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# Stably Securing the Financial Resources for Social Security and Fiscal Reconstruction\*<sup>1</sup>

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## **What Drove National Finances to (de facto) Bankruptcy?**

In this article I will discuss the causes that drove national finances to (de facto) bankruptcy. Following Table 1, I will begin by discussing my personal thoughts and how to break free from this situation, particularly in regards to the manner in which social security should be positioned.

To start out, Fig. 1 indicates the causes for the increase in outstanding government bonds following the collapse of the bubble, using figures that were provided by the Ministry of Finance, as these are at the very least objective.

In the first half of the 1990s, public works projects as part of measures to boost the economy particularly increased, naturally serving as the cause for the increased issuance of government bonds. In this sense it was undoubtedly the expansion of public works projects in this period that caused an increase in debt outstanding. However, from the year 2000 on—with the Koizumi Cabinet beginning in 2001—reductions of public works projects were duly promoted. Owing to this as well as the aging of society which has been unavoidably visited upon us, social security expenses have expanded. Accordingly, this could not be adequately compensated for through revenue.

In terms of the revenue side, government debt increased because even though expenditures eventually increased, revenue was not able to adequately make up for this. This was affected by the reduced tax revenue which came in the wake of the tax reductions and economic recession.

As to why expenditures inflated in the 1990s following the collapse of the bubble, this was undoubtedly due to the fact that public works projects increased, along with a variety of other causes. However, if these were to be combined and all lumped together under some sort of catchphrase, I believe it would carry the connotation that expenditures increased due to payments of social security benefits.

## **Debt Expansion due to a Shifting of Expenditures to “Provisions of Insurance Benefits”**

Insurance benefits are provided to people who are faced with some sort of risk. In the case of automobile insurance, insurance benefits are paid to people who have experienced an automobile accident, and are granted to people who have become ill in the case of medical insurance.

The Japanese government increased “provisions of insurance benefits” in the 1990s, when it increased debt outstanding (see Table 2).

Public works projects are actually supposed to be conducted for the sake of creating infrastructure pertaining to the lives of the people. But in looking at several, it almost appears as if payments were made to start up public works projects so as to stave off unemployment for rural areas in which employment had dried up.

Furthermore, measures for small and medium-sized enterprises were actively carried out during the financial crisis of the latter 1990s, as it would be problematic if small and medium-sized companies were to go bankrupt. Due to this, it is

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Table 1 Outline

1. Causes that drove national finances to (de facto) bankruptcy
  - Status of insurers who excessively underwrote "insurance"
  - Status of not being able to take in "insurance premiums" proportionate to the risk, however
  - Worsening financial condition due to mounting payments of "insurance benefits"
2. Concept of social security under fiscal reconstruction
  - Social security consistent with fiscal reconstruction and alleviating intergenerational disparities
  - To what extent can fiscal expenditures be reduced?
3. Stably securing the financial resources for social security
  - Intention of making consumption tax a financial resource for social security
  - Clearing up misunderstandings surrounding consumption tax

