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## *Does a Tax-financed Public Pension System Favor Corporations?*

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In May, the government's National Commission on Social Security made public the results of its calculations pertaining to the adoption of a system under which the basic public pension would be financed exclusively with tax money. The fact that the subject of exclusively tax-financed public pensions, which had been on the shelf, was taken up for discussion was in itself a great step forward. However, the results show two problems which could hamper the shift to a tax-financed public pension system: 1) It is likely to require a large increase in the consumption tax rate; and 2) Pension insurance premiums, which are now partly shouldered by corporations, would be shouldered entirely by households in the form of consumption tax. The former problem might be alleviated by adjusting the level of benefits, but the latter is inherent to a system under which basic pensions are financed exclusively with tax money. If the proposed system favors corporations over households, it could become the focus of political dispute. Does a tax-financed public pension system really favor corporations? What follows is a study of the economic effects of a shift to a tax-financed pension system based on a macroeconomic model.

### *Payback in Wage and Job Increases*

The government has decided to fund half of the basic pension with tax money starting in fiscal 2009, which starts in April 2009, with the remaining half (slightly over 9 trillion yen) to be funded by insurance premiums. Let us examine the case in which these insurance premiums are simply replaced by consumption tax.

In this case, corporations would no longer have to shoulder their portion of the insurance premiums. How would they use these savings? This study has used the Keynesian model under which aggregate production is determined chiefly from the demand side. Incomes of corporations and households are important factors determining demand, which, in turn, influences the levels of wages and jobs.

According to this model, there would be changes in three directions. First, wages increase. It has been verified by data that when the employer's share increases due to the decline in labor share, the employer increases wages after a time lag. Second,

corporations become more aggressive about hiring. It appears that employers adjust the levels of employment according to labor share. This could change the unemployment rate. Third, plant and equipment investment are enhanced. Our model suggests that cash flow is a factor which determines the level of investment.

Using these estimation formula, we find that workers' total compensation, including the employers' social contributions, (i.e., personnel costs of corporations) declines temporarily, but that this is followed by an increase in wages paid to employees, which restores corporations' personnel costs to their former levels [Figure②]. Also, the unemployment rate declines slightly [Figure③]. As a result, corporations would have paid back most of their windfalls from the reduction in social insurance premiums to the household sector in the fifth year after the shift [Figure①].

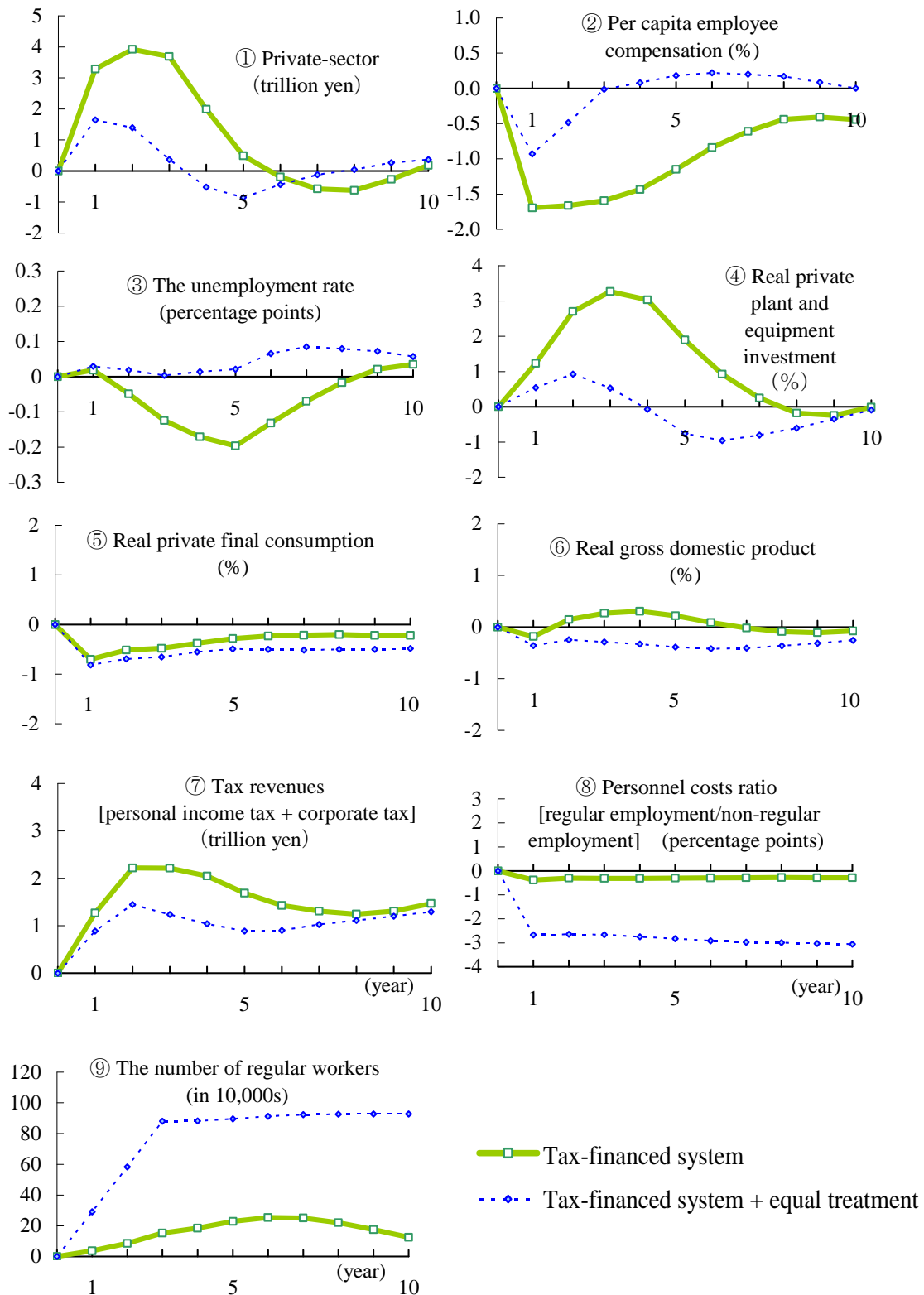
What, then, would be the impact of the proposed system on business conditions? It would have a positive effect on plant and equipment investment [Figure④]. However, since the new system would require an increase of slightly more than 4 percentage points in the consumption tax rate, households' real income would decline, depressing personal consumption [Figure⑤]. These two factors would offset each other and gross domestic product (GDP) would remain more or less unchanged [Figure⑥].

