

Pension Scheme in Japan:

Problems and Reform Efforts

by

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Organization

- **Brief Outline of Pension Provisions**
- **Demography**
- **Basic Facts:**

Identifying Main JPN Problems

- **The 2004 Reform Bill**
- **Future Policy Options**
- **Concluding Remarks**

Brief Outline of Pension Provisions before the 2004 Reform

- **2-tier Benefits**
- **Contributions**
- **The Biggest Business**

Two-tier Benefits (DB)

- **Basic Flat-rate Benefits (PM, PP)**

66,200 yen = USD 630

- **Earnings-related Benefits (40Yrs)**

28.5% of Career Average Monthly Real Earnings

- **Replacement Rate (One-earner Couple)**

Around 60% Net (233,000 yen = USD 2,200)

- **CPI Indexation**

- **Normal Pensionable Age: 65**

Contributions/Transfer from GR

- **Contributions**

 - 13.58% of **Annual Wages**

 - 13,300 yen = USD 125 (PM, PP)

- **Subsidy from General Revenue**

 - 1/3 of Flat-rate Basic Benefits

- **Mainly PAYG, but**

 - with Partial Prefunding**

The Biggest Business in Japan

- **Aggregate SS Pension Benefits**

44 tr. Yen = USD 420 billion in 2003

(9% of Japanese GDP)

cf. The Automobile Industry

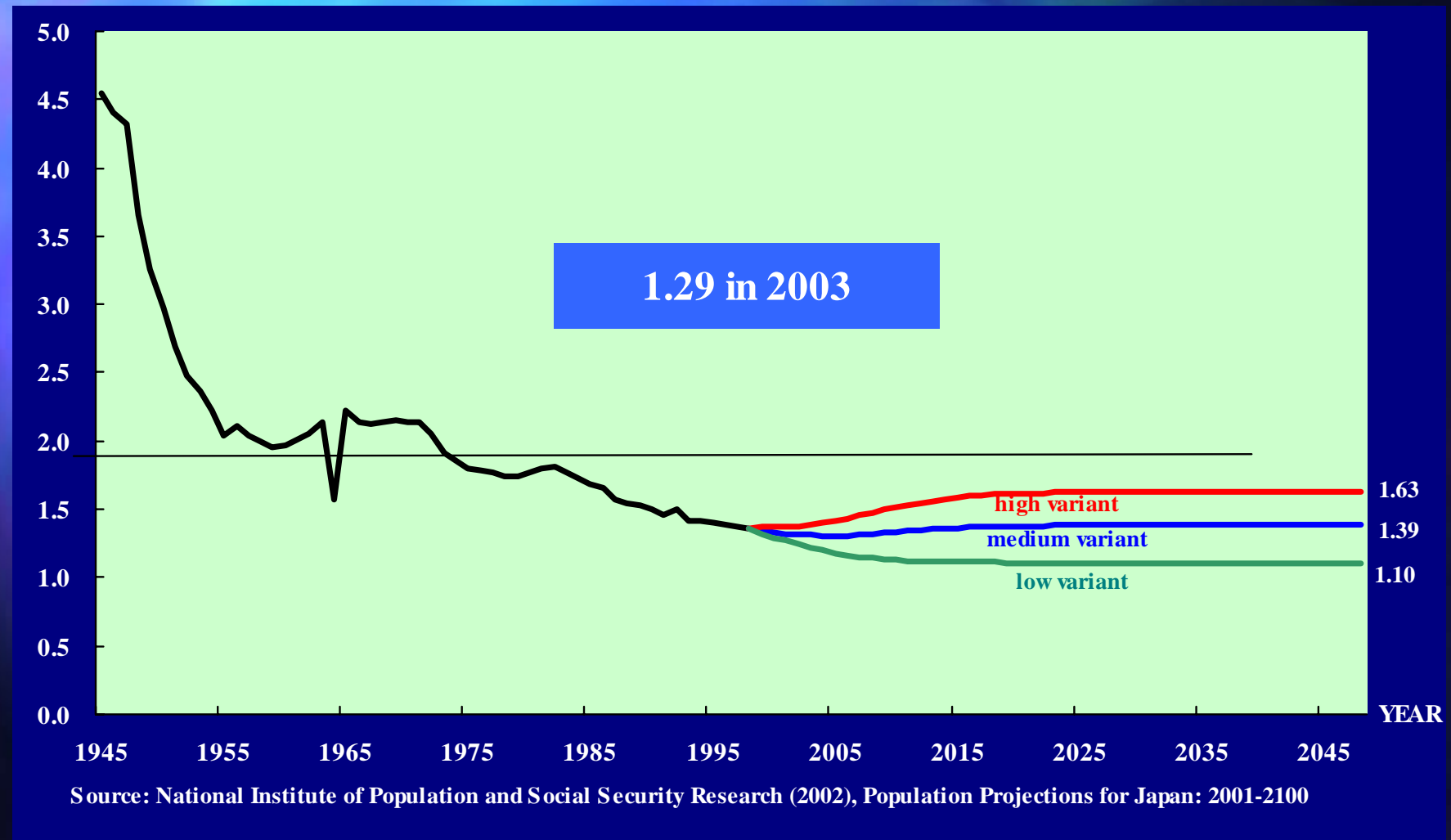
40 tr. Yen (Domestic Output in 2000)

