percent in 2010, and 0.9 percent in 2025, if government expenditures including those of social security funds will not be controlled. By contrast, real growth rate will increase temporarily to 2.8 percent by the year 2000, owing primarily to developments of economic deregulation (see **Figure 14**). Major reasons for the projected slowdown of economic growth are as follows.

First, a decrease in the working-age population (i.e., potential total labour force), caused by rapid population aging, will counteract an increase in labour productivity. The latest population projection tells us that the number of working-age people, in the 15-64 year-old range, will decline remarkably from its peak of 87.260 million, 69.5 percent of the population in 1995, to 71.976 million, 59.5 percent of the population in 2025 (see **Figure 15**).

Second, according to a life-cycle model of people's consumption and saving behavior, rapid aging of the population will decrease the household savings rate, which will in turn restrain investments by raising interest rates. Similarly, population aging will decrease government savings, when public pension schemes are operated on a pay-as-you-go basis, not on a funded basis, as in the case of the National Pension Insurance and the Employees' Pension Insurance.

Third, an increase in total government expenditures (including social security expenditures) as the population ages particularly will promote a rise in interest rates by deteriorating the fiscal balance, including social security funds, of central, state, and local governments. According to the above mentioned projection (see **Figure 16**), the fiscal balance of all levels of government relative to GDP will worsen from -1.4 percent (3.4 percent for the social security fund) in 2000 to -14.7 percent (-5.8 percent for the social security fund) in 2025.

Fourth, an additional increase in total burden of taxes (including social insurance contributions), which is required to finance growing government expenditures, will be imposed primarily on the shrinking working population, and thereby have adverse effects on labour-supply, personal savings, and corporate investments through lowering marginal after-tax rates of return. In microeconomics, these effects are termed "substitution effects" of changes in the marginal tax rate.

For reference's sake, keeping the ratio of total burden to the national income under 50 percent at the peak of the population's aging process is considered as a self-evident policy goal in Japan, since adverse effects of an additional burden have been particularly emphasized. The above mentioned projection by the Economic Council and the Economic Planning Agency indicates that the ratio of taxes and social security contributions to national income will increase from 35.8 percent in 1994 to 51.5 percent in 2025, on the basis of the projected rapid population aging and slowdown of economic growth.

However, if we add the projected fiscal deficit to this ratio for measuring the real financing burden, "the potential total burden ratio" (the ratio of a sum total of taxes, social security contributions and fiscal deficits to national income) will increase remarkably from 39.2 percent in 1994 to 73.4 percent in 2025 (see **Figure 17**).

Fifth, social security benefits themselves have a variety of adverse effects on the economic behavior of the beneficiary. These so-called moral hazard problems, induced by social security programs, include promoting early-retirement, dwindling private savings, creating unemployment and poverty, and so on. These types of moral hazards will worsen economic performance that suffers from a shortage of labour and savings on account of rapid population aging.

Criticism of the Popular View

As described above, it is widely argued in Japan that population aging and social security, and these two factors combined in particular, are primarily responsible for poor economic performances. However, we make an objection to this popular view, because the mechanism by which population aging and social security may affect economic performance is not so simple as is generally argued.

First, even in an extreme case, the total labour force will be unchanged provided that an increase in labour force participation rates offsets a decrease in working-age population. There will surely be room to increase the female labour force participation rate by expanding childcare assistance programs, and by promoting equitable treatment of the sexes in the working environment. The average rate of female participation of 64.1 percent for the core working-age population (25 ~ 59 years old) is by much lower than the 97.1 percent of men in that age group who participated in the labour force in 1995 (see **Figure 18**).

An improvement in labour productivity will be expected to some extent, caused by increasing investments to cope with a shortage of labour, even if the labour force participation rates does not actually increase.

Second, population aging does not necessarily decrease the household savings rate, because the life-cycle model does not take into account a variety of intra-family and other private transfers from parents to children.

If the aged increase savings by leaving more bequests or gifts in order to offset the growing burden on their children in financing social insurance schemes operated on a pay-as-you-go basis – this is known as the Barro's proposition – the household savings rate would not change. We are sure that the aged in Japan are more altruistic in leaving bequests or gifts than those in Western European and North American countries.

Third, the retired or the frail elderly have long been supported largely by their children in Japan. Consequently, even if social security programs are operated on a pay-as-you-go basis, the programs will not necessarily reduce private savings, because social security programs are substitutes for intra-family transfers from children to parents rather than private savings.

Fourth, an increase in additional tax burdens (including social insurance contributions) does not necessarily decrease thew labour supply or private savings, if we take fully into consideration "income effects" of changes in the marginal tax rate as well as "substitution effects". As all the textbooks on microeconomics teach us, "income effects" work in the opposite direction of "substitution effects".

Furthermore, a decrease in employer's social security contributions (wage or payroll taxes) resulting from a reduction of social security benefits does not necessarily reduce total labour costs, since we regard social security programs as partial substitutes for company or occupational welfare service programs.

Fifth, so-called moral hazard problems also occur in the private insurance market: adverse selection or cream-skimming. For example, it is widely recognized that a private old-age pension insurance scheme, occupational or individual, is likely to have early-retirement effects, and that a private medical care insurance scheme for inpatients is likely to keep patients hospitalized longer, because a certain degree of discretion is approved by the government for even tax qualified private insurance .

Concluding Remarks of This Section

We have found, as a matter of fact, no significant inverse relationship across countries between the level of population aging or the relative size of social security programs and real GDP growth rates or macroeconomic performance. We therefore should not be in haste to criticize the social security system under population aging as the primary factor in deteriorating economic performance.

This does not mean, however, that either the rapid aging of the population or the growing relative size of social security programs has no adverse impact on economic performance. We only argue that neither factor is the most decisive among a variety of factors affecting the economic performance.

Considering that population aging in Japan is the most rapid in the world, and that slowdown of long-run economic growth will be inevitable in the future, we should consider seriously both the growing deficit of the government and the deteriorating equity in intergenerational transfers. They will not only adversely affect economic growth but also undermine financial stability of the social security system.

We must, then, start restructuring the whole social security system immediately in order to prepare for the advent of the very aged society with stagnant economic growth.

3. Restructuring Plans for Social Security Programs

Guidelines for Social Security Reform

Before suggesting restructuring plans for social security programs, it is necessary to clarify an aim and guidelines for the restructuring.

To begin with, it must be emphasized that the aim of restructuring social security programs is not to scale them down without priorities, but to reorganize them in accordance with policy priorities, based on people's choice (sovereignty of the consumer). Specifically, expansion of long-term care and childcare programs is urgently needed in response to the population's rapid aging.

