

# JAPAN ECONOMIC CURRENTS

A COMMENTARY ON ECONOMIC AND BUSINESS TRENDS

## Reforming Japan's Elderly Health Insurance

by Hiroyuki Takahashi

Unlike the United States, Japan provides universal medical coverage for its population through a complex system of public health plans. Japan's health insurance system can be divided into two broad categories: (1) employee's health insurance, and (2) National Health Insurance, which covers those who are not covered by the employee's insurance. The latter includes retirees previously covered under an employee's health plan.

The employee's health insurance category is not a single system, but a collection of four categories of insurance plans that are managed by or on behalf of particular employers or groups of affiliated companies. They are subject to different regulations—some are managed in part by the government, while others receive government funding. Government-managed health insurance plans are the most popular type of employee insurance. These plans are for employees working at small

and mid-sized companies which cannot establish their own health insurance plans.

Nearly as many employees are covered by society-managed health insurance plans offered by large private companies (and sometimes offered to employees of different companies within the same group or same industry.) In addition to these plans, significant numbers of employees receive coverage through mutual aid associations—including government employees and private school teachers. Seamen are covered by Seamen's insurance operated by the government.

The availability of universal health coverage is an extremely popular concept. From the Japanese citizen's perspective, Japan's health insurance system means that:

- All citizens have equal access to health care;
- Quality medical care is available at affordable prices; and
- Each individual can freely choose which hospital or clinic to visit.

However, these tangible benefits have contributed to rising medical costs. Nationwide, health costs have risen from ¥513 billion in FY 1961 to ¥30 trillion in FY 1999. The increase is 58-fold in 30 years, an average annual increase of more than 14 percent a year. This dramatic rise in costs reflects systemic problems with Japanese health insurance.

The biggest challenge that Japan's health insurance system faces is Japan's aging

population. Currently, health care costs for the elderly (those aged 70 and over) comprise about 40 percent of total health care costs. As these numbers increase, health care costs will increase as well.

One solution to the rise in insurance costs is to increase the portion paid by patients. But the political difficulties inherent in that solution are self-evident. In Japan, opposition to raising patient's contributions is particularly fierce. This reflects, in part, the historical development of the health insurance system's treatment of elderly patients.

The most significant event in elderly health insurance took place in 1973, when the government first required 100 percent coverage for elderly patients. Predictably, the elderly flocked to hospitals for free medical coverage of even the most frivolous of ailments, and insurance costs skyrocketed.

Indeed, the rise in medical costs was so explosive that the system was abolished 10 years later. In its place, the government instituted a patient cost-sharing system, the so-called Medical Care for the Elderly plan. This plan required the elderly to pay a portion of their health care expenses.

Last year, an elderly patient paid ¥540 (about \$4.62) per office visit for the first four visits, with a monthly total cap of ¥2,120 (about \$18.12). They paid ¥1,200 (about \$10.26) for each day in the hospital. Yet, this is only a fraction of the cost of treatment. According to the Ministry of

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Health, Labor and Welfare, elderly patients paid only 7 percent of their total medical costs in 1998. Against this background, it should come as no surprise that elderly Japanese citizens believe they deserve heavily subsidized health care.

Not only is an elderly person's contribution towards their own medical care extremely low, but government and insurance plans other than National Health Insurance are being forced to make up the difference. Contributions from these groups came about as part of the government's attempt to rectify the disproportionate number of elderly insured under National Health Insurance.

For example, in 1997 about twice as many elderly patients were members of National Health Insurance compared with government managed insurance plans. This was seven times more patients than were enrolled in society-managed plans.

The result is that National Health Insurance bears the financial burden of paying the higher treatment costs incurred by elderly

patients. The government has tried to solve this problem not only by chipping in itself, but also by forcing the other insurance programs to share the cost of elderly coverage.

While this alleviates the financial burden for National Health Insurance, it shifts the fiscal strain to the other contributing plans. Because the other plans must pay this contribution from premiums collected from their members, and because they

have no control over the amount charged by the government, this solution has become an enormous threat to their fiscal health. This problem is particularly acute for the society-managed plans, which receive no government funding (unlike

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National Health Insurance and government-managed plans, which are respectively 50 percent and 16.4 percent government funded).

