Social Security Reform in Japan in the 21st Century

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Abstract

The paper examined and discussed several problems of pension programs in Japan which are caused by aging trend in the age-population structure. In particular, it examined several policy reforms in the public pension programs, and the role of firms in welfare provisions.

The paper presented two major reforms in social security in Japan. The first one is to switch the public pension system from the current pay-as-you-go method to the tax financing method at least for the basic part of the pension benefit. More concretely, it is recommended that progressive consumption tax or progressive expenditure tax is introduced. The second is to admit and even encourage firms to withdraw from welfare provision programs.

The paper examined the present status of social security systems in Japan, and concluded that Japan was not a welfare state. The major providers were families and firms, in particular large firms regarding the latter. The paper also discussed various issues of public pension and enterprise pension reforms in the advanced countries, including privatization, efficiency-equity trade-off, tax incidence, etc.

The paper presented a fairly concrete reform in the public pension system, and a recommendation of withdrawal from firms’ contribution to welfare provisions. I believe that such reforms and recommendations are useful to support the living condition of the aged under the uncertain world, and improve the economic prosperity of firms which are currently in a serious recession and facing acute competition edge internationally.
1. Introduction

One of the most serious social and economic problems facing Japan in the 21st century is the aging trend in the age-population structure. It affects, in particular, the social security systems seriously in the field of pension, medical insurance, old-age caring, growth rate of the economy, etc. The purpose of this paper is to pay attention to the pension program which supports the consumption level of the aged.

The aging trend is likely to reduce the pension benefit level if the current pay-as-you-go system is kept without any modification. The present author believes that it is not preferable to reduce the benefit level because the public pension benefit is the overwhelmingly important source of incomes for the aged. It is important to keep the present benefit level in order not to provide uncertainty and uneasiness in their consumption level with the aged. The paper presents several policy reforms to support such a feature.

The paper, in fact, presents two major reforms. One is to switch the public pension system from the current pay-as-you-go method to the tax financing method at least for the basic part of the benefit, and the second is to admit firms from withdrawing from any welfare provision programs. The first half of this paper argues the former issue, and the second half argues the latter one.

2. Several Characteristics of Welfare Provisions in Japan in Comparative Perspective

2.1 Japan is not a welfare state

Japan has not been a welfare state at all, judging from various aspects of welfare provisions. The U.S. and Japan are only two countries among industrialized countries where both are non-welfare states, which are quite different from the other industrialized countries mainly in Europe. Here, the welfare state is defined as a country where the public sector plays a considerably
important role in welfare provisions both in designing the system and providing actual services.

Let us confirm the above by looking at several quantitative evidences. Tables 1 and 2 show the size of social expenditures, and the size of both tax and social security contributions, respectively for the OECD countries. These two tables clearly indicate that the public sector plays only a small role in social expenditures and welfare provisions because the two governments collect only a small amount of funds from the private sectors and provides fellow citizens with very minor social services.

Tachibanaki (2000 a) concluded that both families and enterprises used to be two representative suppliers for welfare provisions, which compensated for a lower degree of social services supplied by the public sector in Japan. It would be feasible to proclaim that both fellow citizens and enterprises are responsible for various services in old-age pensions and medical cares in the U.S. There is a tradition in the U.S. that the idea of self-support is a dominant principle.

I believe that the so-called libertarianism is the most preferred philosophical doctrine in both Japan and the U.S., while the liberalism is the most popular doctrine in Europe. This distinction regarding a social principle and a philosophical thought between Japan- U.S. and Europe reflects one of the causes for the differences in the size of the public sectors in welfare provisions, although I accept that it is two simplistic to attribute the difference between the two regions only to the distinction in the preferred philosophical doctrine.

It is, nevertheless, interesting to note that both Japan and the U.S. have been the champions of the capitalism or the free market economy, while many countries in Europe have been suffering from slower growth rates and higher unemployment rates. It is possible to conjecture that the feature of the welfare states, which asks normally a higher financial burden to both individual persons and firms, is responsible for this weak economy in Europe. In fact, the welfare state was attacked not only by politicians but also by economists in Europe. Representatively, we can raise

We need a quick reservation about the comment on my statement, namely both Japan and the U.S. have been the champions of the capitalism or the free market economy. In the 1990s the U.S. enjoyed a very strong competitive edge, and experienced the prosperous economy due possibly to the new economy, while Japan suffered from the worst recession for ten years since World War II. Incidentally, it is possible to propose that the U.S. is only one winner in the world economy in the 1990s. The other countries, including both developed and developing countries, are possibly all losers. There are, of course, several problems even in the U.S. For example, widening income distribution and a large difference in the life expectancy between the rich and the poor, if we are concerned with social issues. These problems, however, may be regarded as minor because the average citizens can enjoy the prosperous economy currently.

The success of the U.S. economy, moreover, may lead to suggest that the welfare state is harmful to the overall economic performance. In other words, a trust in non-welfare states or a dislike of welfare states would gain a more stranger power. In fact, such a feeling or a movement is now popular in the U.S. We can point out several phenomena which reveal such a feeling or a movement. The first is the failure of creating a nation-wide public health insurance program, and the second is the recent proposal of privatizing old-age pension program. The other countries, both developed and developing countries, are influenced by the U.S. privatization movement in pension program. In particular, the latter countries receive a strong recommendation of privatization from the IMF and the world Bank in which the influence of the U.S. is strong. See, for example, World Bank (1994) about it. Japan is not an exception. Several economists propose privatization of the public pension program influenced largely by the U.S. economic success.

Going back to the story of Japan, I concluded previously that both families and enterprises, and not the public sector were responsible for welfare provisions in Japan.
Nevertheless, it is important to recognize the fact that only large firms were suppliers of social welfare. Regarding the role of enterprises, only larger firms played on important role. Both employees in smaller firms and self-employed were outside the area of generous welfare services. I called it the Dual Structure of Social Services in Tachibanaki (2000 b).

It is quite easy to recognize this dual structure by seeing several observations. First, large firms normally have their own housing facilities for married employees and dormitories for non-married employees. The rents are very cheap generally. Second, large firms operate and manage their own health insurance systems, although they belong to the public health insurance system formally. Extremely larger firms have their own hospitals, and cultural and athletic facilities for their employees. Third, the amount of pension payments and of health services to employees and retired employees in larger firms is considerably higher than these in smaller firms and self-employed people.

The above observations can be verified easily by several statistics. Table 3 shows the amount of non-wage payments by firm size, and its components. It is possible to suppose that non-wage labor payments are largely related to welfare provisions. The most striking result in Table 3 is the large difference in monthly per-employee payment between extremely large firms (i.e., employees’ number over 5,000 ) and extremely large firms (i.e., 30-99 employees). The former is 116,949 yen, while the latter is 57,710 yen. The difference is almost a twice. Another difference appears in the amount of severance payment. Although this table does not show the difference in the actual payment, it is well-known that the large difference in severance payments is observed. Table 3 supports it indirectly because the rate is 5.6% for the former, while it is 2.8 % for the latter.