However, in expanding these programs, tight economic and budgetary constraints should be taken into account, as mentioned in the preceding section. This means that every effort should be made to control an increase in the total cost of social security programs, and to improve equity in intergenerational relationship between benefits and financing burdens of the programs.

Thus, we propose two guidelines for restructuring: coordination and privatization.

The former, coordination of social security programs, is the most fundamental and effective way to reorganize and streamline the programs on the priority basis. It is widely recognized today that the major cause of misallocation, inequality and wastefulness in the existing social security programs lies in lack of coordination due to the completely divided system of policy-making.

The examples are as follows. In spite of the remarkable diffusion and improvement of public old-age pension schemes, the burden of paying for social insurance, taxes and user fees for health care and long-term care is still kept down to a minimum for the aged.

A considerable shortage of institutional and long-term home care services due to budgetary restraints brings about a remarkable increase in total long-term care cost, because part of the long-term care cost is actually covered by medical insurance schemes with a higher unit cost than long-term care program.

With regard to privatization of social security programs, we are sure that much weight should be placed on an extension of consumer's rights to choose, and on a reduction of uniform and inflexible government regulations in the field of social security. Privatization or deregulation is indispensable for restructuring public programs in two respects: one is to make better use of developed private insurance schemes, the other is to make best use of flexible and competitive private welfare services.

To be a little more specific, selective or additional programs of social insurance schemes for pensions and health care should be transferred to private insurance schemes, including home equity conversion plans, and publicly provided welfare services dealing with long-term care and childcare should be fundamentally privatized.

Coordination of Social Security Programs

We are convinced that a new social insurance scheme for long-term care, now under deliberation in the Diet, will play a key role in adjusting benefits and burdens among social security programs. With its introduction, basic schemes for health care, pensions and long-term care will be unified. On the assumption that the social insurance scheme for long-term care will be introduced early, three important reform plans for coordination of health care, pensions and long-term care schemes are discussed below.

One of the major grounds for introducing new social insurance for long-term care is a widespread concern over the inappropriate use of medical resources for long-term care. In fact, an estimate by the Ministry of Health and Welfare indicates that about 20 percent of total medical costs for the aged in FY 1995, covered by medical insurance schemes, was for long-term care provided in hospitals (see **Table 1**). **Table 2** reveals that the unit cost of medical service is nearly two times as high as that of long-term care currently provided in care-service institutions.

Then, the first reform plan is to separate care service from an intrinsic medical service by providing care services at care-service institutions or at home rather than at hospitals. In addition, the funding should be done by long-term care insurance, not by medical insurance. We are sure that this separation will contribute not only to a more efficient use of medical resources but also to restraining total cost of care services.

Holding down the total cost of care services will also contribute to a more equal intergenerational transfer, since new social insurance for long-term care is supposed to be operated on the same financing scheme as the Health and Medical Services for the Aged, which is close to a pay-as-you-go system.

In the Employees' Pension Insurance, operated on a nearly pay-as-you-go basis, the current ratio of average benefits to average earnings in the case of a full pension model, the so-called replacement rate, is about 68 percent on a pretax monthly earnings basis, which is equivalent to about 80 percent on an after-tax monthly earnings basis. This high level of replacement rate is often criticized as the most dominant factor causing the expansion of pension expenditure and the deterioration of equity in the intergenerational relationship between benefit and financing burden. In consequence, a reduction of the replacement rate will become the focal point when the next financial revaluation of public pension schemes occurs in 1999.

Of course, the great majority of the aged are strongly opposed to this reduction plan, primarily because they must bear the heavy financial burden of long-term care expenses under the existing social welfare program. As a matter of fact, most of the aged in need of long-term care at home have no other choice but to purchase expensive private care services, on account of the remarkable shortage of long-term care services provided publicly.

Since the introduction of a long-term care insurance scheme makes it possible for the aged to purchase private long-term care services at the same low user fees as charged for publicly provided services, the aged will accept a plan for lowering the replacement rate. Although this means the substitution of long-term care insurance for pension insurance, this plan will certainly contribute to holding down total social security cost, and to improving equity in intergenerational transfers because it is projected that a saving of pension expenditures would be much larger than an increase in expenditures for long-term care services.

According to the traditional view that the economic status of the aged is homogeneously poor, the aged's financing burden for health care and long-term care programs is still kept down to a minimum. In fact, the average economic status of the aged has been improved considerably, owing to full distribution of public old-age pensions and to steady accumulation of their personal assets. On the other hand, the gap between the rich aged and the poor aged has been widening. An across-the-board containment of burdens to be shouldered by the aged is contrary to both intragenerational and intergenerational equity.

For this reason, it is desirable that user fees for health care and long-term care in social insurance should be raised to a level that is well balanced with the benefits of the Basic Pension (a universal and flat-rate pension scheme for all residents). This measure, at the same time, will control excessive supply and demand for medical services (including excessive use of medicines), and long-term care services.

A more important step towards improving intragenerational and intergenerational equity should be taken with personal income taxation. Now "pension income" (including benefits paid by public and quasi public pension insurance schemes) is almost completely excluded from taxable income owing to its generous itemized deduction (at the same time, social security contributions paid by the insured are fully deductible), and "interest income" received only by the elderly (aged 65 and over) is completely tax-free.

We therefore propose that additional income tax revenue, raised by eliminating these tax preferences, should be appropriated to reduce the burden of earned-income taxes or social insurance contributions on working-age generations. The elderly whose total income, including pension benefits and interest, remains under the tax exemption threshold do not need to pay any income tax.

In reference to the current taxation of "pension income", we must reveal how it is treated inequitably and preferentially. First, the generous and uniform pension deduction is inequitable because there are very rich elderly people (pension beneficiaries). As **Figure 19** shows, pension beneficiaries account for 15.6 percent on average over the period 1990-95 of taxpayers filing income tax returns with total income over 20 million yen (the proportion of tax returns with total income over 20 million yen to total income tax returns is only 3.7 percent on average). Second, the current tax treatment of "pension income" is unquestionably preferential when compared with that of "employment income" (wages and salaries), since the average effective rate of withholding-tax on "pension income" is by far lower than that of "employment income" (see **Figure 20**).

We are fully convinced that full taxation of "pension income" is a more efficient and equitable means of improving both intragenerational and intergenerational equity than adopting conventional means testing, which imposes a penalty on hard work and savings, or an increase of value-added tax (general consumption tax), which deteriorates intragenerational equity.

Possibility for Privatization of Social Security Programs

In recent years, regarding earnings-related old-age pension schemes for the employee (e.g., the Employees' Pension Insurance), the possibility of changing either from pay-as-you-go financing to funding or from social insurance to private insurance has attracted increasing attention among employers and economists in particular.