- **Rapidly Growing**

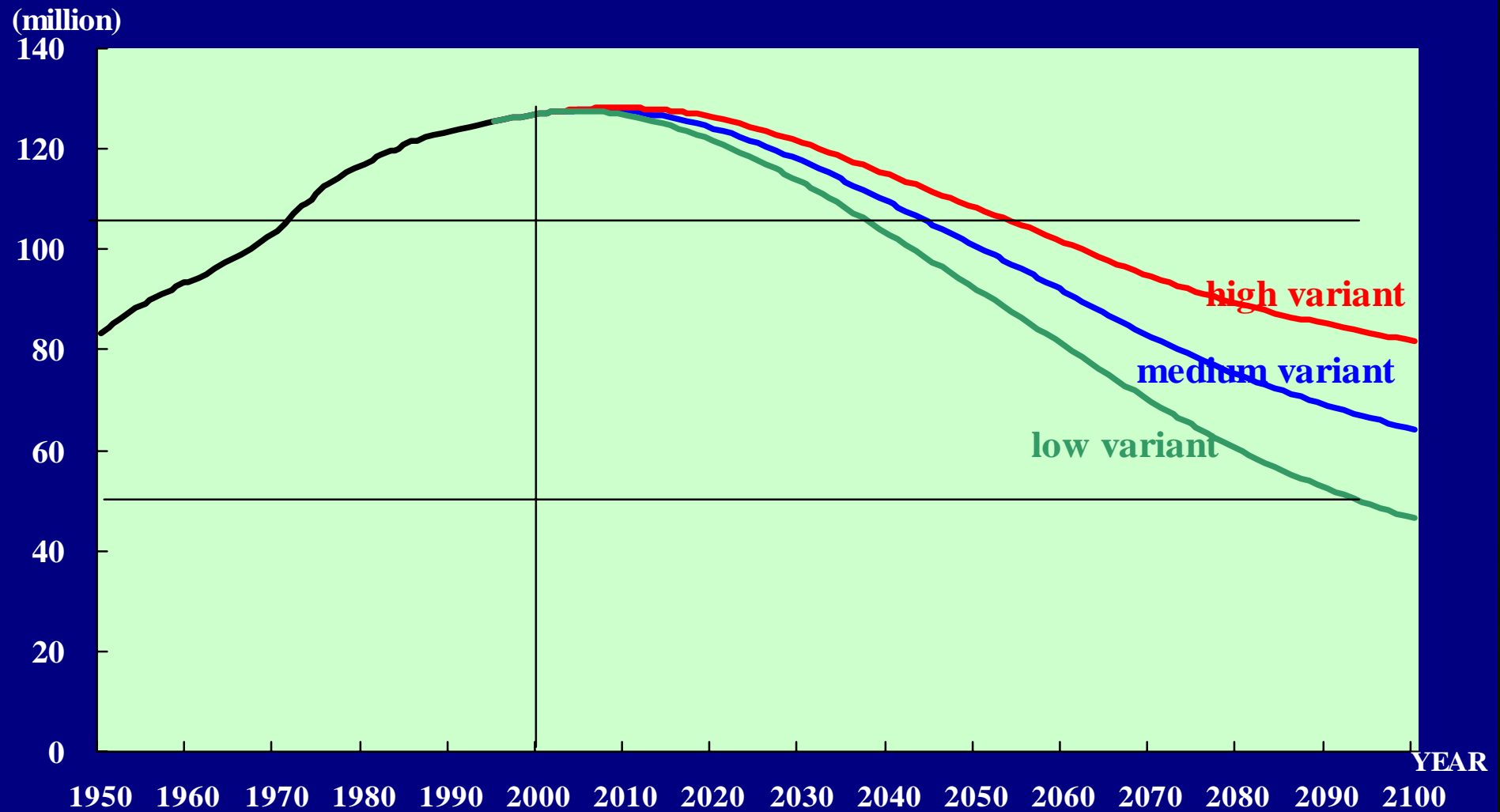
Demography

- **TFR**
- **Total No. of Populations**
- **Proportion of 65+**

Trends in the Total Fertility Rate of Japan

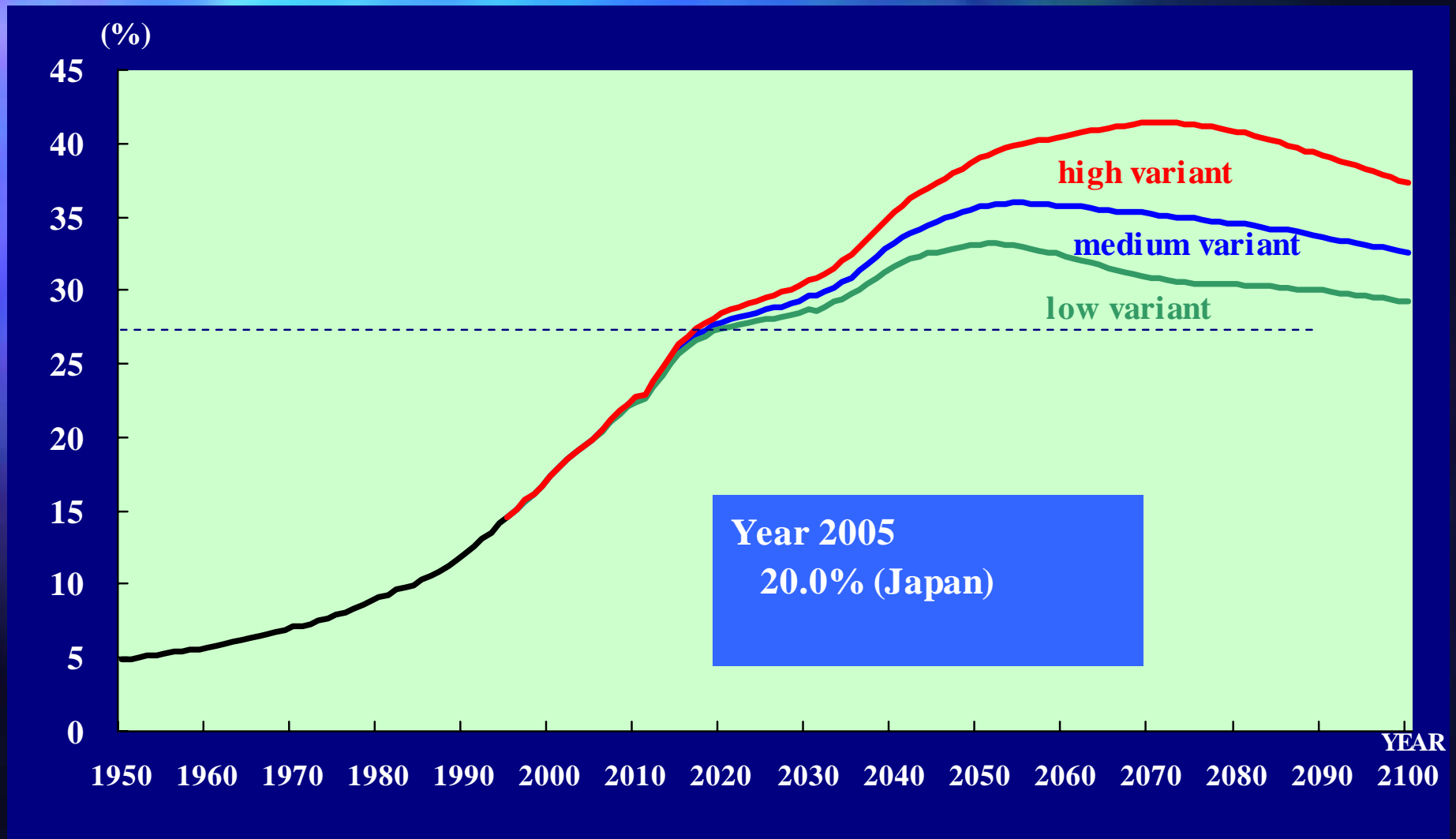


Actual and Projected Population of Japan



Source: National Institute of Population and Social Security Research (2002), *Population Projections for Japan: 2001-2100*

Proportion of the Elderly (+65) in Japan



Source: National Institute of Population and Social Security Research (2002), Population Projections for Japan: 2001-2100

Basic Facts

- **Deficit in Current Account**
- **Balance Sheet:**
 - Huge Excess Liabilities**
- **SS Pension Contributions:**
 - Heavy Burdens Outstanding**
- **Too Much Income Transfers between Generations**
- **Increasing Drop-out**

Current Account of the KNH

(trillion yen)



KNH Balance Sheet: Before Reform

(as at 31st March 2005)



Which Is More, SS Contributions or Tax Revenues?

FY 2003 National Budget, Japan

(trillion yen)