Table 4 presents the figures of non-statutory fringe benefits by each component. Non-statutory fringe benefits imply voluntary payments to employees. A more striking difference than in Table 3 appears in Table 4: The monthly amount in extremely large firms is 23,601 yen,
while it is only 6,907 yen for extremely small firms. The difference is almost over 3.0 times higher. The largest difference appears in the amount of housing costs, as indicated previously. Employees in larger firms can enjoy a large amount of subsidies in housing facility including a generous housing mortgage system with a very low interest rate to their employees, while those in smaller firms cannot.

Why do enterprises pay non-wage labor costs? Why are there large differences by firm size in Japan? Tachibanaki (2000 c) discussed them extensively. Thus, repeating is avoided. It would be useful, nevertheless, to give the reasons without any explanation. (1) Agency model (i.e., deferred payment), (2) Tax advantage theory, (3) Worker preference, (4) Cost saving apart from tax advantage, (5) Better industrial relations.

It should be necessary to add another factor in addition to the above five items, if we are concerned with the difference by firm size. That is “ability to pay.” Larger firms are able to enjoy higher productivity for various reasons, which enables them to pay higher remunerations, both wages and non-wages, than smaller firms, as shown by Tachibanaki (1996 b).

2.2 Current problems in Japan

The most serious problem facing currently in Japan with respect to socio-economic issues is the lack of confidence in the public pension program by Japanese people. People, in particular the youth and post-baby boom generations, fear that their future pension benefits would not be sustained. They anticipate that their benefit level after retirement would be lowered significantly because of the forecasted pension budget deficit for various reasons, as long as the pay-as-you-go system continues.

Such various reasons may be summarized as follows. (1) Excessive payment to the past generations (i.e., retired people), (2) Unanticipated slower growth economy after the oil-crisis and
very slow growth rates (sometimes negative rates) in the 1990s, (3) Very low rates of interests in the 1990s, (4) a significantly more rapid aging trend in population-age structure than expectation, (5) No financial contributions to the system by a certain portion of participants, and a considerably high rate of people who refuse to participate the system. The final item, namely (5), is the outcome of the lack of confidence in the public pension system. An irony is that it also contributes to the predicted budget deficit.

Since the former four items have been discussed and documented fairly well, and are easily understandable, I pay attention only to the final item, (5). Information on the figures of no contributions and/or no participations is scarce. Journalism is concerned with this issue, and presents the estimated figures of no contributions and/or no participations. I am obliged to rely on these because the government does not disclose such figures officially.

What is the current situation, and who are no contributors and/or no participants? First, the most serious problem for the basic part of the public pension system is that the sum of no contribution rate and no participation rate is 23.4 % in 1998. According to several casual observations, it is said to be about one-third. The survey released by the Social Insurance Agency shows that the principal reason for no contributions, namely 63.8 %, is due to insufficient income during the period which encourages them not to contribute. The secondly important reason, namely 41.7 %, is that people do not trust the public pension system. The multiple answers are allowed in this survey.

Second, about 15 % of firms, which are required to participate the public pension system by law, do not participate it. Moreover, the current serious recession does not unable part pf participating firms to contribute financially to the system.

Third, the great majority of house-wives, who do not work, are exempted from contributing financially to the system, but are entitled to receive the pension benefit. This principle
is not applied to women who work. Certainly, the lack of contributions by a certain portion of women is one of the causes for less revenue in the system. Although the third problem is important, and requires a policy reform, I do not argue it because it needs a space of one paper.

The second and third problems are so serious that a free-rider problem and/or no pension benefit for a portion of retired people in future might arise. Also, they inevitably contribute to less revenue in the public pension system, and thus to aggravate the problem. I propose my reform plan later to cope with this problem.

3. Reform in Welfare Programs

Nearly all countries suffer from predicted budget deficits in public pension systems for the following reasons. First, the pay-as-you-go system gives a favorable benefit to the first generation who did not contribute sufficiently. Second, the ageing trend observed in many countries aggravates the budget deficits because of higher aggregate payments to a large number of retired people and lower aggregate contributions by a fewer number of young people. Third, slower growth rates of the macroeconomy in the 1980s and 1990s observed in many countries also intensify the difficulty.

There are various kinds of proposals, suggestions and movements in regarding policy reforms in welfare programs in advanced countries. The first is privatization movement in the public pension system. The U.K. had the first attempt in this field; a shift from the pay-as-you-go system to the funded system with individual liberty of financial management was implemented. The U.S. attempts to follow it. We can observe serious debates in Kotlikoff (1996), Feldstein (1998), Diamond (1999), Aaron and Shoven (1999), and some others. The idea of privatization receives some support by several specialists in Japan. The representative example is Oshio (1999).

The second proposal is delaying the starting age of public pension payments. It is natural
to see the fact that a large number of countries prolonged the starting age of benefits facing predicted budget deficits. Needless to say, several countries lowered the pension benefit. Japan, in fact, committed to these two policies, namely delaying the starting age and a cut in benefits.

The third movement is given by several proposals which demand to lower the size of welfare programs in general such as pensions, medical cares, unemployment compensations, etc. Such a movement is observed mainly in Europe where the feature of the welfare states has been dominant. It proposes that a higher burden of both taxes and social security contributions is harmful to overall economic performance because it is likely to discourage the incentive of households and firms. A moral hazard problem was also raised in this movement.

The fourth is the argument of financing method for welfare programs, in particular pension programs. Japan is currently in this debate. One proposal was made to deal with the anticipated budget deficit in pension program: replacing social security contributions by general tax revenues in order to finance the benefit. One-third of the basic part (i.e., the first-tier) is financed by tax revenues in Japan. There is a proposal, including myself, that all portion of the basic part should be financed by tax revenues.

There are several countries in advanced countries such as Australia, Canada, Denmark, Finland, Iceland, New Zealand, Norway, Sweden, etc, where tax revenues are the only source for financing the basic part of public pension.

The reason why I mentioned the names of the countries where tax revenues are used is somewhat ironic; I spoke at the hearing organized by the Ministry of Finance about my proposal of tax-financing. A comment by one official at the Ministry was, “The countries to which Mr. Tachibanaki referred are non G-five countries like France, Germany, Japan, the U.K. and the U.S., and thus smaller countries. Japan should pay more attention to the system in the G-five countries.” I accept that the size of the country matters to a certain extent when we argue the pension system. I
do not, however, accept the idea that a larger country cannot implement a tax-financing method. It is noted that the U.K. is famous as a country where tax revenues are used to finance the basic part of medical cares, as the NHS shows.

