

Japan's Income Inequity and Social Security System

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Introduction



For detailed discussion, please refer to:

Hatta, Tatsuo (2024) “日本社会保障制度及其问题”
 (“Social Security: Japan’s System and Its Problems”). 比較*Bijiao*,
 No. 6.

(<https://bijiao.caixin.com/2025-01-03/102274828.html>)

Theme

I want to outline Japan's social security system and highlight its drawbacks from the perspective of facilitating improvement of China's social security system.

1.The social security system has two pillars:.

- A typical example of **income redistribution** is the welfare program. The market mechanism is incapable of redistributing income. Therefore, the government has this role.
- The governments of many countries provide **medical insurance and pensions** (insurance against the risk of increased living costs due to longevity) as compulsory social insurance even though the market offers a variety of insurance, such as fire insurance in most countries.

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PART ONE

Income Distribution and Redistribution System in Japan

I

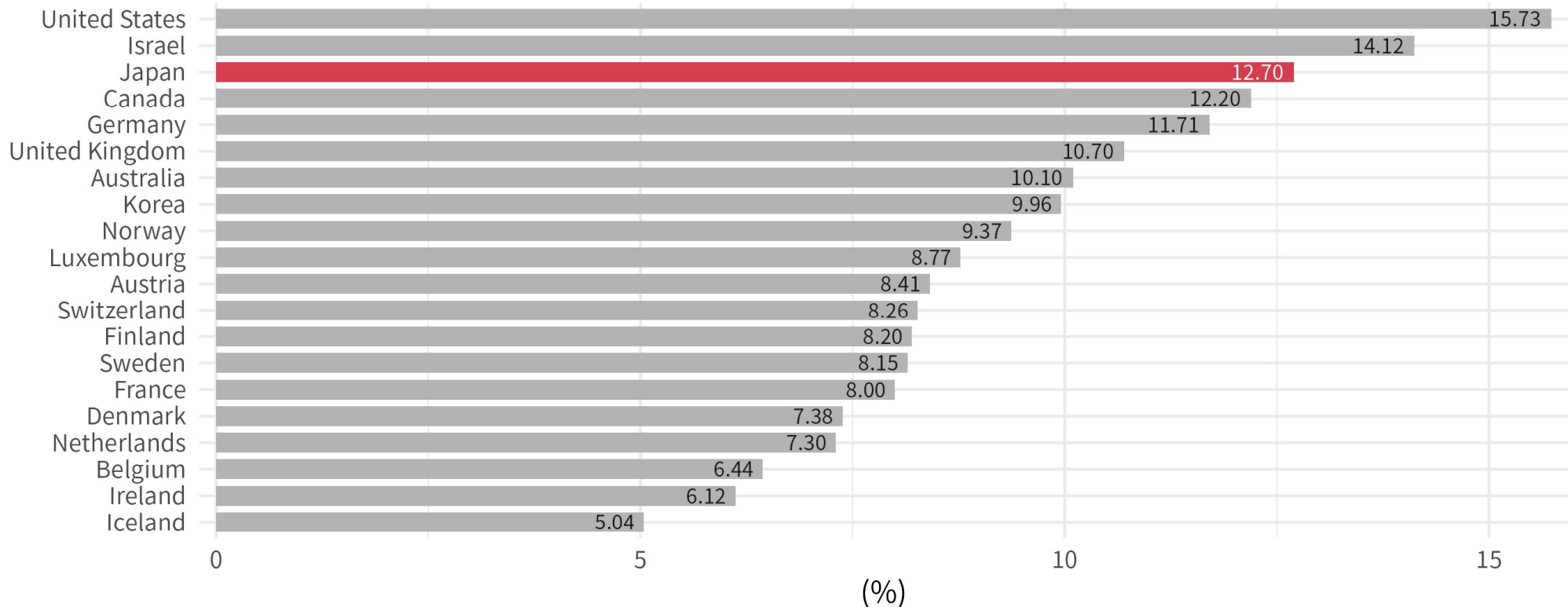
International Comparison of Poverty Rate

Japan Ranks Third in Poverty Rate

- Japan is the third most unequal country in the world in terms of the OECD's “relative poverty rate” based on disposable income of the working-age population (ages 18 to 65) among 20 advanced OECD member countries.
- The only countries with higher poverty rates than Japan are the United States and Israel, where a large number of Palestinian refugees reside.

Poverty rate based on disposable income

Age: From 18 to 65 years



Source: OECD Income Distribution Database. Data follow the OECD's "Income definition since 2012." The countries shown are selected OECD advanced members, all of which had a higher per capita GDP than Japan in 2019 (measured in nominal USD), and Korea. For each country, the most recent year available in the database is used; therefore, the data do not necessarily refer to the same year.

Relative poverty rate

- An individual is in **relative poverty** if their disposable income is less than half of the median disposable income for the entire population.
- *For example, if the median income is 4 million yen, a person with an income of less than half of that (2 million yen) is considered to be in relative poverty.*
- The percentage of the total population that is in relative poverty is the **relative poverty rate**.
- *Suppose that the economy described above has 100 million population and that 10 million people are receiving less than 2 million . Then, the relative poverty rate of the country is 10%.*