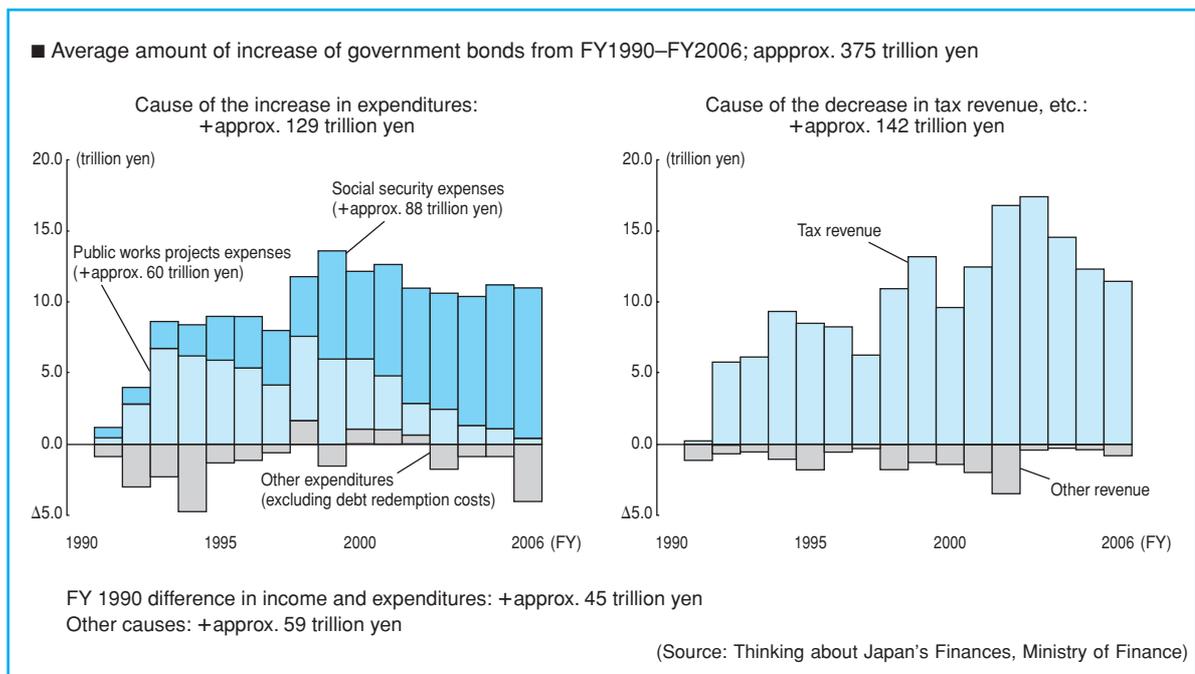


Fig. 1 Causes for the increase in outstanding government bonds

possible that expenditures were given out in a form such as insurance so as to avoid having the people that work at these companies become unemployed.

Local Allocation Tax Grants to local governments have the inherent role of compensating for areas where tax revenues of local municipalities

are insufficient.<sup>\*3</sup> Yet in reality, because the tax revenues of the local governments have plunged following the collapse of the bubble, the central government has provided expenditures to compensate for this. As a matter of course, social security has come to fulfill the role of insurance regardless of whether the business climate is

\*3 Local Allocation Tax Grants are a certain proportion of national tax that the central government transfers to local governments as a tax source whose purpose is not restricted to balancing local revenue sources between the central government and local governments without prejudicing the independence of local governments.

**Table 2 Causes that drove national finances to (de facto) bankruptcy**

<p>■ Shifting expenditures to “provisions of insurance benefits”</p> <ul style="list-style-type: none"> <li>□ Public works projects—“unemployment insurance” for rural areas</li> <li>□ Measures for small and medium-sized enterprises—“unemployment insurance” for small and medium-sized enterprises</li> <li>□ Local Allocation Tax Grants—function of securing financial resources = “insurance” against insufficient tax revenue of local municipalities</li> <li>□ Social security—“insurance” for illness, primary nursing care, insufficient living expenses in one’s old age</li> </ul> <p>In the economic sluggishness of the 1990s, we entered a stage wherein insurance companies had mounting payments of insurance benefits</p> <p>However, they were not collecting “insurance premiums” proportionate to risk</p>
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**Table 3 Concept of social security in an age of fiscal reconstruction (1)**

<p>Conventional concept of social security</p> <ul style="list-style-type: none"> <li>□ Article 25 of the Constitution of Japan</li> <li>□ Assistance principle <ul style="list-style-type: none"> <li>Benefits provided according to need, burden borne according to ability</li> <li>→ To receive such benefits is a right</li> <li>Benefits should not be affected by the policies of the administration at the time</li> </ul> </li> </ul> <p>➢ But there have been enormous fiscal deficits and unprecedented aging of society</p> <ul style="list-style-type: none"> <li>• The procurement of financial resources must be considered before providing benefits</li> <li>• Focus on the insurance function of social security</li> </ul>
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good or bad.

