

# **Setting Social Policies for Japan's Declining Birthrate and Growing Elderly Population**

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As Japan's birthrate continues to decline and its elderly population grows, we are facing the need to make changes in our social systems. Particularly, Japan's social security systems have to be reformed. These reforms include (1) reducing pension benefits, (2) increasing investment in IT, and (3) implementing the necessary housing policies. Each of these reforms is needed in its own right.

First, reducing pension benefits is necessary to ease the burden on current workers, which is the basic principle of public pension reform.

Second, increasing investment in IT is important to (1) reorganize the current medical system into medical care insurance for the elderly and medical insurance for current workers, and (2) to enhance insurance industry functions.

Third, implementing housing policies is necessary to support the elderly and their daily lives.

Meanwhile, Japan's economy must keep growing to compensate for the falling birthrate and the growing population of the elderly by increasing the number of workers. This will necessitate promoting the employment of the elderly and the further participation of women in social activities. If greater participation by women is vigorously advanced, we must establish a social environment in which child-care and work can stand together, which will eventually require (1) increasing the number of day-care centers for children, and (2) amending Japan's tax and social insurance systems. If we borrow a statement from the 1993 employer and employee contract agreement in the Netherlands, we will have to "take heed of...the employees' child-care and care for the elderly."

## I Facing the Declining Birthrate and Growing Elderly Population

Table 1 shows how the birthrate has been declining and the elderly population has been increasing in Japan. In 1955, the average remaining life expectancy of men aged 60 was 15 years. By 1998, however, it had climbed to 21 years, registering an increase of six years over a span of 43 years. On the other hand, the total fertility rate (see VI Measures for the Declining Birthrate) fell by one child during this period, a drop from an average of 2.4 children in 1955 to 1.3 children in 1998. These Figures show the typical trend in declining birthrates and a growing elderly population; namely, the proportion of retired to current workers has been sharply rising.

Intergenerational support underlies Japan's social security system, which mainly consists of public pensions, medical care, and care for the elderly. In Japan, salaried workers pay employee pension insurance premiums, and these premiums are transferred to the elderly as pension benefits. This means that Japan's present public pension system is simply a socialized form of supporting our parents by sending money to them. For instance, elderly people go to hospitals more often than do current workers, who pay the medical costs of the elderly. Therefore, unless the number of current vs. retired workers continues to maintain proper proportions, the social security system will break down and greatly disrupt people's lives after retirement.

Proportionally, 4.3 workers aged between 20 to 64 supported one retiree aged over 65 in 1995. If the birthrate continues to fall and the number of the elderly continues to increase, however, two workers will have to support one retiree in 2025. Because the social security system presupposes intergenerational support, these current workers will be squeezed early in the 21st century if the government is to maintain this system. As social insurance premiums rise, most wage increases will be completely offset, which creates a massive disincentive for working generations.

As long as Japan's birthrate is slow to recover, its future labor force will shrink rapidly. In Japan there are currently 78 million people aged between 20 and 64. Until 2025, however, the population of the 20–64 population will keep declining, falling to 65 million people in 2025, which will eventually create concerns regarding the negative impact on Japan's economic growth rate.

Moreover, Japan's public debt for both the central and local governments has so far climbed to ¥650 trillion. With the reform of government finances high on the agenda, we must ensure that Japan's economic activity does not shrink due to the narrowing labor pool.

Consequently, we will have to enact full-fledged countermeasures to cope with the falling birthrate and the increasing elderly population during the first ten years

**Table 1. Trend in Declining Birthrate and Growing Elderly Population**

	1955 (A)	1998 (B)	B - A
Average remaining life expectancy, males aged 60 (years)	15	21	6
Total fertility rate (children)	2.4	1.3	-1.1

Source: Ministry of Health, Labor and Welfare, *Vital Population Statistics*.

of the 21st century, because (1) the economic growth rate will possibly decline, and (2) the social security system will become more fragile.

The first step we should take is to reasonably ease the burden of current workers to support the retired. This requires social security system reform, particularly the reform of the public pension and medical insurance systems. Such reforms must not deprive senior citizens of security in their lives, however.

## II Public Pension Reform

Japan's public pension system can be simply explained as follows. Let us assume that (1) wages do not change, and (2) 60 percent of a worker's wages is provided as a pension benefit when a person retires at the age of 65.

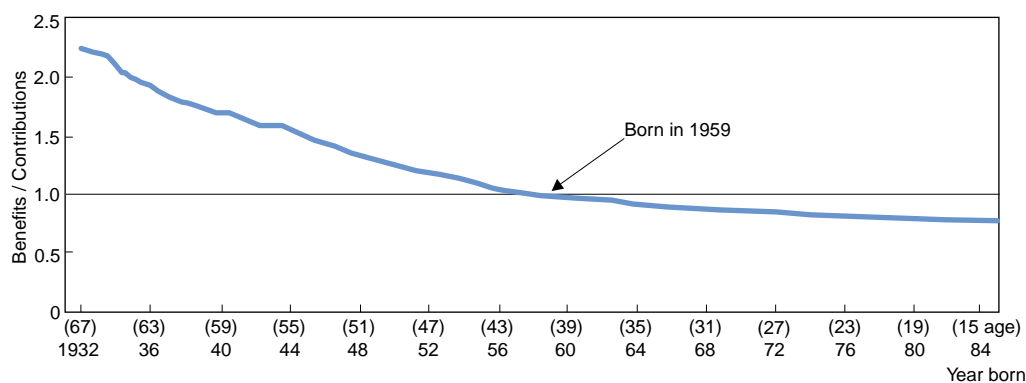
Since the public pension is simply a mechanism for intergenerational support, we need to consider what percentage of the total pay of current workers should be allocated to the employee pension insurance premium in order to provide retirees with 60 percent of the wages they used to earn:

$$\begin{aligned} \text{Number of retirees} \times \text{wages} \times 0.6 &= \text{number of} \\ \text{current workers} \times \text{wages} \times \text{employee pension in-} \\ \text{insurance premium rate; therefore,} \\ \text{employee pension insurance premium rate} &= \\ \text{number of retirees} \div \text{number of current workers} \\ &\times 0.6. \end{aligned}$$

The formula "number of retirees ÷ number of current workers" shows how many workers support one retiree. By using the projected population composition, we find that the insurance premium rate is 15 percent in 2000, 21 percent in 2010 and 28 percent in 2025.

If we are unwilling to tolerate this premium rate increase, the ratio of public pension benefits must be reduced to balance the amount of the benefits under present wages (assumed here to be 60%). This is the essence of public pension reform.

Presently, the standard employee pension benefit covers about 90 percent of the average consumption expenditures (including education, amusement and entertainment expenses) of an elderly household that consists of a non-working married couple, with the husband aged 65 or older and the wife aged 60 or older. The govern-

**Figure 1. Public Pension and Generation Account**

Note: The upper row of the horizontal axis shows the age in 1999, and the lower row shows the year when born.  
Source: Nomura Research Institute.

ment says it will have to raise the employee pension insurance premium from the current level of 17.35 percent of current employee wages to as much as 27.6 percent in the future in order to maintain this benefit level. As current workers clearly cannot accept such a large insurance premium hike, the government must reduce the pension benefit levels.

Incidentally, when the current public insurance premium rate is increased, what is the ratio of pension revenues to expenditures by generation (the level of a worker's benefits compared to his or her contributions)? The ratio for workers born in 1959 (42 years old in 2001) is exactly 1. However, this ratio falls below 1 for those born after 1959 (Figure 1). In other words, workers born after 1959 will not receive benefits that equal their contributions. Consequently, younger workers will lose interest in the public pension. Moreover, the present benefit levels are unfair between generations, which we believe must be corrected.

The government carries out a reform of the public pension system once every five years under an actuarial review of pension schemes. As the next review is scheduled in fiscal 2004, we propose that the government should establish a special committee for public pension reform and prepare a final proposal for an appropriate public pension by fiscal 2003.

Preferably, the committee should discuss (1) how much pension benefits should be reduced with the regard to the burden on the current workers, and (2) what is the most appropriate means to reduce the benefits. We think it is also desirable for the committee to debate the pension and required tax systems.

### III Medical System Reform

Although we are concerned about the sharply increasing medical expenses, we cannot accept any system that allows for inexpensive medical care of poor quality because medical care is essential. Public pension reform presupposes a role for the financial assets all of us have

accumulated in the past, which directly leads to reducing benefit levels. When we discuss medical reform, however, especially medical insurance reform, we cannot rely on any financial assets. Consequently, our task is to preserve an appropriate rate of growth in medical expenses along with maintaining quality.

Current national medical expenditures total ¥30 trillion annually. If all other factors remain the same and only the medical expenses of the elderly increase as the elderly population grows, however, the total medical expenses in 2030 are estimated to reach ¥40 trillion. If, however, medical expenses as a whole (including the medical expense of the elderly) increase, the total medical expenses in 2030 are estimated to climb to ¥100 trillion. We should discuss how to find the most desirable medical system between the ¥40 trillion and ¥100 trillion while maintaining the quality of medical care.

Most of the income of retirees is pension income, particularly for the elderly aged 70 and older. Inevitably, both medical expenditures and nursing care expenditures for these elderly people increase rapidly. An elderly person is required to pay a maximum co-payment of (1) ¥36,000 as his or her medical insurance payment per month, and (2) ¥37,000 as his or her long-term care insurance payment when certified as requiring Level 5 Nursing Care (a condition in which assistance is needed for all aspects of living). In other words, these costs constitute the minimum that an elderly person needs to pay to live.

It is too much to raise the share of medical expense borne by the elderly, however, because their medical expenses are five times as high as the amount needed by current workers. Therefore, communities must pay the medical expenditure for the elderly. Naturally, insurance for young workers and that for the elderly should be separated.

Any new insurance for the elderly must (1) aim at improving the overall quality of their lives, (2) include cost control mechanisms, and (3) be supported by the whole community. Particularly, elderly patients suffer from various ailments and pains simultaneously. This means

that (1) they will not completely recover even if doctors can ease symptoms or prevent them from worsening, and (2) they feel worried about living alone at home without any assistance.

