Medium-term economic forecast — Japan Center for Economic Research

Establish Social Security that will Support the Future Generation

— Allocate 13 trillion yen to childcare support. Stop investing public funds in medical insurance and seek independence.

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< **Key Points** >

* Action on the declining birthrate will revive the birthrate, bolstering the growth rate.
* Raise medical and nursing care insurance premium rates and patients' self-pay rates.
* Encourage nationwide discussions by showing choices for painful reforms.

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Following the Lower House election that was held in December 2014, it has been determined that the next consumption tax hike will be put off for eighteen months, and the roadmap for fiscal reconstruction has become increasingly uncertain. Meanwhile, the number of births fell in 2014 to a level that almost dropped below the benchmark of 1 million. The government has set a target of maintaining a population of approximately 100 million in fifty years time. However, it has not taken any specific measures to achieve that target.

The Japan Center for Economic Research (JCER) recently published a medium-term economic forecast. First, the forecast provided for anticipated economic developments in the future as a baseline scenario under the condition that the consumption tax hike stops at 10%. It then examined a reform scenario in which the future generation can retain hope based on the implementation of fiscal reconstruction and measures to counter the declining birthrate through tax and social security reforms (refer to the table).

The baseline scenario is based on the precondition of the implementation of highly achievable fiscal policies, such as increases in the burdens on the public (increases in consumption taxes to 10% and health and nursing care premium rates) that the government has already decided to adopt and the introduction of measures to control pension benefits (benefits linked with the macro economy). Under this scenario, average annual economic growth of 0.9% will be achieved during the forecast period up to FY2025. This figure does not appear to be high, but it is a little higher than the average growth rate since the start of Abenomics, and slightly exceeds the potential growth rate.

Table: Forecast for Major Economic Indicators (Annualized growth rate, %)		FY2011-FY2015	FY2016-FY2020	FY2021-FY2025
Baseline Scenario	Real GDP	0.8	1.1	1.0
	Nominal GDP	1.0	1.2	1.1
	Consumer Price Index (composite)	0.8	1.0	0.7
	Current accounts (ratio to nominal GDP)*	1.7	2.1	0.9
	Compensation of employee per capita	0.6	0.9	1.0
	Unemployment rate*	3.9	3.4	3.3
	Primary balance (ratio to nominal GDP)*	-5.2	-2.9	-2.8
	Outstanding debt (ratio to nominal GDP)#	195.1	201.2	210.3
Reform Scenario	Real GDP	1.0	1.8	1.4
	Nominal GDP	0.2	1.9	1.4
	Consumer Price Index (composite)	0.8	0.9	0.5
	Primary balance (ratio to nominal GDP)*	-5.2	-2.0	-1.6
	Outstanding debt (ratio to nominal GDP)#	193.4	188.9	189.2

Notes: The Consumer Price Index includes consumption taxes. Figures marked with * are the average figures during the relevant periods and figures marked with # are those from the last year of the relevant periods.

The supply-demand gap will also narrow, the pace of which will be gradual, and although the economy will not be in a deflationary phase, the inflation target of the Bank of Japan will not be able to be met. As the unemployment rate will remain low, the real wage will grow at a rate at least in line with the economic growth rate, resulting in the bottoming out of the labor share. The Chinese economy is expected to slow, yet the growth rate of the overall global economy (the weighted average of the growth rates of Japan's exporting countries) is likely to remain at least at 3%. With a limited rise of crude oil prices, the situation in which the current account falls into a deficit is expected to be avoided.

However, there is still no prospect for the government to achieve its target of a positive primary balance in FY2020. A deficit of approximately 3% compared with the nominal GDP is likely to persist, and the government debt (a ratio to nominal GDP) is also expected to continue to grow. If the government faces a significant fiscal deficit, funds for childcare support will be limited. One of the reasons for Japan having a low potential growth rate for many years is the non-utilization of female workers who have professional capabilities. If childcare support is not strengthened, problems concerning the utilization of female workers would not be addressed either.