We consider either plan desirable in the long-term, if both an increase in benefit levels of the Basic Pension and issuance of "inflation indexed (adjusted) bonds" can be realized. We consider, however, neither to be feasible in the medium-term, since in neither case the hardest obstacle, what is generally called the "double burden" imposed on transitional working generations, can be avoided. This point is unanimously agreed to by pension experts.

Consequently, it is more practical, in our view, to reduce the scale of public earnings-related pension schemes by lowering the benefits/earnings replacement rate, maintaining the principle of pay-as-you-go financing. In this case, however, the government must disclose detailed information on the actual condition of pay-as-you-go financing.

This reduction will certainly be expected to bring about a further improvement of private occupational or individual old-age (retirement) pension insurance, and a further development of a variety of financial mechanisms by which the home equity of the aged will be converted to retirement income. When these private old-age pension schemes diffuse widely, the privatization of public earnings-related pension schemes would be regarded as practical.

With reference to this, although the tax-qualified occupational pension scheme, the Employees' Pension Fund, is approved by government as the substitute for the Employees' Pension Insurance, the Employees' Pension Fund is by no means a private pension in essence, because financing of its inflation-indexed benefits depends completely on the Employees' Pension Insurance.

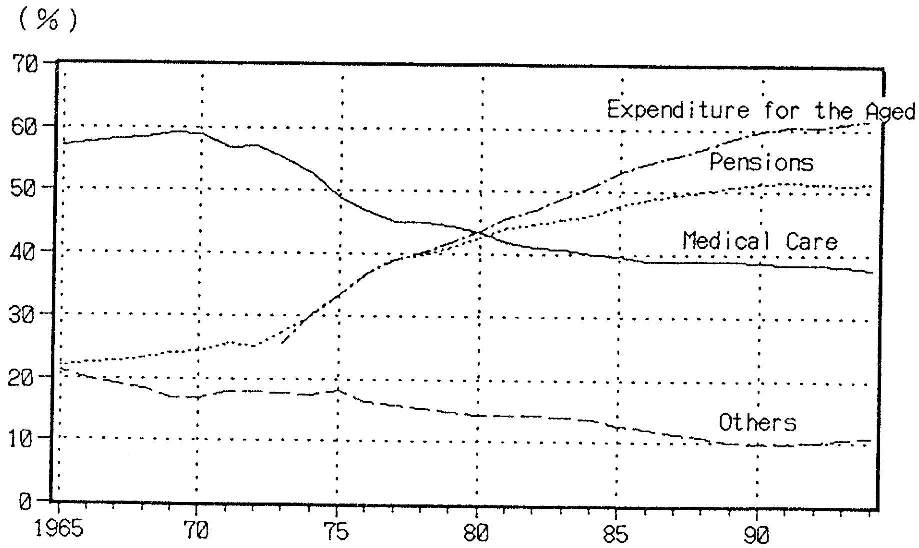
Concerning privatization in social security programs, the most urgent issue confronting us is deregulation in providing social welfare services, such as long-term care and childcare. However, cost-saving reform in medical services, primarily by deregulating the pharmaceutical market, is actually emphasized today.

Since the provision for welfare services is virtually monopolized by the public sector (i.e., municipalities including a fully subsidized non-profit organization) under rigorous regulations and budgetary constraints, as described earlier, the performance of public care service is too poor in both quantity and quality to meet the expanding and diversifying needs for long-term care and childcare.

We can point out several reasons why deregulation of provisions for welfare services is indispensable. First, the sovereignty of consumers should be respected by using market mechanisms, since the degree of market failure in the provision of welfare services is by far smaller than that of medical services (i.e., imperfect information). Second, the flexibility inherent in market mechanisms can best meet the expanding and diversifying needs for long-term care and childcare services. Third, a considerable increase in employment opportunities is expected through the expansion of profit and non profit organizations into the welfare service market.

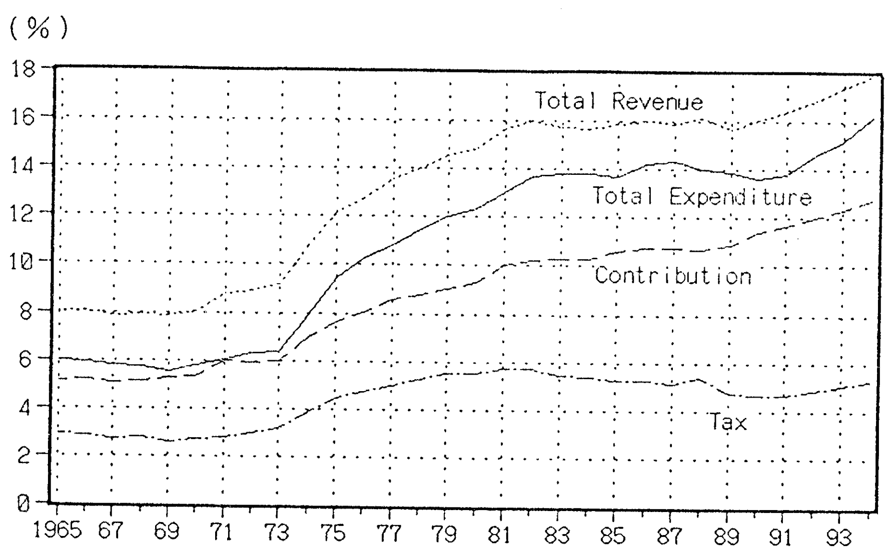
Fundamental reform in the welfare service, which is the most underdeveloped area in Japan's social security system, cannot be carried out without drastic deregulation or privatization, even though some regulations to protect consumers should remain upon quality control, price range and sound management.