Moreover, the reduction in the social insurance premiums would increase the government's tax revenue. Social insurance premiums are treated as costs for corporations, while households can claim them as an exemption from taxable income. Therefore, their elimination would enlarge the tax base. Our calculations show that the proposed system would push up the combined revenues from personal income and corporate taxes by a maximum of approximately 2 trillion yen [Figure⑦].

### *Good Opportunity to Improve Working Conditions for Non-regular Employees*

The proposed system would also influence the employment map. In most cases, employers do not shoulder social insurance premiums for non-regular workers. This has been a factor in the relatively low levels of costs of non-regular workers. However, if the basic pension were to be financed exclusively with tax money, corporations' personnel costs would decline due to the reduction of social insurance premiums, which they shoulder primarily for regular workers [Figure⑧]. It is expected that this would lead corporations to re-appraise regular employment. When we build into the model an estimation formula under which corporations determine the ratios of regular and non-regular employees based on their relative personnel costs, we find that a maximum of approximately 200,000 non-regular jobs would be switched to regular jobs [Figure⑨].

**Figure. Economic Effects of Shifting to a Tax-financed Public Pension System (Compared with the Premium-financed System)**  
 (Economic effects during the 10 years following replacement of 50% of fund sources for basic pensions with consumption tax)



Notes: Computations using this writer's model. Economic effects for the 10 years from fiscal 2009. The margins of divergence from the case in which the premium-financed system is continued. Figures ②, ④, ⑤, and ⑥ show the rates of divergence.

In the first place, the proposal of an exclusively tax-financed public pension system has been made because of the present conditions, namely that non-regular workers tend to fall through the social insurance system due to their non-participation in the system or non-payment of pension premiums. If there is an argument that the proposed system favors corporations over the household sector, it might be made mandatory for corporations to shoulder a portion of health insurance and other social insurance premiums for non-regular workers as well as for regular workers (“Tax-financed system + equal treatment”, dotted lines in the figures).

It is estimated that such an arrangement would push up the personnel costs of corporations by approximately 0.7 trillion yen compared with the straight tax-financed system. As corporations try to pass this cost increment on to the household sector, the unemployment rate would be higher than that in the tax-financed pension system without equal treatment. As surplus funds of corporations would also be smaller, the buoying of investment in plants and equipment would also be limited. However, one should note that this would have the effect of sharply increasing regular employment. As personnel costs of regular workers would decline, while those of non-regular workers would rise, it could cause a shift of non-regular jobs to regular jobs in the order of nearly one million.

It is not advisable to rule out a tax-funded public pension system solely on the grounds that it appears to favor corporations over the household sector. Combined with a measure to improve the working conditions of non-regular workers, such a system could provide a good opportunity to rectify the present distorted picture of employment.

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