I am not necessarily saying that this is a bad thing. However, when the economy is sluggish, the populace as a whole is faced with risks. As such, the situation reaches the point where insurance benefit payments for these risks are given out with abandon. What is more, it has become nearly impossible to put a stop to this. At the same time, this naturally means that financial resources are necessary in order to pay out suitable insurance benefits. However, since financial resources—including these insurance premiums and taxes—could not be secured in proportion to the risks, this eventually resulted in government debts of such an unprecedented magnitude arising.

### **Is Fiscal Reconstruction Feasible with a Concept of Social Security Under the “Assistance Principle”?**

As a result of this, talk of fiscal reconstruction

began to be voiced around the time of the Koizumi Cabinet. For future social security, when you ignore issues like fiscal reconstruction and merely advocate firmly maintaining the necessary benefits, it is considerably difficult to obtain broad-based understanding from the people. Yet even while exhibiting an attitude of cooperating for fiscal reconstruction, one must advocate the necessity of appropriate social security. In doing so, the conventional concept of social security must inevitably be revised.

For example, regarding social security there have heretofore been numerous arguments which are grounded in Article 25 of the Constitution of Japan or on the “assistance principle” in technical terminology (see Table 3). The assistance principle essentially states that social security is to be provided under the general rule that benefits be given according to need and the burden borne according to ability. This led to the appearance of the so-called theory of curbing social security benefits, which will be discussed later on.

• Insurance principle  
Benefits and burdens are proportionate to risk

	Low income	High income
Low risk	Low burden Few benefits	Low burden Few benefits
High risk	High burden Numerous benefits	High burden Numerous benefits

Intolerable burdens

Fig. 2 Concept of social security in an age of fiscal reconstruction (2)

If you follow the reasoning behind the conventional concept of social security, such benefits are an inherent right. It is said that for living one's life it is the right of each and every person to, at the very least, be enabled to lead a minimum cultural life and to be capable of living in such a way. However, simply having this right is meaningless unless there is the requisite money for it. Social security cannot be described solely in terms of money, but social security is not feasible when this requisite money is absent. We are living in a tough world where we have to be mindful of money in a variety of capacities, particularly these days when fiscal deficits have been allowed to accrue.

It is necessary to make social security sustainable by means of better associating it with the issue of financial resources. I think that embedding the function of insurance in the social security mechanism in a more refined manner would be effective in terms of proficiently advocating the necessity of social security for the future.

### **Intergenerational Disparities Brought about by the Assistance Principle**

The principle behind insurance essentially boils down to bearing burdens and providing benefits in proportion to risk. This does not take one's amount of income into account. If this is done in regards to social security, for example, when you consider people for whom the risk of illness is

high or people with a high chance of receiving nursing care, then going by the insurance principle such people would naturally be provided with benefits according to said risk. Owing to this, such people come to be granted greater benefits.

What about the burden for these financial resources? If the insurance principle is followed thoroughly, those people with large incomes would not be the ones to bear most of the burden, but rather it would be those with a high risk who should bear the majority of this. Those people at low risk—regardless of whether or not they have a high or low income—would not have to bear that much of the burden when the insurance principle is followed stringently. This could prompt the question: couldn't this also be handled by insurance companies in the private sector? Yet this is how it turns out, at least when you thoroughly adhere to the insurance principle (see Fig. 2).