Figure 1 Percentage Distribution of Social Security Expenditure, by Category : FY 1965-1994



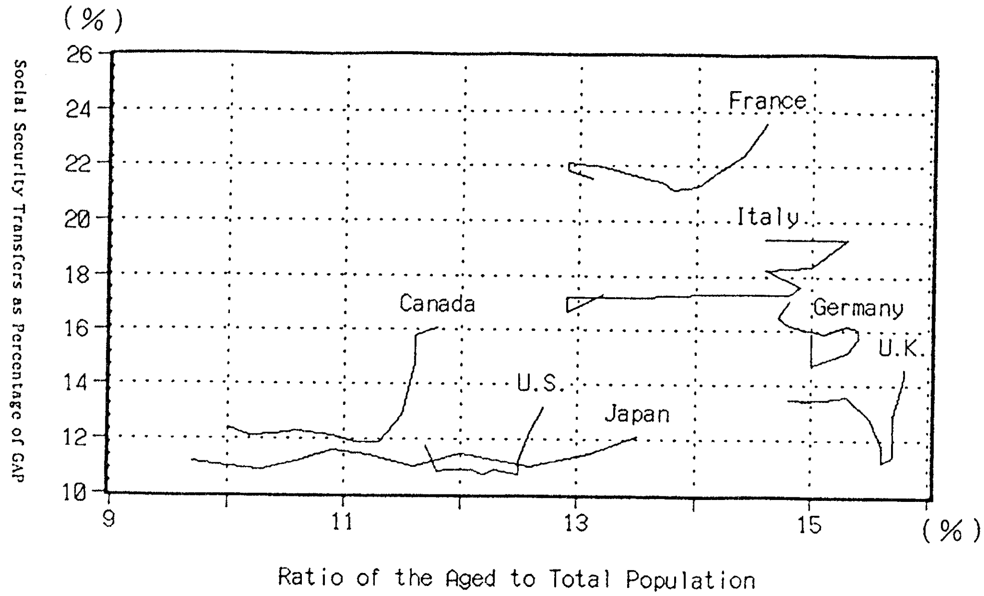
Source:The National Institute of Population and Social Security Research,The Cost of Social Security

Figure 2 Social Security Expenditure and Revenue,by Source as Percentage of National Income: FY 1965-1994



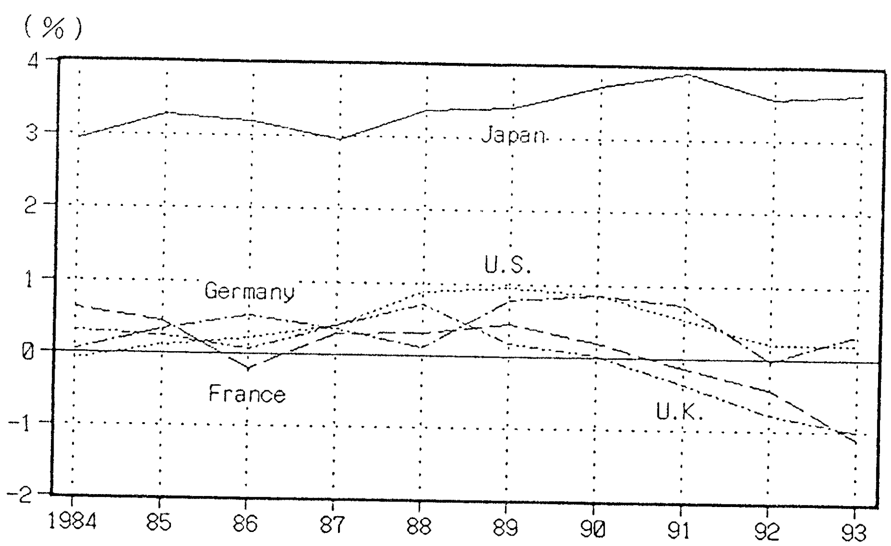
Source:The National Institute of Population and Social Security Research,The Cost of Social Security

Figure 3 Aging Population and Social Security Transfers: FY 1984-93



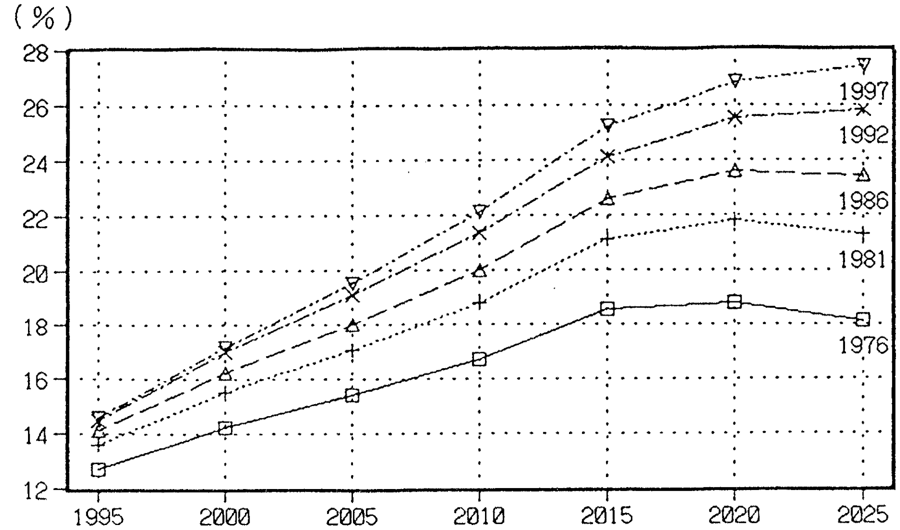
Source: OECD, Historical Statistics
OECD, Labour Force Statistics

Figure 4 Net Saving of Social Security Fund as Percentage of GDP : FY 1984-93



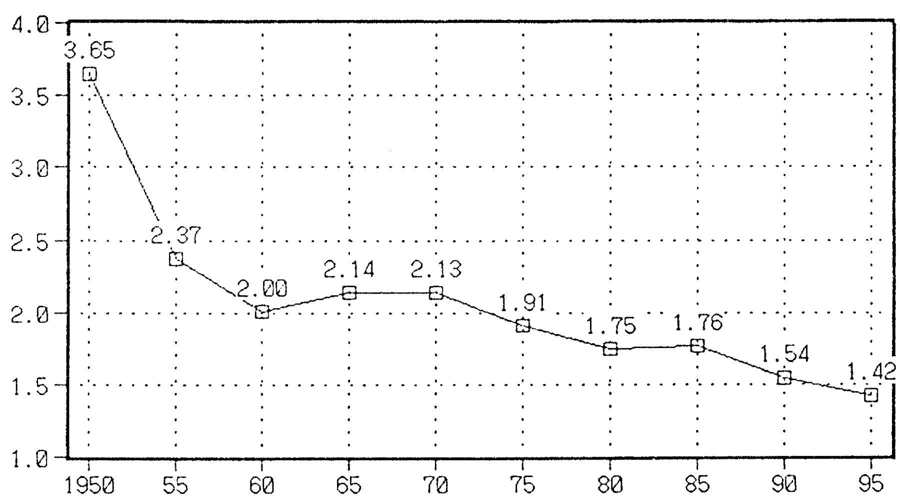
Source: OECD, Historical Statistics

Figure 5 Projected Percentage of the Aged Population, by Year of Projection Made : 1995-2025



