

Demographic Impacts on Social Security System and Fiscal Policy: Contexts in Japan

G20 Symposium

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Income support for elderly people (Pension)

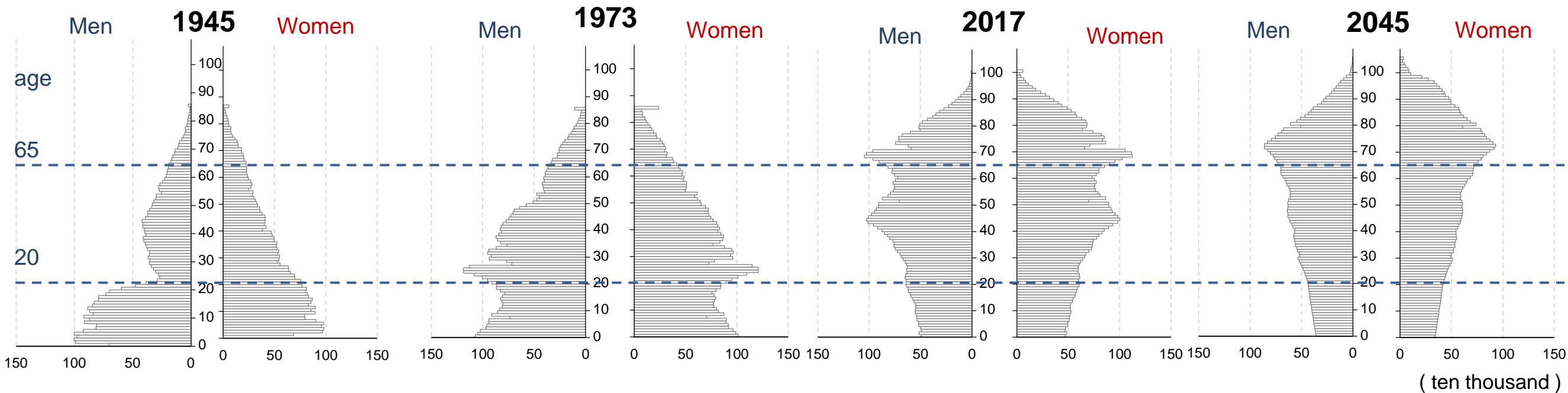
- How can we cope with uncertainties under demographic changes, while keeping social equity and fiscal sustainability?
- Can we attain a better combination of public/private pension, and a better design for public pension combining pay-as-you-go/funded systems?

Healthcare

- How can we cope with increasing demand and supply for healthcare services, while achieving better health outcomes, efficient service provision and fiscal sustainability?
- What would be possible measures for curbing healthcare spending, and financing increasing spending?

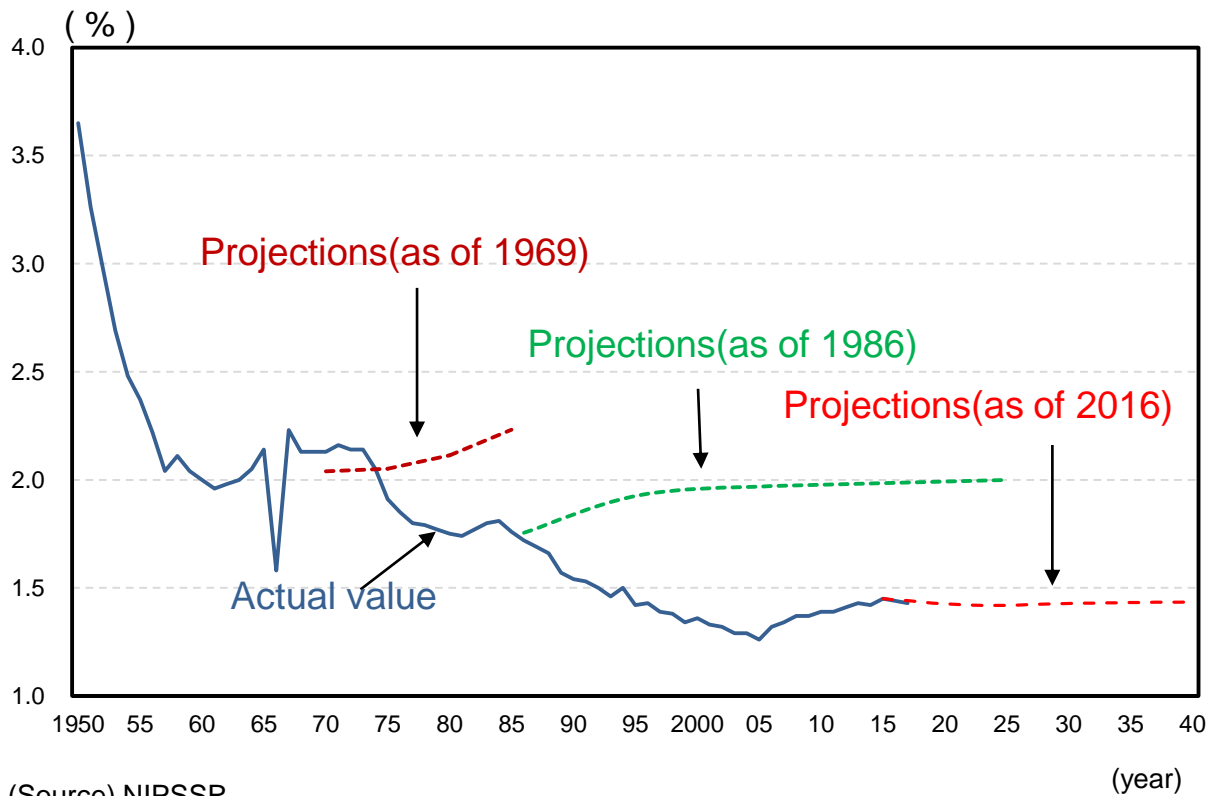
Uncertainties for demographic changes in Japan