Therefore, it may be appropriate to (1) combine medical care and nursing care, and (2) introduce a home doctor system to comprehensively support the elderly in improving the quality of daily life.

The home doctor system functions as follows: (1) an elderly person would first consult his or her home doctor whenever he or she feels sick; (2) the home doctor, familiar with the patient's physical condition, would classify him or her as a patient in need of (a) acute medical care, (b) chronic medical care, or (c) nursing care; (3) if the patient is in need of nursing care, the doctor and care managers would exchange information in detail to establish the most appropriate care plans for him or her (Figure 2).

As a cost control mechanism, it is recommended that a fixed-amount system be introduced.

As immediate care is essential for an elderly patient receiving acute medical treatment, the fee-for-service payment system should be maintained for now and a fixed-amount system should be introduced in the future.

On the other hand, many elderly patients need chronic medical care as life assistance, which allows them to choose different types of medical care. Medical payments should therefore be ranked according to an evaluation of the time, effort and costs required for the management and guidance required by each chronic illness.

For nursing care, the present fixed-amount payment procedure should be maintained. This procedure is divided into (1) certification as elderly people in need of nursing care, and (2) the maximum payment based on certification as elderly people in need of nursing care.

With regard to finances, it is advisable to adopt a long-term care insurance system funded half from public expenditures and half from insurance premiums as a means that both the elderly and communities can financially support.

To reform medical insurance for young workers, it is necessary that (1) employers and employees each bear

half the insurance premiums, and (2) the number and capacity of medical insurance entities must be greatly increased to strengthen the financial base of medical insurance for young workers. While there are 5,300 medical insurance entities currently involved in providing both local and occupational insurance, the number of the insured these entities cover varies from several thousand to several hundred thousand. Moreover, the financial condition of 80 percent of these entities is now in the red, including those under the national health insurance program. Therefore, it is necessary to integrate these medical insurance entities in local areas into an insurance group with 100,000 to 500,000 participants to achieve economies of scale. Strengthening the financial base is urgent to expedite investment in medical sector computerization.

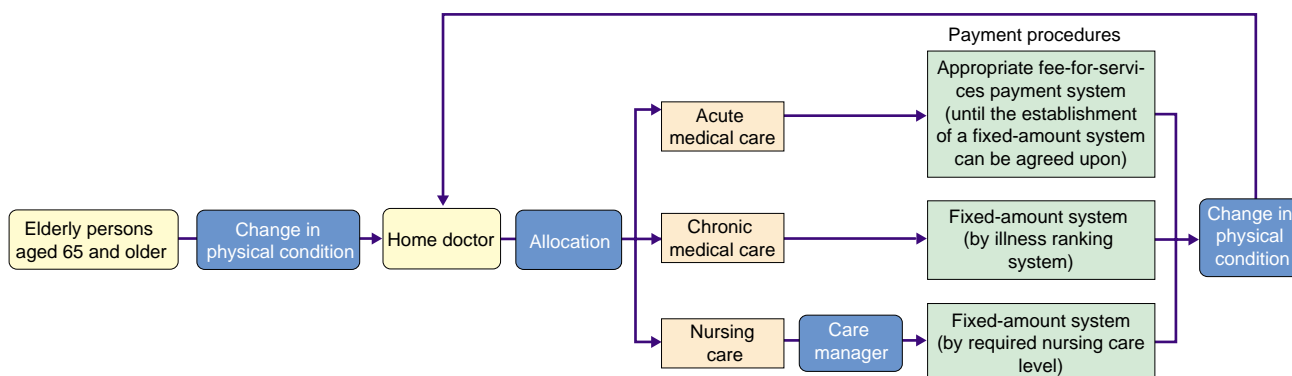
While these measures are a basic framework for medical insurance reform, they cannot alone reduce medical expenses to make them more appropriate. It is critical to find a way to achieve a reasonable rate of growth in medical costs that each of us can bear. To foster reasonable growth, it is important to publicize full information on medical institutions and let them fully compete to enable patients to make informed choices.

Full public disclosure mandates that medical institutions release as public announcements basic information on their specialties, details on beds and facilities available, how many nurses are on staff and so on.

At the same time, it may be necessary to establish medical service ratings on medical facilities to enable patients to make reasonable selections among institutions. Providing objective rankings will, however, be difficult for external organizations. Consequently, if medical service organizations can remain fully objective in providing reliable information for third parties to review, they should be permitted to freely and fully advertise their capabilities.

While internally censored information about medical institutions strip patients of a chance to choose the best, free advertising about the confidence, performance and capabilities of medical institutions reasonably diversifies the choices available to patients. This will introduce

Figure 2. Elderly Medical Care and Nursing Care Flowchart



Source: Nomura Research Institute.

real competition for medical services into medical organizations. We believe positive actions are necessary to achieve a more appropriate level of medical expenses than the patchwork government reforms of the past have been able to find (Figure 3).

We will have the necessary infrastructure for medical care by (1) separating medical insurance for the elderly and the young, (2) strengthening the financial base of medical insurance entities, and (3) introducing measures to promote competition among medical institutions. The final step is to encourage physicians, patients and insurance companies to agree on an appropriate level of medical expenses. To achieve this we must actively invest in medical sector computerization and create a medical information database.

Once standardized as uniformly shared and analyzed knowledge, various medical benchmark data will identify (1) the types of patients and illnesses, (2) medical expenses and costs to provide appropriate care, (3) readmittance rates, and (4) mortality rates during hospitalization. When a nationwide database becomes available, we will have the necessary quantifiable data to discuss (1) the distribution of medical expenses, (2) factors that increase such expenses, and (3) cost effectiveness.

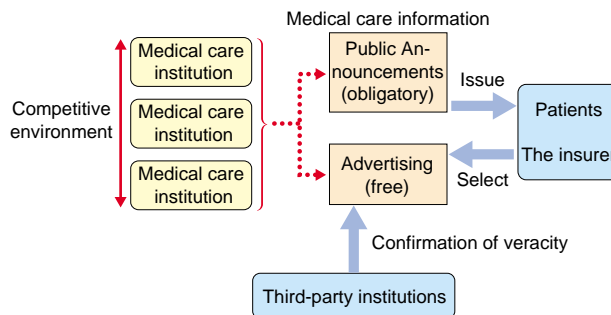
Specifically, we will be able to (1) verify the exact amount of medical expenses we incur for medical care for mild symptoms and terminal care, (2) ask if high-quality medical care for critically ill patients is really justifiable, and (3) understand the differences in medical expenditures when various medical institutions and doctors treat each illness. We will also uncover the discrepancies among costs and payments on a case-by-case basis under today's medical care payment system.

If we know that medical expenditures are inadequate, we can rectify such inadequacies since we believe resources should essentially be distributed to vital sectors. If we know which sectors are important with a help of the medical benchmark data, we can easily determine the allocation of resources and ensure an appropriate rate of growth in medical expenses.

Furthermore, if it becomes evident that medical care procedures to treat illnesses have not become standardized as investment in computerization increases, we can take steps towards standardizing medical care procedures. Because medical care more or less depends on the experience and expertise of each doctor, standardization will contribute to spreading the most cost-effective strategies. The public sector and insurance companies should (1) actively support the development and diffusion of diagnostic and treatment guidelines by physicians' associations and specialized medical disciplines, and (2) establish a better medical environment such as the creation of document databases.

Patients will also benefit from such medical care data. If benchmark data from a nationwide database—such as the average number of hospitalization days, re-admittance rates, mortality rates during hospitalization and

**Figure 3. Flow of Medical Care Information and Selection of Institutions by Patients**



Source: Nomura Research Institute.

related details—become open to the public, patients can smoothly select medical institutions. Moreover, if patients can easily choose good medical institutions, those they select will reap the rewards of striving for effective management.

We believe that by investing in computerization we will be able to (1) form a consensus on the appropriate future rate of growth for medical expenses, (2) improve overall efficiency, and (3) introduce administrative policies that promote full competition in the medical service industry. We expect such changes to lead to a broader reform of Japan's medical security system.

## IV Life Plans for the Elderly Examined

Japan has introduced long-term care insurance to help families that are impoverished by caring for the bedridden elderly. We've stated that to reform the medical system it will be necessary to integrate medical care for the elderly and long-term care insurance. Here we will look at the future demand for long-term care insurance.

According to Japan's Ministry of Health, Labor and Welfare, the first-year cost for the national care insurance scheme in fiscal 2000 was ¥4.3 trillion. Using this as a standard, we have projected the medium- to long-term financial demand by combining (1) the number of the elderly in the future, and (2) the growth rate and utilization rate of the elderly in need of nursing care. Consequently, we obtain a total expense of approximately ¥9.3 trillion in 2010 at the fiscal 2000 base and approximately ¥12.7 trillion in 2030 (Table 2).

In Japan, we have designed long-term care insurance to be run by public expenditures and the nation's insurance premiums: the government pays 50 percent of the total cost and all individuals aged 40 and older pay the remaining 50 percent. Current workers aged 40 to 64 pay about 33 percent of the insurance premiums, which amounts to ¥1.2 trillion in 2000, ¥2.7 trillion in 2010, and ¥3.7 trillion in 2030 according to our estimate. Compared to the ¥16.0 trillion that current workers must pay

as medical insurance premiums, these insurance premiums represent a relatively small burden on those currently employed. Consequently, as there is no immediate need to consider the rate of long-term care premiums for the elderly, we can focus on how to ensure a sense of security for the elderly.

Table 3 is a forecast of the population composition in 2025. In 1995, 4.3 workers supported one retired person. In 2025, however, two workers will have to support one retired person. Therefore, the most important issue for social security reform in dealing with the declining birthrate and growing elderly population is to alleviate the burden on workers, while at the same time taking heed of a sense of security for the elderly.

As shown in Table 3, the elderly population in 2025 will reach more than half of the working population, and 1.7 times as large as the younger cohort. If the elderly feel so worried about the future as to decrease consumption, personal consumption will remain sluggish and provide little support for Japan's economy—which should lead to a miserly old age for each current worker who, we assume, will not accept an impoverished future. We believe Japan must first popularize life plans for the elderly in order to give them a feeling of security.