Japan's Relative Poverty Rate

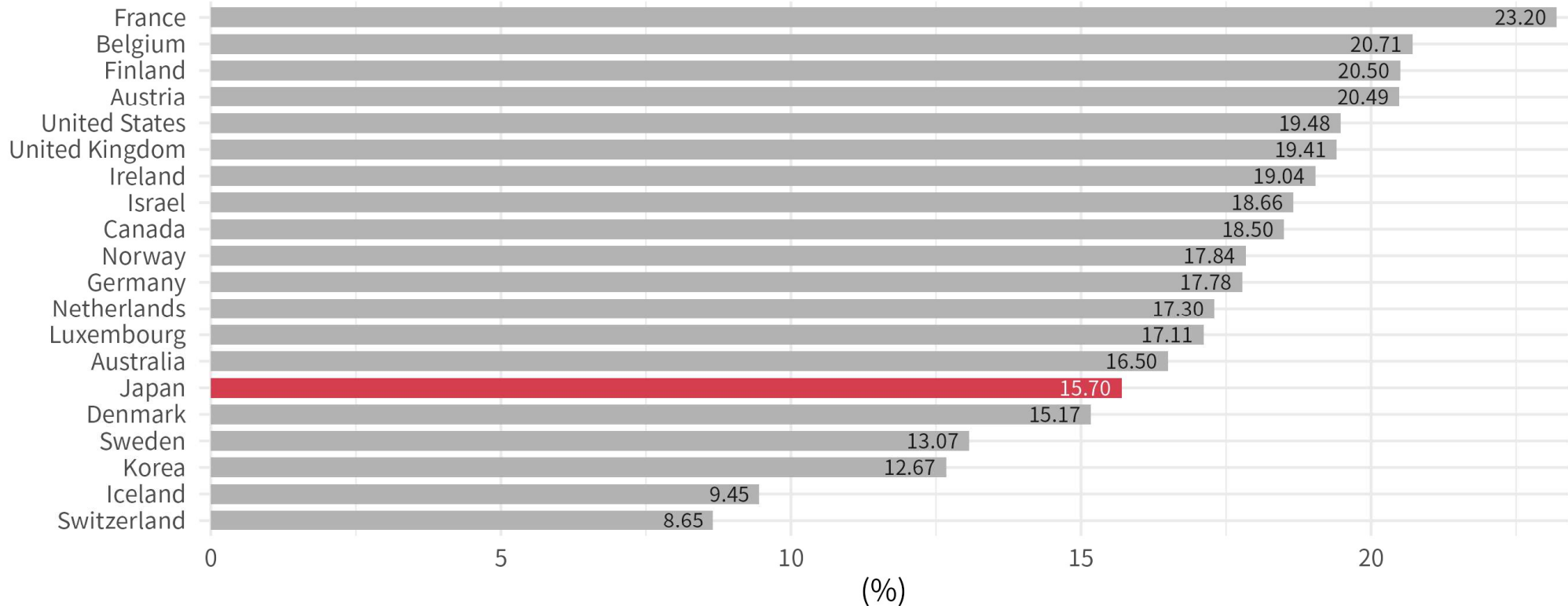
- **The median disposable income** in Japan for 2021 was 2.54 million yen.
- **The relative poverty line** is half of that amount, which is 1.27 million yen.
- **The relative poverty rate** is the percentage of people with disposable income below the poverty line.
 - If this percentage is 0%, the relative poverty rate would be 0%.
 - Since this percentage is 15.4%, the relative poverty rate is 15.4% (as it was in Japan in 2021).

Japan's Redistribution Function is Weak

- What I described above is Japan's poverty rate measured by **disposable**.
- But Japan's poverty rate measured by **market income** is lower than the average of the advanced countries, where market income includes taxes and social insurance premiums but excludes government transfers .

Poverty rate based on market income

Age: From 18 to 65 years



Source: OECD Income Distribution Database. Data follow the OECD's "Income definition since 2012." The countries shown are selected OECD advanced members, all of which had a higher per capita GDP than Japan in 2019 (measured in nominal USD), and Korea. For each country, the most recent year available in the database is used; therefore, the data do not necessarily refer to the same year.

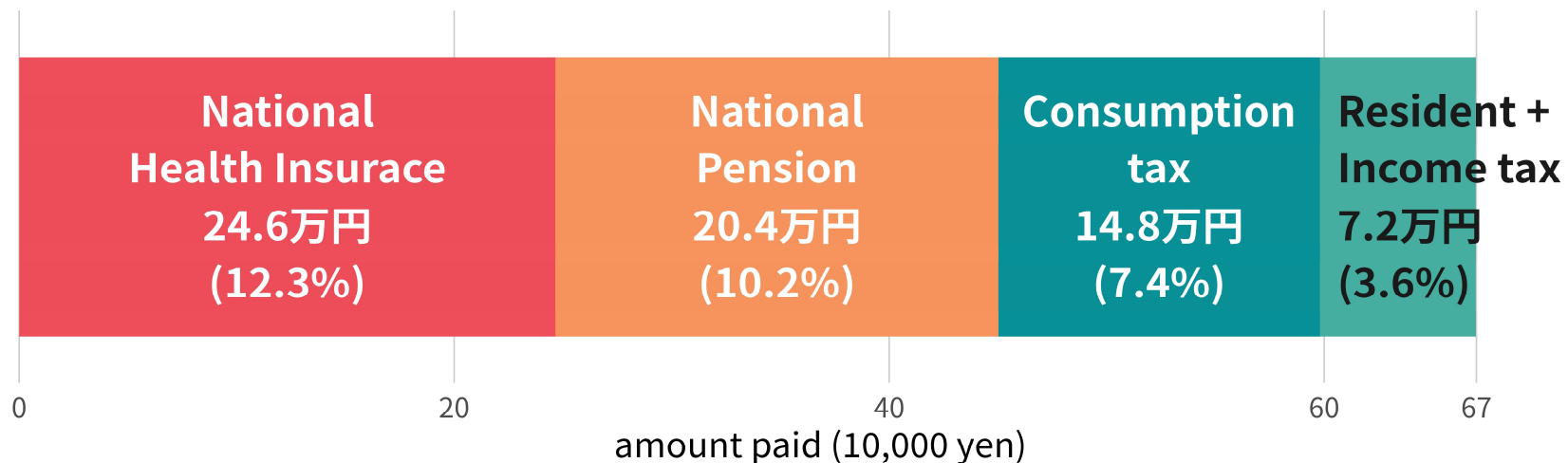
The cause of Japan's high ranking in poverty rate based on disposable income.

- Japan's high ranking in poverty rate measured by disposable income is not primarily due to inequality in market income.
- The gap between the two ranks stems from the heavy individual burden of taxes and social insurance premiums faced by low-income earners, combined with limited benefits provided to them.

Annual Taxes and Public Insurance Premiums

Consider a 40-year-old single person household in Saitama-city, Saitama prefecture with an annual income of 2 million Yen and self-employed. His personal contribution would be **34% of his income**.