Demographic Change in Japan



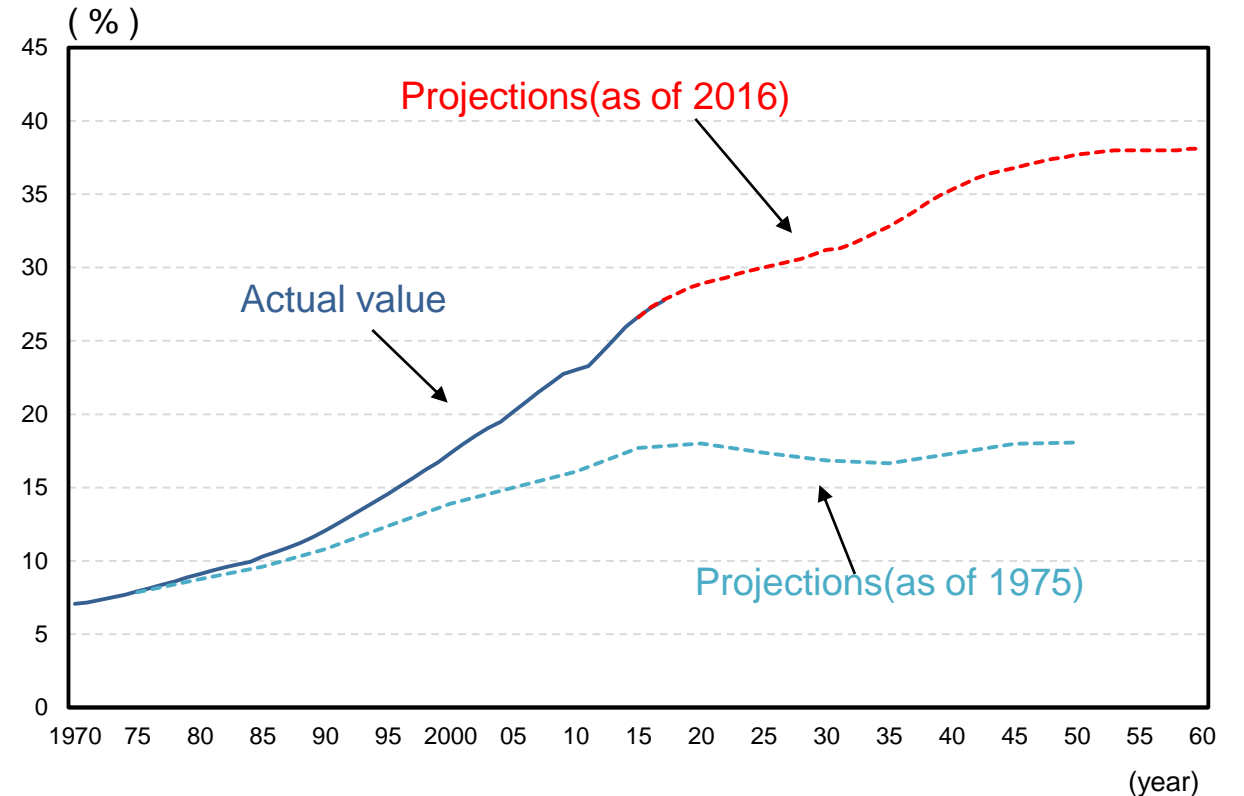
(Source) MIC (1945-2017), NIPSSR (2045)

Fertility rate



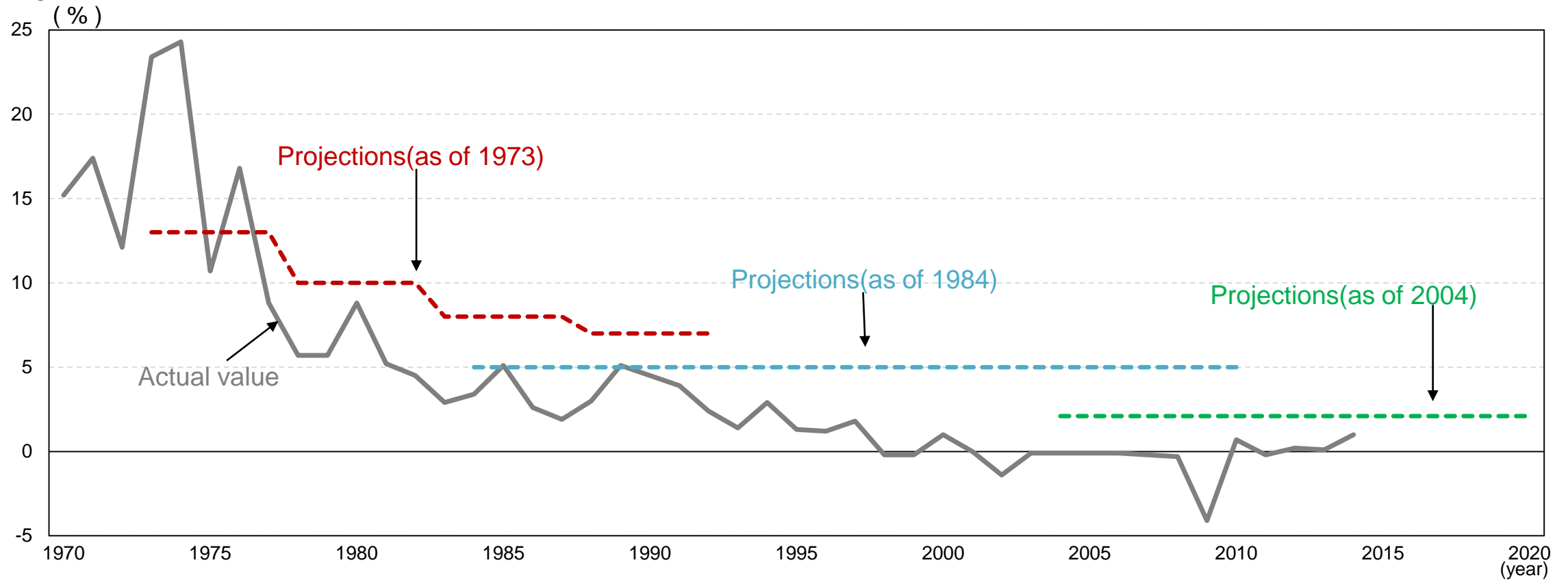
(Source) NIPSSR

Aging rate (65 and over)