A related question deals with how the elderly are living in Japan. Figure 4 shows the long-term trend in the average number of persons per household. This number has been continually declining since 1960, when it was 4.13 persons per household. The shift to corporate employment and urbanization has led to the collapse of the traditional three-generation family and increased the

number of nuclear families. This trend is likely to continue during the first half of the 21st century.

When we compare Japanese household trends in 1975 and 1999 more closely, the proportion for childless married-couple households and single-person households has continued to rise (reaching some 80% of the incremental growth). The number of families with parents and children sharing the same household barely increased (Table 4).

Moreover, elderly married-couple households are increasing among the childless married-couple segment, and elderly single-person households are also increasing among single-person households. Eventually, we may see the traditional three-generation household only in comic strips such as *Sazae-san*, where a married child's family supports their elderly parents. Expecting the further decline of the three-generation household, you should think of the following items if you intend to live with your spouse in an urban area after retirement,

#### <Health>

1. Do you understand your mental and physical condition and have a home doctor whom you can consult?
2. Do you have (1) a care manager to consult, (2) an institution that will provide nursing care, and (3) a facility where you want to live when you need nursing care?

#### <Housing and way of life>

3. Have you made your home barrier-free in order to provide a convenient and safe place for you to continue to live for the rest of your life?

**Table 2. Projected Long-Term Care Insurance Finances**

	¥ Trillion			
	2000	2010	2020	2030
Total long-term care insurance	4.3	9.3	11.5	12.7
Public expense	1.9	4.1	5.0	5.6
Employee burden	1.2	2.7	3.3	3.7
Company burden	0.4	0.8	1.0	1.1

Notes: (1) Employee burden indicates the total insurance premiums paid by the second insured individual (age 40 through 64); (2) company burden indicates the employer's burden for government-managed health insurance and health society insurance included in the employer's burden for the second insured individual (excluding the government's burden of the insurance premium); (3) year 2000 base.

Source: Nomura Research Institute.

**Table 3. Composition of Japan's Population in the First Quarter of the 21st Century**

	1995	2000	2010	2025
Age 0–19 (youth)	2,836 (22%)	2,593 (20%)	2,295 (18%)	1,910 (16%)
Age 20–64 (presently working)	7,775 (63%)	7,894 (62%)	7,521 (60%)	6,527 (56%)
Age 65 and older (elderly)	1,819 (15%)	2,187 (17%)	2,813 (22%)	3,312 (28%)
Total population (ten thousand individuals)	124.3	126.7	126.3	117.5
Current worker/elderly ratio: how many workers support one elderly person? (persons)	4.3	3.6	2.7	2.0
Elderly/youth ratio	0.6	0.8	1.2	1.7

Source: National Institute of Population and Social Security Research, *Future Population Changes*.

4. Have you found a place to live when you can no longer live in your own house?

<Finances during old age>

5. Do you understand roughly the amounts you must pay for expenditures such as the monthly cost of living, various insurance premiums and medical expenses?

6. Have you planned to use your assets (financial and property assets) in order to enjoy your life after retirement? How much capital do you have for emergencies?

<In the event of diminished mental capacity>

7. Have you planned to take advantage of a voluntary guardianship system—a system that would allow you to select a representative ahead of time to be a voluntary guardian to manage your assets and act for a spouse living alone and facing diminished mental capacity?

When pension plans are discussed, it is important to note the available revenues and needed expenditures of elderly people. The annual public pension benefit amount for an average elderly couple (aged 65 or older) is ¥2,840,000 (normally ¥237,000 per month), while the average consumption amount is ¥3,080,000. Currently, the public pension covers 92 percent of an elderly

person's consumption, leaving a shortfall of ¥240,000 per year.

If the government (1) reduces the benefit amount by 10 percent as part of public pension reform, (2) assesses a 10 percent tax on pensions, and (3) raises the consumption tax to 10 percent to restore government finances because it believes that the elderly should also bear a suitable burden, the annual shortfall would become ¥1,090,000:

**Consumption amount (¥3,080,000 × 1.1) – real amount of pension (¥2,840,000 × 0.9 × 0.9) = the final shortfall (¥1,090,000).**

If an elderly married couple were both to live for another 20 years, the total shortfall would become ¥21.8 million (¥1,090,000 × 20).

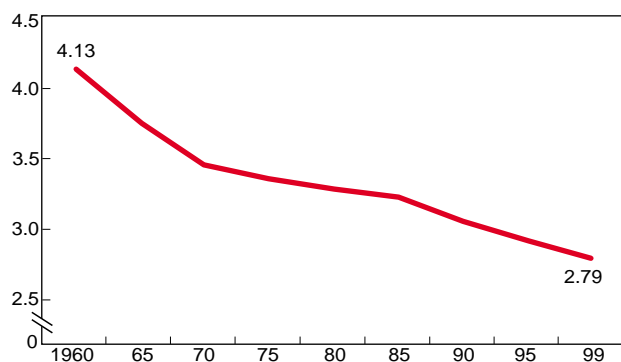
Currently, the average savings balance per elderly couple is ¥23 million, thereby enabling some elderly persons to just get by if they have savings of this amount. Otherwise, they will suffer when they have less than the average amount of savings and require nursing care after being certified as requiring Level 5 Nursing Care (involving a personal burden of ¥37,000 per month). Japan should therefore introduce a reverse mortgage system to enable the elderly to obtain cash while they continue to live in their own residences.

The reform of the social security system and tax increases to restore government finances is likely to have serious consequences for the elderly. When changing both systems, the government must both ease the burden on current workers and give due attention to providing the elderly with a sense of security.

## V Improving the Living Environment for the Elderly

The insurance system provides medical care and nursing care for the elderly. We believe the future focus, however, should be on improving the living environment for the elderly.

Figure 4. Trend in Average Number of Individuals per Household (Persons)



Source: Ministry of Health, Labor and Welfare, *Vital Population Statistics*.

Table 4. Increase in Households

(Ten thousand households)

	1975 [A]	1999 [B]	B - A
One-person households	599 (18.2)	1,059 (23.6)	460 (38.2)
A married couple only	388 (11.8)	916 (20.4)	528 (43.9)
A married couple and their unmarried children	1,404 (42.7)	1,544 (34.4)	140 (11.6)
Other	897 (27.3)	973 (21.6)	76 ( 6.3)
Total	3,288 (100)	4,492 (100)	1,204 (100)

Notes: (1) Figures within brackets are percent of total (%); (2) "Other" includes households such as three-generation households and households with a single parent and unmarried child.

Source: Ministry of Public Management, Home Affairs, Posts and Telecommunications, *Population Census*.

Figure 5 outlines residential accommodations and services for the elderly in Amsterdam in the Netherlands. Elderly people who can no longer live in their own homes due to physical infirmities can move into a home for the elderly that offers such services as simple household chores and a barrier-free restaurant on the first floor with menus for the elderly.

As the elderly person needs the further assistance of home-helpers, visiting nurses, and/or visiting care services, he or she chooses either to receive these services while remaining at the home or moving to an institution for the elderly or a nursing home with specialized care facilities. In other words, as an elderly person's need to receive assistance increases, the individual changes where he or she lives. Under the care system in the Netherlands, the elderly change their residence according to their own needs and the needs of their families.

Japan has made various efforts over the past years to study housing policies for the elderly and has taken various measures to achieve progress in this area. Such steps include, for example, (1) loans from the Housing Loan Corporation at low interest rates to build barrier-free homes, and (2) "Silver Housing" that includes on-site care facilities (housing with a manager who also provides living support).

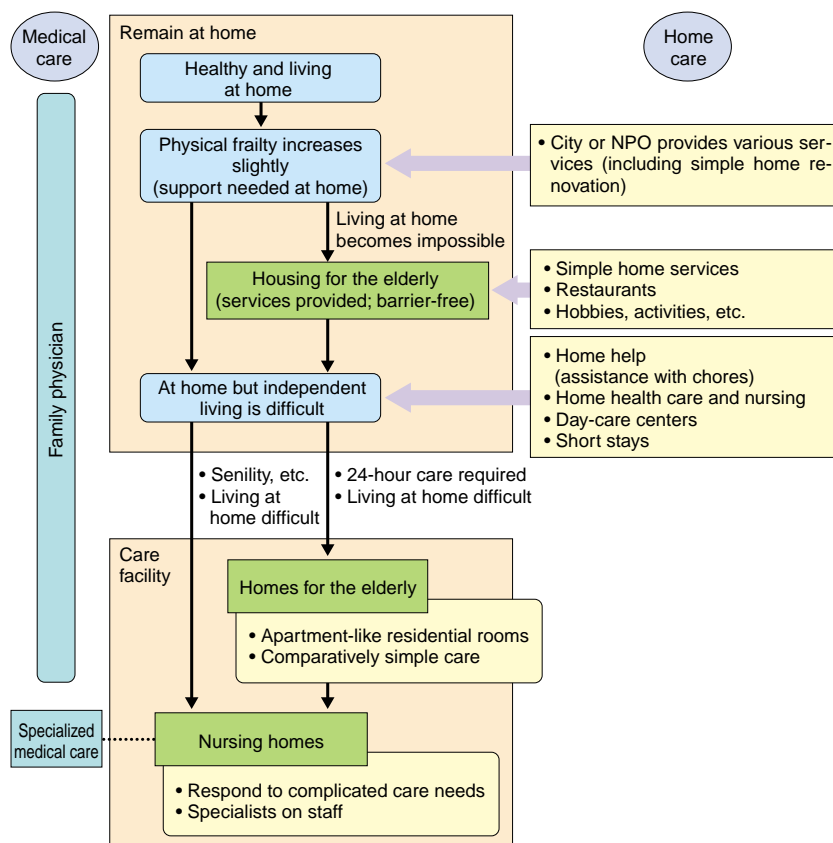
Currently, Japan's elderly care insurance system covers certain home renovations that include (1) installing

handrails, (2) eliminating differences in flooring heights, (3) changing flooring materials to prevent slipping and improve mobility, (4) changing doors so that they slide open, (5) installing Western-style toilets and facilities, and (6) making other incidental repairs. A maximum of ¥200,000 is paid for all six of these renovations.