Nobody questions the need to reform Japan's health insurance system in the face of its rapidly aging population and the enormous demands that this alone will place on an already fiscally strained sys-

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tem. Indeed, action must be taken before the problem grows too large, a possibility illustrated by the Ministry of Health, Labor and Welfare's prediction that elderly health care costs will constitute more than 50 percent of all health care costs by 2025.

However, there has been some recent activity in the field of health insurance reform. Last year, the Diet approved an increase in patient contributions for elderly care of 10 percent—although it placed caps on monthly contributions of ¥5,000

(about \$42.73) for large hospitals and ¥3,000 (about \$25.64) for other institutions. Although a step in the right direction, this measure with its monthly caps does little to alleviate the fiscal burden for the employee health insurance, which is

currently supporting about half of the elderly's medical costs.

Unless the government itself addresses the issue of forced contributions, employee

health insurance will be a growing threat to the fiscal stability of member companies. For this reason, many companies whose employees use society-managed health insurance are pushing to replace forced contributions to elderly health care with a new system.

The public, in general, is increasingly receptive to elderly health care reform.

Out of 2000 respondents to a 1999 Keizai Koho Center survey, 80 percent responded that they were concerned about the sustainability of the

current elderly health care insurance system. More than 50 percent said that the current health care system for the elderly should be replaced, with the percentage among younger respondents being even higher.

The question, of course, is what type of system should replace the current one. Up to this point, two proposals have been seriously considered. The first proposal would create an entirely separate system for elderly health care. Recognizing the

statistically greater need for medical care of the elderly, this separate system would provide government-funded health care for those over 75.

Keidanren, Japan's premier business chamber, supports a plan along these lines. Specifically, Keidanren says that the current system is unsustainable and that elderly patients themselves need to bear a greater portion of their health care costs. The solution proposed by Keidanren involves splitting the elderly into two groups: (1) those under age 75, and (2) those above age 75. Elderly health care recipients under 75 would pay a higher health insurance premium and a higher deductible for their health care.

At the same time, the Keidanren plan acknowledges the high susceptibility to illness and the higher medical costs associated with those over 75. It proposes the use of consumption tax funds to heavily subsidize the health care costs of this group. (The Keidanren plan can be viewed at <http://www.keidanren.or.jp/english/policy/2000/057.html>.)

The Japan Medical Association supports a plan similar to this. There are two significant differences. First, the JMA plan would rely on employee health insurance to cover a greater part of the health care costs of those under age 75. For those over age 75, the JMA proposes even greater subsidization of health care costs.

The second type of plan for reforming elderly health care insurance would create

a separate elderly health care plan for each currently existing health insurance plan. The idea would be for each plan to take care of its own elderly members with some plans perhaps receiving government assistance. This proposal would create differences in the form and amount of health care subsidization, but would neatly avoid the problem of excessive forced contributions. The National Federation of Health Insurance Societies and Japanese Trade Union Confederation have come out in favor of this solution.

“In the midst of Japan's recession, an increasingly competitive global economy, and the new challenges created by Japan's economic deregulation, Japanese firms and their workers can no longer afford to support this elderly health care system.”

Currently, policymakers are considering both plans. But their fear of a political backlash in the July elections for the Diet Upper House has stifled any meaningful debate on this issue. With 2002 fast approaching and no consensus on the basic plan, it is unlikely that Tokyo will meet the deadline for implementing reforms.

Up to now, Japan has been able to cobble together a workable solution for its increasing elderly health care costs by relying on the forced contributions of various private sector health insurance plans. Indirectly, this has placed a great burden on the companies and workers contributing to those plans.

In the midst of Japan's recession, an increasingly competitive global economy, and the new challenges created by Japan's economic deregulation, Japanese firms and

their workers can no longer afford to support this elderly health care system. For now, however, no solution is in sight. Some plans—specifically, society-managed insurance plans—are headed for a crisis. According to a survey by the National Federation of Health Insurance Societies, last year 40 percent of society-managed insurance plan premiums were spent on elderly health care. Twenty percent of these plans also responded that they may be forced to dissolve by next fiscal year. Unless the elderly health care costs of these plans are reduced, the

whole system may go bankrupt.