But what soon becomes apparent is that for people with low income yet at high risk, symbolically speaking this could refer to elderly persons with low incomes, even if they are belatedly told to go out and earn money, their bodies cannot perform labor. In this situation it is natural to wonder whether or not these people will be compelled to shoulder a heavy insurance premium burden. In the conventional system with the assistance principle—in other words where people bear the burden according to ability (ability were to be replaced with income)—this would mean providing benefits according to need by means

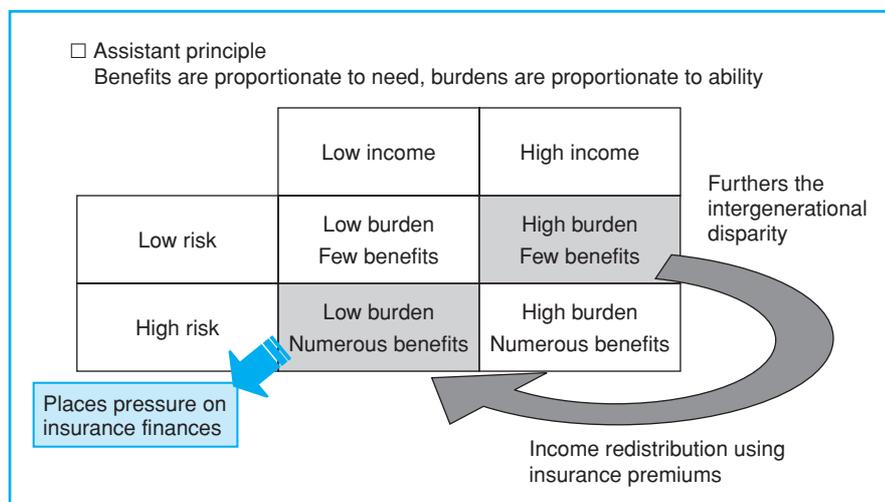


Fig. 3 Concept of social security in an age of fiscal reconstruction (3)

of imposing heavy burdens on people with high incomes, and not imposing burdens on people at high risk but with low incomes. The situation would be one where benefits are provided when risk arises.

What would happen if this were to be carried out? As it shows in Fig. 3, that would allow a gap in the balance of payments to arise in finances for such insurance. If you were to go by the assistance principle, people with a high income but at low risk would receive benefits that would be almost entirely out of proportion to the high burden they shouldered. People with a low income but at high risk would come to receive a great deal of benefits while shouldering a low burden. While it would be preferable to make this balance of payments correspond, what we have been doing is to take a great deal from high income with low risk people and distribute it to low income with high risk people.

Speaking in terms of health insurance for a young person with a high income, unless that person falls considerably ill, they will not receive benefits to an extent that is proportional to the significant burden that they have borne. As was stated previously, since considerable benefits are provided to elderly persons with low incomes, what this amounts to is conducting a transfer between generations. Speaking in terms of recent social security as a whole, somehow the claims by people of the younger generations that their benefits are relatively low and that they are

dissatisfied carry an implicit recognition of such aspects.

### No End in Sight for Provisions of Benefits to the Low Income with High Risk Group

One further point to be made is that beneath the assistance principle there is the possibility that it will in fact be nearly impossible to put a stop to benefits provided to low income with high risk people. If benefits cannot be suitably held in check, this will serve to put pressure on insurance finances. It was undoubtedly for this reason that the theory of curbing benefits appeared under the Koizumi Cabinet. There was talk of macroeconomic slide for pensions, as well as talk of a macroeconomic linkage for medical benefits appearing as well. These are pretty outrageous disputes, but a state of affairs came to pass where this theory of curbing benefits could not be stifled by arguing from the view of the assistance principle.

In my view, if you ground yourself on the assistance principle, there are all too many points of overly slipshod accounting when it comes to the benefits and burdens. Some people say that for the time being we should just go ahead and hand out benefits and then later have whoever is capable foot the bill. Seeing this, other people begin to criticize that benefits will go on increasing without end. I believe that it has come to have