60

50

40

30

20

10

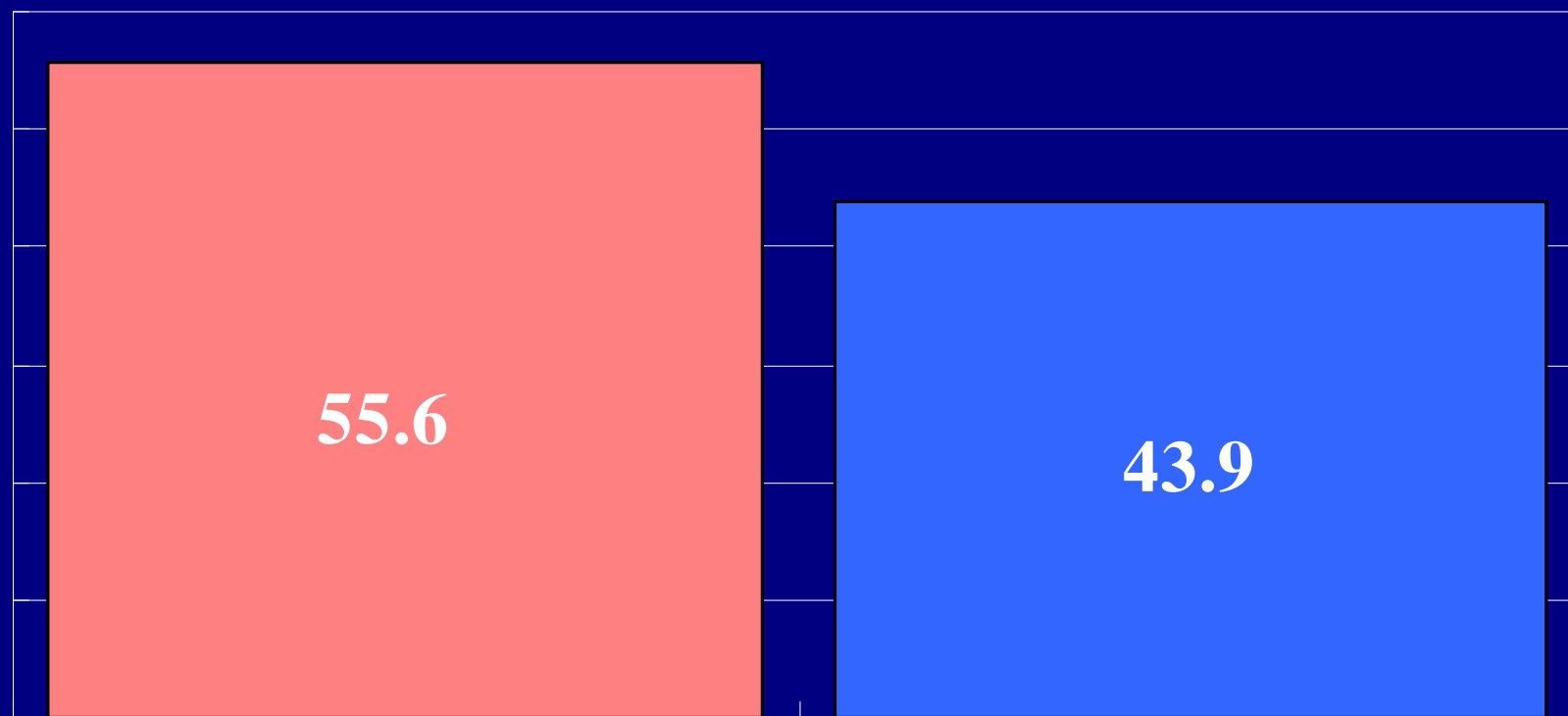
0

55.6

43.9

SS Contributions

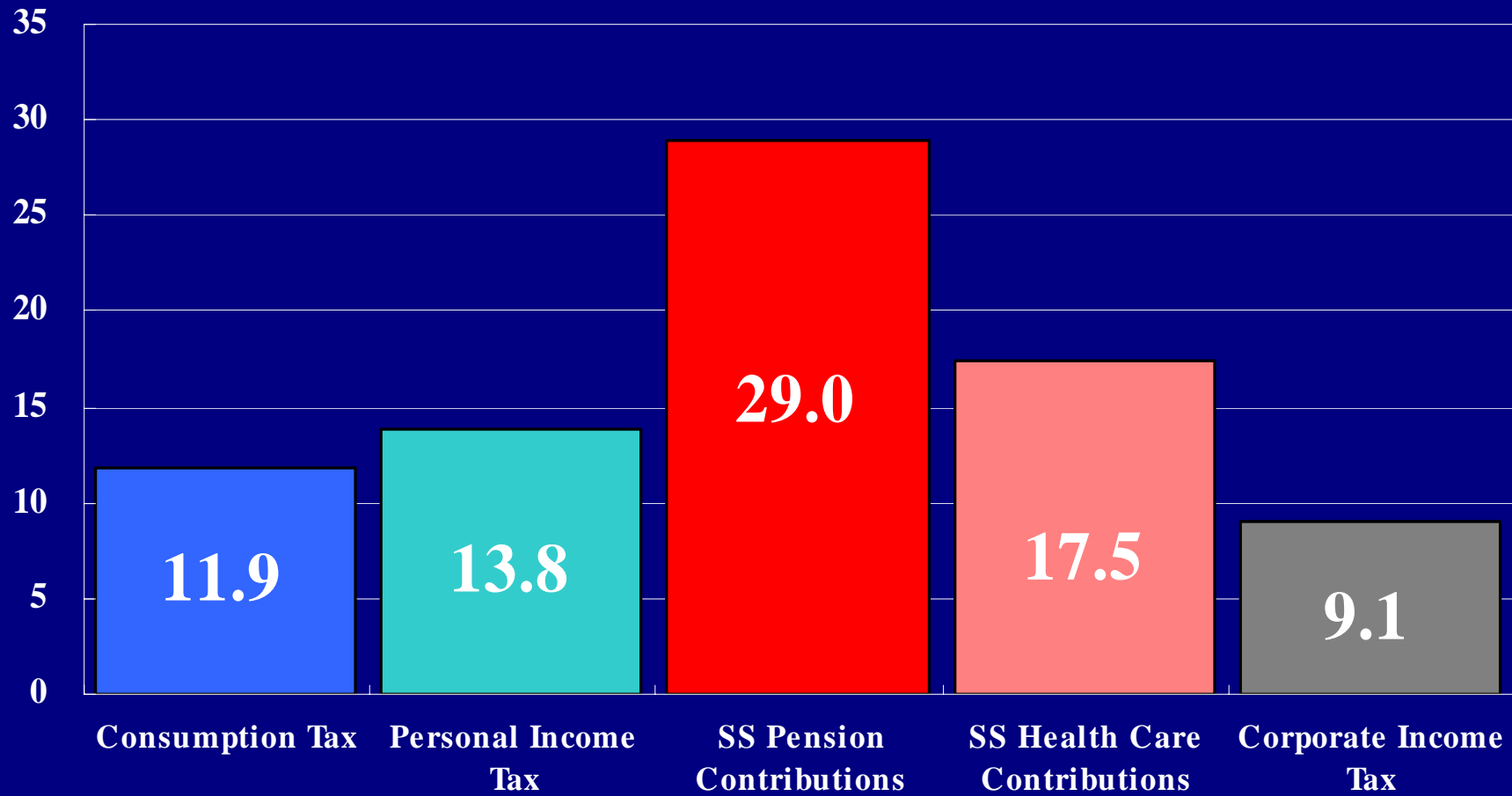
Tax (Central Gov.t)