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With the understanding of these factors, a reform scenario is presented. Firstly, consideration is given to ways to raise the total fertility rate to 2.1 by 2050 to turn around the trend in the declining population. As a measure to achieve this, the Japan Center for Economic Research stated in its long-term economic forecast published in FY2013 that childcare support must be provided to the standard in France and Northern European countries, with a 13 trillion yen increase in funds. The results of this trial calculation are also basically adopted in the latest medium-term economic forecast.

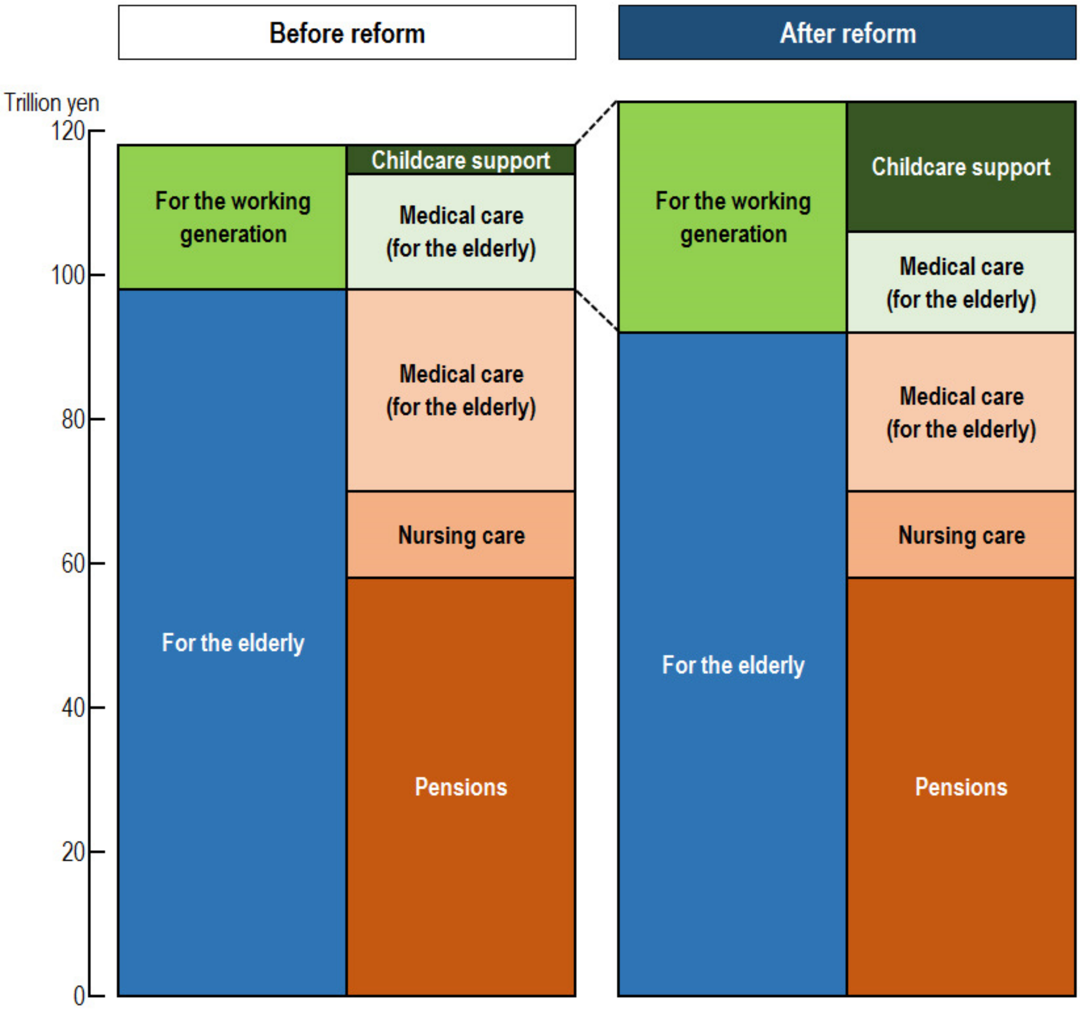
Of the 13 trillion yen, the important initiative is the provision of 8 trillion yen in physical benefits mainly for childcare support. This will ensure the establishment of a structure in which all children who are on the waiting list for nursery facilities will be accepted by the relevant facilities. The goal through this is to realize a society in which both men and women who are of child rearing age will not be forced to quit their jobs.