Self-employed (filed under Japan's "blue return" system)



Note: Based on a model of a 40-year-old single-person household living in Saitama City, Saitama Prefecture, as of 2024. The individual is assumed to be enrolled in the National Pension and National Health Insurance systems. Fixed-amount income tax reductions (Teigaku Genzei) are not included in the income tax calculation. The consumption tax is estimated by assuming that all income remaining after income tax, resident tax, and social insurance contributions is spent, and applying a 10% tax rate. Figures in parentheses indicate the share of each item as a percentage of annual income. “万円” represents units of 10,000 yen.

II

Measures to Improve Disposable Income of the Working Poor

A. Tax-Financing of Social Insurances

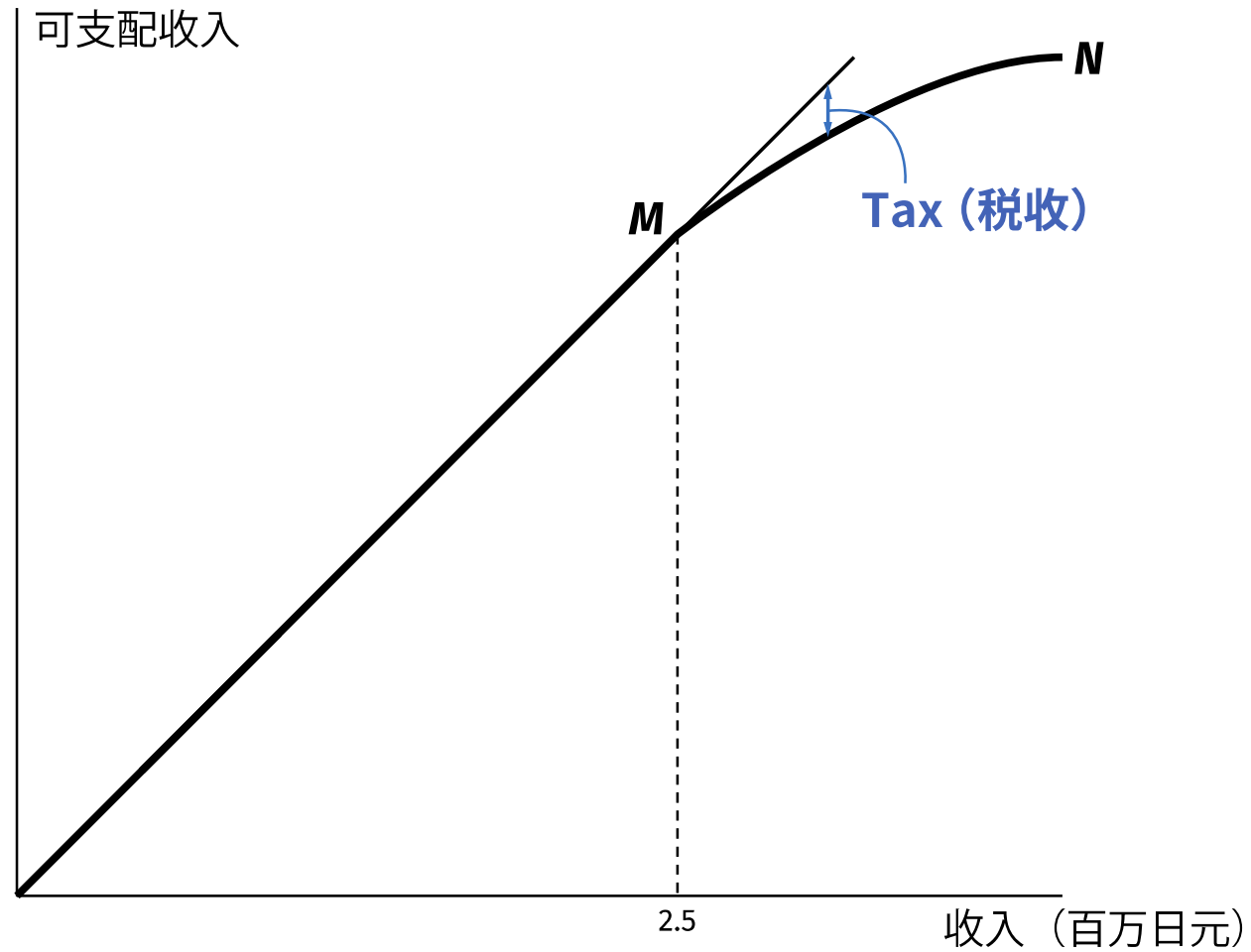
- Abolish premiums for the **basic pension** and **health insurance**, and instead, finance them by progressive taxes, following New Zealand, Australia, Canada and all the Scandinavian Countries.

This will cause a redistribution of income among different income levels but keeps the total combined amount of taxes and premiums intact.