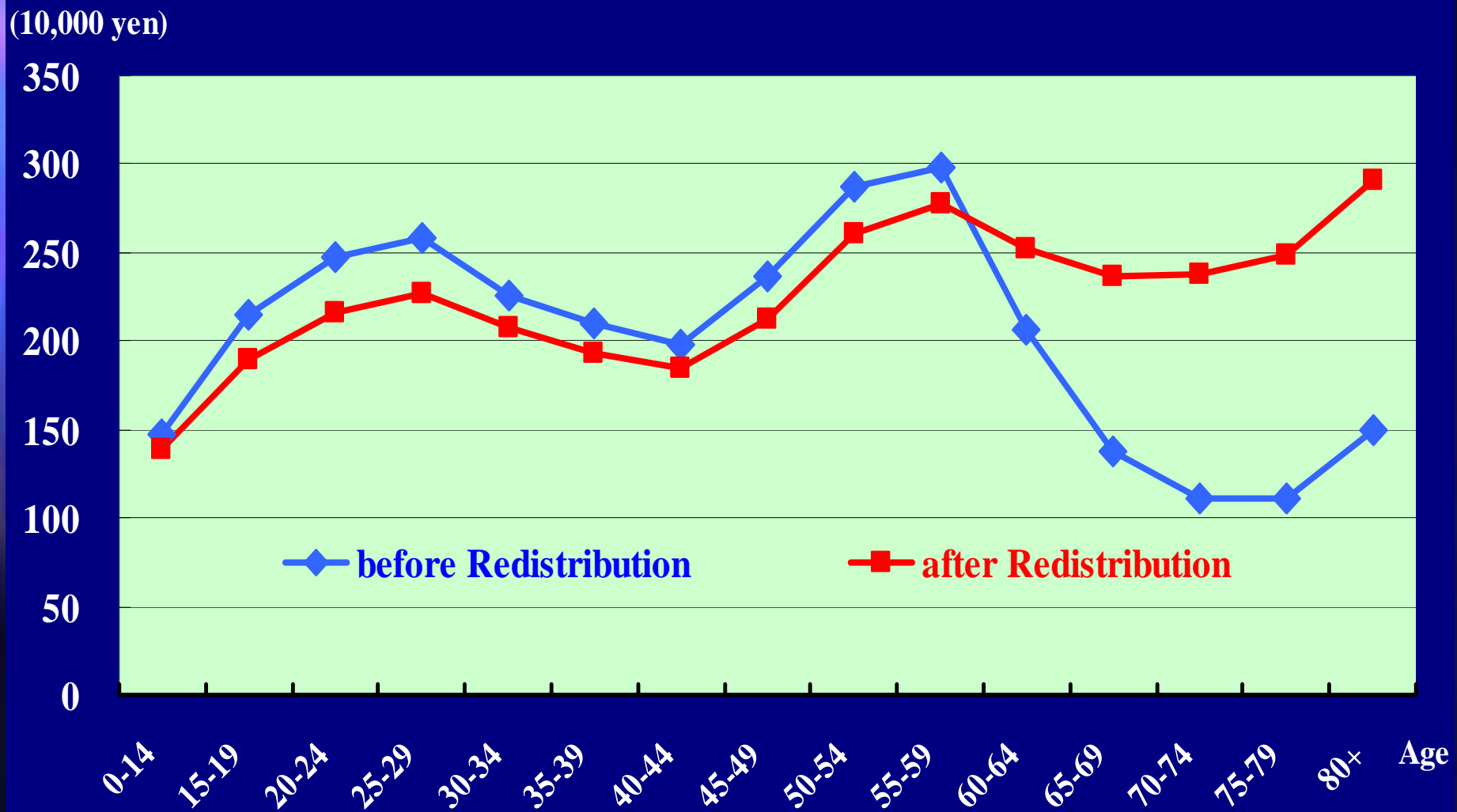
Main Income Sources of Japan's Central Government

FY 2003 National Budget, Japan

(trillion yen)