Why are reforms in welfare programs proposed? As was mentioned previously, some strong negative opinions and criticism arised against generous welfare programs, in particular welfare states in general, in Europe. Atkinson (1999) called such movement “Rolling Back the Welfare State”. Atkinson (1996, 1999) defended the merit of the welfare state, and presented his frustrations by showing the following two points. First, such criticism often ignores the virtue or benefit of the welfare state, and overemphasizes the negative side. Second, the cost of the welfare state, i.e., the negative side is not verified both theoretically and empirically, as was proposed by various critical evaluations. Atkinson prefers a more balanced view of the welfare state.

I am, in principle, in agreement with Atkinson, and presented my personal views for Japan in Tachibanaki (2000 b). There are several critical comments on welfare provisions even in Japan, which demand a lower level of welfare provisions. At the same time, it is proposed that a small government is preferable, i.e., a lower rate of the public role in welfare provisions and deregulation policies in many fields. I do not disagree with the necessity of deregulation policies in industries and other areas in Japan. I do not, however, share with a proposition that the role of the public sector must be reduced in welfare provisions. The main reason for declining such a proposition is that the role of the public sector in welfare provisions is still very minor in Japan, as was presented previously in comparison with other advanced countries. It might be more justifiable to accept some criticism against the welfare states in Europe where the role of the public sector is much more significant in welfare provisions than in Japan where there is no sign of the welfare state.

Several reasons were presented in Japan in order to propose that a higher rate of tax and social security contributions would be detrimental to labor supply and saving incentive. The
negative effect on labor supply and saving motive caused by a possibly higher financial burden of households is likely to be harmful to the growth economy, namely the overall economic performance. This is the main justification for lowering the public sector’s role in welfare provisions.

I do not agree with this justification or proposition for the following reasons. First, there is no empirical proof which supported the negative effect of taxes and social security contributions on labor supply. It is possible that several demographic groups such as married female part-time workers and aged workers are concerned with the effect of their burdens of tax and social security contribution, and in fact it is reported that several empirical studies support a minor negative effect. The effect for prime-age male workers, however, has not been revealed empirically. Therefore, a possible detrimental effect proposed frequently for them is only a campaign or a hypothetical dissatisfaction which does not have any empirical background. It is impressive and useful to notice that lowering income tax rate in the U.S. has changed little the labor supply behavior of the rich in the U.S., as shown by Moffitt and Wilhelm (1998).

Second, a possibly detrimental effect of a higher income tax on saving motivation is not supported empirically in Japan. The interest rate elasticity with respect to savings is normally very low in Japan, as proposed for example by Tachibnaki and Suruga (1999), and thus it is impossible to predict that a change in the income tax rate on the rate of interest would alter the amount of saving figures. In other words, savings are unaffected by the burden of income taxes. Consequently, the rate of capital accumulation, which determines the growth rate of the economy, is not influenced by the financial burden of tax and social security contribution at least in Japan.

Third, somewhat related to this second point, it is necessary to evaluate a proposal of replacing state pensions i.e., public pensions by a means-tested private funded pension. This proposal is common in the U.S., for example by Feldstein (1987), and by the World Bank (1994). The idea behind this proposal arises from a fear that the generous state pensions, more broadly
speaking the welfare state, is likely to reduce the amount of personal savings. Thus, it may be harmful to the growth economy.

Atkinson (1999) showed in chapter 6 that the saving trap would matter, if this policy reform were introduced. Under the model of two different representative groups whose wages are above a critical level and whose wages are below it, the former group may raise the saving rate while the latter may reduce their savings to zero. Atkinson concludes that whether or not aggregate savings increase depends on the number of people above and below the level, these relative wages and the other parameters. In sum, it is premature to draw a definite answer about the influence of state pensions on personal savings.

Fourth, as repeated previously, Japan is not a country of the welfare state. Thus, neither individual people nor enterprises are paying higher taxes and social security contributions to the government. Both sides, nevertheless, complain the government, by saying that it levies higher burdens.

Let me discuss why Japanese individuals and enterprises complain about their higher burdens in spite of the fact that they contributed to the government very little statistically speaking.

I would like to raise several reasons for this misunderstanding or misconception. First, people do not know the exact situation of their tax payments and social security contributions, in particular from the international perspective. They do not know exactly how the welfare state in Europe works, and collects a considerably high amount of tax and social security contribution from the private sector. Related to this argument, people know fairly well about the situation in the U.S. where no feature of the welfare state is observed. A higher degree of information on the U.S. is released to the public because it is regarded as not only a country of the main competitor but also a country of future dream. Consequently, it is natural that they want to keep the burden of taxes and social security contributions at the minimum level like the U.S.
Second, people in Japan have a suspicion of the government activity both in public expenditures and welfare provisions. They regard the government as inefficient, and at the same time they do not feel higher satisfaction from it. For examples, there is a belief that the private sector is more efficient in productivity than the public sector. Some people dislike internal benefits enjoyed by government employees who sometimes commit to bribes. There is a common understanding that those who receive benefits from public expenditures are limited to a certain groups such as the construction industries, financial industries, and some others. In sum, people feel a lower degree of returns to their financial contributions to the public sector.

Third, the second reason is also applicable to the welfare aspect. Various welfare programs such as unemployment compensations, public pensions and health insurances are normally financed by social security contributions by both individual persons and enterprises. Therefore, the amount of these benefits are determined largely by their contributions, although the each person’s contribution-benefit relationship is not so strict, as shown by the existence of both intergenerational and intragenerational transfers. An additionally difficult matter is the contribution by the general tax revenues to welfare provisions, which makes the each person’s contribution-benefit relationship obscure. By evaluating the above points, it is possible to conclude that Japanese people are suspicious about their return on social security contributions because they feel that they do not receive sufficient benefits compared with their contributions. This feeling is much stronger in younger generations than in retired generations. The latter group received a considerably higher level of benefits in both public pensions and medical cares, while it is predicted that future retirees, i.e., younger generations would receive a considerably lower level as was described previously.

Fourth, there is a misconception in Japan that the benefit of social welfare programs comes from the “heaven”. In other words, a non-negligible portion of people feel that they are able to enjoy the benefit of social welfare programs, but that other people should pay for it. The reason why a
non-negligible portion of people feel in this way is, according to my judgment, that they regard various social welfare provisions as an extension of social assistance programs such as poverty relief, payment for the handicapped, etc., which are normally financed by general tax revenues. In sum, there is a feeling of the following statements; “Others should pay for social welfare programs”, and at the same time “I would like to minimize my contribution for it.”