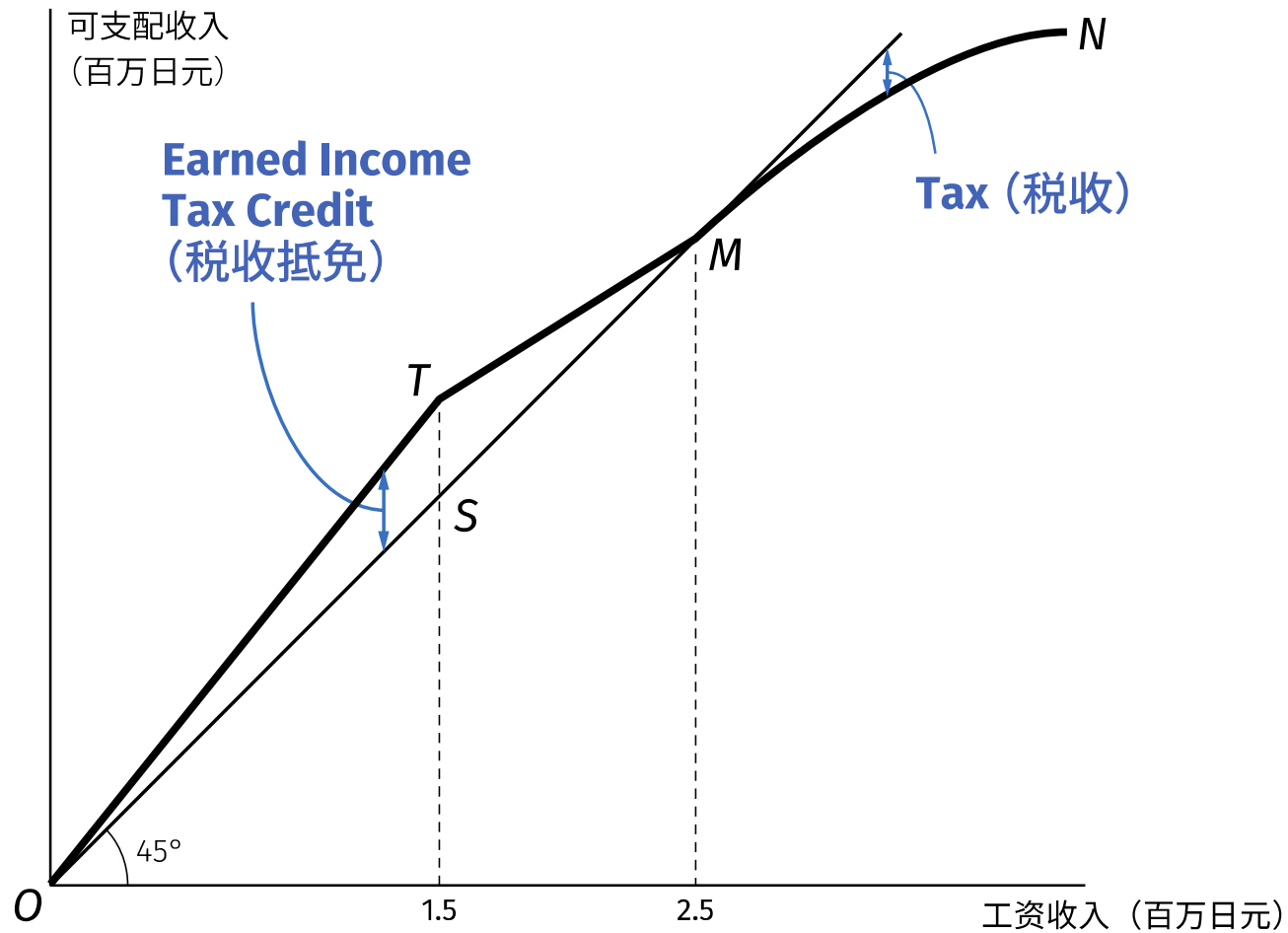
B. Earned Income Tax Credit EITC

The second measure is to introduce a subsidy system for low-wage earners. Under this system, the government provides income subsidies, called earned income tax credit (EITC), to those with low-wage incomes.

Current Income Tax System



Earned income tax credit + Income tax system



International Comparison

- EITC has been adopted by most developed countries.
- In particular, Canada, Australia, and New Zealand introduced EITC to as a measure to offset the repressive effects of a value-added tax (VAT).

VAT-offsetting EITC

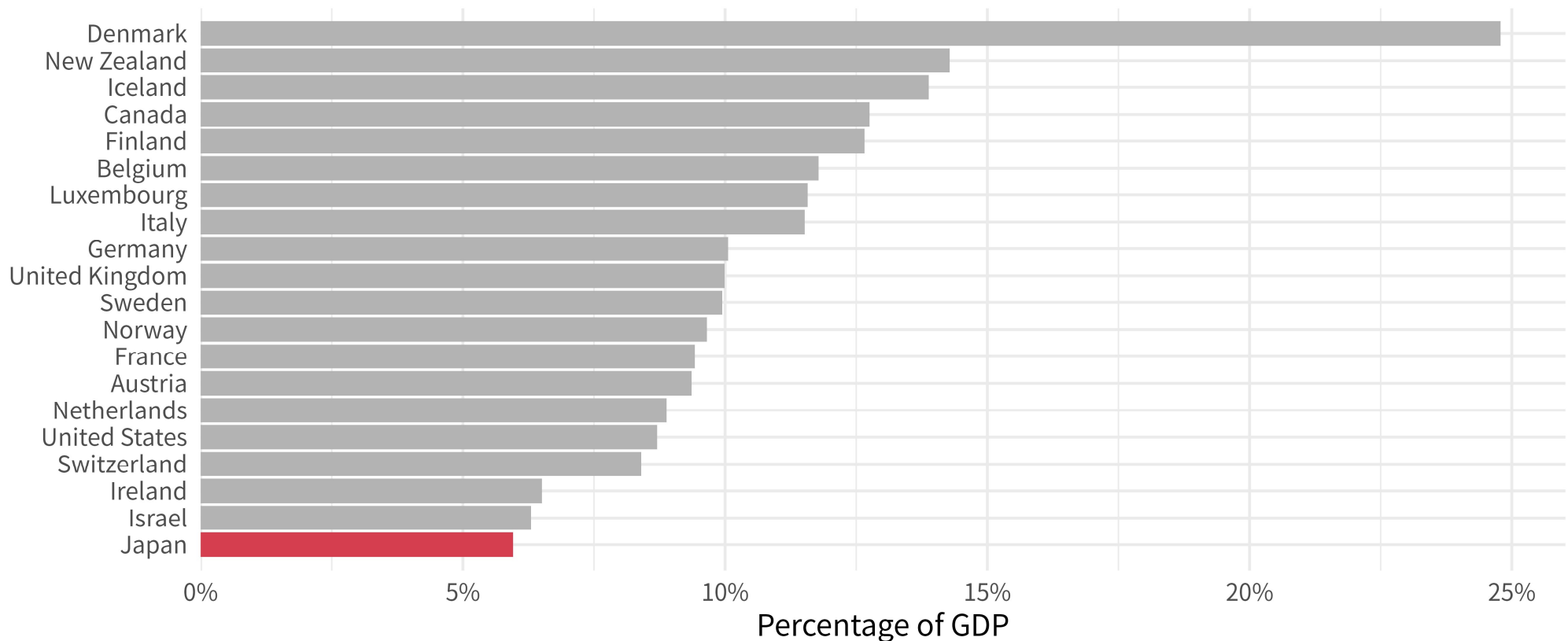
- Suppose that the government introduces an EITC at the rate that would offset the burden of the consumption tax for the low-income individuals and that the government abolishes the premiums for the national pension system and health insurance.
- Then the disposable income of the poor people will rise substantially. In the example of the Saitama-city residents given above, their personal burden ratio of 34% would shrink to the level of 3.5% income tax rate only.