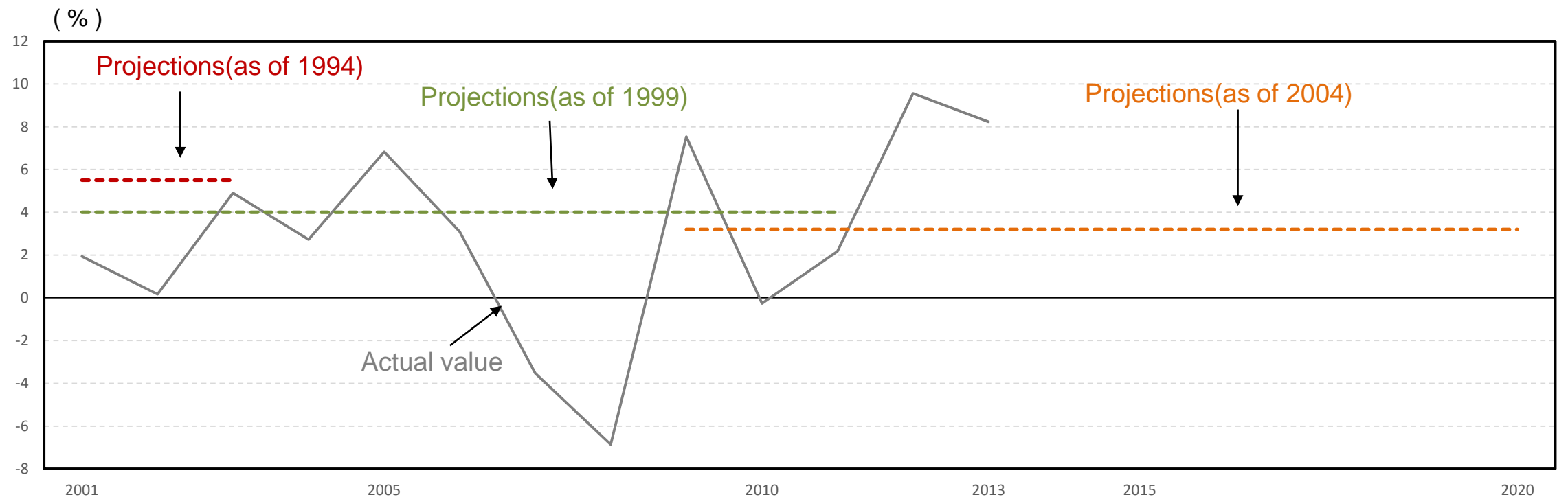


Uncertainties for macroeconomic variables in Japan

■ Wage



■ Yield on investment



Uncertainties for public pension system

Demographic changes

- Longevity
- Fertility
- Migration

Macroeconomic variables

- Productivity (and long-term economic growth)
- Capital-labor ratio (and interest rate, or return on assets)
- Saving / investment balance

Societal changes

- Changes in relative size of different social groups, such as:
 - employed/self-employed (formal/informal)
 - urban/regional
 - status of immigrants, etc.affecting coverage, eligibility, contribution history, and expected benefit level

Before 2004 reform : Regular 5-year actuarial review

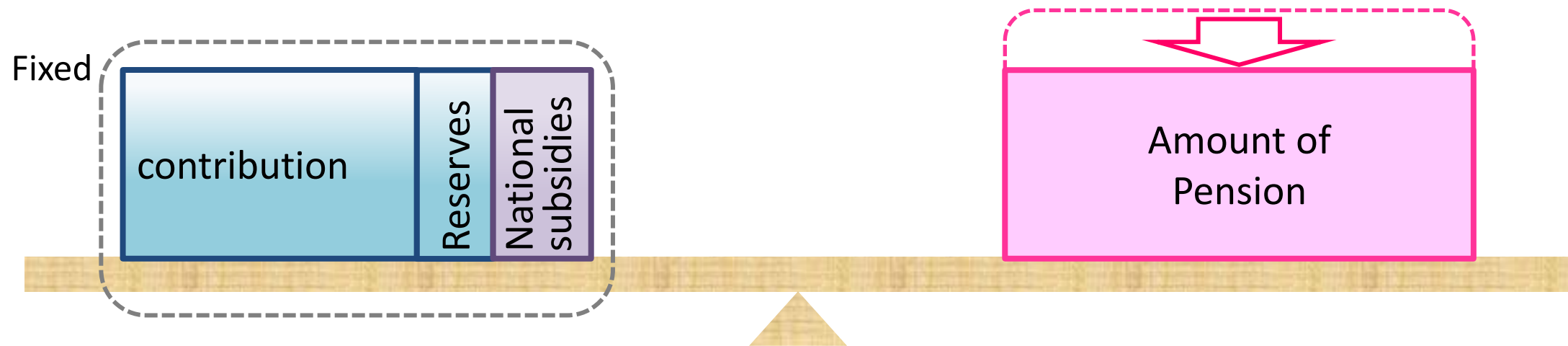
- Amending a future contribution rate
 - To assure balance between actuarial liabilities and future revenues under the currently revised projections for exogenous variables
- At the same time, negotiate for changing policy parameters, such as benefit accrual ratios, eligibility age, indexation rules, etc.
 - To avoid significant increases in the future contribution rate