Finally, the position of enterprises is complicated for the following senses. Enterprises do not complain formally about their financial burdens to social security systems because there has been a general support of the Bismarckian tradition which asked equal burdens to both employers and employees in social insurance systems. A voice of dissatisfaction from the employer side is arising, as was stronger in Europe. The current serious recession, which is the largest and the longest in the post-war period, aggravated such a voice, facing difficult financial conditions in many firms and a risk of bankruptcies. This observation is confirmed by a recent trend which showed an increasing rate of no contributions and/or no participations of enterprises in social insurance systems, as was disclosed previously. Although I do not say that this trend is so predominant, it suggests us a necessity of reforms in future. We have to understand that the role of enterprises is vital in the economy because they guarantee both economic prosperity, and thus employment. Thus, it is desirable to prepare the social welfare program which does not hurt the active role of enterprises. I will argue this issue later.

4. Policy Reform in Pension Programs

This part argues reforms in public pension systems, and present my own policy reform particularly for Japan.

4. 1. Arguments for Policy Reforms

I discussed briefly about several policy alternatives for public pension programs. One big
issue was a shift from the pay-as-you-go-system to the funded system with personal financial management. The latter is frequently called privatization. Thus, such an issue may be contrasted between the public pension with the pay-as-you-go scheme and the privatized pension with the funded scheme.

Disney (2000) classified the treatment of public pension system into the following four proposals. (1) A ‘Parametric’ Reform of the Unfunded Programme, (2) An ‘Actuarially’ Fair, (3) ‘Clean Break’ Privatization, and (4) Partial Privatization. The first two retain a strong unfunded component, while the last two reforms involve a strong private component. It is surprising to recognize the fact that funded scheme is superior to unfunded scheme for ten advanced countries, if the real return to pension assets exceeds the sum of the growth rates in the working population and in labor productivity, as shown by Blake (2000). At the same time, Blake shows that unfunded scheme is not viable for ten advanced countries again, if real pensions grow in line with productivity.

The above studies as well as the studies in the U.S. cited previously seem to suggest that a shift to unfunded scheme to funded scheme is unavoidable. However, it should be fair to point out several reservations which do not agree with privatization. Representatively, they are Diamond (1998), Aaron (1999), and some others for the U.S., while they are Atkinson (1999) for the U.K. and Sandmo (1991, 1999) for Scandinavia.

Since the purpose of this paper is not to compare these two different opinions extensively, I describe only briefly my personal judgment on the issue. One important issue, which I find crucial, is several detrimental effects caused by privatization. In particular, since privatized pension funds hold a greater portion of shares in equity market under privatization, an increasing monitoring costs of shares and an interest in a short-run view of equity returns which maximize share values than a long-run view may lead to lower the growth rate of the corporation, and thus that of the macro economy. This fear was indicated by the examination in chapter 7 in Atkinson (1999), who
analyzed the relationship among investment, pension funds, and capital market elegantly. Atkinson gives a caution such that privatized pension funds may give a shower growth rate of the economy than state pension programs.

I would like to point out several other reasons why privatization would not work so well at least in Japan, as expected by advocates of privatization. Also, I would like propose an alternative policy reform which departs from the contrast between unfunded scheme and funded scheme. That is replacing the social insurance principle by the tax principle. In other words, the financing method for pension benefits is shifted from social security contributions to general tax revenues.

The first reason why privatization is doubtful is that Japanese are not prepared for investing their funds in the financial market. The investment behavior by average Japanese is characterized by an extremely high amount of financial assets which were deposited at banks and postal saving accounts as time deposits. A very low rate of investment on equity and bond which gives normally a higher rate of return but a larger fluctuation. These evidence can be verified by, for example, Tachibanaki (1996 a), who discussed the reason why the Japanese have not taken a risk in the financial investment. If individual households were asked to commit to their asset management based on their initiative under privatization, it would be likely that their return to financial investment would be lower. In other words, it is difficult to expect a higher financial return at least in Japan under privatized pension funds. It would take considerable time, if a higher financial return to asset investment by ordinary people were one of the targets of privatization.

Second, it is possible that privatization increases the number of people who do not participate the pension program because it is anticipated that the enforcement activity in participations in privatized pension program will be very weak. I raised previously that the number of no contributions and/or no participations in public pension programs would be increasing fairly rapidly in Japan even under a strict rule of mandatory participations. Such no participations under
privatized pension program may increase the number of no income or a very small amount of income after retirement. A higher public expenditures may be necessary to rescue these retired people from poverty who did not participate the privatized pension program. Such public expenditures, who should be financed by general tax revenues, may be regarded as a moral hazard by those who participated privatized programs, and then paid general taxes as well. Simply, it is unfair.

Third, my personal view such that the role of firms in welfare provisions must be reduced greatly recommends a fairly drastic policy reform in welfare systems in general. I am suggesting a departure from the Bismarck and the Beveridge traditions of social security system where both employers and employees are expected to contribute financially to social insurance systems.

Since Tachibanaki (2000 c) discussed fairly in detail the reasons why enterprises can escape from social security systems, repeating is avoided. It should be useful to summarize them very briefly here. First, it is natural to have a social security system where beneficiaries are the sole contributors to financing. In other words, financing for social security benefits should be borne by beneficiaries. Firms are not direct beneficiaries, although they enjoy a limited degree of indirect benefits.

Second, the intrinsic role of firms is to enhance economic activity, and thus to keep employment. Thus, worrying about employees’ welfare should not be the first priority of firms’ management policy. Responsibility must be borne by a society as a whole. The existence of firms’ contribution to social security may be distortional for efficient allocation of labor and capital.

The third reason for proposing a very limited role of firms in welfare provisions is that the degree of the benefit levels by welfare provisions differs greatly not only from occupation to occupation but also from firm size to firm size both in statutory and non-statutory welfare benefits in Japan, as was disclosed previously. Symbolically, self-employed workers receive no support from
firms, and employees in large firms receive an excessively high level of benefits. This may be regarded as unfair.

In sum, there is no strong justification to believe that firms are required to be responsible for welfare benefits of workers. I believe that the benefit should be financed by an individual person’s contribution through the public sector’s transfer to each beneficiary.

4. 2. An Actual Reform Policy

This part presents my proposal for reforming social security systems in Japan, in particular the public pension system, and shows several simulation results which support such a proposal.

The overall proposal may be summarized as follows.

The current financing method, namely the pay-as-you-go system may be replaced by the method by the (general) tax revenues, more concretely speaking, full (i.e., 100 percent) financing by progressive value-added tax or progressive expenditure tax levied on individual people, for the first-tier (i.e., the basic part of the pension benefit). The second tier might be abolished, if the payment amount of the first-tier were sufficient, or might be modified to privatized funded scheme, if the amount of the first-tier were not sufficient. I estimate that the desirable monthly amount of the first-tier is 170,000 yen for a couple, and 90,000 yen for a single. The contribution of firms to social security is no longer expected. It requires a careful policy reform in implementing the above particularly for a transitory period in order to minimize an excessive welfare loss in transitory generations.