Japan's ratio of personal income tax revenue to GNP

- Japan is in a position to finance it by raising the level of personal income tax. Japan's ratio of personal income tax revenue to GNP is the lowest among the advanced OECD countries.

Ratio of personal income tax revenue to GDP

OECD member countries with higher per capita GDP than Japan, 2023



Source: OECD Data Explorer, “Comparative tables of Revenue Statistics in OECD member countries” and World Bank, “GDP per capita (current US\$)”. Note: Australia meets the criteria of having a higher per capita GDP than Japan, but its data for this year is not yet available and thus is not included in the chart.

PART TWO

Japan's Public Pension System

I

Overview of the Public Pension System in Japan

Table 1.

Hierarchical structure of Japan's public pension system and examples of insured

	National Pension (国民年金)	Employees' Pension (厚生年金)	
	Category I (Self-employed, etc.)	Category II (Company employees, civil servants)	Category III (Homemakers)
Tier 2		Earnings-related pension	Survivors' pension
Tier 1	Basic Pension (¥780,000/year)	Basic Pension (¥780,000/year)	Basic Pension (¥780,000/year)

2. The Insurance Premiums

National Pension (国民年金) :

- The premium is **fixed regardless of income level**
- 16,980 Yen/month (as of 2024)

Employees' Pension (厚生年金) :

- The premium is **proportional to Income level**
- 18.3 % of the "standard monthly remuneration," with the maximum of ¥1.5million.

3. BENEFITS of Employees' Pension

Benefits of National Pension

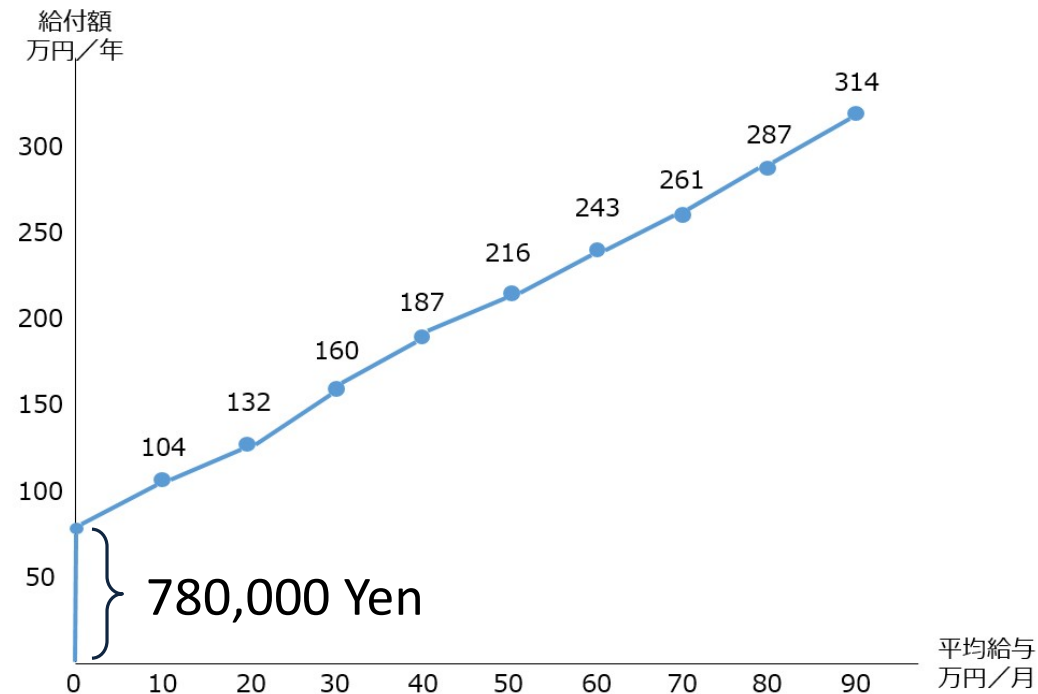
= Basic Pension (¥780,0000)

Benefits of Employees' Pension

= Basic Pension (¥780,0000) 【1st Tier】

+ Income proportional amount 【2nd Tier】

Benefits to an EP participant



4. Flaw ①: Unfair Treatment between National and Employees' Pension

- A poor non-employee has to pay a higher premium than an employee earning the same income. (The premium for the Basic Pension is fixed for non-employees but is proportional to income for employees.)
- The non-working wife of an employee receives Basic Pension without additional premium, while the non-working wife of a self-employed has to pay premiums to receive Basic Pension.

5. Flaw ②: The 1.3-million-yen Income Barrier

- If an employee's housewife earns more than 1.3 million yen, she can no longer obtain a basic pension from her husband's employee pension. She has to pay her premium for her National Pension or her Employee's Pension.
- This discourages housewives from earning more than 1.3 million yen.

II

Reform Proposals for the Public Pension System

1. Rationale for the Second Tier

- Pension is an insurance that covers the risk of unexpected longevity. Unlike fire insurance, insurance companies can not observe the risk of the insurance purchasers. This creates **adverse selection**, a form of market failure.
- **Mandatory participation**, i.e., socialization of pension, is effective in avoiding adverse selection.

Example: Tax-Financing of the Basic Pension

- Two types of premiums are abolished:
 - ① National Pension premiums, which are fixed regardless of income level, and
 - ② The portion of the Employees' Pension Insurance premiums corresponding to the Basic Pension.
- Increase progressive taxes to finance the resulting 13 trillion yen shortfall.

2. Rationale for the First Tier

- **The original rationale: to prevent the abuse of the welfare program,** *i.e., to prevent people from excessively spending before retirement* so that they can qualify for the welfare program in retirement.
- **Contemporary rationale: to redistribute income.**
Since the payout of the first tier is flat for every recipient, financing it by a progressive tax or insurance premium redistributes income from the rich to the poor.

3. Proposed Reform of the First Tier Financing

- Finance the first tier entirely by the progressive income tax rather than insurance premiums.

4. Effects of Tax-Financing of the First-Tier

- Reduction of premiums will **raise the living standard of the working poor**, especially those under the National Pension.
- **Fair treatment of the wives of employees** and self-employed individuals will be ensured.
- **The 1.3 million-yen income barrier** faced by the wives of Employees' Pension participants will disappear.

