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Unification of Social Security Pension Schemes for Employees in Japan:

Toward a Single Scheme for Both the Civil Servants and the Private Employees

A Presentation at the Wharton Impact Conference

May 1-2, 2008

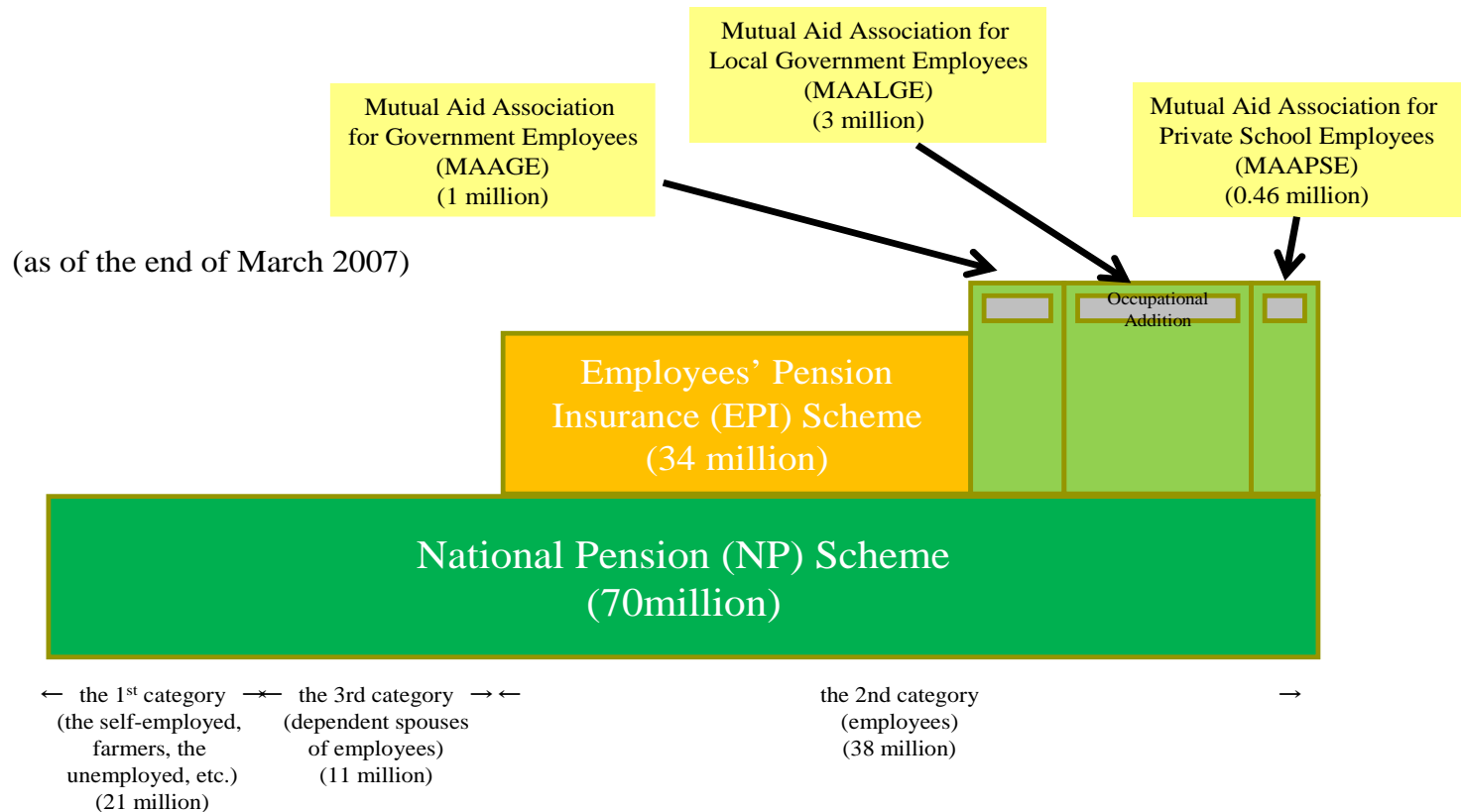
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Classification of Countries by Type of Coverage of Civil Servants by Social Security