**Table 4 Concept of social security in an age of fiscal reconstruction (4)**

- Social insurance method
  - Emphasis on assistance principle and insurance premium method (≠insurance principle)
  - However, slipshod accounting for the benefits and burdens
  - Complete harmony between the insurance and income redistribution functions
  - For "benefits corresponding to need" there will be no end to such benefits
  - Appearance of the theory of curbing benefits
    - Macroeconomic slide for pensions
    - Macroeconomic linkage for the net amount of medical benefits (held down to a GDP growth rate adjusted for the aging of society)
    - Differentiation (to the extent possible) of the income redistribution and insurance functions within social security

**Table 5 Concept of social security in an age of fiscal reconstruction (6)**

- For example, cases where a person making a 100,000 yen monthly salary would have to pay insurance premiums of 50,000 yen when said premiums are proportional to the risk
- Currently... Insurance premiums set at 5,000 right from the start
  - Insurance premiums proportional to risk are not indicated at all
- Strengthening the insurance principle... together with imposing insurance premiums of 50,000 yen, provide subsidies (using taxes as their source) of 45,000 yen
  - Income redistribution through tax resources based on an awareness of insurance premiums proportional to risk (a thorough insurance function)

just such a composition.

This severe theory of curbing benefits can be overcome by means of making the relationship between the burdens and benefits more transparent (see Table 4). Who will bear the burdens, who will receive the benefits and why these benefits are necessary should be precisely explained. Doing so would have some persuasiveness in calming radical assertions that benefits should be interlinked absolutely with economic growth.

### **Insurance Premiums Corresponding to Risk and the Income Redistribution Using Taxes**

One way of clarifying the relationship between the benefits and burdens is that for people who are unable to endure a burden proportionate to their risk it would be best to move away from insurance and conduct redistributions of income using taxes. As Table 5 shows for example, for

people with a low monthly income of 100,000 yen, if they are made to pay insurance premiums corresponding to risk, it would come to 50,000 yen. Therein, if they pay insurance premiums of 50,000 yen per month out of a 100,000 yen monthly salary, they would be unable to make a living. However, under the current system it is said that they should pay 5,000 yen in insurance premiums, for example. Whether this 5,000 yen figure is the correct figure or not is a separate matter. However, in the present condition the basis for these reduced insurance premiums is explained by saying that since people with a low income cannot bear the burden of exceptionally high insurance premiums of 50,000 yen, this has been lightened to 5,000 while setting aside the reasoning for this figure.

But why 5,000 yen? Insurance premiums of 5,000 yen are not indicated anywhere in the current system. In terms of why low insurance premiums are best for these people, the explanation for this is surely because these people have a

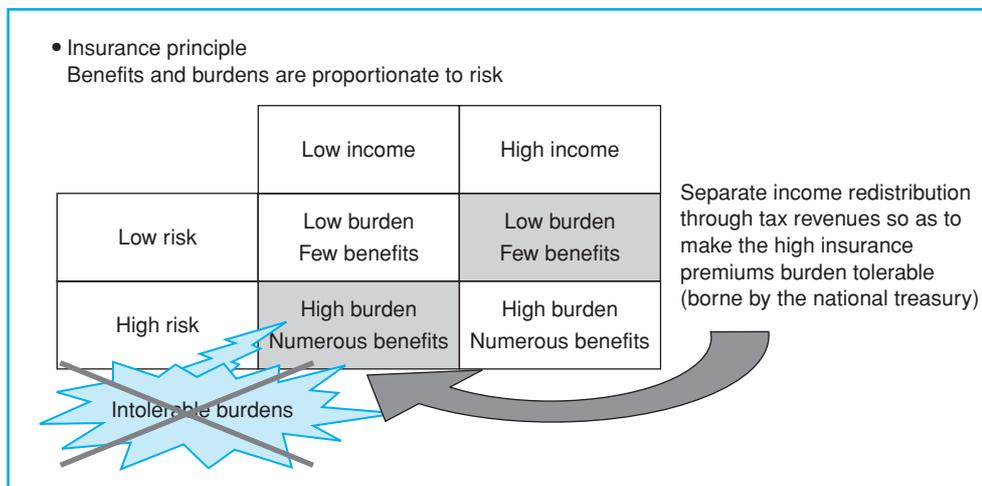


Fig. 4 Concept of social security in an age of fiscal reconstruction (5)