III

Pension Financing Schemes Including the Macroeconomic Slide System

1. Pay-as-you-go Scheme (现收现付制)

- Japan adopted a pure and simple pay-as-you-go scheme in financing public pensions until 2004.
- This scheme finances the benefits of retired cohorts through the premiums by contemporary working cohorts. The first generation of the system benefits the most.
- This scheme imposes heavy burdens on the young cohorts when population size is declining.

2. Fully Funded Scheme (完全积累制)

- The fully funded public pension scheme finances the benefits of retired cohorts through the premiums they made while working.
- This scheme **does not impose extra burdens on the young** cohorts even when population size declines.

3. “Double Burden” Caused by Switching to a Fully Funded Scheme.

- Suppose a pay-as-you-go is switched to a fully funded one.
- Then, the working cohort at the time of switching must bear the “**double burden**” of paying for
 - ① their future benefits and
 - ② the redemption of the **pension debt**, which is created by the excessive payment to the present and past retired generations under the past pay-as-you-go system.

4. To Avoid Double Burden

- **Many future cohorts**, rather than the young cohort at the switching time, **must redeem the pension debt** over many years.



- In 2004, Japan adopted **the Macroeconomic Slide System** to disperse the burden on redemption of the pension debt over 100 years.

5. Macro-economic Slide System 宏观经济滑动机制

- Let me explain this system for the Employee's Pension.
- This system sets a constant premium rate (18.3%) for the period of 100 years. Then, it sets a constant benefit rate for the same period that would satisfy the following equality:

the sum of the PV (present value) of the premiums over the 100 years
= the sum of the PV of the benefits over the 100 years
+ the pension net debt at the switching year.

6. Benefit Adjustment

Under a Macro-economic Slide System

- The government revises the benefit rate every five years based on the latest population projections.
- The macroeconomic slide system can be viewed as a “pay-as-you-go system over 100 years.”
- It can also be regarded as a “combination of a fully funded scheme and a repayment scheme (spanning over 100 years) of the pension net debt.”

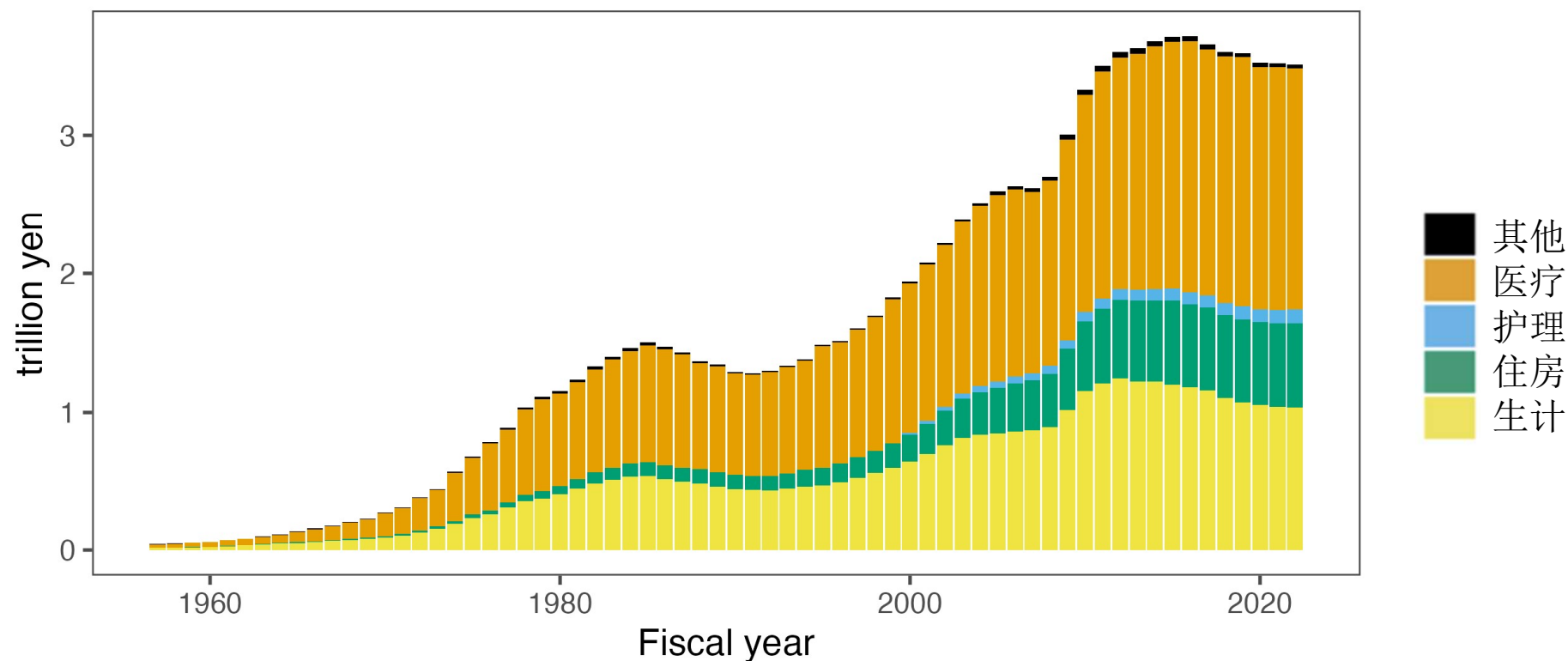
IV

Reform Proposals for the Welfare Program (低保)

1. Japan's Welfare Program

- **Recipients are not allowed to have assets**
[Means test (经济状况调查・资产调查)].
- Welfare program consists of
 - **Livelihood** assistance (including housing assistance)
 - **Medical** assistance, and
 - **Nursing care** assistance.
- **The monthly livelihood assistance benefits** for a 70-year-old single-person household are **¥128,000 in Tokyo** and **¥98,200 in Okinawa**.