- **Two groups**
 - countries with the social security pension schemes covering both civil servants and private employees
(examples) the UK, Canada, Sweden
 - countries with civil servants covered by pension schemes totally different from the social security pension schemes
(examples) Germany, France
- **The US is in transition from the second to the first.**
- **Japan is currently in the intermediate position between the two, but, if the reform bill passes the Diet, it will be in the first group.**

Current Social Security Pension Schemes in Japan



Agenda

- How the social security pension schemes evolved
- How the move to unify the social security pension schemes emerged
- What happened afterwards
- What the driving forces were to have the government prepare the bill to unify the social security pension schemes for employees
- What the bill is going to do
- What the retirement provision will be for civil servants
- Conclusion

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Civil Servants in the 19th Century

- **1868: Meiji Restoration**
 - The new government endeavored to build an industrialized country.
 - It necessitated human resources.
 - It studied civil service system in Western countries.
- **Two groups of government employees**
 - civil servants
 - public employees
- **Basic concept of civil servants:**
 - Civil servants were those whose lives were bought by the country.
 - employment for life, service for life
 - smooth transition from the feudalism of Tokugawa Shogunate Regime
- **Superannuation system for civil servants**
 - a form of salary after retiring from the front line (Ruhegehalt)

Superannuation System

- **1875: for the navy**
- **1876: for the army**
- **1884: for civil servants**
- **1923: unified into a single system**
- **Benefit design: final salary system**

Mutual Aid Associations

- Introduced by government organizations in charge of day-to-day operations for their public employees
- 1905: Yawata Iron Manufacturing Public Corporation
- 1907: the Imperial Railway Agency
- Several other organizations followed.
- Public employees working for government organizations for planning and not in charge of day-to-day operations were without benefits until 1949.

Evolution of Social Security Pension Schemes in Japan (1)

Until the end of 1930's

- Superannuation system for Civil servants (SSCS)
- Mutual aid associations for public employees (MAAs)

In the 1940's

- SSCS
- MAAs
- Seamen's Insurance
- Employees' Pension Insurance (EPI) scheme for private employees

In the 1950's

- SSCS was merged with the MAAs (government, local government, JR, JT, NTT)
- Seamen's Insurance
- EPI scheme
- New MAAs (private school employees, agricultural cooperative employees)

Evolution of Social Security Pension Schemes in Japan (2)

In the 1960's

the EPI scheme
the Seamen's Insurance
the NP scheme
MAA for Government Employees
MAA for JR Employees
MAA for JT Employees
MAA for NTT Employees
MAA for Local Government Employees
MAA for Private School Employees
MAA for Agricultural, Fishery and Forestry Coperative Employees

JR=Japan Railway Company
JT=Japan Tobacco Company
NTT=Nippon Telegraph and
Telecommunication Company

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Problems in the 1970's

- **Pension jealousy discussion**
 - final salary scheme (MAAs) vs career average scheme
 - pensionable age (MAAs=55, EPI=60)
- **Financial problems caused by changes in industrial structure or employment structure**
 - NP scheme
 - Seamen's Insurance
 - MAA for JR employees

Number of Active Participants of the MAA for JR Employees

(at the end of FY; in thousand)

FY	number of active participants
1965	478
1970	468
1975	436
1980	419
1985	282
1990	196
1995	196

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Unification Process (1)