I will explain the reasons why the above reform is desirable, and present several supporting evidences. I also describe several anticipated reservations and critical comments on my arguments.

The reasons can be summarized as follows. First, it is possible to anticipate that people’s mind, in particular younger generation’s fear, is eased, by proclaiming that the society has a strong
intention of supporting the basic level of income for all people after retirement because general tax revenues rather than social security contributions which are expected to be considerably insufficient in future for various reasons are used.

Second, there is a serious concern about intergenerational inequality in the rates of returns to public pension premiums, which has been caused by many factors. Adopting general tax revenues makes the calculation of the rates of returns impossible or unreliable, and thus obscures inequality argument. It is similar to the following observation; no one calculates the rate of return to educational expenditures financed by general tax revenues. In other words, pension benefits may be regarded as a public good like public expenditures on education, if general tax revenues are used.

Third, there are, in principle, two public institutions which collect funds from the private sector, namely the tax bureau and social insurance bureau. The former collects taxes, while the latter collects social security contributions. My proposal suggests an integration of these two institutions. Thus, it contributes to lowering the administration cost, and individual households and enterprises also can receive a benefit because of administrative simplification.

Fourth, the amount of the basic part, i.e., 170,000 yen per month for a retired couple according to my estimation, can be regarded as the national minimum or civil minimum which justifies the existence of social security systems, or social safety nets for all citizens. This eliminates poverty from the society. This has been a tradition since the Beveridge. Although I proposed a departure from the Bismarckian and Beveridgean traditions in the sense that employers can withdraw from contributing financially to the social security system, I would like to keep the Beveridgian tradition regarding the concept of the national minimum at the side of benefits.

Fifth, as described previously, Japan was not a welfare state where the public sector was not the provider of welfare services, but both families and enterprises were the main providers. The recent social and economic phenomena in Japan can be characterized by the following trend; (1)
erosion of solidarity and tie of families, and (2) weakness of enterprises’ financial and management conditions. These phenomena imply that both families and enterprises cannot support family members and/or employees in welfare provisions, and thus an alternative method must be introduced to compensate for the decreasing rate of welfare provisions by them. I believe that such a method is the active role of the public sector which collects fund from individual persons and gives the minimum level of welfare services to them.

Sixth, there is an economic justification because replacing social security contributions by general tax revenues provides an economy with a better allocation of resources regarding the public pension system. In particular, several simulation studies indicate that a social welfare is improved greatly when a progressive value-added tax or a progressive expenditure tax rather than social insurance premiums is used to finance pension benefits. Efficiency is assured by virtue of the indirect nature of a value-added taxes and/or of an expenditure tax rather than the direct tax, and equity is assured by virtue of the nature of progressivity. Both efficiency and equity are assured, as proposed by Okamoto and Tachibanaki (2001).

It should be useful to describe the essential result given by Okamoto and Tachibanaki (2001). They attempted to show a simulation study, by utilizing an extended life-cycle general equilibrium model of overlapping generations with heterogeneous households. “Heterogeneous” here implies that households are different by their income level.

They considered four cases about policy reforms in public pension programs. See Figures 1 and 2. Case B; partial integration and a progressive income tax. “Integration” here implies that a tax system and a social insurance system are combined. Thus, “perfect integration” signifies that only tax revenues are used, and thus social security contributions are no longer used. “Partial” signifies that 50 percent is tax revenues, and thus the remaining 50 percent is social security contributions. “Progressive” here implies that the tax rate is higher for higher income
households or higher expenditure households than that for lower ones. Case C; partial integration and a proportional expenditure tax. Case D; perfect integration and a proportional expenditure tax. Case E; perfect integration and a progressive expenditure tax.

Cases B, C, D, E in Figures 1 and 2 are classified by the following three elements; (1) tax base, whether income or expenditure, (2) tax rate, whether proportional or progressive, and (3) the degree of integration, whether perfect (i.e., 100% are tax revenues) or partial (i.e., 50% are tax revenues). The horizontal line shows the income class (i.e., lower at left and higher at right). The vertical line (i.e., RWC) indicates a relative change in individual welfare by percentage figure, implying that a positive figure shows an improvement in welfare, while a negative figure does deterioration.

The result in Figure 1 and 2 suggests that the highest aggregate welfare gain is obtained by case E among the four cases. More importantly, all individual households gain positive improvements in Case E. Although case C also gives all positive improvements, Case E gives higher improvements for nearly all households than Case C. Also, lower income households gain considerably higher improvements. In summarizing the above observations, it is concluded that the 100% replacement of the current social security contributions by progressive expenditure taxes is the most desirable policy reform based on both efficiency and equity. Please see Okamoto and Tachibanaki (2001) for details.

Let us go back to the story of policy reforms. By combining the above six reasons, it would be possible to conclude that a progressive consumption tax or a progressive expenditure tax can be used to replace the current system of social security contributions.

It would be useful to give several supporting evidences which consolidate the policy reform. First, Denki Rengo (2000) released a document which proposes that the amount of 170,000 yen per month for a couple can be financed by the introduction of the 10% rate value-added taxes.
Since the current rate is 5%, doubling the rate is sufficient. Since the report does not propose a progressive tax rate but keeps a proportional rate, it is considerably different from my proposal. It should be emphasized, nevertheless, that the two proposals are in the same position because the main financing method for pension benefits is taxes rather than social security contributions.

Second, Ushimaru and others (1999) published a report, suggesting that tax revenues rather than the current one-third rate of tax revenues should be used to finance the basic part of the public pension benefits. Their tax base is an income tax. Although there exists a clear distinction between this proposition and mine because of the difference in the tax base, the two suggest a common idea, i.e., the tax principle is better than the social insurance principle. Also, they prefer a progressive tax to a proportional tax. Therefore, the two have a common preference of progressivity rather than of proportionality in the tax rate.

It should be fair to describe various reservations and critical comments on my proposal. In fact, it is true that the government, i.e., both the Ministry of Welfare and the Ministry of Finance, does not accept this proposal, but continues to support the social insurance principle.

There are several reasons why the government is negative. First, it says that the pension benefit financed only by tax revenues is nearly equivalent to the social assistance program to the poor. Keeping the insurance principle makes the relationship between benefits and contributions straightforward, and thus it fits well the idea of self-support after retirement. In other words, the benefit financed by taxes only may lead people to have a moral hazard, as it is observed in various social assistance programs.

Second, a means-test may be required, if all retired people are entitled to receive the constant amount of the basic pension benefit. In other words, is it necessary to pay the pension benefit based on tax revenues to rich retired people?

