Japan : Impact on Net lending Borrowing of Pension « Returns »

François Lequiller, OECD, 22 March 2005

In the Defined Benefits Corporate Pension Law which came into effect in April 2002 in Japan, corporate pension funds were allowed to abandon their responsibility in the management of the public part of the pension reserves which they had managed on behalf of the government, in exchange of a lump-sum paid to the general government. This new feature was introduced in two stages: it was allowed to stop accumulating new reserves of this public part in April 2002, followed by the permission to transfer the reserves accumulated in the past to the government from September 2003. This transfer payment is called '*Daiko Henjo*' ('Pay Back' or 'Return' the Substitutional benefits[1]). The total of these transfers amounted in 2004 to more than 0.6% of GDP. Smaller amounts were recorded in 2003, and some amounts are still expected in the rest of 2004[2], but the bulk of the payments seem to have occurred in Q1 2004 (thus in fiscal year 2003, the latest fiscal year for which national account data is available).

This payment has been treated in the national accounts as a capital transfer from the private sector to the general government, thus exceptionally improving the net lending borrowing of general government by more than 0.6% of GDP in 2004.

Context

Before the reform, the system was organised in two parts: (1) the Public Pension system ('Employees' Pension Insurance') which is a basic social security system organised by the general government, (2) the Corporate Pension, which constitutes an additional pension layer, managed by corporations (see chart next page).

The latter system was itself separated in two parts, the Basic Pension, managed by corporations but under general rules set by the government, and the Supplementary Pension, fully managed by the corporations. The consequences of the 2001 reform resulted in replacing the Supplementary Pension and part of the Basic Pension by a new Defined Benefits Corporate Pension system.

The '*Daiko Henjo*' corresponds to the transfer of the management and of the reserve of the remaining part of the Basic pension, called 'Substitutional Benefits', *back* to the general government.

The present memo discusses the national accounts treatment of this transfer of the reserve (in form of a cash lump-sum) to the government[3].

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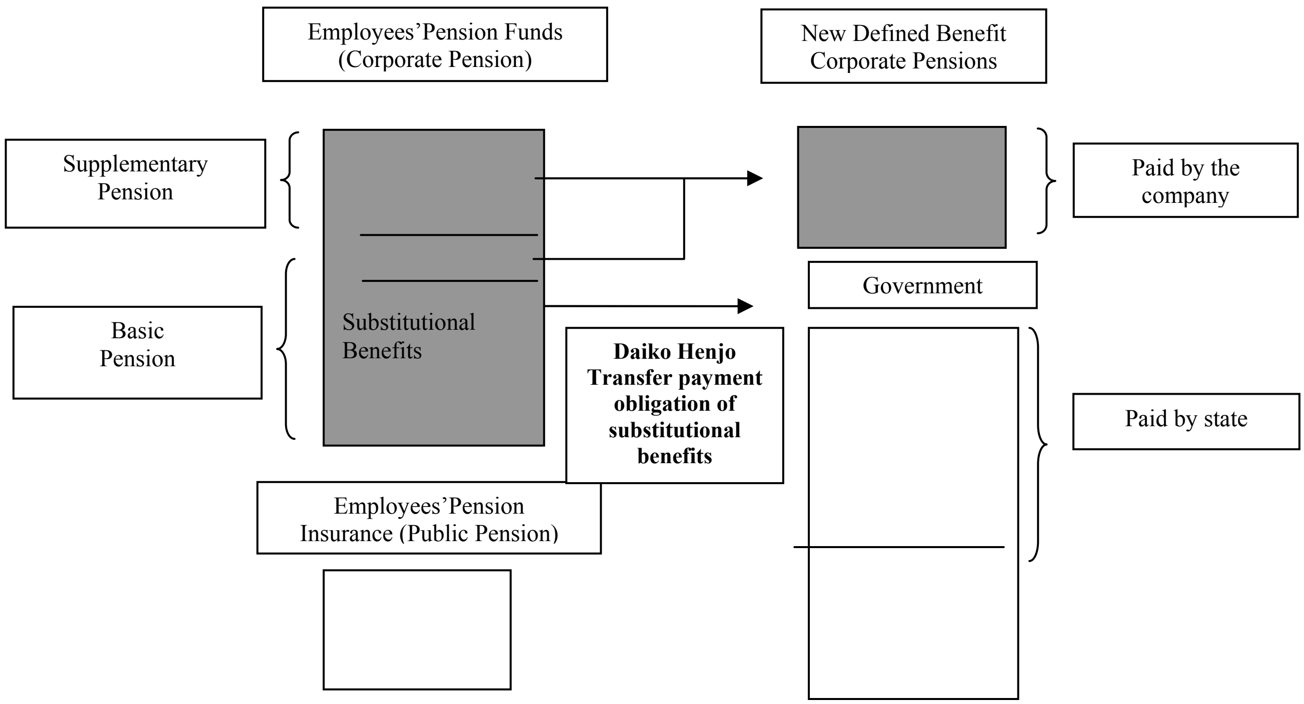
[1] *Daiko* means to carry out something on behalf of someone, *Henjo* means to return.
[2] The impact after Q2 of 2004 is not known yet.
[3] For information: this reserve was often held by companies in the form of equity holdings. As the payment was, in principle, to be made in cash, companies sold the corresponding equity, with some impact on equity prices during this period.