- **1979 reform**

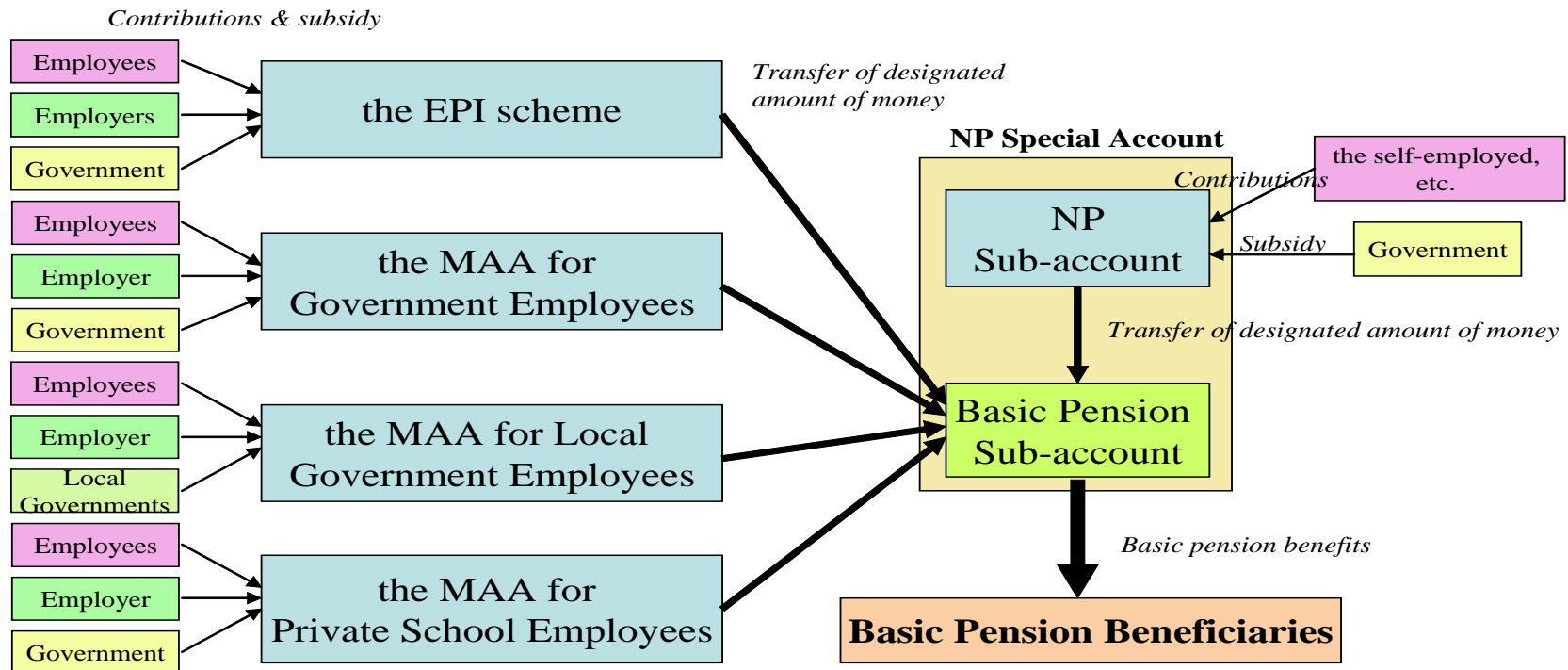
- pensionable age of MAAs: 55 → 60

- **1985 reform**

- coverage of the NP scheme: extended to the whole nation
- Seamen's Insurance was merged with the EPI scheme.
- benefit formula of MAAs: final salary → career average
(MAAs earnings-related formula)
= (EPI earnings-related formula) + (occupational addition)
((occupational addition) = 0.2 x (EPI earnings-related formula))

Unification Process (2)

- 1985 reform unified the flat-rate part.