The first and the second reservations come from a fairly common background, namely it
depends on the idea that the pension benefit is not a public good which can be financed by general tax revenues. Although I do not argue this idea theoretically and extensively, I believe that the tax principle for pension benefits throws away various shortcomings of the current public pension program, and the overall merit exceeds the overall demerit. Incidentally, I am inclined to support a means-test even for the basic part of pension benefits.

Third, employees at the Social Insurance Bureau in the Ministry of Welfare worry about a loss of their jobs because there are no social security contributions. This problem is easily solved by an integration of the Social Insurance Bureau and the Tax Bureau, as the U.K. succeeded in it recently.

Fourth, the Ministry of Finance does not like an idea that a large amount of tax revenues from value-added taxes and/or expenditure taxes is used for pension benefits. The Ministry, implicitly, assumes that an increased amount of tax revenues induced by an increase in the tax rate for the value-added tax in future should be used to reduce the huge amount of the budgetary deficit in Japan. The answer to this problem is simple. It is rational to think of the overall budget in the government including the social security account, and thus not of only the budget administered at the Ministry of Finance. At the same time, if the overall benefit to citizens in Japan caused by a change in the financing method for pension payments is positive, the Ministry cannot complain because the government exists for the benefit of citizens.

5. The Role of Firms in Welfare Provisions

5.1 Introduction

Section 2 of this paper showed that Japan was not a welfare state at all. Also, it showed the role of firms in welfare provisions in Japan.

There are basically four important forms (or components) of firms’ contributions to
welfare. The first is statutory contributions to social security, accounting for about 50% of non-wage labor payments, the second is non-statutory fringe benefits, and the third is retirement allowances (or severance payments). The residual fourth is the sum of payment as a form of real goods, expenditures on education and training for employees, hiring costs, etc.

5.2 Why Do Firms Contribute to Welfare Provisions

What kind of economic theories and/or reasons can be proposed to explain why there is a considerably high share of non-wage payments, in particular non-statutory fringe benefits? This section presents such interpretations.

It is crucial to understand that a large part of fringe benefits such as payment to private retirement systems (including severance payments), life insurance systems, health benefits and other agreed-upon plans, are deferred compensations. Thus, the intrinsic nature of deferred compensations describes the main reason for both employers’ and employees’ preferences, although the factors which are not associated with deferred payments also have to be examined.

Rice (1966) in an early study gave four factors for explaining the growth of fringe benefits in the United States: i) preferential treatment under federal personal income tax laws; ii) savings that are made possible by group purchase of some benefits, notably insurance; iii) efforts to reduce turnover in the face of rising costs of labour turnover; iv) unionization. Woodbury (1983) added three factors: v) preferential treatment under federal corporate income taxes since contributions by employers to pension funds and insurance benefits are largely deductible from employers’ taxable income; vi) the changing age composition of the labor force; vii) the effect of rising income. Hart (1984) provided a useful survey for these results in the 1960s-early 1980s, and analyzed non-wage labour costs.

The above factors have been scrutinized recently to interpret the rationales of fringe
benefits, and new results were added. I would like to summarize them by the following five headings: i) agency theory; ii) tax advantage theory; iii) worker preference; iv) cost saving apart from tax advantage, and v) better industrial relations. These are mainly the factors to explain in level of fringe benefits. However, these may be used also to explain the growth of fringe benefits by reinterpreting them. Each heading is discussed below.

1. Agency model

This model was developed by Lazear (1979, 1981) by extending the idea of Becker (1964). The fundamental idea of this model suggests that the optimal age-earnings strategy for a firm is to pay workers less than their marginal value product in their early years within the firm and more in their later years. There are several reasons for supporting this strategy. First, an employee who has received costly training may quit before the firm has recouped the cost of training, or may engage in a suboptimal level of shirking. Lazear emphasized the importance of deferred compensation to increase the employee’s opportunity cost of quitting or shirking, with its attendant prospects of being discharged. Secondly, fringe payments may increase directly workers’ productivity. Thirdly, somewhat contrary to the second view, there is a finding that productivity grows far less than proportionately to earnings by length of service in the firm, as given by Medoff and Abraham (1980). If this finding was true, a more steeply rising age-earnings profile would increase a worker’s incentive to shirk.

Several reservations may be raised for the agency theory. First, the model refers implicitly to total labor compensation rather than to fringe benefits only. Secondly, the causal mechanism is less clear. Thirdly, some empirical evidence on the difference in working hours between younger workers and older workers is contradictory with the theory. Fourth, it is not easy to identify which one is more appropriate between human capital theory and agency theory based on empirical wage data.
2. Tax advantage theory

Three basic arguments are possible under the tax advantage model. First, it benefits from the fact that most forms of non-wage compensation are not taxed as income. By applying a standard microeconomic theory, it is possible to conjecture that employers could reduce compensation costs without reducing employee utility by offering compensation packages which contain non-wage costs, when these costs are free from income taxation. This provides employers with an incentive to raise the rate of non-wage compensation.

Secondly, somewhat related to the argument of the agency model, Mumy (1985) has shown that deferred payment has a clear advantage when all the factors about payroll taxes, social security benefits, and income taxes are taken into account. The reason is as follows. When wage income is deferred, the present value of the payroll taxes on wage income declines, but a later wage income enters the calculation of average earnings for social security payment in an undiscounted manner. In other words, the social security and payroll tax incentive is to defer compensation early in working life, and avoid payroll taxes and allow pension benefits to accrue, while the concentration of compensation in the latter life-stage raises the average earnings base for social security benefits. Again, the reservations on the agency theory may be applicable here.

Thirdly, corporate tax laws favor employers contributions to social security and pension funds because of deductibility from employers’ taxable income.

In sum, the tax advantage model is quite promising for interpreting the rapid growth of non-wage labour costs, in particular pensions. We can see a nice example of the usefulness of this tax advantage theory from the rapidly growing enterprise pension systems such as 401(k), etc. in the U.S. Since there are so many references regarding the U.S. enterprise pension systems recently, they are not written here expect for one, namely Poterba, Venti and Wise (1994).

3. Worker preference
A large number of empirical studies such as Freeman (1981), Lester (1967), and Woodland (1983) propose that unionized firms have a higher proportion of total compensation in the form of fringe benefits in comparison with non-unionized firms. An exception is Reynolds (1974). Since the union gives a greater weight on the preference of older workers and permanent workers, who are likely to desire to substitute more deferred compensations such as health insurance and pensions for less wage payment, than on younger and more mobile workers, unionized firms tend to have higher fringe benefits. This argument is an application of the median voter model advocated by Freeman and Medoff (1979). See Tachibanaki and Noda (2000) about unions in Japan which prefer such arrangements. An interesting thing is that large Japanese firms reacted positively to their unions’ preferences.