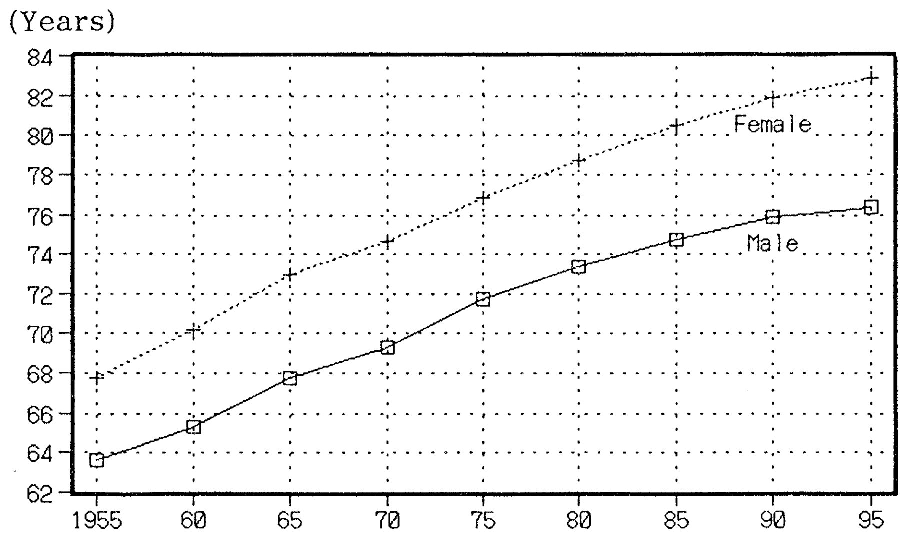
Source:The National Institute of Population and Social Security Research,Population Projections for Japan

Figure 6 Changes in Total Fertility Rate:1950-95



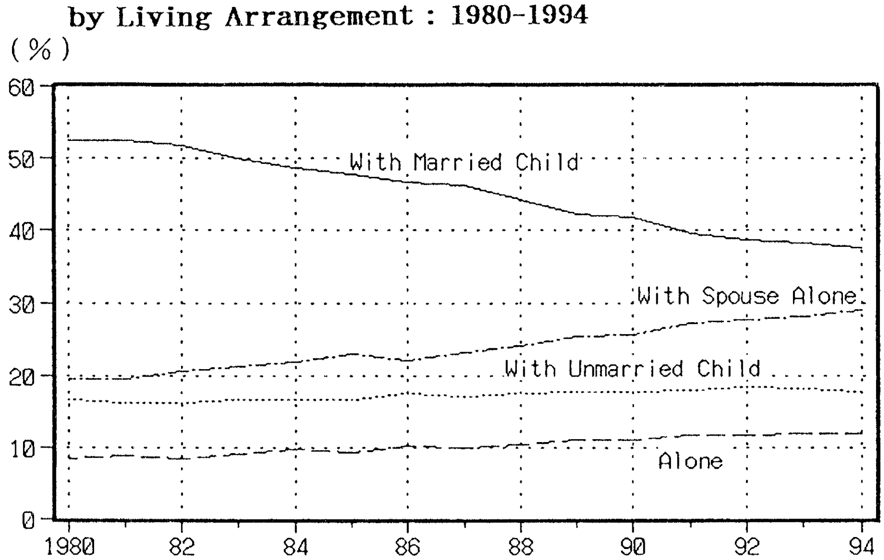
Source:The National Institute of Population and Social Security Research,Population Projections for Japan

Figure 7 Changes in Life Expectancy at Birth, by Sex : 1955-95



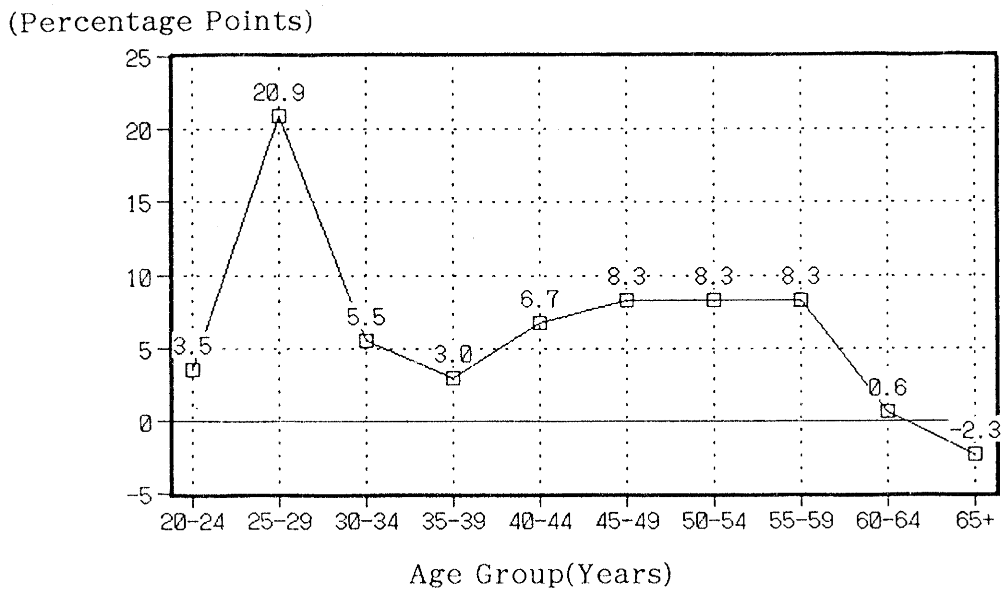
Source: The National Institute of Population and Social Security Research, Population Projections for Japan

Figure 8 Percentage Distribution of Elderly People (aged 65 and over), by Living Arrangement : 1980-1994



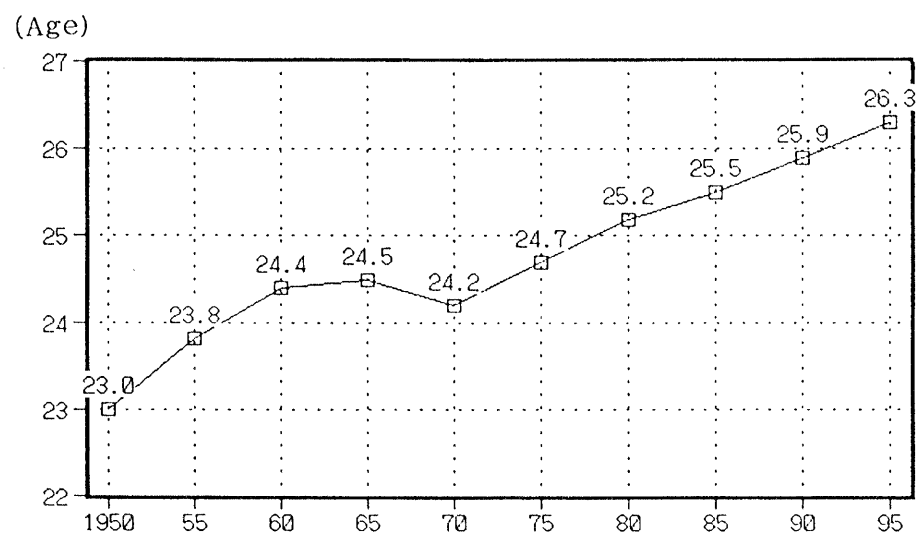
Source: The Ministry of Health and Welfare, Comprehensive Survey of People Living on Health and Welfare