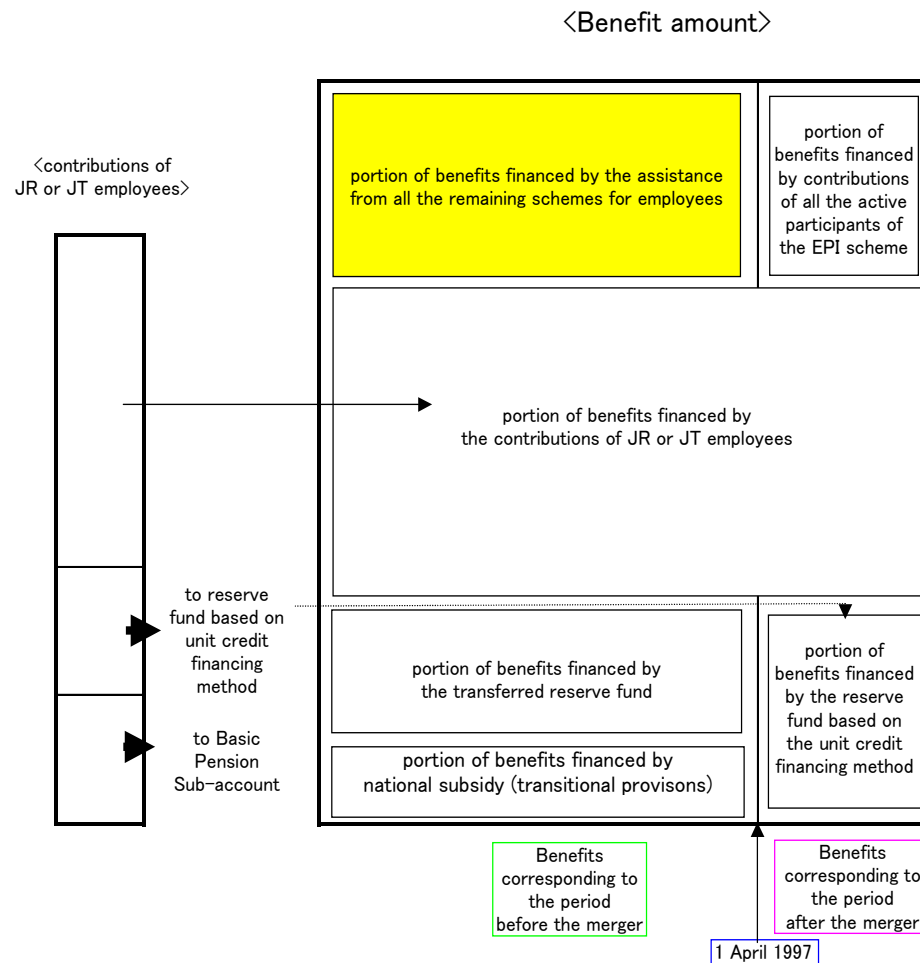


The designated amount of money is the share of each scheme of the total amount of basic pension benefits in proportion to the number of employees aged 20-59 in the 2nd category plus their dependent spouses in the 3rd category or to the number of people paying contributions in the 1st category.

Unification Process (3)

- **1997: MAAs for JR, JT, NTT employees were merged with the EPI scheme.**
- **2002: MAA for Agricultural, Fishery and Forestry Cooperative Employees was merged with the EPI scheme.**

Financial Framework upon Absorbing the MAA for JR Employees in the EPI



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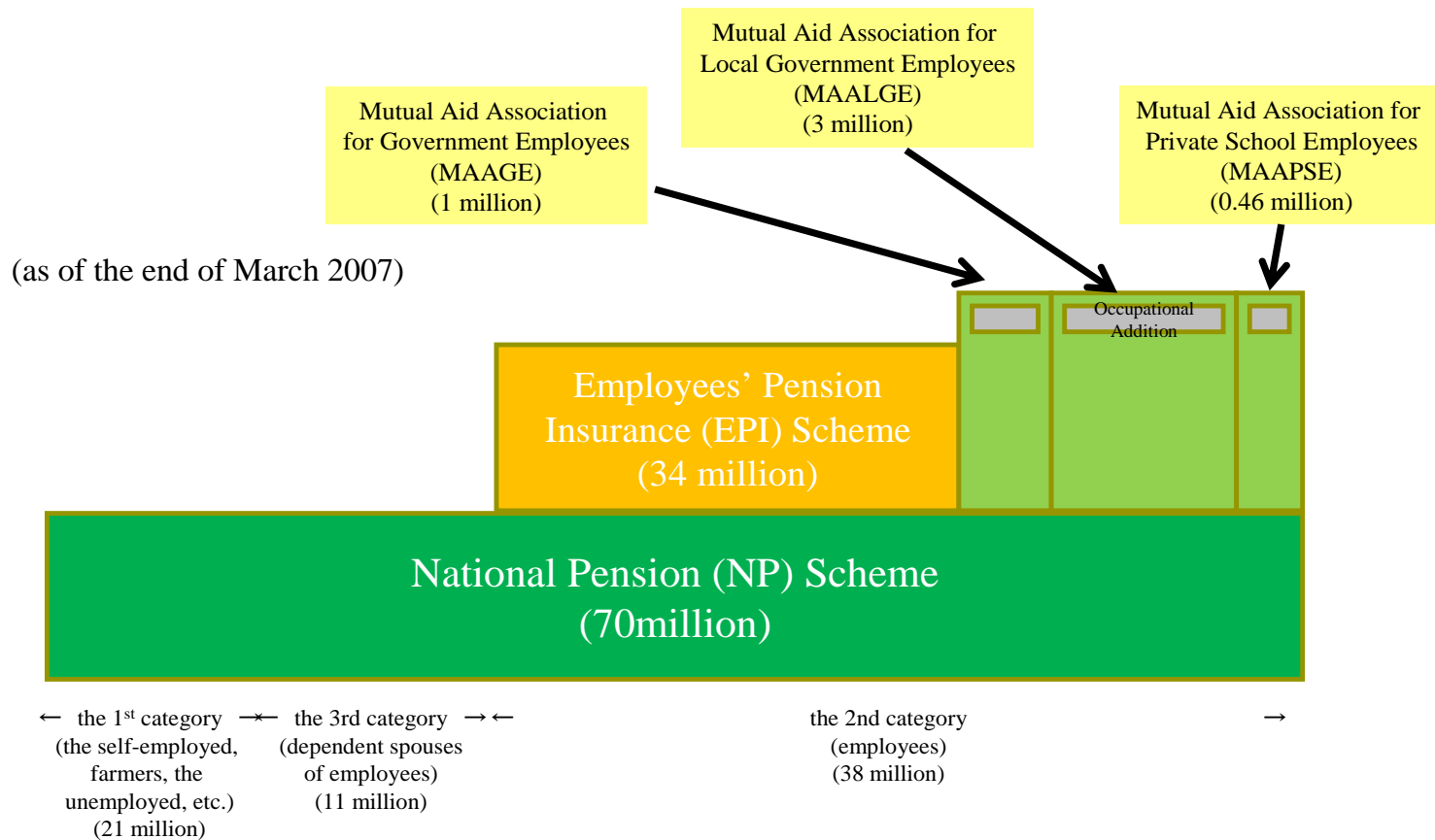
Driving Forces for the Bill