We should now recognize that (1) we change residences according to overall family and personal needs, (2) the need for residential changes increases particularly as we grow older, and (3) the government should support us to improve our housing environment before we need a full-fledged care facility. The government should provide assistance in (1) making our own houses barrier-free, and (2) when we find it difficult to live in our current homes even though we do not yet need to enter a full-service care facility. We should broadly and seriously discuss this latter issue.

Sooner or later we will see an increase in the number of elderly couples who once lived in suburban houses when their children were young, but now who wish to move to small, barrier-free condominiums or apartments near downtown when the children are grown. For these people the government should provide more favorable tax treatment for capital gains when they sell real estate used as their principal residence. Moreover, for those who cannot move to barrier-free housing for the elderly because of their income, public institutions should strive

Figure 5. Residential and Service Systems in Amsterdam That Vary with an Elderly Person's Needs



Note: NPO = Non-profit organization.  
 Source: Nomura Research Institute.

to supply barrier-free rental housing for the elderly in the first half of the 21st century.

Elderly people who can no longer live in their own homes must move into a care facility. Figure 6 shows the relationship between home health care and care facilities in Japan. Let's examine this relationship by following the flow chart in the figure.

Assume that an elderly person has been hospitalized when stricken with a serious illness. Those who feel confident to return to their own homes when the treatment ends become eligible for home health care.

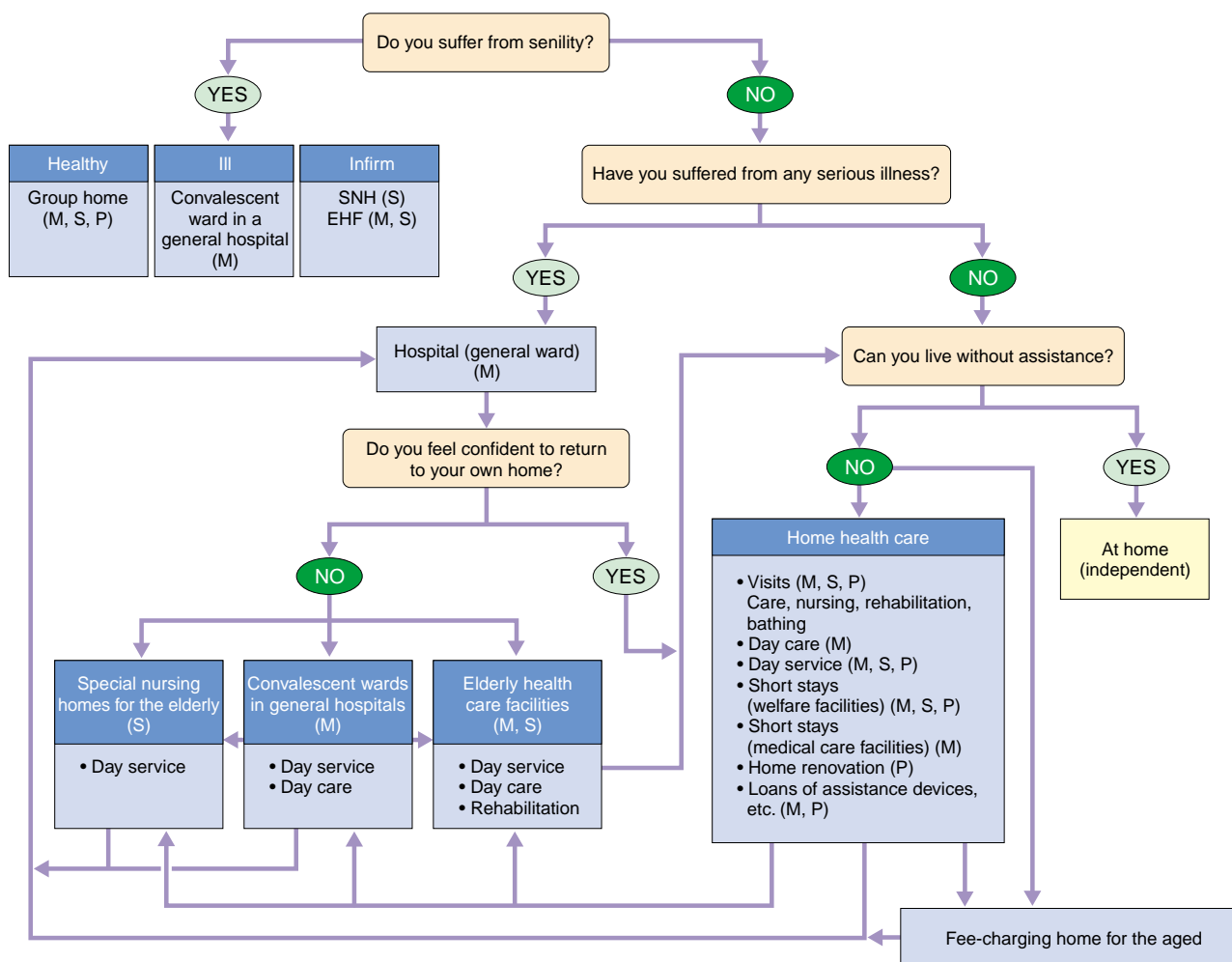
If the person does not feel confident about returning home, however, he or she can move from the hospital into a care facility. Convalescent wards in general hospitals are set up as care facilities to provide medical care for the elderly persons who require nursing care rather than medical treatment while remaining hospitalized. Moreover, elderly persons are placed in elderly health care facilities offering rehabilitation services if they can recover some functions in order to return to living independently. If the person feels that it is diffi-

cult to live at home, he or she can move to a special nursing home for the elderly that gives greater emphasis to the daily aspects of living. In care facilities in Japan, however, private rooms have not yet been fully established in conformity with the original planning. Accordingly, the government should immediately try to take some measures to improve the quality of care facilities for the elderly.

For instance, when an elderly person is in need of home health care while renting an apartment, he or she must pay his or her own food expense, rent and ten percent of the care service cost. On the other hand, when an elderly person moves into a special nursing home for the elderly, for example, he or she is responsible only for ten percent of the total amount and part of the food expense, whereas the long-term care insurance covers both housing costs (food expense and rent) and care costs. Obviously, home health care is both disadvantageous and unfair.

In order to eliminate these inequities, care facilities should receive their compensation separately in rent, food

Figure 6. Flowchart of Nursing Care for the Elderly



Notes: (1) Letters in parentheses indicate the organization that will provide the services indicated: (M) = Medical corporation; (S) = Social welfare entity; (P) = private provider (including NPO); (2) SNH = Special nursing home for the elderly; EHF = Elderly health care facility. Source: Nomura Research Institute.

costs, and care service. In other words, care recipients should be responsible for their own rent and food expense, as well as bear the cost of ten percent of care services. They would then be able to objectively choose either to receive home health care or to enter a facility depending upon their own physical condition. This would free the government from the need to incur the enormous expenses of constructing facilities to cope with the mushrooming requests from elderly persons who want to enter a facility under the advantageous rate system for such care.

At the same time, the management of these facilities (social welfare entities and medical corporations) will always receive certain revenues as housing costs, which will enable them to effectively meet their business expenses. Accordingly, they can begin to make decisions on (1) what facilities to construct, (2) which segments of the population to target, (3) what layout is necessary, and (4) what costs are needed, and introduce market mechanisms into their decisions. Private-capital companies can develop multiple-function complexes that include special nursing homes for the elderly. These complexes would include nursing care condominiums for the elderly at the center, restaurants, clinics and a care service provider in an attached facility.

In other words, such newly introduced market mechanisms would bring into full competition social welfare entities, medical corporations and private capital to provide facilities and services. This competition will (1) invigorate the market, (2) increase consumer convenience and benefits, and (3) lead to improving the living environments of care facilities. For elderly persons who find it difficult to pay a facility's housing costs from their income, however, the public sector will have to support the housing expense.

## VI Measures for the Declining Birthrate

Economic growth is also necessary in addition to social security system reforms. In order for Japan to cope with its declining birthrate and growing population of the elderly,

the nation must increase the added value that working people create.

For example, if current workers bear a indexed burden of 100 in supporting retirees and create an added value of 500, the burden/added value ratio is 0.2. If, however, current workers create added value of 1000 instead of 500 and all other elements remain the same, the ratio falls to 0.1. In short, the smaller the ratio, the smaller the burden that current workers must bear. Moreover, reviving Japan's financial vitality will probably be easier if the added value created by working people is, for instance, 1,000 rather than 500. Added value is expressed in a formula as the amount of production per individual  $\times$  the number of workers, so the higher the number of workers the better. It is important for the stabilization of the social security system as well to have more people shoulder the insurance premium burden.

To increase the number of workers we must first promote the employment of the elderly. We must determine during the next 10 years whether a mandatory retirement system at age 65 should be introduced. Since the further participation of woman in social activities is also needed, we must build a labor market that will be easy for women to enter without reducing the birthrate.

Now, let's consider the background to the declining birthrate. To begin we will examine the trends of births, the birthrate, and the total fertility rate (Table 5).

In 1949 we saw the peak of the postwar baby boom, when 2,700,000 births were recorded. Between 1969 and 1973, when the postwar baby boom generation reached the marriage age, Japan experienced a second baby boom. Since then, the number of births has been steadily declining. Recently the average number of births has been about 1,180,000 per year.

The total fertility rate is an indicator to watch when we talk about the birthrate. Put simply, the ratio shows the number of children a woman will bear during her lifetime. The total fertility rate fell below 2.0 in 1975 and declined to 1.57 in 1989 and to 1.34 in 1999. Japan has the lowest total fertility rate among the advanced countries of the world.