Table 6 Concept of social security in an age of fiscal reconstruction (7)

- Merit of separating out insurance premiums proportional to risk and (income redistribution nominal) benefits from tax resources
- ◆ Impress upon the insured a cost awareness regarding the fact that in social insurance when benefits accumulate this leads to a hike in insurance premiums (in local districts this is not linked with income redistribution of tax resources)
- ◆ Initiatives to reduce the risk for the insured  
→ (Noncompulsory) voluntary curbing of benefits effects
- ◆ Can clarify who bears the burden and receives the benefits and to what extent. Doing so will make it possible to increase the reliability of the social insurance system

low income. However, if you were to ask whether these people are really bearing a burden that is proportionate to the risk, the answer would be that this is not the case. But naturally for the question of why 5,000 yen the current system is operating in a manner that does not fully comprehend how much insurance premiums proportionate to risk would be.

If this were made more transparent, when it comes to people for whom 50,000 yen in insurance premiums was proportionate to risk, these people would be requested to pay exactly 50,000 yen. Instead, for people that would not be able to lead their lives if this is done, then 45,000 yen would be provided in the form of income redistribution using taxes, which would be separate from medical insurance. In this way, materially the burden for these people would amount to 5,000

yen. It becomes possible for them to properly receive medical insurance and to lead their lives (see Fig. 4). In addition, we will be able to clearly see who shoulders insurance premiums and in what manner redistributions of income are carried out (see Table 6). Of course this does not mean that it will be possible to make it this clear-cut in reality, but it would be beneficial if such aspects were to be expressed within the system.

### Unclear Stabilization Policies regarding the Financial Resources for Social Security

Next, there is naturally criticism that if we reduce benefits in such a reckless manner then social security would not last. In response to this, the opinion can be heard that for the Ministry of

**Table 7 Stably securing the resources for social security (1)**

- Fiscal System Council (advisory committee for the Minister of Finance) “Basic Reasoning for the Expenditures and Revenues Combined Reforms” (June 2006)  
(<http://www.mof.go.jp/singikai/zaiseseido/tosin/zaiseia180614/zaiseia180614.htm>)
- *Organizing the Issues for Stably Securing Financial Resources pertaining to Social Security* is a document attached to this proposal  
“It is extremely important that we stop postponing for future generations and aim to strike a balance between the benefits and burdens by means of stably securing financial resources regarding the burden for public expenditures for the necessary benefits  
“For the resources for the burden for public expenditures, it would be appropriate to have the burden broadly and evenly distributed to the public as a whole”
- However, “converting the consumption tax into a special purposes tax for social security” is not stated definitively

**Table 8 Stably securing the resources for social security (2)**

- Assertion that “The way to curb social security benefits is to reduce costs for public works projects or personnel expenses for public servants, as just curbing social security benefits would be outrageous”
- But are advocates of social security benefits actually toiling in order to reduce costs for public works projects or personnel expenses for public servants?
  - No such sense of duty to go that far
  - Eventually pressure to reduce expenditures other than social security expenses abates to some extent, which is not conducive for fiscal reconstruction
- Rather, the way of advocating securing financial resources for social security benefits is able to maintain social security benefits

Finance in its capacity as financier to cut social security left and right is outrageous, but perhaps the condition has begun to change since the closing stages of the Koizumi Cabinet.

An attached document affixed to the proposals issued in June 2007 by the Fiscal System Council, “Organizing the Issues for Stably Securing Financial Resources pertaining to Social Security” incorporates wording found in Table 7. The Ministry of Finance has essentially begun to make the claim that it is necessary to continue properly securing the financial resources for social security.