- **Unification Has long been discussed since the 1985 reform**
 - **Cabinet Decisions in 1984, 1996 and 2001**
- **The Diet deliberations in 2004**
 - **three party agreement**
- **The landslide victory of the government parties on the Lower House election in 2005**
 - **the former Prime Minister Junichiro Koizumi ordered the government to prepare the bill**

Agenda

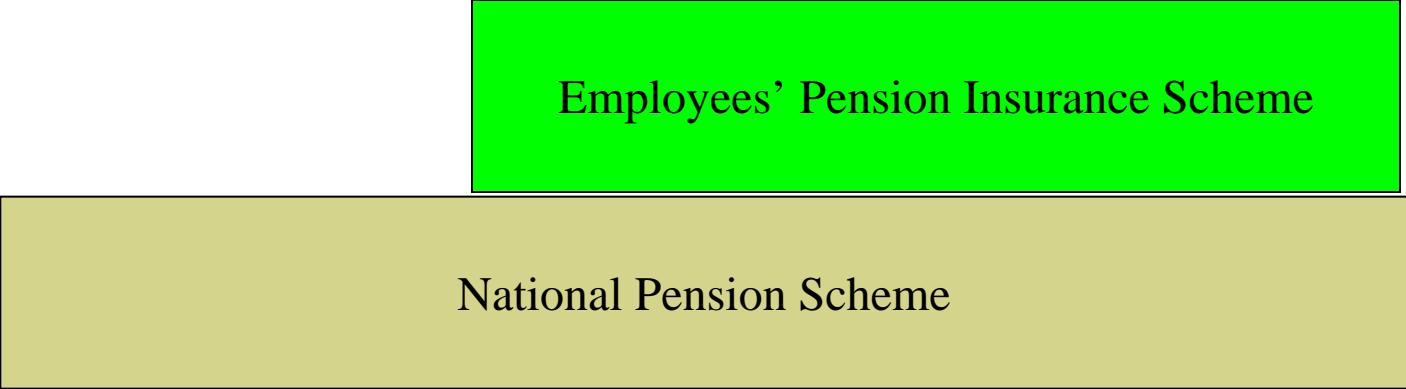
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Current Framework



The Bill

Going to be simplified!



Employees' Pension Insurance Scheme

National Pension Scheme

Unification---objectives

- **Equity**
- **Financial stability**

Unification---issues

- **Benefit design**
- **Financial framework**
 - way of pooling contributions
 - financial interchange
 - reserve fund to be shared
 - investment rule when the reserve fund to be shared is separately managed by the former insurers
- **Administration**

Issues---benefit design

- **To be converged into a single design**
 - with transitional provisions
- **The 1985 reform greatly facilitates the convergence**
- **No accruals for occupational addition after April 2010**
 - to be replaced by an occupational pension scheme for civil servants
- **Other small differences**
- **MAA Benefits corresponding to the period before the merger of SSCS with MAAs are to be reduced.**
 - being financed by tax
 - 27% reduction with the floor of $\max\{90\% \times (\text{total benefit}), \text{JPY } 2.5 \text{ million}\}$
 - not applicable to private school employees