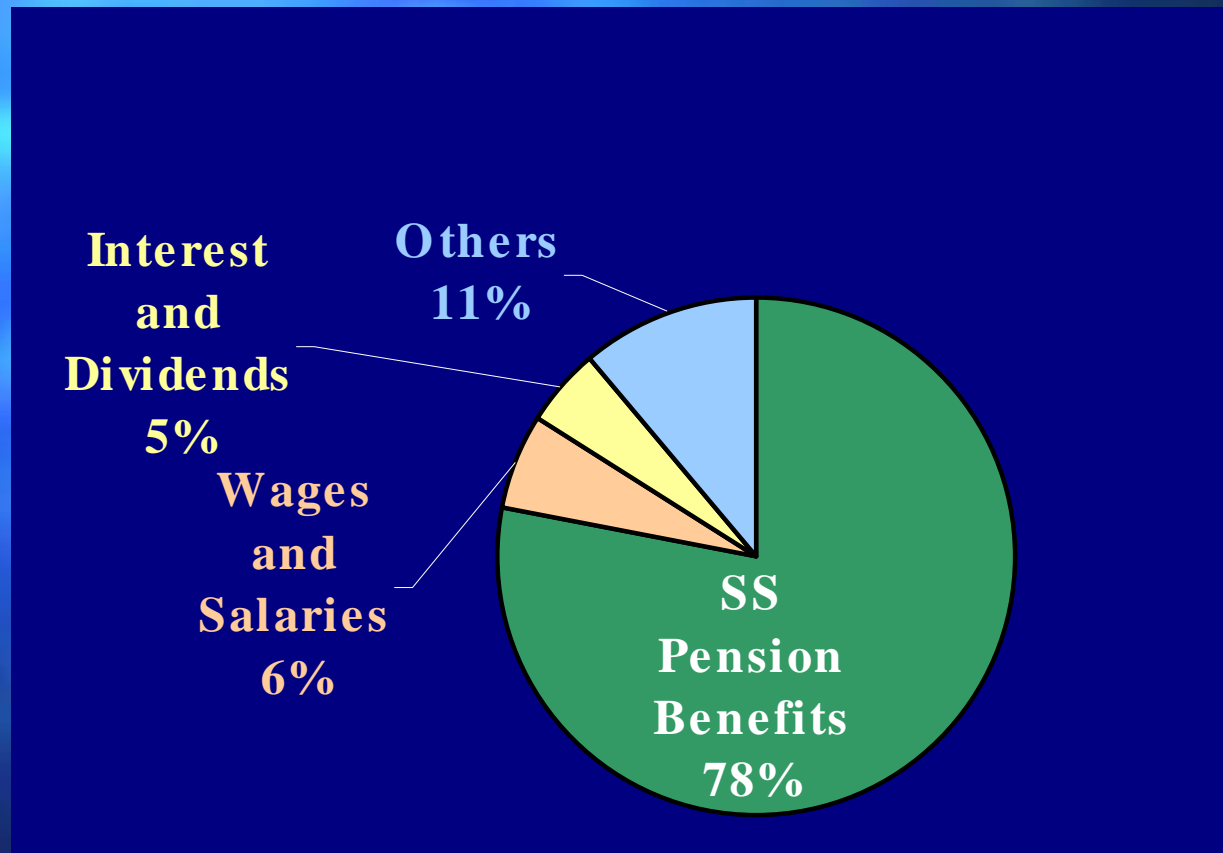


Per-capita Income by Age in Japan



Source: Ministry of Health and Welfare, *The 1996 Income Redistribution Survey*

SS pension benefits are the major source of retirement income

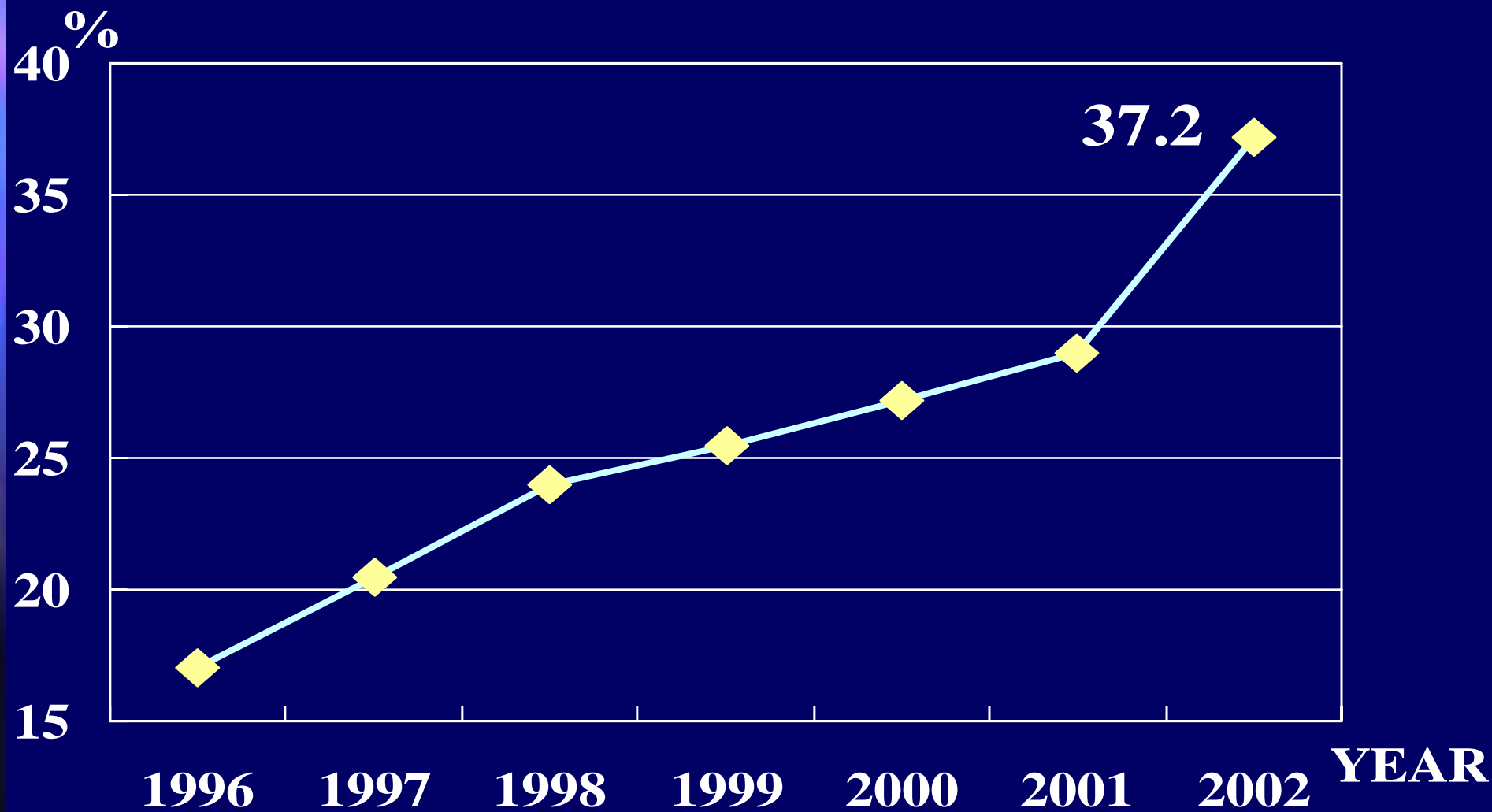


median income: 3.38 million yen

Source: *The 1989 NSFIE* (elderly couples: median income group)

Drop-out from SS Pensions (Non-employees)

Delinquency in Paying Pension Contributions