It must be noted, however, that although the theory of union preference is reasonably persuasive, we have to offer adequate explanations why even non-unionized firms prefer fringe benefits in some countries, and why highly unionized countries such as Germany and Sweden have a lower rate of voluntary non-wage labor costs.

The case of Germany and Sweden is not complicated. Those countries which have a lower rate of non-statutory social programs have a higher rate of statutory social welfare programs. Thus, the necessity of non-statutory social programs is greatly reduced. It would be an interesting subject, however, to inquire whether relying upon statutory social welfare programs heavily or upon non-statutory programs heavily is more efficient and productive to make a national economy stronger.

The case of non-unionized firms is not so simple. The tax advantage model may be working quite adequately for non-unionized firms as well. In other words, both employers and employees agree upon raising the rate of deferred payments for the purpose of benefiting the favorable tax treatment of those payments. It is possible that firms also pay fringe benefits on a
purely “voluntary” basis outside of the system of collective bargaining in expecting employees’ loyalty to firms.

4. Cost saving apart from tax advantage

A specialized agent, like an insurance company, can offer the insurance business with lower charges. The employee’s risk would be reduced when a large number of workers could form a group insurance program with the consent of an employer. Management cost of pensions and insurances also can be reduced if an employer and its employees administer, monitor and evaluate their programs collectively. These cost saving features encourage an employer and its employees to increase the number of fringe programs and the employer’s expenditures on these programs.

5. Better industrial relations

We saw a considerably high share of non-statutory fringe benefits in larger firms in Japan. One of the causes of this feature can be explained by the fact that larger firms wanted to have better industrial relations, by paying higher fringe benefits to their employees. Generous treatment, which is representatively given by better housing facility, medical insurance, food for lunch, cultural and athletic facilities, etc., can attract more qualified workers, and keep employees in their firms by preventing them from turnovers. Royalty to firms also can be expected, and thus employers can enjoy their employees’ high motivations and hard working. Also, firms hesitated to pay higher wages only to their own employees because a harmony in the industry was believed to be important. These are the main reasons why larger firms in Japan paid considerably high shares of fringe benefits. Trade unions in these firms responded positively to them, and thus the both sides, namely employers and employees were cooperative, as Tachibanaki and Noda (2000) analyzed.

6. Tax Incidence

There are several criticisms against the high share of social security contribution, in
particular employers contributions, and non-statutory fringe benefits, by raising the following five issues. First, this high rate increases labor costs in general. It is detrimental to the financial condition of a firm, and thus to employment. Secondly, it may encourage a firm to employ a more capital intensive technique rather than a labor intensive technique because of an increase in labor costs. This is again harmful to employment. Thirdly, related to the second point, labor intensive industries are hurt more seriously in comparison with capital intensive industries. Fourth, non-manual workers (or skilled workers) will be preferred compared with manual workers (or non-skilled worker) due to a ceiling of wages in determining the contribution rate. Fifth, since the benefit of welfare provisions is enjoyed nearly entirely by individual persons, it would be possible to have an idea that firms can be relieved from the contributions of firms in welfare provisions. The reduction in these contributions can be used to increase in the number of employment and/or in the per hour wage payment.

There is one extremely important subject which must be considered before proceeding to these questions. That is payroll tax incidence. It is crucial to understand who actually bears employer contributions. Three cases are possible. (1) Backward shifting which defines that a firm can pass on employer contribution (payroll tax) to its employees. (2) Forward shifting which specifies that a firm can pass on the tax to consumers in the form of price increases. (3) No shifting at all. The previous five propositions regarding the effect on employment are made under a presumption that a firm does not shift the burden at all. When the direction and the degree of tax shifting are available, the stories must be modified greatly. Several theoretical results and empirical evidence about payroll tax incidence are reviewed.

\textit{a) Payroll tax incidence}

In a world of competitive market the incidence of a payroll tax depends upon two parameters, namely the labor supply elasticity, and the labor demand elasticity. If capital is
considered as an additional factor input, the substitution possibility between capital and labor also plays an important role. The common technique to estimate the payroll tax incidence was initiated by Brittain (1972) who estimated a labor demand equation derived from a production function. The effect of a payroll tax was estimated by an indirect method. There was a common understanding based on this technique that payroll taxes are mostly borne by labor in the long-run because long-run labor supply elasticity is perfectly inelastic or very low, as Break (1974) found mainly for the United States. In other words, it had been believed that employer contributions were fully shifted backward to workers' real wages.

Feldstein (1974) proposed a model of the incidence of the payroll tax which assumes that the supply of labor is not necessarily inelastic. He also introduced a growth dynamic through capital accumulation into the model. When the estimates on the labor supply elasticity and the labor demand elasticity are applied to the model, a slightly different result is obtained. For example, for the United Kingdom data Beach and Balfour (1983) estimated that only 45-60 per cent for prime-age males and 14-19 per cent for married women were shifted back to labor. Since the value of labor supply elasticity is considerably high for married women, say 0.8-1.1 per cent compared with 0.08-0.20 per cent for men, only a small portion is shifted back. Thus, the effect of the payroll tax is equally shared between wage rate loss and employment reduction for married women, while the major effect is on wage rate loss for men. Irish results show a similar story. Kirwan (1979) adopts a higher value of the elasticity of labor supply, 0.74, while Hughes (1985) applies a lower value, 0.21. The estimated results of shifting turned out to be considerably different between the two. Consequently, a possible reduction in the employer contribution produces a different result in the estimate of job creation. Those two studies clearly show the importance of the labor supply elasticity in estimating the effect of the payroll tax on shifting and on the number of possible job creations (or job losses) due to a change in the rate of employers contribution.
Hamermesh (1979) estimated it for the United States, and obtained the result that 36 per cent of payroll taxes is borne by labor as lower wage rates for white males. Although his 1979 paper recognized the difference in the elasticity of labor supply among demographic groups, he failed to take account of such differences. His emphasis was placed upon the adjustment process of labor demand and supply. Extending the idea of the adjustment process, Hamermesh (1980) obtained the result that the impact of a change in the payroll tax rate on a change in the wage rate is delayed for several years because the adjustment of both labor supply and labor demand is not instantaneous in reality. He applied the recent estimated values of the adjustment coefficients to estimate his result.

Another important finding derived from Hamermesh (1980) is that the response to a decrease in the payroll tax is much slower than to an increase. This asymmetric nature arises from the fact that the adjustment of actual supply to desired labor supply is slower than that of actual demand to derived labor demand because he adopted Barro-Grossman (1976) type employment model. The Barro-Grossman type employment model specifies that actual employment must be the minimum of amounts supplied and demanded. This asymmetry has an important policy implication; when the tax rate is increased, employment adjusts quickly (i.e., employment is cut quickly because labor demand is the binding constraint). When the tax rates is decreased, employment increases only slowly because the labor supply is the constraint. Thus, a policy which aims at lowering the payroll tax rate in order to increase employment has only a limited value, while increasing the tax rate is quite detrimental to employment.