Let us give a concrete example of the total fertility rate below. To simplify matters we will assume there are

**Table 5. Leading Population Statistics**

1. Trends in the number of births and total fertility rate in Japan

	1949	1959	1969	1979	1989	1999
Total population (millions)	8.2	9.3	10.2	11.5	12.2	12.5
Birthrate (per 1,000 individuals)	33.0	17.5	18.5	14.2	10.2	9.4
Number of births (tens of thousands)	270	163	189	164	125	118
Total fertility rate (per females)	4.32	2.04	2.13	1.77	1.57	1.34

2. Total fertility rate in major countries

	Japan	U.S.	England	France	Germany	Sweden
Total fertility rate (per females)	1.34 (1999)	2.03 (1996)	1.73 (1996)	1.72 (1996)	1.32 (1996)	1.61 (1996)

Source: Ministry of Health, Labor and Welfare, *Vital Population Statistics*.

**Table 6. Trend in Number of Births**

1. Trend in birthrate by age (per 1,000 individuals)

	1970 (A)	1975	1980	1985	1990	1995 (B)	B - A
Age 20-24	96.5	107.0	77.1	61.7	44.8	40.4	-56.1
Age 25-29	209.2	190.1	181.5	178.4	139.8	117.6	-91.6
Age 30-34	86.0	69.6	73.1	84.9	93.2	93.5	7.5
Age 35-39	19.8	15.0	12.9	17.7	20.8	26.2	6.4
Age 40-44	2.7	2.1	1.7	1.8	2.4	3.0	0.3

2. Trend in birthrate among married women (per 1,000 individuals)

	1970 (A)	1975	1980	1985	1990	1995 (B)	B - A
Age 20-24	348.4	353.1	352.1	344.7	331.9	320.6	-27.8
Age 25-29	260.5	244.3	243.6	263.5	243.1	237.1	-23.4
Age 30-34	95.7	77.5	83.1	98.6	112.7	122.4	26.7
Age 35-39	22.1	16.6	14.3	20.0	23.8	30.9	8.8
Age 40-44	3.1	2.4	1.9	2.0	2.8	3.5	0.4

Source: Ministry of Health, Labor and Welfare, *Vital Population Statistics*.

1,000 women at each age, and also assume the average number of births in a year for each age group is as follows:

<b>Age 15-19</b>	<b>Average number of births</b>	<b>20</b>
<b>Age 20-29</b>		<b>60</b>
<b>Age 30-39</b>		<b>50</b>
<b>Age 40-49</b>		<b>10</b>

The total number of women between the ages of 15 and 49 is 35,000 (1,000 × 35), and the number of births in a year is 1,300 (5 × 20 + 10 × 60 + 10 × 50 + 10 × 10). Therefore, the number of births per 1,000 women is 37.1 (1,300 ÷ 35,000 × 1,000). Given that the ratio of women between the ages of 15 and 49 to Japan's total population is 24 percent, we have a total fertility rate of 8.9 (37.1 × 0.24) for 1,000 Japanese.

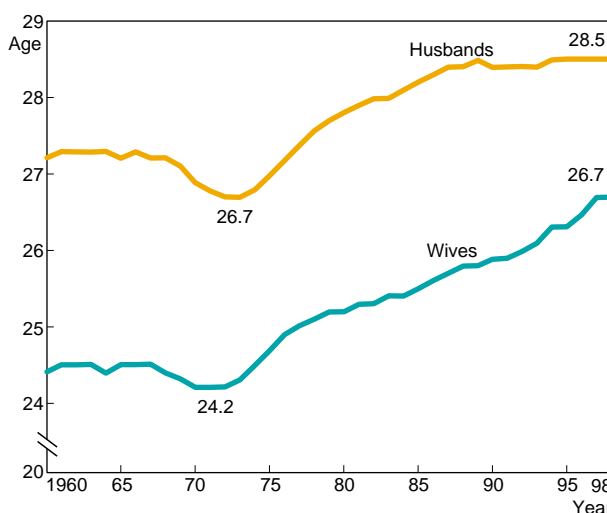
It is difficult to directly grasp the essence of total fertility rate from this index, however. Therefore, we'll ask in this way: if a woman is to give birth to children during her lifetime in accordance with the birthrate for her age, how many children will she bear?

Using the above example, we will assume the same 1,000 women give birth to 1,300 children when they are between the ages of 15 and 49. According to this assumption, the total fertility rate becomes 1.3 (1,300 ÷ 1,000). Therefore, we can solve for the total fertility rate as follows:

$$\text{Birthrate for ages 15-19} [(20 \times 5) \div 1,000] + \text{birthrate for ages 20-29} [(60 \times 10) \div 1,000] + \text{birthrate for ages 30-39} [(50 \times 10) \div 1,000] + \text{birthrate for ages 40-49} [(10 \times 10) \div 1,000].$$

In other words, the total fertility rate is the total of the birthrates during a one-year period at each age for all women. Therefore, we should direct our attention to changes in the birthrate for each age for women in analyzing the reason for Japan's falling total fertility rate.

**Figure 7. Trend in the Average First-Marriage Age**



Source: Ministry of Health, Labor and Welfare, *Vital Population Statistics*.

Table 6 shows the birthrate trends according to age and the birthrate for married women. Among the birthrate of married women, which overall shows no large changes, the birthrate among women between the ages of 20 and 29 has been decreasing rapidly, which results in a broad decline of Japan's total fertility rate. Accordingly, the cause of the decline in Japan's total fertility rate is not a drop in the number of births by married women as a whole. Instead, we find the average age of the first marriage in Japan has risen steadily during the low-growth era following the oil crisis in 1973 (Figure 7). The shift to late marriages, therefore, can be understood as a major cause of the declining birthrate.

Recently, women as well as men are marrying later and are positively participating in social activities. As Japan's economic growth has slowed since the first oil shock, housewives actively continue to earn outside income to maintain a middle-class lifestyle in the face of slowly rising real wages. Moreover, women as well as

men have been pursuing higher education, making work and their careers a natural choice for them. As a result, the birthrate has been declining.

Therefore, it is essential to consider what can be done to create an environment where dual-income couples can maintain a middle-class life, work and raise two children without difficulty.

Actually, working conditions in Japan are unsatisfactory for women, which is shown by the M-shaped curve that characterizes the pattern of female social participation in Japan. In other words, although women participate more in social activities when they are young, they return to their homes in their early 30s to give birth and rear their children. The work force participation rate for this age group therefore drops.

In Japan even today, many women stay home and keep house for their families once they get married and begin raising children. Then, as their children grow up, they usually start to work part-time to cover home loan repayments and educational expenses. It is so difficult to keep working regularly when married that most housewives begin to work again as they formerly did some 15 to 19 years after their marriages. Currently in a typical Japanese family, however, the housewife is beginning to work as well as the husband, and she is not concerned only with keeping house. Since married women are required to share the responsibility for the family's finances

and to take care of the children, they are often frustrated with their lives today.

Table 7 shows the paths adopted by women before and after marriage. A major characteristic is that women are gradually less attracted by merely staying at home and keeping house for their families. That is, women today seem to have decided to work outside the home as men do because wages do not increase as they expect. They choose to stay home and keep house only when their husbands are wealthy or they expect their husbands' future income will likely increase greatly. Instead, they gradually choose to (1) maintain both job and family, and (2) seek employment again when the children have grown up.

What is remarkable is the gap seen in 1997 between the paths taken before and after marriage (B - A) to cope with the declining birthrate. Although women ideally wish to work and maintain a family, they seem to seek re-employment. This is important because it shows a social environment that prevents women from both working and rearing children. Japan must therefore enhance day-care center accommodations for children in metropolitan areas and arrange a working environment that is supportive of women working and raising children.

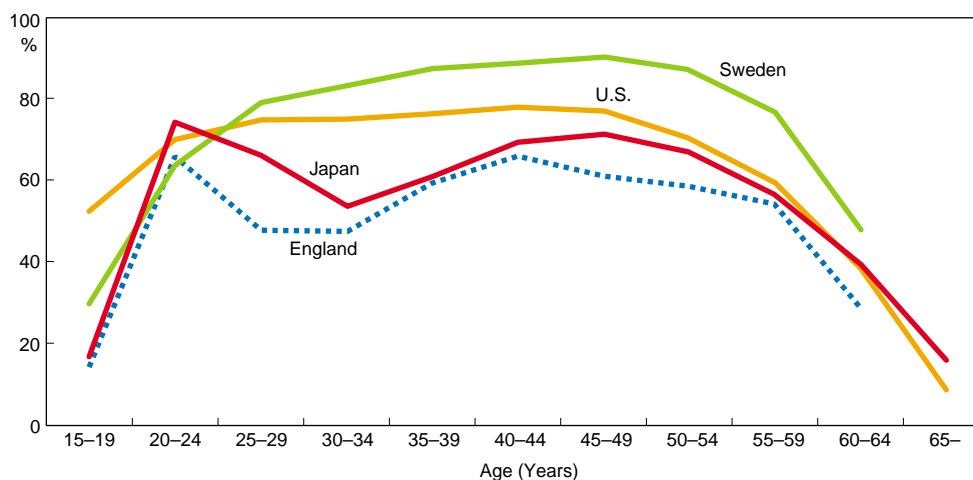
For a labor market where young dual-income couples find it easy to stay active, let us look at the work sharing

**Table 7. Ideal and Actual Paths Selected by Women**

	Before			After			B - A
	1987	1992	1997 (A)	1987	1992	1997 (B)	
Unmarried and working	3.7	3.3	4.4	7.1	9.5	9.3	4.9
Married, no children (DINKS)	2.5	4.1	4.4	1.4	2.6	3.0	-1.2
Maintaining both job and family	18.5	19.3	27.2	15.3	14.7	15.5	-11.7
Seek re-employment	31.1	29.7	34.3	42.2	45.8	42.9	8.6
Housewife without outside occupation	33.6	32.5	20.6	23.9	19.2	17.7	-2.5

Source: National Institute of Population and Social Security Research, *11th Basic Survey of Birthrate Trends, 1997*.

**Figure 8. International Comparison of Female Participation in Social Activities**



Source: ILO, *Year Book of Labour Statistics*.

system in the Netherlands, which is typically described as follows:

A full-time dual-income couple gets a total income of, say, 200. The husband then chooses to work four days a week and his wife chooses to work for three days. Although their income declines to 150, they can spend more time together at home, caring for their children more easily (1.5 work model in the Netherlands).