Japan is not the only nation facing the fiscal problems associated with population aging and the debating how best to fund elderly care. However, for Japan, those problems are especially acute and the need to reach a consensus on a solution is very real. ■

Hiroyuki Takahashi is Senior Representative of the Keizai Koho Center, Washington, D.C. office.

# Japan's Dangerous Debt Trap

by David Asher

Attempting to jump start its economy over the last decade, Japan has amassed the largest debt burden of any advanced industrialized country since the end of World War II (see figures). Yet this massive fiscal stimulus has failed to achieve the long promised goal of self-sustaining recovery. For FY 2000 (which ends March 31, 2001), nominal gross domestic product (GDP) likely will fall by nearly 0.5 percent—the third consecutive year of contraction—and the economy could easily contract by another 2 percent in FY 2001. Real GDP continues to increase marginally only because prices have fallen even faster than output. Consumers, fearing a huge decrease in public pension transfers and a large increase in taxes, have proved unwilling to boost spending even as interest rates decline.

This build-up of a “financial Mt. Fuji” casts a dark shadow over Japan’s future. Trying to avoid a liquidity trap with the bursting of the asset bubble, Japan has instead become mired in a debt trap of even larger proportions. Japan’s ratio of gross central government debt to recurring revenue (on a cash-flow basis) is more than three times that of the United States and twice that of Italy at the height of its fiscal problems in the early to mid-1990s.

In FY 2000, with a gross fiscal deficit of roughly 10 percent of GDP, nearly 65 percent of central government recurring tax revenue went to debt service (after mandatory transfers to prefectures), and the ratio of central government long-term debt to recurring revenue was over 1,500 percent. By contrast, the United States, after a difficult fiscal adjustment in the 1990s, now runs a budget surplus of over 2 percent of GDP, pays less than 13 percent of tax revenue to debt service, and enjoys a ratio of long term debt of less than three times tax revenue.

By all conventional indicators, Japan has breached the boundaries of sustainable fiscal policy. At the present trajectory, the combined sum of central and local

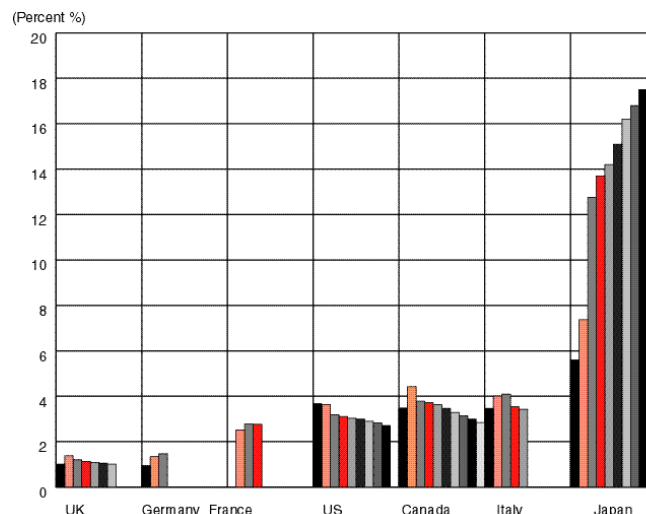
government debt will exceed 200 percent of GDP in FY 2005 and 300 percent of GDP before FY 2010. Given that Japan also has the fastest aging society and most underfunded public pension system of the Group of Seven major industrial nations, it simply cannot afford to delay adjustment any longer. It is running out of time to reform without incurring enormous collateral economic damage.

Getting Japan’s government out of its debt trap will be a tremendous public policy challenge. Basic economic modeling shows that just to stabilize national debt below 160 percent of GDP between now and 2005 will require a tax hike or spending cuts equivalent to 2 percent of GDP—about ¥55 trillion—an amount greater than total

central government revenue and more than two-thirds of expenditure. This would likely be the largest fiscal shift ever attempted by an advanced industrialized economy.