■ 'Defined Benefit' scheme with 5-year renegotiations and revisions

- Affording some incentives for policymakers to :
 - postpone raising contribution rate (assuming higher contribution rate in the future)
 - make optimistic projections for exogenous variables to avoid both cutting benefits and increasing contribution
- Uncertainties for future policies about benefit and contribution, and less credibility of public pension system

Measures coping with demographic impacts on public pension system

After 2004 reform : Automatic balancing mechanism (ABM)



1. Fixing future contribution rates

- Gradually increasing the EPI contribution rate on wages from 13.58% (2004) to 18.3% (2017)

2. Automatic adjustment for benefit level

- Introducing a modified indexation rule reflecting demographic factors

→ To assure fiscal sustainability, the rule will be automatically applied for necessary periods, which will be described in regular 5-year actuarial valuations.

3. Increasing subsidies to basic pension (NP)

- Using additional revenue from consumption tax raised in 2014

Other reforms for pension system

1. Expanding the mandatory coverage of EPI*

- Including short-term workers [since 2017]
(working 20 hours in a week, earning 800 USD in a month, at companies with more than 500 employees)
- To enhance old-age income support by public pension for short-term workers

*EPI: *Employees' Pension Insurance*, providing an earning-related pension on top of a basic pension (both public, pay-as-you-go)

2. Expanding the role of private pension and saving

- Introducing personal DC pension with tax allowance (iDeCo) [since 2001; expanded in 2017]
 - Expanding tax allowance for small saving by households (NISA) [since 2014]
- To supplement smaller public pension by voluntary private saving

Further reforms

1. More incentives for working longer

- More flexibility for pushing back the starting age of receiving public pension
- To allow working longer, and receiving more pension after the deferred starting age

2. More re-distributional functions of public pension

- Need to reconsider pension benefit and tax on pension for high-income earners
- To focus the role of public pension on preventing old-age poverty

3. More flexible adjustments of benefit level

- Need to reconsider 'nominal floor' of pension benefit adjustment
- To avoid intergenerational inequity

Objectives of a national healthcare system

Quality of healthcare services

: better services by competition and technological progress

Asymmetric information between patients and providers results in inefficiency, such as supplier-induced demand / increasing costs



Japan's context:

- **Laissez-faire approach for service delivery**
(dominated by private service providers, without gatekeeper functions)
- **Strict price control to contain costs**
(using uniform fee schedule revised every 2 years at global and item-by-item level)

Decent benefit coverage with limited copayment

: assuring equal access by all income level citizens to decent healthcare services



More redistribution for equity purpose requires more fiscal resources

Limited fiscal burden

: not requiring excessive fiscal resources (mandatory social contribution and general tax)

Japan's context:

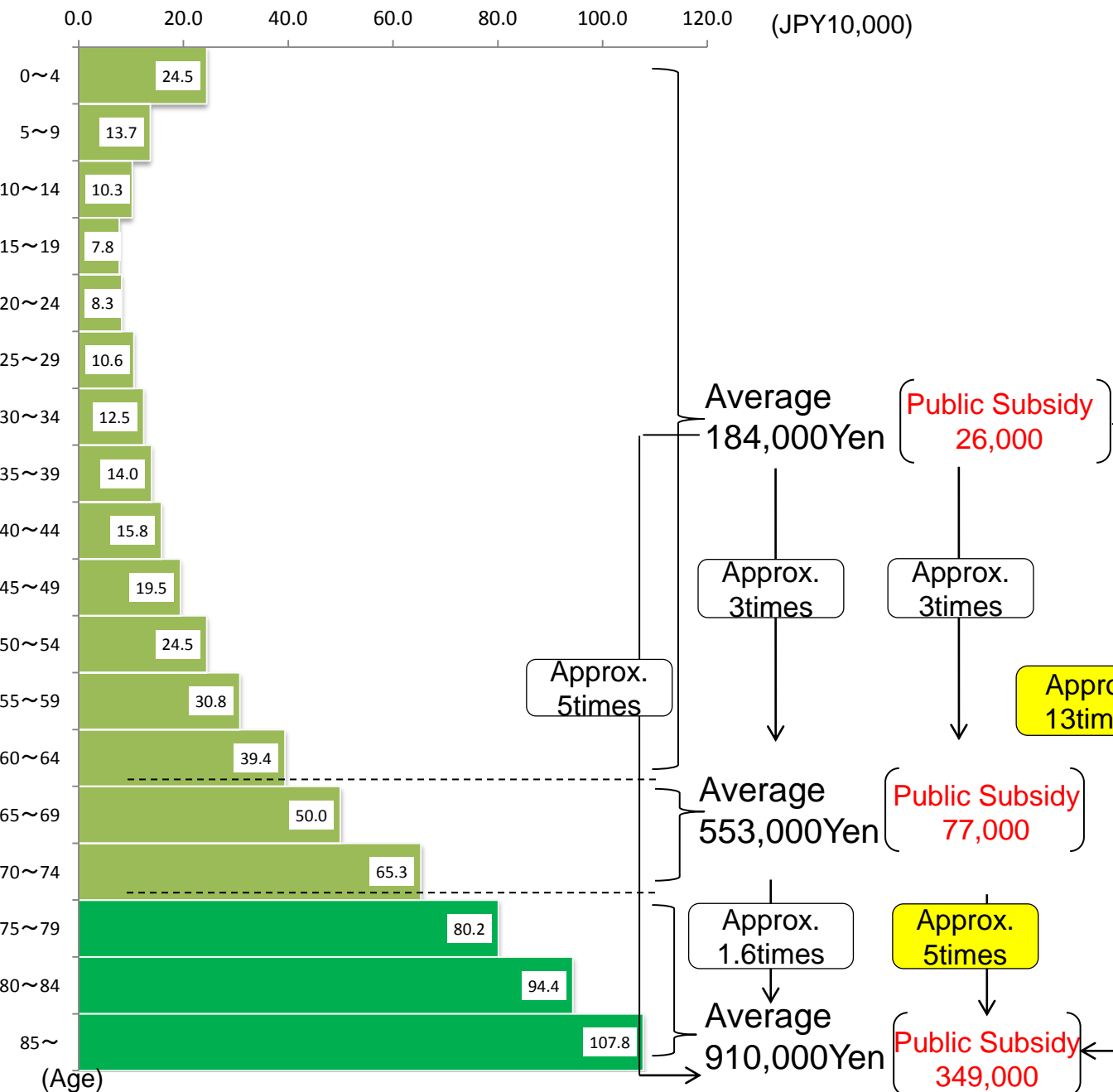
- **Increasing fiscal deficit**

Challenges for healthcare system under demographic changes

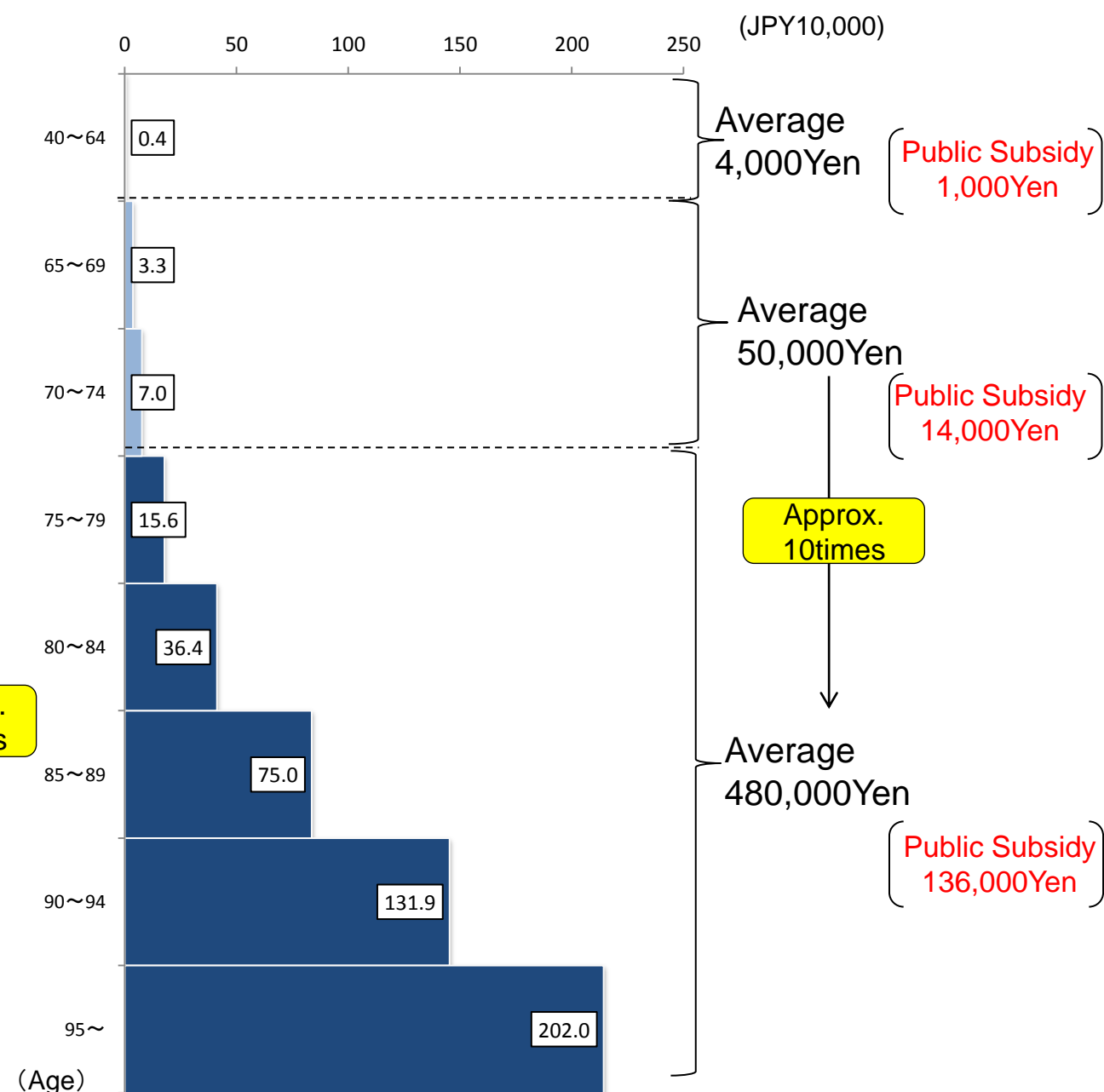
Higher per capita healthcare spending by elderly people

- Higher ratio of elderly people results in higher healthcare spending in total.