Figure 9 Percentage Point Changes in Female Labour-Force Participation Rates from 1970 to 1995, by Age Group



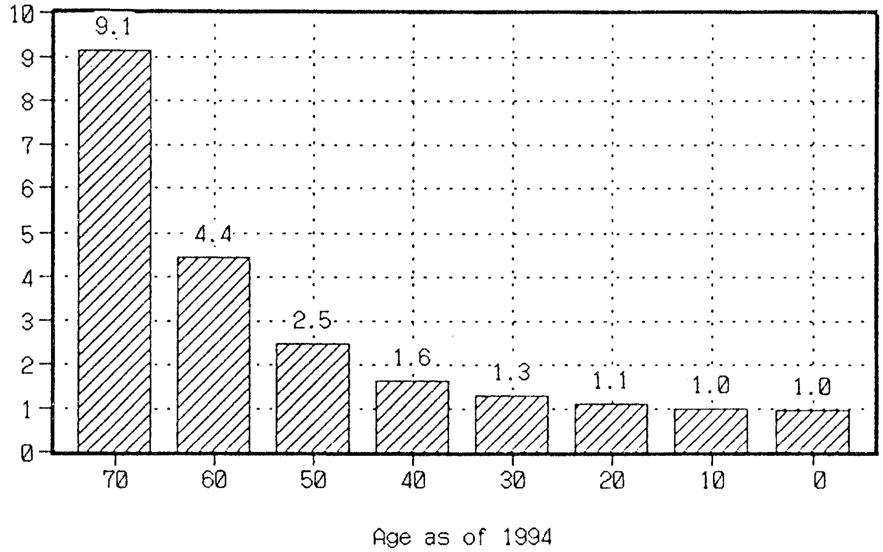
Source:Statistics Bureau,Management and Coordination Agency,Labour Force Survey

Figure 10 Changes in Average Age When Women First Marry : 1950-95



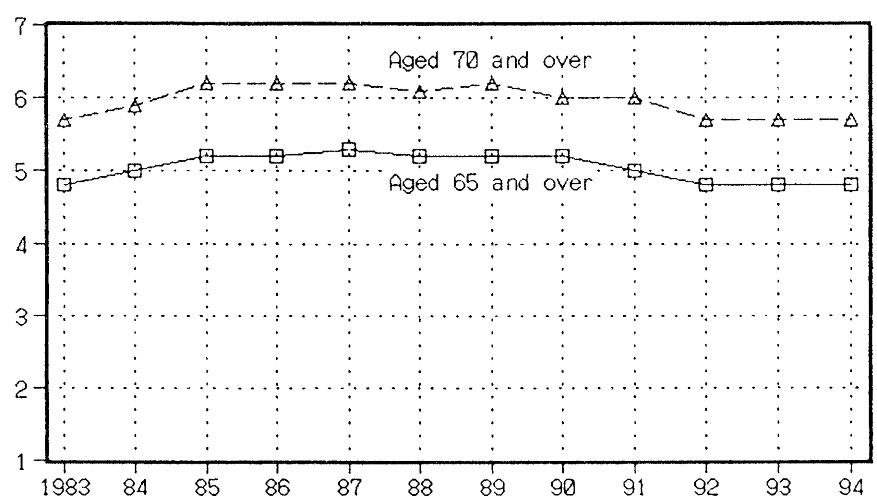
Source:The National Institute of Population and Social Security Research,Population Projections for Japan

Figure 11 Ratio of Benefits to Contributions in Terms of the Present Discounted Value, by Age as of 1994 in Case of Employees' Pension Insurance



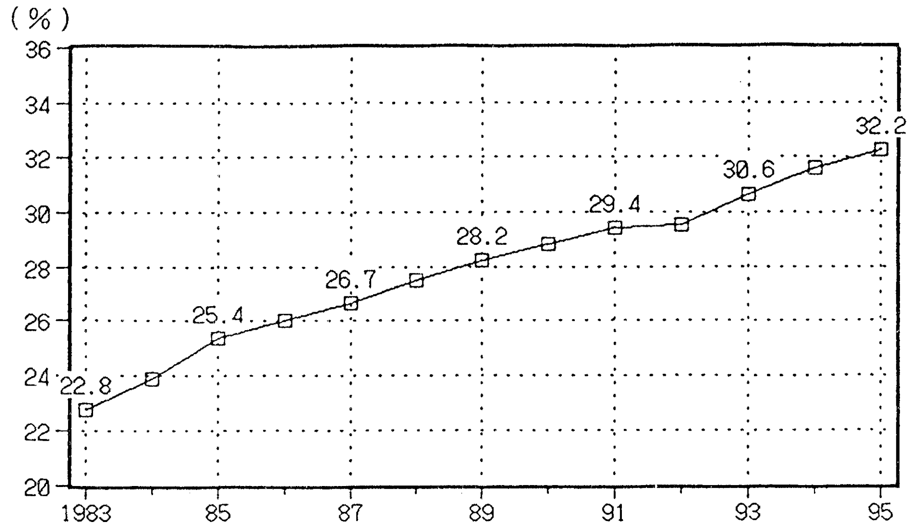
Source:The Ministry of Health and Welfare,<u>Public Pension and Its Financing</u>

Figure 12 Ratio of Per Capita Medical Costs for the Aged to the Non-Aged(aged 0～64) : FY 1983-94