Issues---way of pooling contributions

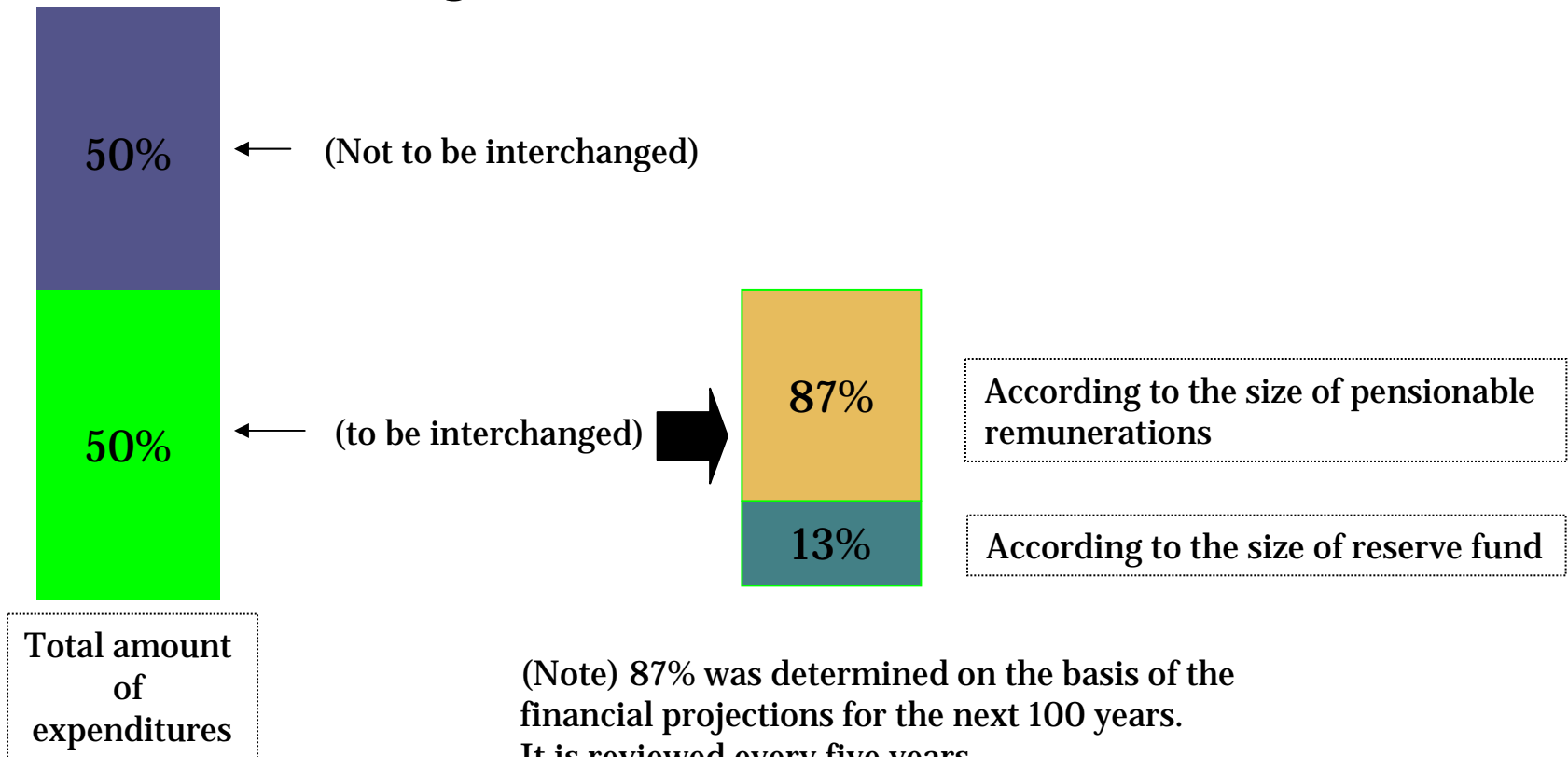
- **Options**
 - (1) perfect pooling
 - (2) former insurers to function as EPI branch
 - to avoid steep increase of transitional cost
- **The bill has chosen (2)**
 - former insurers collect contributions, keep records, pay benefits and manage and invest the reserve funds.