Health Care Spending per capita by Age Groups (CY2016)



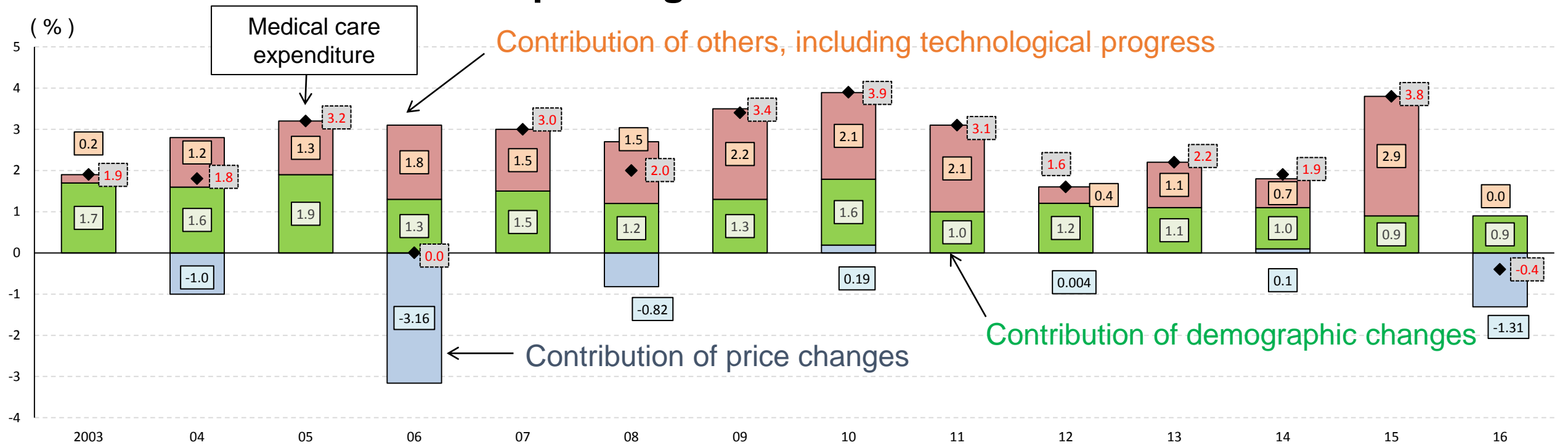
Elder Care Spending per capita by Age Groups (CY2016)



(Source) MHLW, 2018, "Estimates of national medical care expenditure", "Survey of long-term care benefit expenditures"

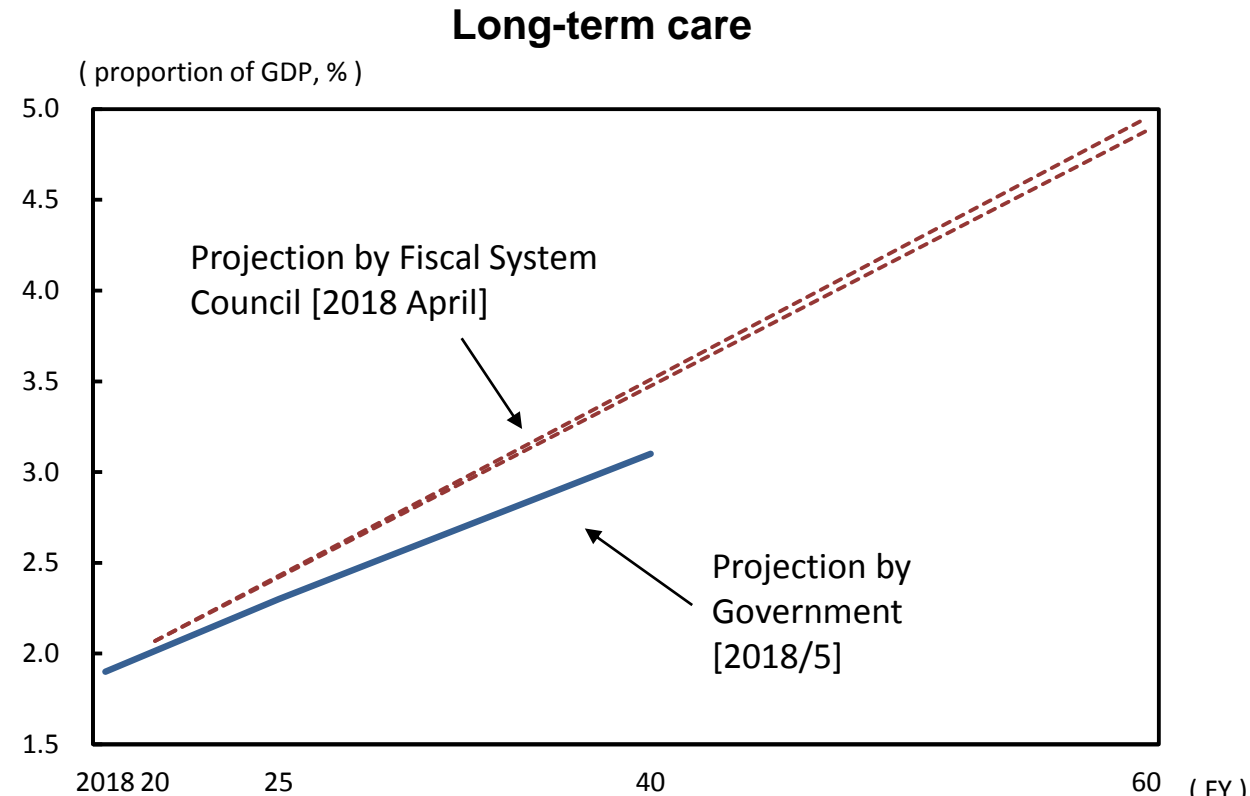
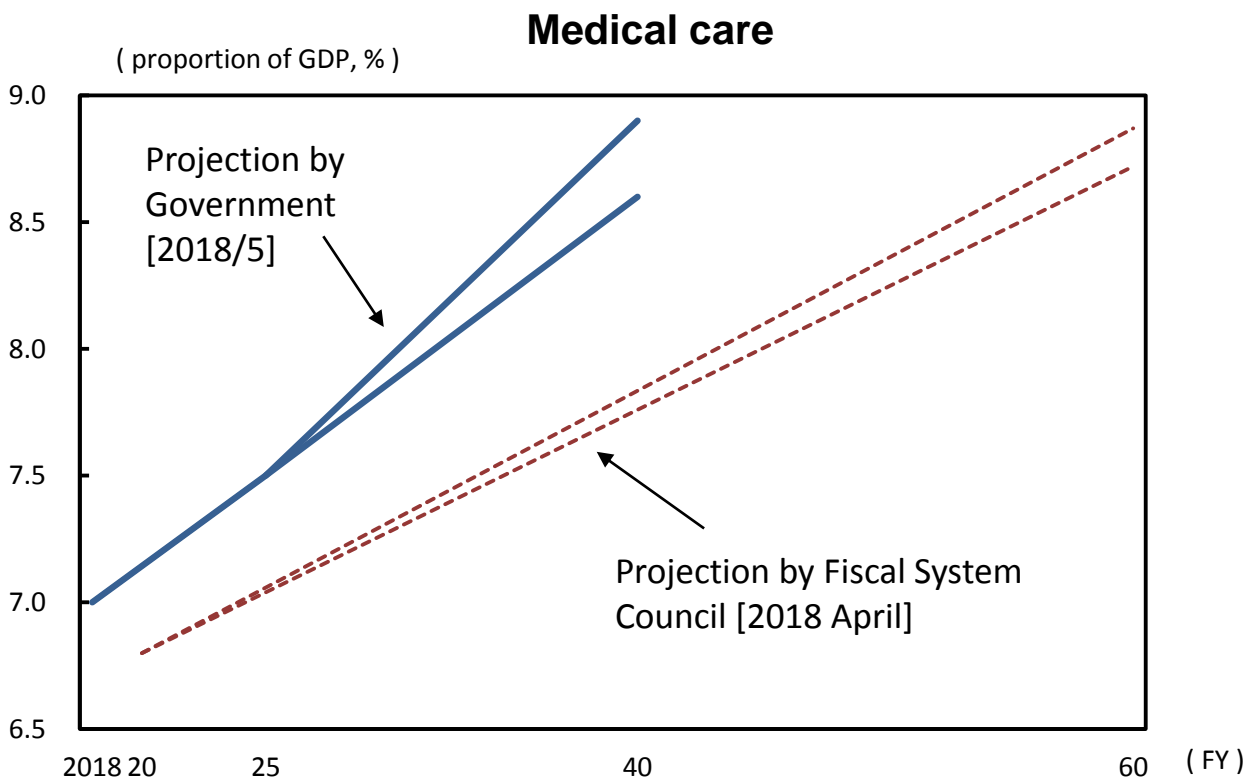
Challenges for healthcare system under demographic changes