Any shirking of reform will be very dangerous. Countries that have experienced similar balance sheet deterioration have eventually encountered a debt-funding crisis. Japan’s national debt is now more than 18 percent of global GDP. Its broad money supply (M3) represents a significant portion of global transac-

GROSS CENTRAL GOVERNMENT DEBT TO RECURRING REVENUE

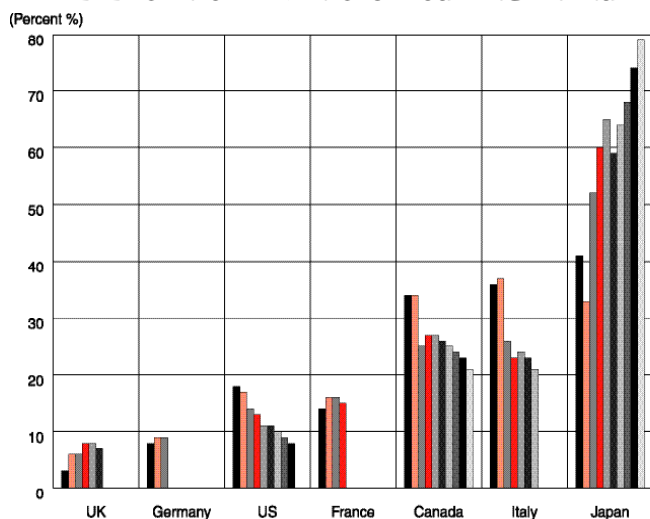


SOURCE: DAVID ASHER, AMERICAN ENTERPRISE INSTITUTE, FROM RESPECTIVE NATIONAL STATISTICS

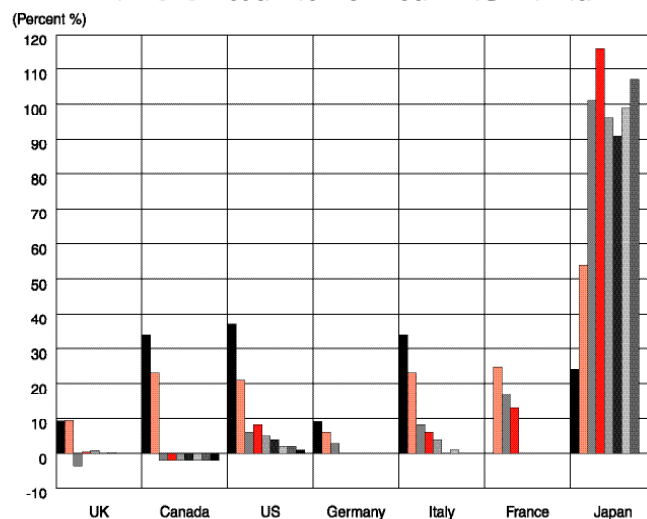


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DEBT SERVICE PAYMENTS TO RECURRING REVENUE



NET DEBT ISSUANCE TO RECURRING REVENUE



SOURCE: DAVID ASHER, AMERICAN ENTERPRISE INSTITUTE, FROM RESPECTIVE NATIONAL STATISTICS

tional liquidity. A crisis in Japan's bond markets would have disturbing global implications.

Thus, the failure of the Japanese authorities to introduce a fiscal stabilization plan is of great concern to policymakers and financial market participants throughout the world. Yet even proactive stabilization of Japan's debt burden could have a negative impact on global capital markets, given the widespread dependence on Japanese capital flows to support current account imbalances. The United States, with a current account deficit of well over \$400 billion, is particularly vulnerable to a reversal of capital flows from Japan.

To fend off the possibility of a government credit crisis and to free the economy from its debt trap, the Japanese government should introduce a fiscal stabilization plan that is aimed at balancing the budget over the next three years and halting debt expansion by 2005. Because stabilization will

depend on a revival of positive nominal GDP growth, marginal tax hikes will need to be kept to a minimum. Current proposals that rely principally on an increase in the consumption tax seem counterproductive. Instead, fiscal reform should focus on four areas:

1. Increasing tax revenue by increasing the efficiency of the collection system (for example, by implementing a taxpayer identification system to eliminate evasion and introducing an incorporation tax to force chronic loss-making companies to pay a "minimum tax");
2. Making deep cuts in spending (for example, by eliminating revenue transfers to the public pension system and fully funding or privatizing it);
3. Restructuring the nation's debt by rolling over current liabilities into ultra-long-term zero coupon bonds (sold at deep discount to face value) wherever possible; and

4. Rapidly privatizing potentially lucrative public-sector assets (such as the postal savings system and the Housing Loan Corporation).