各类低保支出的实际金额（万亿日元）

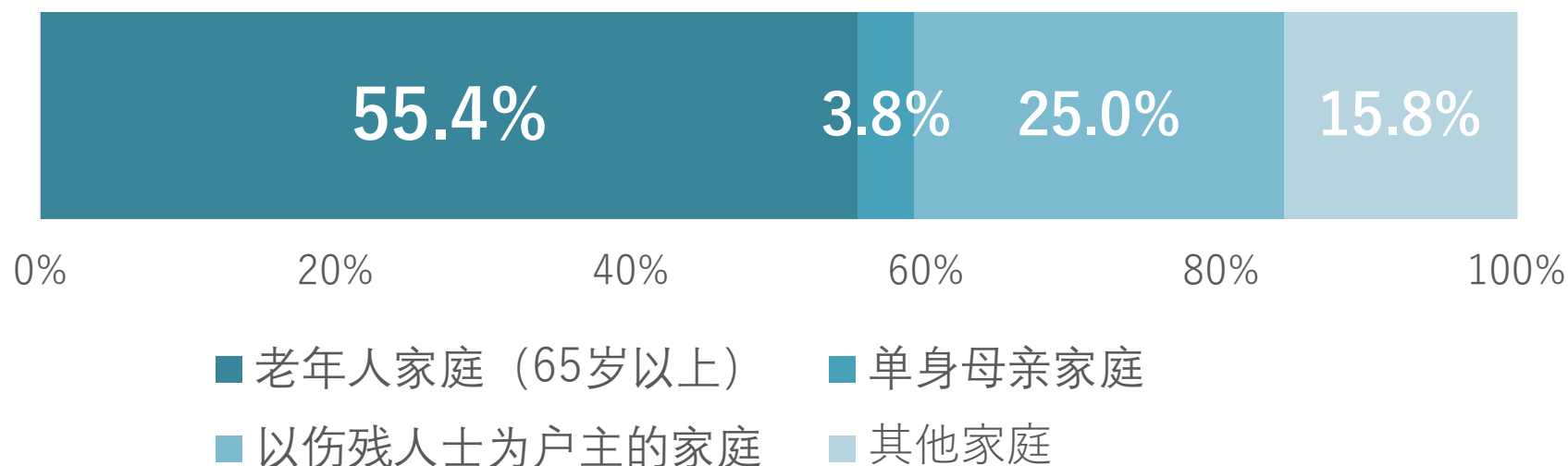


资料来源：国家社会保障与人口问题研究所，《“公共援助”官方统计数据列表》（截至2016财年），以及厚生劳动省，《公共援助费用实际金额变化趋势（按项目）》（社会与救济局相关局长会议材料，第143页）[自2017财年起]。

注：不包括设施管理费用。

2. Percentage of Protected Households by Household Type

- **The number of recipients is 2.02 million (2023).
1.6% of the total population.**