Increases in medical care spending



(Source) MHLW, 2018, "Factor decomposition of national medical care expenditure"

Projection of healthcare spending



(Source) Cabinet Secretariat et al., 2018, "Projections for social security 2040"; Fiscal System Council, 2018, "Long-term projections for Japan's public finances"

Oncoming trilemma and reform options in Japan

- **Enhance efficiency and productivity**
using data and technological progress, redesigning incentive structure, etc.
- **Effective supply control mechanism**
regional supply plans by prefectures

Quality of healthcare services

: better services by competition and technological progress

- **Preventive healthcare, enhancing better health**

Decent benefit coverage with limited copayment

: assuring equal access by all income level citizens to decent healthcare services

- **Rationalize copayment**
considering ability to pay (income/asset), not relying on age
- **Review benefit coverage**
enhancing self-help for low-risk areas;
reflecting effectiveness of medicine and treatment;

Limited fiscal burden

: not requiring excessive fiscal resources (mandatory social contribution and general tax)

- **Secure fiscal resource from tax and social contribution**
earmarking consumption tax revenue to social security spending;
broadening base for social contribution;

Reform agenda and programs for curbing growth

Economic and Fiscal Revitalization Action Program (2015) : FY2016-2018

- Optimization of the healthcare and long-term care delivery systems [11 agenda]
- Incentive reform [8 agenda]
- Industrialization in public services [4 agenda]
- Reviewing burden and benefits [4 agenda]
- Reforms relating to the dispensing of drugs and compensation for drug costs [11 agenda]

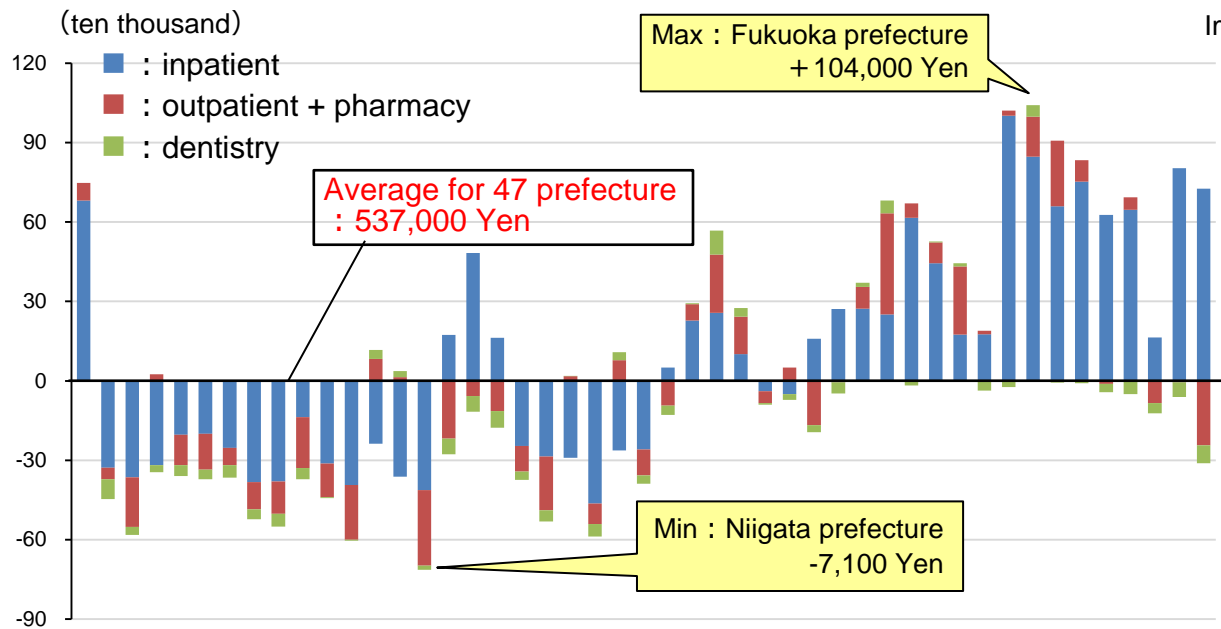
New Plan to Advance Economic and Fiscal Revitalization (2018) : FY2019-2021