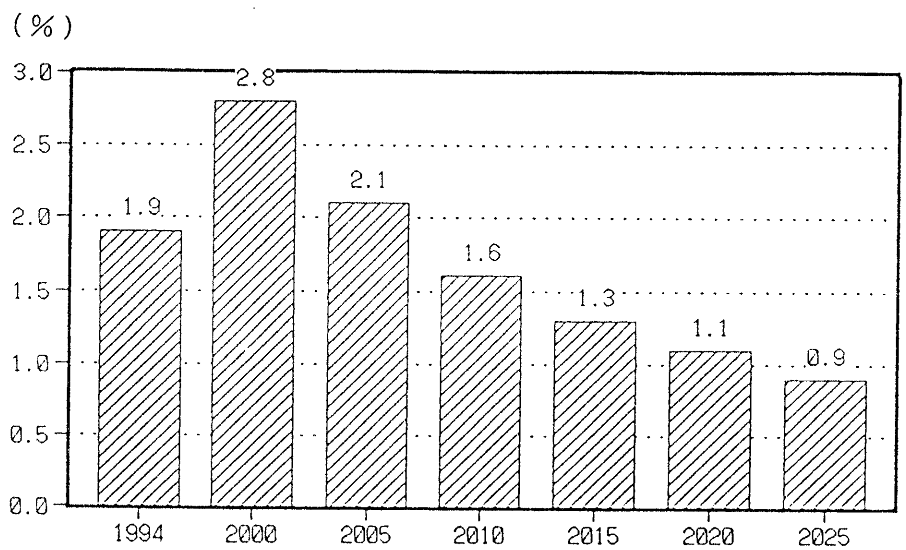
Source:The Ministry of Health and Welfare,<u>National Medical Costs</u>

Figure 13 Ratio of Medical Costs for the Aged to National Medical Costs : FY 1983-95



Source:The Ministry of Health and Welfare,National Medical Costs

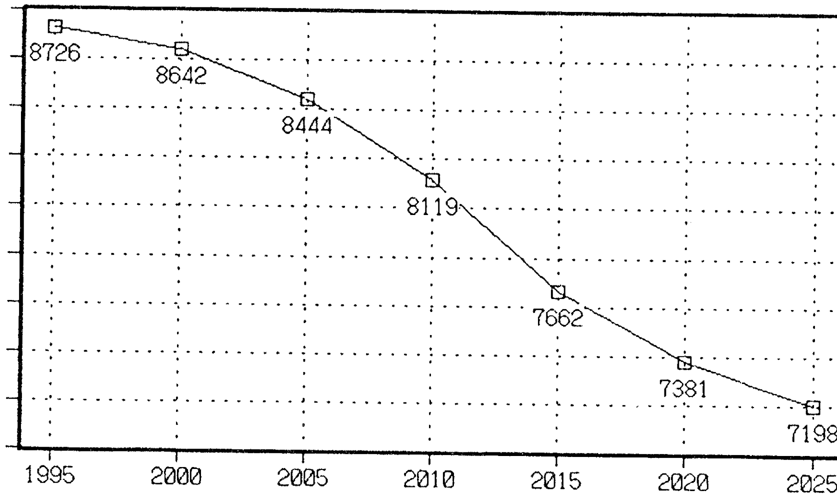
Figure 14 Projected Real Growth Rate of GDP : FY 1994-2025



Source:Projections by the Economic Council

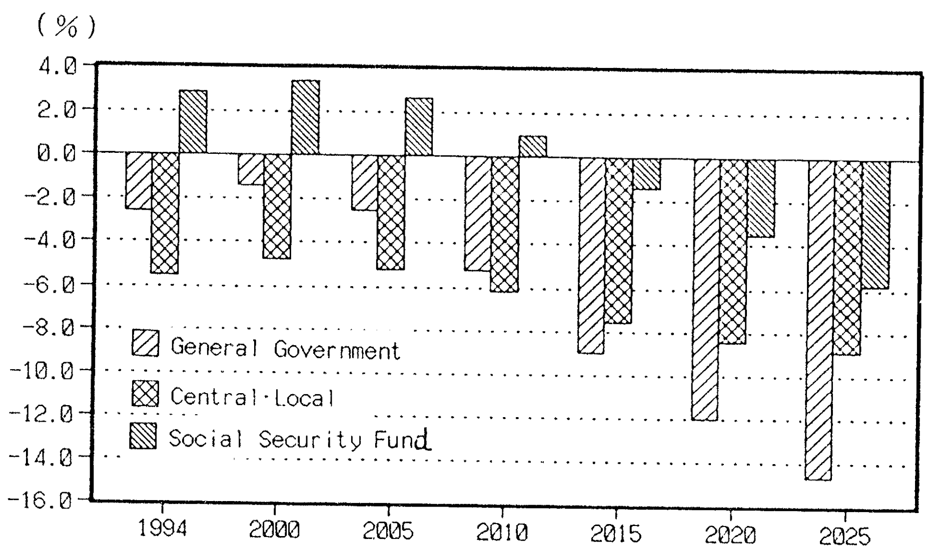
Figure 15 Projected Changes in Working Age Population (aged 15-64) : 1995-2025

(Ten Thousands)



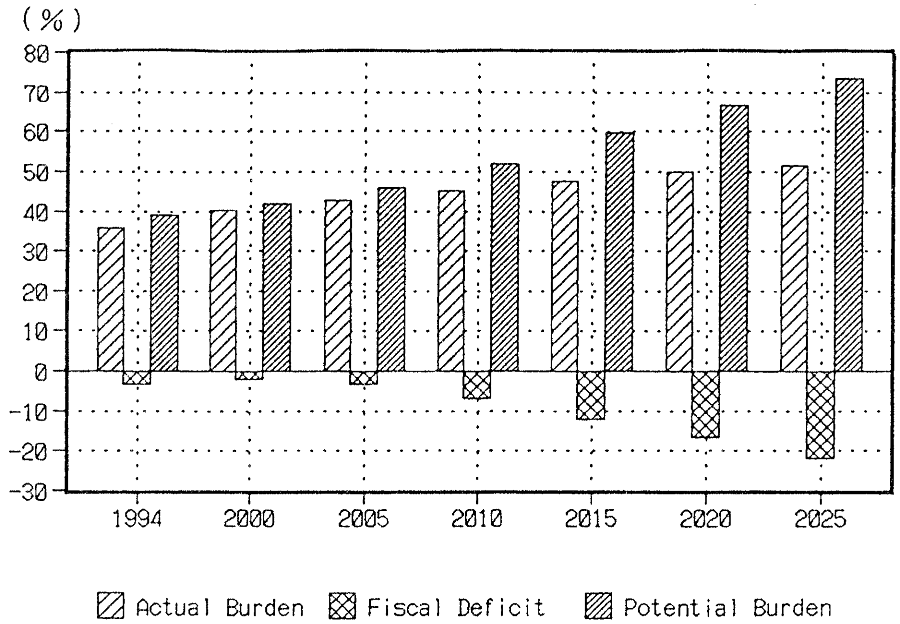
Source:The National Institute of Population and Social Security Research, Population Projections for Japan