Issues---financial interchange (1)

- **Options**
 - (1) **Perfect interchange**
 - (2) **Partial interchange**
 - to avoid violent impact on former insurers
- **The bill has chosen (2) as transitional measure.**
 - 50% interchange
 - Changing it into (1) is to be deliberated, taking account of the experience during FY 2010 – FY 2027. FY 2027 is the year when the contribution rate becomes uniformly 18.3%.

Issues---financial interchange (2)

- Partial interchange formula



Issues---reserve fund to be shared

- **Options**

- (1) the amount of reserve fund that would have been accumulated if the scheme had been operated from the outset in the same provisions as the EPI scheme
- (2) the amount of accrued liabilities assuming there is no indexing provision
- (3) the amount of reserve fund that has the same fund ratio as the EPI scheme on the day of unification
- (4) the amount of reserve fund whose ratio to the present value of benefits corresponding to the past period is equal to that of the EPI scheme on the day of unification
- (5) the amount of reserve fund whose ratio to the difference between the present value of benefits and the present value of contributions is equal to that of the EPI scheme on the day of unification

- **The bill has chosen (3).**
 - political reason

Issues---management and investment of the reserve fund

- **Investment principles**
 - the Minister of Health, Labour and Welfare drafts to consult other ministers concerned
- **Disclosure**
 - the MHLW drafts the annual report to consult other ministers
 - the MHLW drafts measures to be taken to improve the situation of former insurers to consult other ministers concerned
 - each former insurer has to publish annual report

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Current Retirement Provisions for Government Employees

- **Government employees:**
 - old-age basic pension
 - earnings-related benefit corresponding to the EPI benefit
 - occupational addition
 - lump-sum retirement benefit
- **Private employees:**
 - old-age basic pension
 - earnings-related benefit by the EPI scheme
 - corporate DB pension including Employees' Pension Fund
 - DC pension
 - lump-sum retirement benefit

Occupational Addition

- **The bill stipulates:**
 - no accruals of the occupational addition after April 2010
 - introduction of another occupational pension scheme replacing the occupational addition to be stipulated by another act whose bill should be submitted to the Diet before 1 April 2008
 - <<< No action yet since the bill of unification is pending in the Diet
- **Possible scheme design**
 - the benefit level is to be determined on the basis of the survey by the National Personnel Authority on the retirement benefit provisions by the private companies with no less than 50 employees
 - no DC scheme to avoid insider breach
 - advance funding or level contribution method
 - no indexation?

NPA Survey in 2006

- **National Personnel Authority's survey in 2006:**
 - retirement benefits provided in FY 2005
 - by private companies with no less than 50 employees
 - for those with service years of 20 or more
 - number of samples: 6,232 companies
- **Average of present value of benefits:**
 - excluding the portion corresponding to the employee's contributions
 - private employees: JPY 29.8 million
 - government employees: JPY 29.6 million including the occupational addition
- **Claimed by the Chief Cabinet Secretary**
 - The portion of the employee's contributions should be included.
 - recalculated:
 - >>> private employees: JPY 30.4 million
 - >>> government employees: JPY 31.8 million
- **The benefit level of the new occupational pensions replacing the occupational addition is to be lower than that of the current occupational addition by 32 %.**

Future Government Employees' Retirement Benefits

- Equal to the average of retirement benefits provided by private companies with no less than 50 employees
- Too much weight on lump-sums
- Probably one of the civil service systems that are of the least differences between the civil servants and the private employees in the world
- Can it attract competent people?

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Factors for Advance in the Unification Process

- Actual emergence of schemes in financial difficulties due to changes in industrial structure
- Equalized benefit formula
- Good or bad, existence of strong political leadership
- Pension jealousy discussion pointed out the essential roles played by the social security pension schemes.

Prospect of the bill

- The government parties lost majority in the Upper House in July 2007
- The Democratic Party has insisted unification including the self-employed people and farmers
 - attachment of income
 - unrealistic, illusive 'proposal'
 - just the means for political football
- Can they reach reconciliation, admitting that the unification of schemes for employees is a step for the total unification?
- What priority will be given to the bill in the government parties?
 - Are they determined to pass the bill by utilizing the absolute majority in the Lower House?

*Thank you very much for your
attention!*