Principles of accounting

While existing business accounting standards are not yet so prescriptive, there is a general tendency of business accounting (under IAS pressure, in particular IAS 19, when considering pension obligations) to record pension liabilities of defined benefits schemes, whether funded or not. In IAS accounting, to the pension reserves held as assets by corporations managing defined benefits pension schemes, corresponds a liability equal to the actuarial valuation of the present value of the stream of future benefits that the enterprise promised to pay its employees. IAS refers to this as a "constructive obligation" (economists use sometimes the terms "implicit liabilities"). If the reserve matches the liability, the system will be considered as balanced. If the reserve is lower than the liability the system is considered under-funded. It is over-funded in the opposite case. I assume one can say of the Substitutional Benefits schemes in Japan that they were under-funded.

The current system of national accounts (SNA 1993) is less prescriptive than business accounting. It recognizes a pension liability only for fully funded pension schemes (i.e. defined contributions schemes or defined benefits that have a reserve that nearly matches their actuarial pension liability). In addition, it considers that public pension schemes' (called "social security" in the SNA) liabilities are never to be reported. Reserves of public pension schemes are considered as assets of the general government and not assets of households (contributors).

Possible interpretation of the Daiko Henjo

One possible economic interpretation of the rationale of the "*Daiko Henjo*" is that the companies get rid of the implicit liabilities linked to their management of the Substitutional Benefits schemes by transferring it to the general government. In parallel they transfer the value of the reserve to the general government.

Thus, one could say that, from these companies' balance sheets point of view, the transfer of the lump sum should be neutral: they give a lump sum to the government, but in exchange they get rid of the corresponding liability. Thus this transaction should not affect their net worth, and therefore have no impact on their total financial balance. In SNA jargon, one says that this transaction should have no impact on their "net lending/borrowing". Correspondingly, the transaction has no impact on the general government's net lending/borrowing. Indeed, the government has received a lump-sum, but it has also received the management of the scheme, thus the implicit liability that corresponds to the lump sum.

However, this treatment of the transaction is not the one prevailing under the current SNA interpretation. Indeed, accountants do not recognise the implicit pension liabilities and thus "cannot" record an exchange of these liabilities. By a sort of mechanical process, the only acceptable solution for the counterpart of the cash receipt is the recording of a capital transfer to the general government. As a capital transfer is an unrequited operation, it is thus akin to a *gift* received by the general government from the companies, without any recorded increase in its financial obligations. This explains the positive impact on general government net lending/borrowing.

This ruling has been confirmed by Eurostat in cases that are close to the Japanese case. The European cases (France Télécom –1997--, Belgacom –2004--, EDF –2005--) occurred on the occasion of the privatisation of large public corporations which had employer pension schemes that were more generous than the average, thus affecting the stock market value of the enterprise. A deal was struck between the firm and the government, where the firm paid a lump-sum to the government which reflected (at least in principle) the net present value of the future stream of supplementary benefits of the firms employees, against the payment of these additional benefits in the future by the government itself. Eurostat decided to treat these lump-sums as capital transfers with positive impact on net lending borrowing on the year of transfer, as did the Japanese national accountants[4].

[4] There is also an Irish case (1999), where a lump sum was given (on the contrary of the continental cases) by government to the privatised telecom company. The Eurostat treatment was symmetric.

Conclusion

The Japanese Daiko Henjo case is another illustration of the difficulty of finding a sensible accounting treatment of transactions between employer schemes and government schemes under the present SNA.

This highlights the need to modify the existing SNA in order to find a better "accrual" solution reflecting the future obligations.