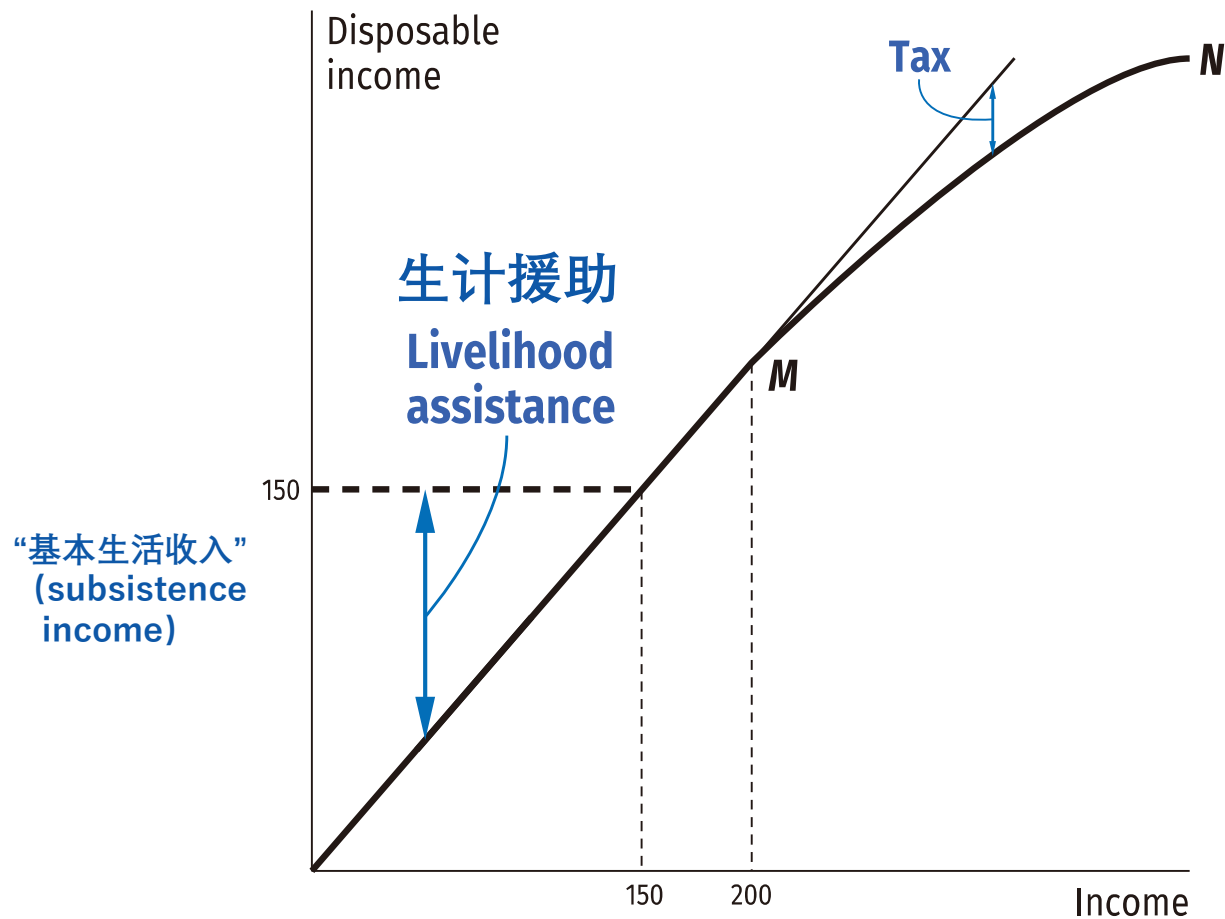


3. Financing the Welfare Program (低保)

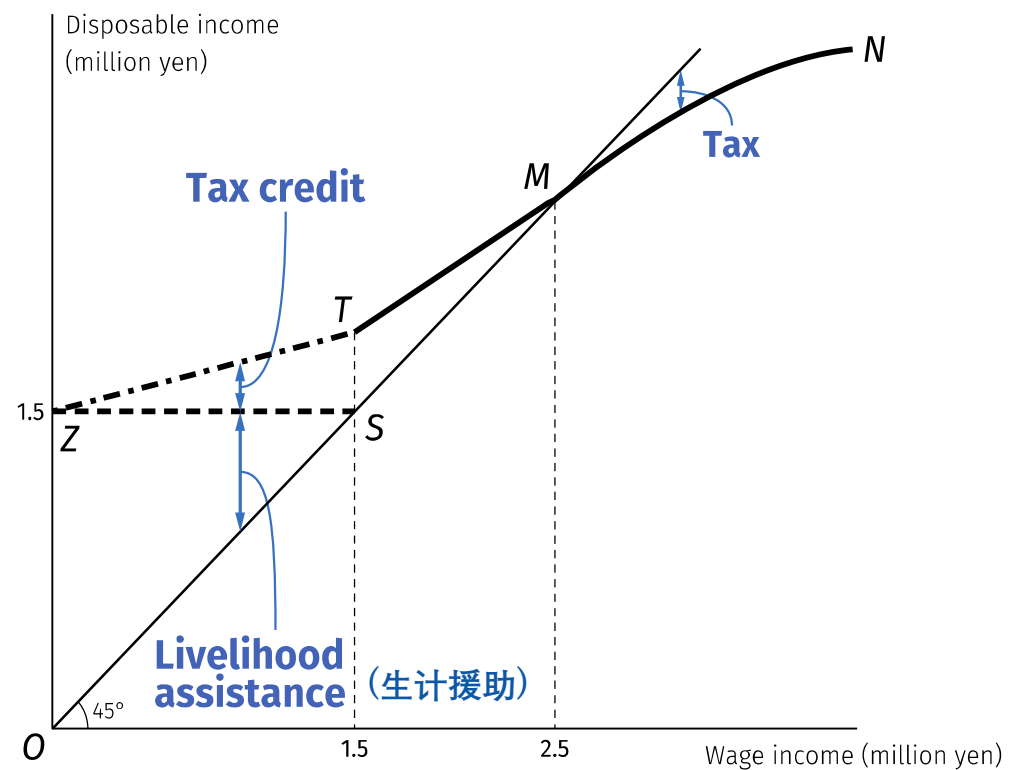
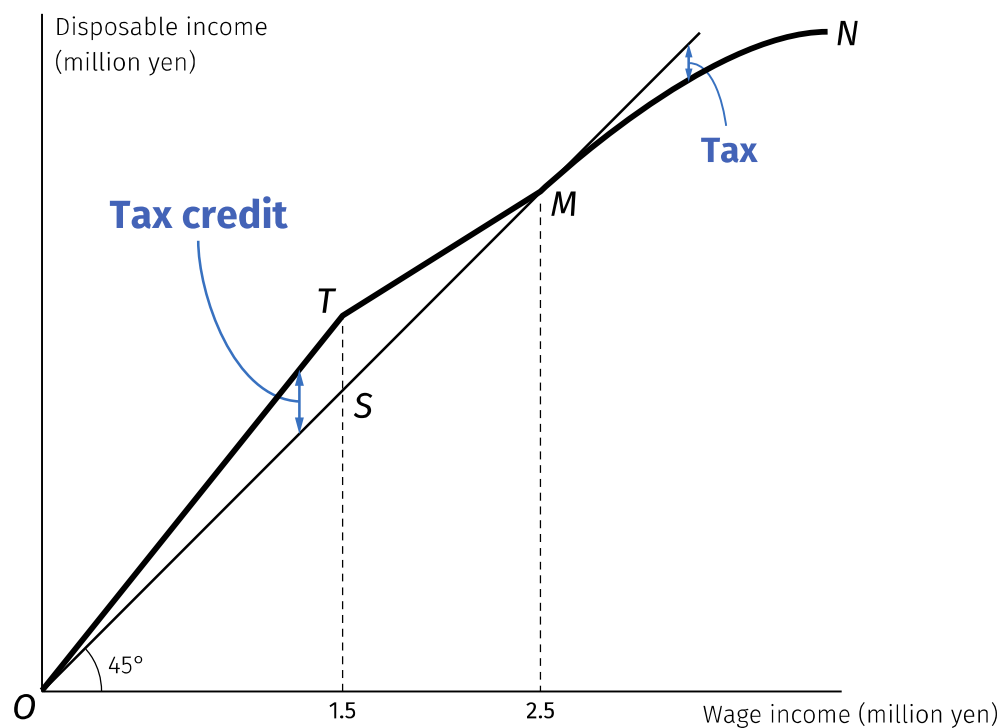
- **Total budget for the central government's** welfare contributions is **2.8 trillion yen**, which is 2.5% of the national budget (2024.)
- **The national government is responsible for 3/4 of the protection costs** and the local government for 1/4.

4. 生计援助中缺乏工作动力

Lack of Work Incentives in the Livelihood Assistance



6. 提供工作激励



PART THREE

Japan's Experience and China's Social Security

1. Intra-Generational Equity

China must not repeat Japan's failures.

- ① China is in a position to introduce **the Earned Income Tax Credit (EITC.)** It would provide work incentives to the welfare recipients and support the working poor.
EITC can be designed to offset the regressive effects of the VAT.
- ① China can incorporate a **redistributive function into the first tier of public pensions** by financing it with progressive taxes rather than insurance premiums.

2. Inter-Generational Equity

- China may consider switching from a pay-as-you-go method to a fully funded one in the future.
- Then, it can avoid overburdening the working cohorts at the switching by adopting a switching scheme like the **macroeconomic slides**.
- Under this scheme, not only the working cohorts at the switching time but also many subsequent future cohorts finance the pension debt created by the first few generations of the public pension.