The 1993 employer and employee contract agreement related to the system includes a statement to indicate that employers shall consider an employee's responsibilities for child care and care for the elderly when determining working hours.

Given its falling birthrate and growing elderly population, Japan needs to substantiate the concept of family-friendly employment as seen in the Netherlands. Companies should approve flexible forms of work for employees with children. With this in mind, the next issue we should tackle is then one of day-care centers.

## VII Increasing the Number of Day-Care Centers for Children

Today many young women want to work throughout their lives, and this number has been increasing. As previously described, however, the M-shaped trend curve marking the female employment rate in Japan indicates that for women, especially in their early 30s, Japan's working environment is still extremely unsatisfactory in terms of handling both work and child care.

This M-shaped curve is not seen in other industrialized nations (Figure 8). In Sweden, where the rate of female employment is the highest in the world, the curve is not M-shaped but trapezoidal. Additionally, the birthrate in Sweden is higher than in Japan, which suggests that Sweden has achieved a harmonious balance between work and family life.

Figure 9 plots a female index and the total fertility rate to provide an international comparison. The female index is an indicator Japan's Economic Planning Agency prepares to show how easy it is for women to work. The index consists of (1) the ratio of women to men in managerial positions, (2) the wage gap between men and women, (3) the proportion of working women in the labor force, (4) the difference in the unemployment rates between men and women, and (5) the labor force participation ratio for women between the ages of 30 and 34 in comparison to those between the ages of 20 and 24—a ratio that tells us whether women stop working for a while to give birth and raise children.

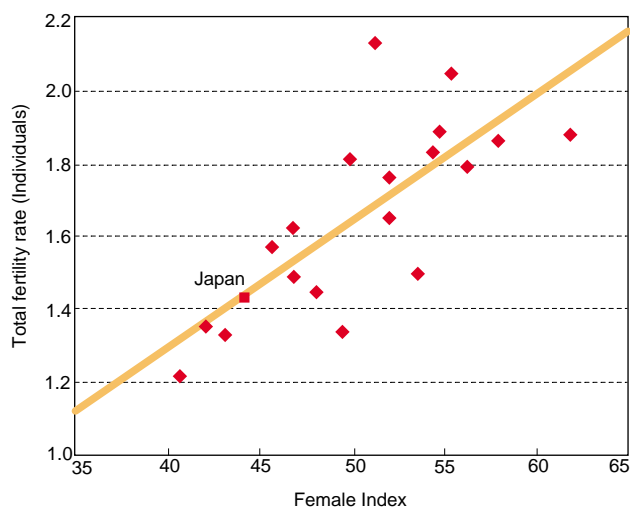
We can see from Figure 9 that in countries that ensure women can work fairly easily, the birthrate is also high. In Japan, however, women stop working to rear children.

Accordingly, we believe it is urgent to further provide and greatly expand day-care centers for children since it can be inferred that Japan is not a country where women can positively participate in social activities.

What is the current state of day-care centers for children in Japan? Such facilities in Japan have a total capacity of 1.9 million children, with an actual enrollment of 1.7 million children (as of 1998). Broadly speaking, therefore, these day-care centers appear to have adequate capacity. On a regional basis, however, while day-care centers for children in rural areas have surplus capacity owing to depopulation, those in Japan's three major economic zones, particularly in the Tokyo metropolitan area, cannot provide the necessary care especially for newborns and children under two years old because of the increase in the number of dual-income couples in such areas. Actually, about 40,000 children nationwide are now waiting to enter day-care centers even after their parents have formally applied for admission to the municipal governments.

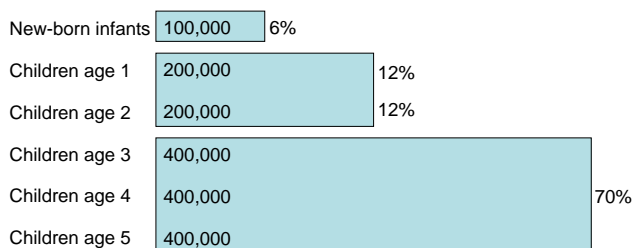
The capacity of authorized day-care centers for children is based on the applicant's age. Figure 10 shows a breakdown of this capacity. The overwhelming number

Figure 9. Female Index and Birthrate



Note: The Female Index is an indicator from the Economic Planning Agency that shows how easy it is for women to work.  
Source: Cabinet Office, *White Paper on the National Lifestyle*.

Figure 10. Capacity of Day-Care Center for Children



Source: Ministry of Health, Labor and Welfare, *Social Welfare Administrative Activities Report*.

of children under two years old in the Tokyo metropolitan area are waiting for admission because the authorized capacity for children under two years old is only half that of children from three to five years old. Municipalities hesitate to increase the capacity for children under two years old because (1) looking after such children is costly, (2) numerous regulations must be observed to keep child-care providers, and (3) a staff nutritionist is necessary.

Because legal child-care leave covers the period only until a child's first birthday, however, the overemphasis on capacity by age is inappropriate. It is inappropriate because it is extremely difficult for the parent (mother) to (1) continue to work unless a day-care center looks after her children, (2) change jobs or return to the same office when her children reach three years old, the age for which day-care centers have greater capacity. Particularly in Japan today, it is disappointingly difficult for a woman to change jobs or return to her former office and receive the same pay and comparable working conditions as she used to enjoy.

More importantly, the number of wait-listed children that appear in the statistical figure primarily represents the number of children whose mothers have given birth while working and already submitted a request for admission to a day-care center for children only to be rejected. This, therefore, does not reflect the number of working parents who have (1) given up having children because of worries over whether they can enroll their children in a day-care center, and (2) quit working to look after their children without even applying for placement in a day-care center because it appeared hopeless to obtain the day-care center admission. This latent demand is hidden behind the statistics.

Moreover, we don't know the precise number of children whose parents have enrolled them in unauthorized day-care centers out of the supervision of municipalities. Given that incidents of child abuse have led to fatalities at these unauthorized day-care centers, the government must provide such day-care centers that allow parents to leave their children without fretting over the treatment they might receive. It is irresponsible to think that we do not need to expand day-care services because the number of children will decline in the future and there will be room even if we just maintain existing facilities.

In the discussions below we will make some simple assumptions and carry out some simulations to examine the capacity that is needed in day-care centers for children in the future to enable working women to have children without undue anxieties.

We will compare two cases. Case 1 assumes (1) the current marriage rate, (2) the current birthrate by age, and (3) the M-shaped curve for female participation rate in work—i.e., some working women who give birth will stop working to raise their children, which does not create demand for day-care centers. Case 2 presupposes that (1) the present birthrate returns to the birthrate of 1.76

children of 1985 because the number of unmarried women decreases, and (2) the M-shaped curve is eliminated because the capacity of day-care centers for children increases—i.e., an increase in the number of women who continue to work even after giving birth to a child.

We've compared the total numbers of births in Table 8. For Case 1 the number of births in 2010 is 990,000 children, finally falling below the one million mark. In Case 2 where we restored the birthrate, we project the number of births will increase to 1,310,000 by 2010—an increase of 320,000—which exceeds the level of births in 2000.

The assumption in Case 2 is that the government greatly expands the number of day-care centers for children and the birthrate recovers because women can keep working even after having children. Under this scenario, how many day-care centers are necessary? Because both the number of working mothers and the number of children will increase, a total of 3,400,000 children aged 1 to 5 will require day-care in 2005, rising to a total of 3,900,000 children in 2010. Because the present day-care center capacity is 1,900,000 children, approximately 1,500,000 children in 2005 and 2,000,000 children in 2010 will remain outside day-care centers.

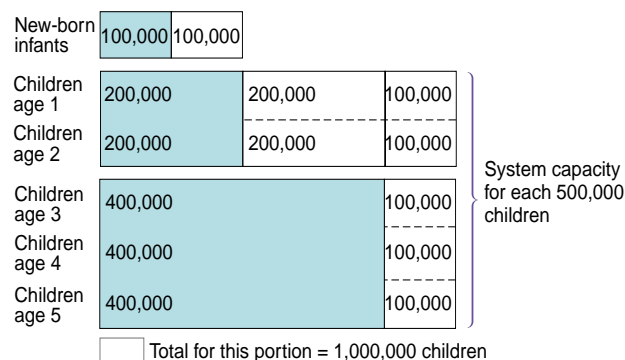
Therefore, the Basic Direction of Policies to Support Child-Rearing in the Future (the second Five-Year Plan of the Ministry of Health, Labor and Welfare) needs to be greatly expanded. It may at least be necessary to first increase the capacity to accommodate 1 million children mainly in metropolitan areas by 2010 (Figure 11). This means that the number of children of each age (school

**Table 8. Birthrate Projections (Million)**

	2000	2005	2010
Case 1	116	111	99
Case 2	116	128	131
Difference between Case 2 and Case 1	—	+17	+32

Source: Nomura Research Institute.

**Figure 11. Projected Increase in Day-Care Center Facilities for Children in 2010**



Source: Nomura Research Institute.

year) amounts to 500,000. Basically, parents should be able to take a one-year child-care leave to look after infants until they become one year old. During the year, parents should be allowed to stay at home to raise their children. As we project a certain increase in demand, however, the capacity for infants should be increased from the present level of 100,000 to roughly 200,000.

Because (1) the number of working women will further increase, and (2) supply tends to generate demand in child-care service, we believe more married couples will raise as many children as they want to have while they are still working if the number of day-care centers can be expected to increase. Hypothetically, if the M-shaped female employment rate curve is fully eliminated, we estimate that the day-care service capacity will increase by an additional 700,000 to 1,000,000. This will mean that 60 percent of all children will be cared for at day-care centers.

Besides the size of day-care centers for children, we should also give some thought to how to make it easy for parents to use such facilities. For example, when a woman gives birth to a second child and takes the allowed child-care leave while intending to return to work in the future, many municipalities will notify the parents that their first child must leave the day-care center since (1) the mother is at home, (2) there are many people waiting to place their children in a day-care center, and (3) the mother should take care of her children since she is staying at home. However, there is no guarantee that these children will be re-admitted to a day-care center when the mother does return to work—clearly an obstacle to having a second child. We can resolve this type of problem by expanding the capacity of day-care centers for children.