- Promoting preventive medicine and better health [18 agenda]
- Reforming healthcare service provision [31 agenda]
- Reviewing benefit and burden [10 agenda]

Measures coping with increasing healthcare service

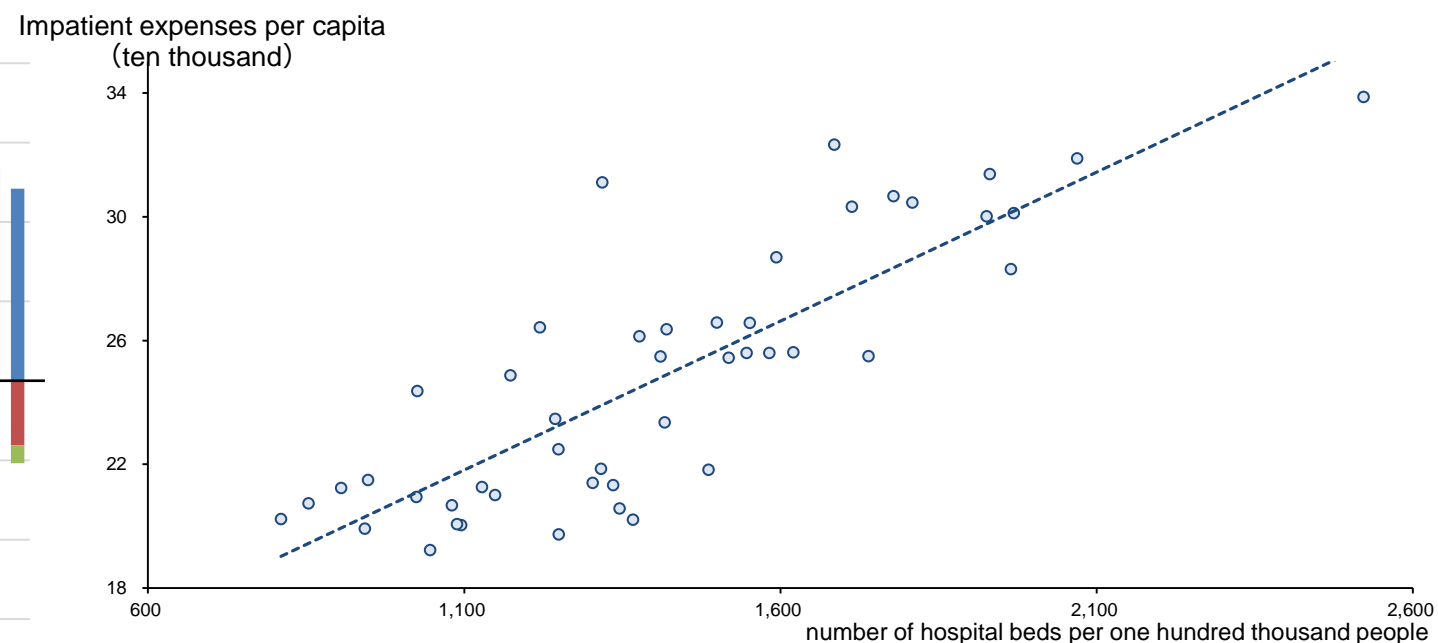
■ Diversified outcomes and demand / supply across different regions (prefectures)

◆ Regional difference of medical care expenditure per capita (47 prefectures)



(Source) MHLW

◆ Relationship between inpatient expenses and number of hospital beds (47 prefectures)



Strengthening the fiscal role of local governments

• Enhance fiscal responsibility of local governments

→ Establishing a **clear linkage between benefit and burden** at local government level, while being supported by national subsidies

Long-term care system : municipalities

Medical care system : prefectures

→ Institutionalizing **mandatory supply plans** made by local governments

→ **Visualizing different outcomes and effectiveness** to motivate reforms

Lessons learned from Japan's experiences

For sustainable pension and healthcare systems

- **Installing flexible and automatic adjustments for benefit parameters**
 - need to cope with realization of uncertainties without renegotiation / political decisions
- **Effective control of demand and supply of services by fiscally responsible institutions**
 - need to focus on and incentivize for better outcomes and efficiency
- **Avoiding commitments based on optimistic assumptions and projections**
 - ✓ Ex. free healthcare provision to people aged 70 and more adopted in Japan from 1973 to 83

Need to assure sustainable growth under demographic changes

- **Output is central** for assuring real benefit of social security system at national level
 - Need to carefully consider impacts of social security system on **labor supply** (elderly and female)
 - Need to effectively use **retirement savings** for long-term economic growth
 - Need to avoid significant economic distortions by further revenue mobilization