Figure 16 Projected Fiscal Balance of General Government as Percentage of GDP : FY 1994-2025



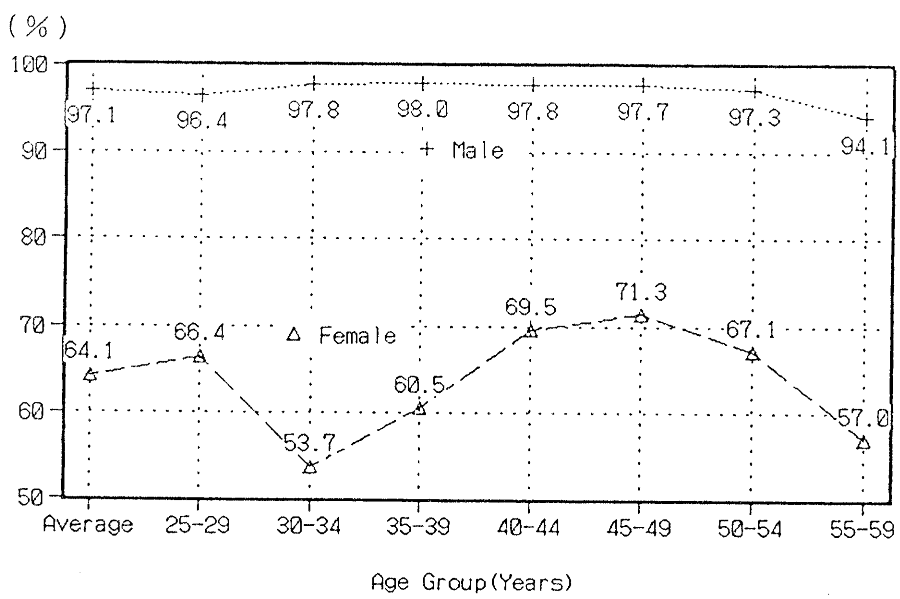
Source:Projections by the Economic Council

Figure 17 Projected Tax and Social Security Contribution as Percentage of National Income : FY 1994-2025



Source:Projections by the Economic Council

Figure 18 Labour Force Participation Rates, by Sex and Age (25-59 Years Old) in 1995



Source:Statistics Bureau,Management and Coordination Agency, Labour Force Survey

Table 1 Total Medical Costs of Long-Term Care for the Aged in FY 1995 (in 100 millions of yen)

	Amount	Percent
Total Medical Costs of Long-Term Care for the Aged	84,600	100.0
Covered by Medical Insurance	18,900	22.3

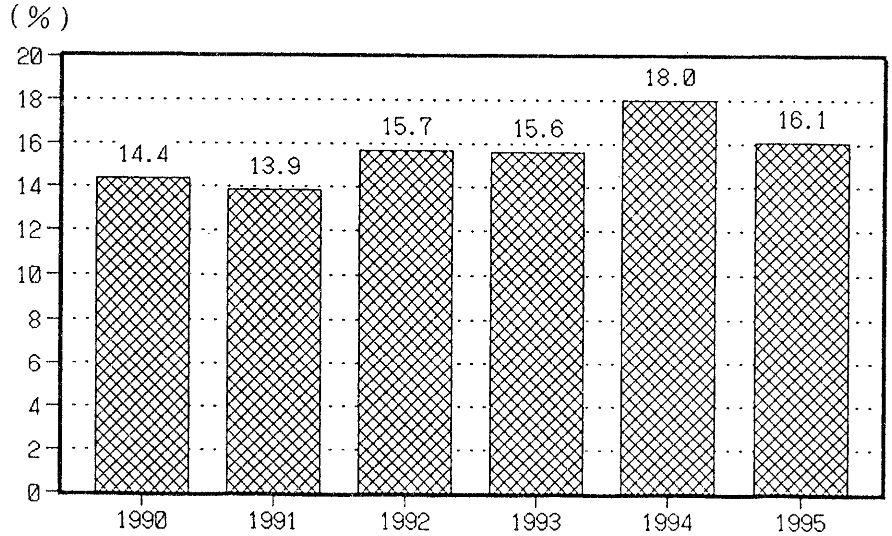
Source:Estimates by The Ministry of Health and Welfare

Table 2 Per Capita Expenditures of Long-Term Care, by Institution in FY 1995 (in 10 Thousands of Yen)

Institution	Expenditure	Revenue by Source	
		User-fee	Contributions and Taxes
Hospital	47.5	3.9	43.6
Convalescent Ward	42.8	3.9	38.9
Health Care Facility for the Aged	32.5	6.0	26.5
Nursing Home	26.2	4.3	21.9

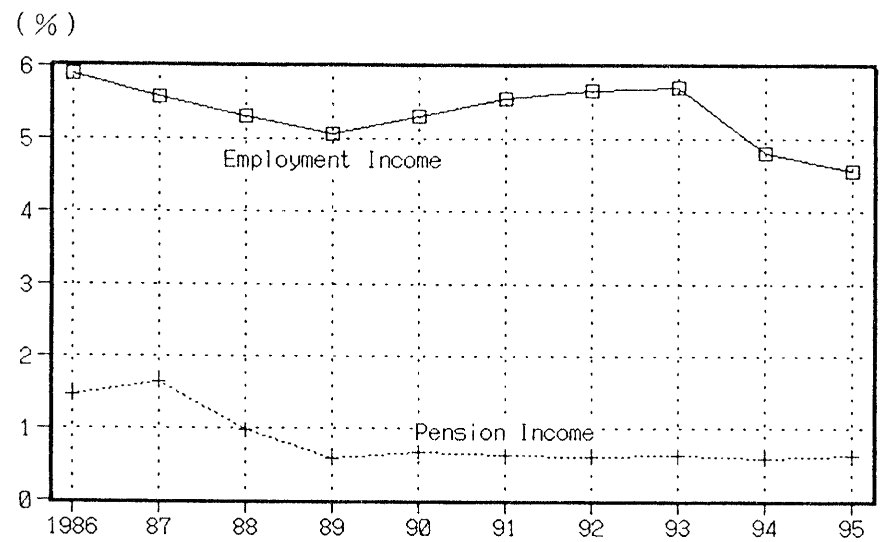
Source:Estimates by The Ministry of Health and Welfare

Figure 19 The Number of Income Tax Returns with Pension Income as Percentage of Total Returns(Returns with Total Income over 20 Million Yen) : 1990-95



Source:National Tax Administration, Annual Report on Income Tax Self-Assessment

Figure 20 Effective Withholding Tax Rates of Employment Income and Pension Income : 1986-95



Source:National Tax Administration,Annual Report

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