Two reservations are necessary. First, it may be still effective to decrease the payroll tax rate to increases employment for an economy where the observed rate of unemployment is very high like several European nations. Secondly, it is necessary to keep in mind that the supply elasticites for both men and women are considerably higher in a country where the average tax burden (both
income and payroll taxes) is considerably heavy. See, for example, Blomquist (1983) in Sweden. In those cases employment adjustment (cut in employment) may be made more quickly than the adjustment suggested by the model.

What happens in an economy in which both factor and product markets are imperfectly competitive with respect to the incidence problem? Unions may resist the lowering of real wages to maintain their real purchasing power. Firms with monopoly power may raise product price, and pass on the tax increases to consumers, i.e. forward shifting. Leuthold (1975) is one example which tackled this problem in the United States. Although she concluded that labor contracts and union actions effectively prevented real wage from falling rapidly, much work is needed to obtain a more conclusive result about this field.

Apart from the common technique described above, another estimation method has been applied by several authors. This may be called a macro-economy approach, or a Phillips curve approach. Perry (1970) proposed that an increase in employers’ contributions did not show any decrease in wage. Gordon (1971), on the contrary, suggested that employers contributions were shifted back to wages entirely. Vroman (1974) showed a result somewhere between the above two. All the studies were conducted for the United States, and the outcome is quite mixed. Holmlund (1983) estimated it for Sweden, by using a similar but more sophisticated method. He concluded that only a fraction (roughly about 40 per cent) of post-war Swedish payroll tax increases had been directly shifted back onto labor as lower wage increases. Incidentally, he also showed that around 30 per cent of employers contributions in the United States were shifted back.

In sum, the studies on the analysis of the payroll tax incidence tends to suggest that only a small portion of employers contributions is shifted back onto labor. The degree depends on many factors, and is very sensitive to the adopted elasticity parameters. However, it must be emphasized that no studies except for one, i.e., Perry (1970), have shown that there is no backward shifting at all.
Some backward shifting must be kept in mind.

It is somewhat strange to notice that the interest in the study on the payroll tax incidence has been lost in recent years. I point out the following two reasons for this. First, there is a wide belief that only a small portion of employers contributions is shifted back onto labor. Thus, there is no strong incentive to add a new result. Second, several technical issues have not been solved yet. Thus, unless a new estimation method is invented, a different result will not be proposed.

Finally, it is noted that the estimated result in Japan suggests the following: no major portion of employers contributions to social insurance is shifted back onto labor. In other words, nearly all portion of employers contributions is borne by employers (i.e., firms). This result was obtained by Tachibanaki and Yokoyama (2002). Since there are few studies which estimated the degree of tax incidence in Japan, it is somewhat risky to rely only on the study by Tachibanaki and Yokoyama. Some reservations are necessary.

7. Policy Recommendations for Firms

This section presents policy reforms regarding the role of firms in welfare provisions. It is possible to conceive three options about them. The first one is to abandon or reduce the burden of firms’ contributions to social security if it is believed to be too heavy, and thus to expect that employees accept a lower level of social security benefits. Since it is not, however, desirable to lower the level of social security benefits, somebody has to accept a higher financial burden to compensate the reduction in social security benefits. I suppose that it is all citizens. The second is that only the part, namely non-statutory fringe benefits, should be transformed to wage payments. The third is to consider a new financing method for social security, if employees do not accept a lower social security benefit level.

My own preference is to propose the combination of the above three choices for the
following reasons. First, it is desirable to reduce the burden of firms’ contributions to social security financing in order that firms can concentrate on engaging in own business activities more easily. We can add the fact that firms’ contributions to social security are likely to give a distortionary impact on labor allocations, as was proposed previously.

Second, there is no strong justification to believe that firms are required to be responsible for social security benefits of workers. I believe that firms’ responsibility is to have prosperous economic activity and thus to keep employment with possibly higher wages. Incidentally, self-employed workers and farmers have no outside support like employer contributions.

Third, it is desirable to have a social security system whose financing is borne by beneficiaries. One way to have such a system is to shift from the social insurance principle to the tax principle regarding its financing method, as proposed previously in this paper.

8. Concluding Remarks

The paper presented two major reforms in social security in Japan. The first one is to switch the public pension system from the current pay-as-you-go method to the tax financing method at least for the basic part of the pension benefit. More concretely, it is recommended that progressive consumption tax or progressive expenditure tax is introduced. The second is to admit and even encourage firms to withdraw from welfare provision programs.

The paper examined the present status of social security systems in Japan, and concluded that Japan was not a welfare state. The major providers were families and firms, in particular large firms regarding the latter. The paper also discussed various issues of public pension and enterprise pension reforms in the advanced countries, including privatization, efficiency-equity trade-off, tax incidence, etc.

The paper presented a fairly concrete reform in the public pension system, and a
recommendation of withdrawal from firms’ contribution to welfare provisions. I believe that such reforms and recommendations are useful to support the living condition of the aged under the uncertain world, and improve the economic prosperity of firms which are currently in a serious recession and facing acute competition edge internationally.
References


3, pp. 411-441.


## Table 1, Social Expenditures (% of GDP)

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*Source: Public Management Reform and Economic and Social Development, OECD, 1998.*
Table 2, The Weights of Tax Revenues and Social Security Contributions (% of GDP)

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Table 3, The Components of Non-wage Labor Costs (yen) and (%) of Total Labor Costs

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<tr>
<th>Size</th>
<th>Total (per month)</th>
<th>Real goods</th>
<th>Severance payment</th>
<th>Statutory</th>
<th>Non-statutory</th>
<th>Education &amp; training</th>
<th>Hiring cost</th>
<th>Other</th>
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<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>(%)</td>
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<td>Total</td>
<td>82,360</td>
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<td>4.3</td>
<td>8.9</td>
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<td>0.2</td>
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<td>Over 5,000</td>
<td>116,949</td>
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<td>0.6</td>
<td>5.6</td>
<td>8.4</td>
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<tr>
<td>1,000-4,999</td>
<td>92,531</td>
<td>17.5</td>
<td>0.4</td>
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<tr>
<td>300-999</td>
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<tr>
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<th>Over 5,000</th>
<th>1,000-4,999</th>
<th>300-999</th>
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<td>4.7</td>
<td>3.3</td>
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<td>9.4</td>
<td>10.4</td>
<td>12.7</td>
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<td>8.1</td>
<td>7.1</td>
<td>7.8</td>
<td>9.9</td>
<td>14.1</td>
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<td>5.8</td>
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<tr>
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