If the capacity of day-care centers is greatly increased, however, surplus capacity may be generated in the future. To solve this problem, which arises from restricting admission to children “who need child-care” (a prerequisite that municipalities think necessary for day-care center admissions), we should change the present day-care admittance requirements to enable anyone to use day-care centers when necessary.

According to a questionnaire survey by the Ministry of Public Management, Home Affairs, Posts and Telecommunications, housewives staying at home to look after their children feel much more worried about rearing children than mothers working in offices who use day-care centers. While 50 percent of women in offices chose “frequently or sometimes” in response to the statement “I feel that I’ll lose confidence in my child rearing skills,” 70 percent of housewives who remain at home to care for their children selected the “frequently or sometimes” response. Mothers feel walled in and their children feel isolated from communities as they desperately try to keep up with others.

This feeling would seem to demonstrate that both the subdivided characteristic of urban families and the so-

cial environment that surround them are gradually eroding the confidence of modern mothers in their child-care capabilities. If so, we should try to (1) create day-care centers for children that individuals who need child care can select and use themselves, and (2) move to the socialization of child care to support child rearing by communities as a whole, and thus (3) eliminate the possible risks inherent in a large increase in day-care centers.

## VIII Preferential Treatment for Families Rather Than Singles

In addition to the reforms mentioned so far, Japan should also amend its tax system and its social insurance system. Presently, Japan does not give any preferential treatment under the tax and social insurance systems to a dual-income couple, while it does give various preferential treatment to a married couple if the husband works and the wife stays at home to keep house. When the housewife begins working again, however, the preferential treatment she has received until then is lost, thereby creating a disincentive to working hard. As a consequence, even when she returns to work to repay a home loan and to raise children, the couple’s income will not increase as they expect.

We believe that when the birthrate keeps falling, the government should start to reform the tax and social insurance systems for families by (1) clearly giving preferential treatment to families rather than single individuals in order to cope with late marriages, and (2) removing all disincentives to working again for housewives who have almost finished raising children.

Before considering specific proposals, let’s take a simple look at Japan’s income tax system. Because a hike in the minimum taxable income has become an issue recently, we’ll use the example of a family with a housewife without an outside occupation and two children (one a university student and the other an elementary school student) to see what the minimum taxable income becomes.

When the husband is a salaried employee with an annual income of ¥3,860,000, the deduction for employment income is ¥1,310,000 and the husband’s employment income is ¥2,550,000. Because premiums such as employee pension insurance premiums are not deducted from bonuses under the present tax system, we calculate the standard remuneration for insurance premium assessment as ¥2,970,000 (¥3,860,000 ÷ 1.3).

If we assume that payments such as employee pension insurance premiums and health insurance contributions come to 10 percent, the annual insurance premium payment comes to ¥300,000, which can be deducted from his income. The basic exemption applicable to the husband is ¥380,000. When his income is ¥10,000,000 or less and the wife is a housewife with no outside occupation, the total exemption applied to his income is

¥760,000 (a ¥380,000 basic exemption for the spouse and an additional ¥380,000 special exemption for the spouse, which is a special exemption for the costs of a working husband and a housewife with no outside occupation who remains at home to raise the children). In addition, dependent tax exemptions of ¥630,000 for the grown child and ¥480,000 for the younger child are also allowed. Thus:

	(¥)
<b>Employment income</b>	<b>2,550,000</b>
<b>Employee pension insurance premium payments, etc.</b>	<b>300,000</b>
<b>Husband's basic exemption</b>	<b>380,000</b>
<b>Basic and special exemption for spouse</b>	<b>760,000</b>
<b>Dependent tax exemption (university student)</b>	<b>630,000</b>
<b>Dependent tax exemption (school-age child)</b>	<b>480,000</b>
<b>Total taxable income</b>	<b>0</b>

Therefore, the total taxable income for this married couple becomes zero and they pay no income taxes. The annual income of the husband in this case is the minimum taxable income for a salaried employee whose wife is a homemaker with no outside occupation and two children. At present the government is debating a reduction in the minimum taxable income. This discussion is specifically focused on (1) lowering the husband's deduction for employment income, (2) reducing or abolishing various exemptions, and (3) eliminating the deduction for the insurance premium payment amount.

Japan's income tax system is characterized by regarding the husband and his at-home wife as separate earners. To put it another way, taxes are levied individually, and preferential treatment is given to a housewife with no outside occupation. Thus, there is no difference in taxation before and after a man or a woman gets married. As we have noted earlier, a dual-income couple receives no preferential treatment in terms of either taxes or social security, even though they are married.

On the other hand, when a single man marries a single woman who subsequently becomes a housewife with no outside occupation, they enjoy preferential treatment measures whereby (1) they can deduct a total of ¥760,000, (2) she can use her husband's health insurance even if they do not contribute spousal premiums to the health insurance entity, and (3) her basic pension is guaranteed even if she does not pay the employee pension insurance premiums. This preferential treatment stems from the basic family model during Japan's high-growth period, which assumed the wife would be a non-employed homemaker. When this housewife wants to return to work, however, this preferential treatment creates disincentive effects.

Let's begin by considering the spousal exemption. Figure 12 shows the relationship between the spousal

exemption and a housewife's annual income. When her part-time annual income is less than ¥700,000, her husband's deduction is ¥760,000. When her annual income is ¥1,030,000, her husband's deduction is ¥360,000. As her annual income approaches ¥1,410,000, his deduction declines, and when her annual income reaches ¥1,410,000 or more, his deduction drops to zero. In other words, her working efforts reduce her husband's deduction for employment income and disposable income.

This tax system creates a ceiling of ¥1,030,000 for a part-time working housewife's annual income for the following reasons:

First, when her annual income is ¥1,030,000 or less, the couple can receive the full spousal exemption of ¥380,000 as the husband's taxable income deduction.

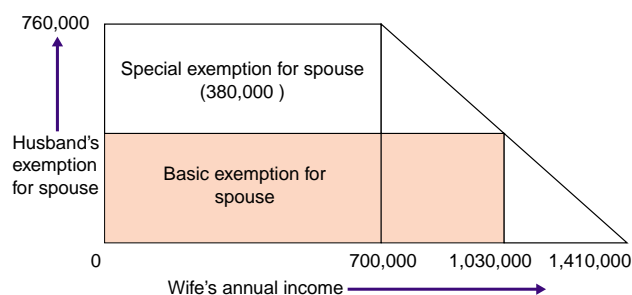
Second, when her annual income is ¥1,030,000 or less, her income tax is zero.

Third, as a requirement for a company spousal allowance, it is often assumed that the husband has an exemption for his spouse. When the housewife's part-time income is ¥86,000 per month (¥1,030,000 annually), the company spousal allowance is, for instance, ¥30,000 per month; but when her part-time income is ¥90,000 per month (¥1,080,000 annually) and the allowance is stopped, the loss of the ¥30,000 becomes a disincentive to working to earn an annual salary of more than ¥1,030,000.

Fourth, when her annual income exceeds ¥1,300,000, she is considered to be regularly employed at a firm and must pay premiums for health insurance and employee pension insurance. If she earns less than ¥1,300,000 annually, she can use her husband's health insurance and receive the same benefit amount as her husband as a basic pension from age 65 without having to pay her own insurance premiums (health insurance premium and employee pension insurance premium). Therefore, although paying such premiums brings her no value, she is obligated to do so when her annual income exceeds ¥1,300,000—consequently reducing her net income.

Accordingly, when a housewife goes to work to help support her family, she is confronted with an income

**Figure 12. Relationship Between a Husband's Exemption for Spouse and His Wife's Annual Income (¥)**



Note: The special spousal exemption is calculated at ¥50,000 increments, which we have disregarded for the purposes of this figure. Source: Nomura Research Institute.

ceiling of ¥1,030,000. In short, the tax, insurance, and company wage systems all operate against her desire to work. Let's look at some specific countermeasures (Table 9).

- (1) Abolish the basic and special exemption for spouses; introduce a marriage exemption.

Abolishing the basic exemption for spouses (and the special exemption for spouses) will make it possible to eliminate the irrational mechanisms whereby a housewife's work reduces her husband's disposable income. In place of these exemptions, we propose the introduction of a marriage exemption that gives preferential treatment to families. This marriage exemption will allow dual-income couples to reduce the amount of their taxable income, and will free housewives

from the disincentives confronting them when they go to work.

- (2) Allow dual-income couples to withdraw from one health insurance entity if they are forced to make contributions to two health insurance plans because both of them are working.

As a measure to (1) resolve the health insurance premium problem caused when a housewife goes to work, and (2) eliminate the irrational need to pay contributions to two health insurance entities when a married couple both work, the best alternative is to adopt the idea of one health insurance company for each household.

- (3) Authorize the wife in the case of a dual-income couple to pay only the earnings-related component of the employee pension insurance premium.