The remaining 5 trillion yen cash benefits are used to help the married lives and childcare of young people who are worried about living expenses. This is the part of the measures to correct the gap of social security benefits among different generations so that the future generation is able to feel hopeful about their lives.

It is necessary to implement comprehensive fiscal reform to simultaneously carry out fiscal reconstruction and countermeasures for the declining birthrate. The main target is social security. Currently, medical and nursing care benefits are provided to a scale in excess of the contributions of individual people, and the resulting deficits are left with future generations to be addressed. People should be urged to share burdens that are compatible to benefits that they receive and fiscal sustainability should be restored. Among current young generations, younger generations are going to have a fewer number of people who will take on social security burdens. As a result, such generations are likely to have less pension benefits and medical and nursing care services when they become old.

In the reform scenario, tentative plans made to invest public funds in medical and nursing care insurance are stopped and such insurance is managed independently. The insurance premium rates and patients' self-pay rates are raised significantly. Reform will be made in a way that the second tier pension will become independent, and, on the contrary, the basic pension that has the characteristics of lifetime security for the elderly will be financed by tax revenue. By making social insurance become independent as insurance, the insurance system will be made to be managed in an efficient manner. Potentially, funds that are generated through rationalization will be used for childcare support.

Changes in Social Security Benefits through Reforms (as of 2020)



Sources: Estimated by the JCER mainly based on the "System of National Accounts" of the Cabinet Office and the "Estimates of National Medical Care Expenditure" of the Ministry of Health, Labour and Welfare

The tax system will be reshuffled and a focus will be set on the promotion of growth. The effective tax rate of the corporate income tax will be lowered to 25% by FY2020. Lowering corporate income tax is likely to prompt economic growth, leading to higher tax revenues. Therefore, the corporate income tax cut will be more or less able to be financed by itself. An increase in tax revenues from a reduction in the income tax deduction and higher tax rates will be used as part of the funds for childcare measures.

Through the reforms described above, the balance of social security benefits will change significantly. In FY2020, compared with the baseline scenario, benefits for the working generation will be able to be noticeably raised. Those for the elderly will be reduced (refer to the graph).

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There is also considerable room for the rationalization of medical and nursing care expenses. Looking at such expenses by prefecture, medical expenses in particular differ in different prefectures. If nationwide medical expenses for an elderly person 75 years old or older becomes the average of those in the five prefectures that record the lowest medical expenses in Japan, the overall expenses will be able to be cut by more than 10%. Moreover, if patients' self-pay rates are raised, excessive medical consultation will be controlled.

An increase in nursing care expenses will be able to be halted by increasing the employment rate of the elderly. Based on a trial calculation, expenses for both medical and nursing care that will increase to approximately 73 trillion yen in FY2025 will be reduced by 9.2 trillion yen or 13% of the total expenses.

Through the reform scenario as described above, if funds for dealing with the declining birthrate are secured, the total fertility rate is likely to be raised to 2.1, enabling the government to achieve its population target. Moreover, with the corporate income tax cut and the promotion of wider roles for female workers, the average growth rate in the forecast period will rise to as much as 1.5%. This will lead to the stability of fiscal conditions and long-term sustainable growth.

However, burdens on the elderly will increase. A trial calculation of a typical elderly household shows that an effective increase in the burden of an elderly household with annual income of 2.6 million yen mainly from pension is approximately 300,000 yen. Expenses that have been buried under fiscal deficit until now will become apparent as a burden on elderly households.

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If such burdens are not endurable, alternative measures, such as additional increases of consumption taxes, will be required to be examined. Under the reform scenario as described above, the national burden rate is in fact almost the same as that in the baseline scenario. It is simply a reshuffling of the excessive social security benefits that are currently provided to the elderly by the working generation.

Therefore, if social security is to be improved for all generations, it is inevitable that the overall national burdens are required to be increased through consumption tax hikes and other measures. In any event, carrying out painful reforms is unavoidable. Nationwide discussions should be encouraged about the various choices in reforms.

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***Note*:** Full version of Japan Center for Economic Research – Medium-Term Economic Forecast is available on the following site. http://www.jcer.or.jp/eng/economic/medium.html

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