Japan's national debt has become a global problem and will require international cooperation and support to address it successfully. Provided that the Japanese government puts together a credible stabilization plan, the United States should be as accommodating as possible. Washington needs to recognize the large-scale domestic adjustment that Japan requires and to understand the implications for the U.S. economy of instability in that country. The health of the Japanese economy—and the stability of the world financial system—are at risk. It is a time for decisive action, not further delay. ■

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## Japan Business Dialogue

*KKC's monthly program featuring Japanese experts on the economy.*

### Japan's Economic Prospects

Akio Ema, Chief Research Associate,  
Fuji Research Institute, New York

Akio Ema, Chief Research Associate of Fuji Research Institute, examined Japan's economic prospects at the Japan Business Dialogue program on January 25. Mr. Ema described three stages of economic recovery: fiscal stimulus, business contributions, and increased consumption. Currently, the Japanese government has phased out use of pump-priming initiatives, he said, while the corporate sector has taken the lead in pursuing measures aimed at realizing a sustainable economic recovery. Noting a lack of change in consumption patterns, Mr. Ema said that the Japanese economy probably had not yet entered the third stage of recovery.

Mr. Ema noted private-sector progress in two areas: investment and information technology (IT). He said that companies are now beginning to adjust and become profitable again as a result of restructuring efforts in 1998 and 1999, which were aimed at reducing excesses of debt, labor, and capital stock. Mr. Ema noted an increase in machinery orders, which suggests an upward trend in business investment. He also argued that growth in the IT sector has had a positive impact on production, business investment, machinery orders and new employment.

The speaker discounted some analysts' negative interpretation of several recent indexes of Japanese economic activity. These numbers were not surprising, he said, since they reflected only one-quarter's worth of economic activity and revealed a more natural level of growth.

Mr. Ema attributed Japan's prolonged recession to a "multi-factor slump", pro-

crastination in adjustments, and ongoing arguments about the best solutions. The "multi-factor slump" refers to problems caused by the combined impact of the collapse of the so-called asset bubble, the shock of a strong yen, fiscal deflation, the Asian financial crisis, and the failure of Yamaichi Securities, Ltd.

The Fuji Research Institute analyst emphasized that the asset-bubble collapse was not the only factor that contributed to Japan's decline. Rather, he argued that profits realized from the sale of stocks that eventually fell, in effect, neutralized the economic damage caused by the actual bubble collapse.

In his view, the yen's appreciation the following year exacerbated the impact of the bubble collapse by increasing export prices and cutting into investment profits. In addition, former Prime Minister Ryutaro Hashimoto's tax increase caused a 2 percent contraction in nominal gross domestic product. The Asian financial crisis and the collapse of Yamaichi Securities accelerated the downward spiral. The net result was a sharp deterioration in public sentiment.

The speaker said that the lack of Japanese confidence in the economy persists even today and continues to constrain consumption. During the height of the slump, the Japanese did not undertake any fundamental economic reforms. And at present, Japanese only debate whether this policy or that policy is best for the economy. Tokyo still has not pursued any meaningful solutions, he noted.

Mr. Ema emphasized that Japan needs strong political leadership in order to turn the economy around. When asked about the impact of U.S. government pressure,

Mr. Ema said that the recovery of the Japanese economy is domestic matter that requires a Japanese solution. ■

Latest Japan Business Dialogue:  
KKC, March 21, 2001

"What's Ahead in Japanese Politics"  
Tsuneo Watanabe, Fellow, Office of the Japan Chair, Center for Strategic and International Studies, Washington D.C.

Next Japan Business Dialogue:  
KKC, April 11, 2001

"Japan IT Policies"  
Masanobu Kato, General Manager,  
Fujitsu, Ltd., Washington D.C.

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KKC offers numerous programs designed to create a favorable business environment within Japan and worldwide. Its efforts extend to promoting free and stable trade by eliminating sources of friction in the global economic community.

KKC fosters a deeper understanding of Japan's basic social structure. Furthermore, it conducts public affairs activities to improve the Japanese people's recognition of Japan's global role.

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