**Table 9. Viewpoints Regarding the Family Tax System and Insurance Premiums**

	Payable by each person	Presently	In this report
Exemption and deduction from income	<ul style="list-style-type: none"> <li>Should abolish the exemption for spouse.</li> <li>&lt;Reason&gt; Eliminate the ceiling of ¥1,030,000.</li> <li>Gives preferential treatment compared to dual-income couples.</li> <li>&lt;Problem&gt; Will increase taxes on all households with a non-employed housewife.</li> </ul>	<ul style="list-style-type: none"> <li>No preferential tax system treatment for dual-income couples.</li> <li>Housewife with no occupation can apply an income tax exemption (up to a maximum of ¥760,000) to husband's income (spousal exemption).</li> <li>A ceiling of ¥1,030,000 is encountered when a housewife with no outside occupation begins working, however.</li> </ul>	<ul style="list-style-type: none"> <li>Abolish the exemption for spouse and provide a marriage exemption.</li> <li>&lt;Result&gt; Eliminates the ¥1,030,000 ceiling. Gives preferential tax treatment to dual-income couple as well.</li> <li>&lt;Problem&gt; Will reduce tax revenues as a whole.</li> </ul>
Health insurance	<ul style="list-style-type: none"> <li>Housewives with no outside occupation should also contribute to national health insurance.</li> <li>&lt;Problem&gt; Increases burden on households with a non-employed housewife. Creates a contribution problem for college students because individuals with no income become contributors (the public pension has the same difficulty).</li> </ul>	<ul style="list-style-type: none"> <li>Dual-income couples contribute to two health insurance entities.</li> <li>Housewives with no outside occupation pay no insurance premiums and are covered by husband's insurance.</li> <li>A ceiling of ¥1,030,000 is encountered when a housewife with no outside occupation begins working, however.</li> </ul>	<ul style="list-style-type: none"> <li>One spouse in the case of a dual-income couple can withdraw from contributing to one of the health insurance entities.</li> <li>&lt;Result&gt; Dual-income couples can eliminate part of the ¥1,300,000 ceiling.</li> <li>&lt;Problem&gt; Increase in burden for health insurance entities.</li> </ul>
Employee pension insurance premiums	<ul style="list-style-type: none"> <li>The unemployed wife of a salaried employee should also contribute.</li> <li>&lt;Problem&gt; Increases burden for households in which the wife has no outside occupation. Furthermore when the housewife pays the earnings-related component, what kind of payment should she have to pay?</li> <li>Should shift the public pension to individual accounts.</li> <li>&lt;Problem&gt; When each person makes payments into their own account, who pays for retirees? (Increase in government bonds issues—outstanding balance already ¥330 trillion)</li> </ul>	<ul style="list-style-type: none"> <li>Both spouses in case of dual-income couple pay the full employee pension insurance premiums.</li> <li>Guarantees the basic pension to the non-employed wife of a salaried employee.</li> <li>A ceiling of ¥1,030,000 is encountered when a housewife with no outside occupation begins working, however.</li> </ul>	<ul style="list-style-type: none"> <li>Continue to maintain the intergenerational support under the existing public pension, while having one spouse in the case of a dual-income couple pay only the earnings-related component.</li> <li>&lt;Result&gt; Dual-income couples can eliminate part of the ¥1,300,000 ceiling.</li> <li>&lt;Problem&gt; Deterioration of public pension financing.</li> </ul>
Basic viewpoint	<ul style="list-style-type: none"> <li>Government should levy all taxes and social insurance premiums on individuals. Therefore, it should not give preferential treatment to housewives with no outside occupation but should adopt an economically neutral position towards single individuals and families.</li> </ul>	<ul style="list-style-type: none"> <li>Current programs (1) put households of salaried employees whose wives have no outside occupation at the center of family system, (2) provide a number of exemptions on the income of married couples, and (3) give preferential treatment to families in which the wife has no outside occupation.</li> </ul>	<ul style="list-style-type: none"> <li>Give greater preferential treatment to families over single persons. Create no disincentives with respect to decisions on whether to stay at home or go to work.</li> </ul>

Source: Nomura Research Institute.

We propose this because it is unreasonable (1) for a housewife to pay the full employee pension insurance premiums when she begins working even though she is entitled to receive the basic pension, and (2) for both spouses in the case of a dual-income couple to pay full employee pension insurance premiums.

These countermeasures will (1) give preferential tax and social insurance treatment to dual-income couples, and (2) eliminate the disincentives that arise when housewives return to work. In other words, greater preferential treatment should be given to marriage and subsequently raising a family than being single.

## IX Introducing US-Style ESOPs to Japan

In order to increase national income, Japan must increase the number of workers and raise production per person. However, how do we go about raising productivity? While such discussions often focus on technological improvements, here we will consider enhancing the incentive system.

Major US firms that lost out in competition with Japanese and European companies in the first half of the 1980s undertook large-scale restructuring, aiming to return to their core businesses. Behind this restructuring was a major change in a firm's treatment of its employees—in short, a full-scale revamping of compensation strategies. Firms resolutely shifted from compensation systems based on years of service to incentive-based compensation systems. While compensation systems based on years of service reward employees if they work for the company for a long time, the incentive-based compensation system does not evaluate them by length of employment. Instead, the system rewards them if they are successful. From the latter half of the 1980s through the first half of the 1990s, incentive plans such as stock options using company shares grew popular throughout the US. In the latter half of the 1990s, Japanese firms also introduced stock option systems as a mechanism to reward employees if they perform well.

We believe that in order to invigorate Japanese firms, Japanese companies must introduce US-type ESOP (Employee Stock Ownership Plan—a system in which employees own shares of their company's capital stock) in addition to incentive-type reward systems.

Japan is still a ways from answering the question of who owns a company. Because its government must rebuild national finances, however, Japan needs a breakthrough. If reducing public investment to restore financial vitality simultaneously leads to an economic slowdown, however, restoring the nation's finances will remain only half complete because tax revenues will be reduced. While the government struggles hard to restore its financial energy, private capital investment must nevertheless be brisk, as a recovery in corporate profitabil-

ity is necessary for any rejuvenation of investment. Accordingly, we cannot consider it positive to give maximum priority to maintaining the status quo for employees while ignoring the interests of stockholders.

To revive Japan's economy over the medium to long term, corporations must restore profitability and take steps to ensure shareholder objectives that are consistent with the goals of employees. In other words, increasing the firm's profits must contribute to the interest of both shareholders and employees. Under the basic concept of converting all employees to shareholders, US-style ESOPs cultivate ownership awareness by making employees the owners of their own company and attempt to harmonize shareholder and employee interests. ESOPs are defined-contribution pension schemes that invest only in the company's own stock. We believe Japan should introduce such a system.

By (1) actively introducing stock incentive plans to Japanese firms and (2) providing mechanisms to reward employees only when they are successful, we can turn corporate behavior away from the "government will foot the bill" mindset. (For details concerning ESOPs, refer to "Summary of ESOPs in the United States and Their Introduction into Japan" in *Chiteki Shisan Sozo*, March 2001.)

## X Are Families Sufficiently Reproducing the Next Generations?

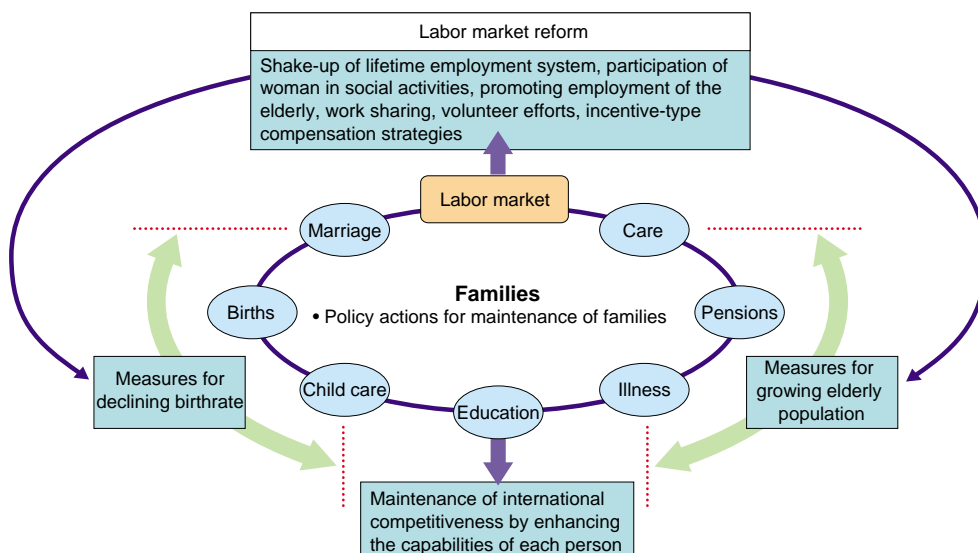
Countermeasures to offset Japan's declining birthrate and growing elderly population should be based on recognizing that families are not sufficiently reproducing the next generations (Figure 13).

In recent years the birthrate has continue to fall because the number of late marriages is growing. In addition, day-care centers for children in metropolitan areas remain in short supply at the same time the number of dual-income couples is increasing. According to recent press reports, school education is fraught with many challenges. Specifically, we face an urgent need to buckle down to take action to improve the mental and intellectual abilities of our children for the 21st century. Simply put, it is hard to claim that Japan's future is bright and in good shape.

At the same time, as life expectancy continues to climb, the proportion of retirees to workers grows unabated and has begun to shake the social security system that provides the income guarantees, medical care and other assistance for the elderly, and which is premised on the concept of intergenerational support.

If a declining birthrate and growing elderly population is inevitable in our future, we must reduce the burden on current workers while protecting the sense of security for the elderly. This is the essence of social security system reform. It is not enough for Japan to solve its problems with only system reforms, however. More

Figure 13. Coping with the Declining Birthrate and the Growing Elderly Population



Source: Nomura Research Institute.

people must work in order to support their future. That’s why Japan needs economic growth.

Therefore, (1) elderly people must also work: more specifically, the retirement age must be raised from 60 to 65; (2) with the support of sufficient and adequate policies to cope with the declining birthrate, women must be encouraged to further participate in social activities; (3) the responsibilities that men and women share at home must be reconsidered; (4) similar to the 1993 employer and employee contract agreement related to the work sharing system in the Netherlands, a declaration must be added to the general principles of Japan’s labor laws that calls on employers to take into consideration their employees’ child care and care for the elderly; (5) we should not think that a pecuniary economy dominates all services but try to activate a sense of charity for the weak by nourishing the concept of volunteerism.

In microeconomic terms, the final stage of company restructuring is a matter of personnel issues—elements that must be characterized not only by logic and ratio-

nality but by employee-friendly considerations as well. When companies begin to take heed of efforts by their employees to develop their potential on their own, they will naturally move to vitalizing themselves macroeconomically, and consequently rejuvenating Japan strategically after the end of the economic bubble. One dictum of Japan’s post-war labor market used to be that full-time male employees whose wives remained homemakers with no outside occupation would buttress a company—which in turn would keep rewarding the husbands with seniority upgrades until the mandatory retirement age. As we have noted, this assumption is no longer valid, and will collapse.

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