There have been mass media reports that this document advocates converting the consumption tax into a special purposes tax for social security, but in fact there is no mention of the consumption tax within the text. It is a peculiar document in that no matter where you search, even holding

it up to the light and looking for writing in invisible ink, shows absolutely no mention of this matter. Yet for some reason the mass media has read between the lines and characterized it as a document which places emphasis on creating a special purposes tax for social security. The proposal issued by the Fiscal System Council is not in any way advocating total commitment to proceeding with reducing benefits.

So for the future we must engage in a national debate over the question of how to stably secure the financial resources for social security. However, the Abe Cabinet sealed off debate on increasing taxes. When the House of Councillors election is over, there is the possibility that the conditions will change again, but at least that is how it stands under the current situation.

The Abe Cabinet was saying that it will reduce expenditures and refrain from raising taxes. But

**Table 9 Stably securing the resources for social security (3)**

- Assertion that “Japan’s fiscal deficits are inherently not a serious problem, and there is no need to go so far as to curb social security costs to suddenly restore finances”
- Regarding the government bond market, if the government dulls its initiatives for fiscal reconstruction even slightly this may possibly cause interest rates to suddenly rise steeply and a drop in national bonds
- If the fiscal deficits are left as they are, then living generations will skip out on the bill by just benefiting with only a light burden, while transferring a heavy burden to future generations
- Fiscal reconstruction is indispensable for the sake of alleviating the intergenerational disparity

**Table 10 Stably securing the resources for social security (4)**

- If we attempt to improve the primary balance solely by reducing expenditures this will not be accomplished unless social security costs are curbed substantially
- As a result it would not be possible to maintain social security insurance and pensions for everyone
  - “Americanization of social security system”...would that be a good thing?
- In order to avoid this, the financial resources for social security must be reliably covered through taxation to some degree
- Consumption tax is important as a tax resource for social security
  - Income tax is already withheld in the form of insurance premiums, and this will increase hereafter

when it comes to talk of reducing expenditures, why do it by curbing social security benefits? There is still a great deal of wasteful spending, such as costs for public works projects or personnel expenses for public servants, that remains to be trimmed before curbing social security. Along these lines, I am also of the opinion that this is the proper way to proceed. Unfortunately, however, advocates of social security benefits are not toiling on various fronts in order to reduce public works projects, or to cut personnel expenses (see Table 8). While they are saying that public works projects should be cut, they are not going to do their duty when it comes to making some sort of move to cut them. As such, they are not actually backing these reductions. Since people such as the road construction lobby who are designed to protect public works projects remain keen to do so, the situation becomes antagonistic, with talk potentially turning back to shifting the burden onto curbing benefits.

### **Moderate Debate will Lead to Stably Securing the Financial Resources for Social Security**

I believe that in terms of the construction of 9,342 km of road in the plans for road development, the decision has already been made to construct all of it. The mass media was naturally critical of the plan, with voices being raised from the people’s side as well asking why it was necessary to construct so many roads. What can be seen within the words “construct all of it,” shows a lack of moderation on the part of the people aiming to construct the road. In other words, it would be slightly better if they were to say, “This road is necessary, but we don’t need that so we’ll cut it.” But if you insert “we’ll cut that” then you would likely hear the criticism that that is insufficient, but at least it might be possible to see some restraint at work in the sense that it clearly stated “we don’t need that.” But since the road

construction advocates did not say anything like that, it has the blatant appearance that there is no moderation. Social security is different from roads, but it is important that social security demonstrate the fact that it has moderation.

For social security, if you were to say that benefits must be applied to all of the areas requiring them, it would invite suspicion regarding the extent to which curbing such benefits is taking effect. It will be necessary to effectively apply

modulation by saying, “This is necessary, this must absolutely be protected, but if we had a little margin here we would still be able to do the job right.” By demonstrating this, it will become consistent with fiscal reconstruction, and the supporting of social security benefits will become more persuasive (see Tables 9 and 10). It will also make it possible to emphasize that the people will not be saddled with a variety of eccentric burdens.