The 2004 Reform Bill (1)

- **Increasing Contributions**

by 0.354 point Every Year

→18.30% from 2017 onwards

by 280 yen Every Year

→16,900 yen from 2017 onwards

- **Increasing Subsidies**

Flat-rate Basic Benefits (1/3→1/2)

The 2004 Reform Bill (2)

- **Reducing Benefits by Considering “Demographic Factors” in Indexing Benefits between 2005 and 2023**

Replacement Rate for a “Model” Couple

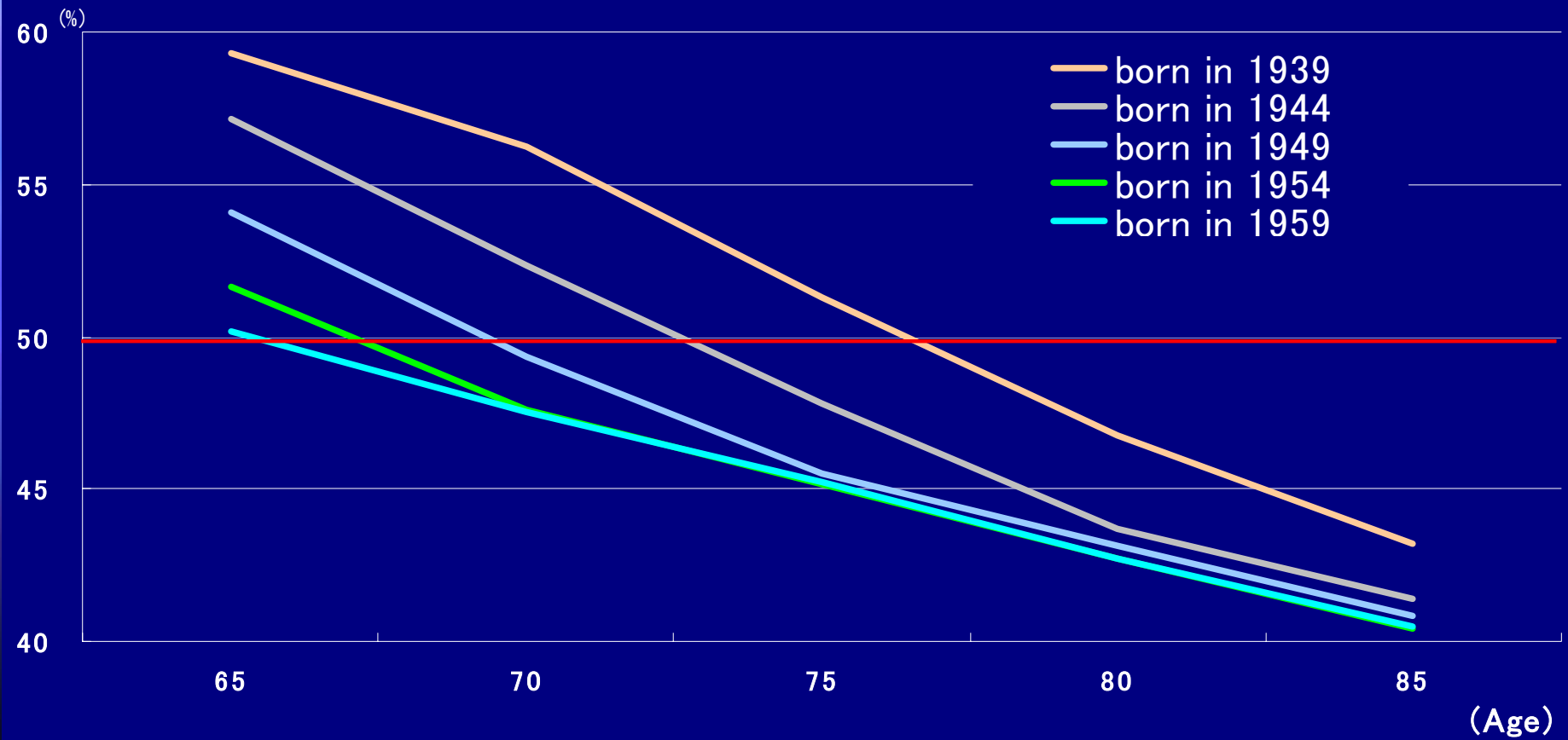
Benefits at Age 65:

60% (2004) → 50% (2023)

Current Pensioners:

60% (Age 65) → 43% (Age 84)

Replacement Rate



KNH Balance Sheet: After Reform

Incentive-compatible?

(as at 31st March 2005)

(Tr Yen)
1,500

1,000

500

0

Excess L : 420 Tr. Yen

320

Transfers (GR)

150

F.R.

170

Assets

Liabilities

Part One (PAST)

Pension Liabilities

740

(Tr Yen)
1,500

1,000

500

0

Excess A : 420 Tr. Yen

1,390

Transfers (GR)

190

Contributions

1200

Pension Liabilities

970

Assets

Liabilities

Part Two (FUTURE)

Future Policy Options

- **Strengthening Incentive-Compatibility**

Shift to NDC

- **Handling Legacy Pensions**

Diminishing Excess Liabilities

- **Strengthening Private Initiatives**

Strengthening Incentive-Compatibility

Shift to NDC

- **Direct Link between Contributions
and Pension Benefits**

“Every Yen Counts”

→ Increased Credibility

Handling Legacy Pensions

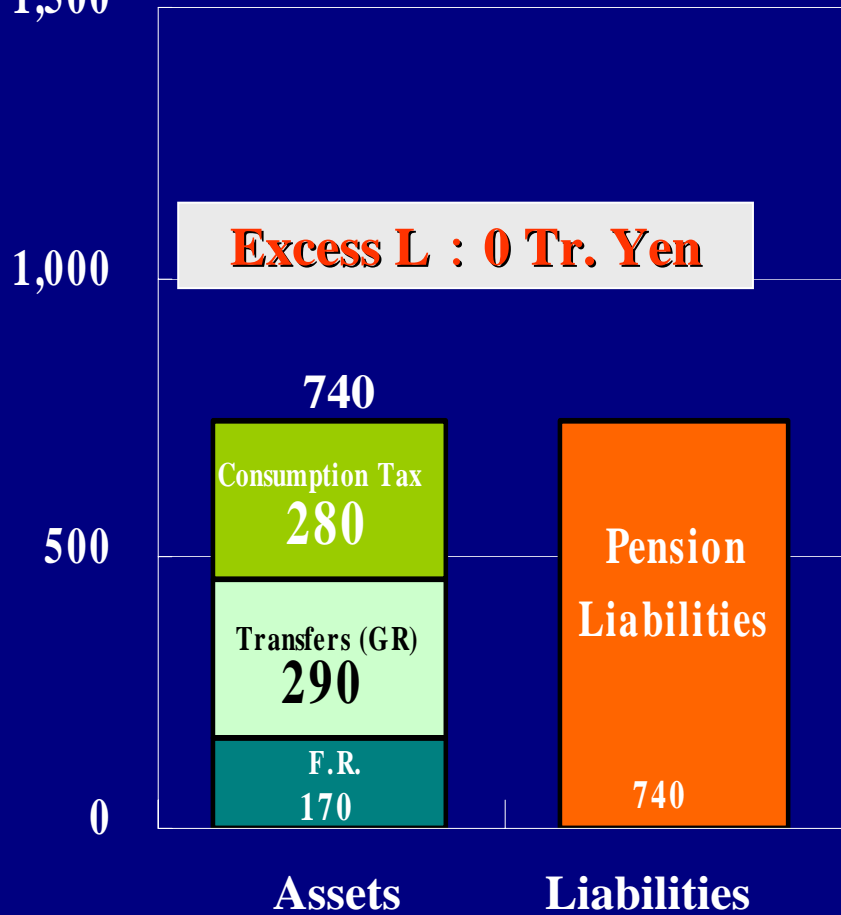
Three Options

- **Reducing Benefits**
- **Increasing Contributions**
- **Increasing Subsidies**

KNH Balance Sheet : Alternative Reform

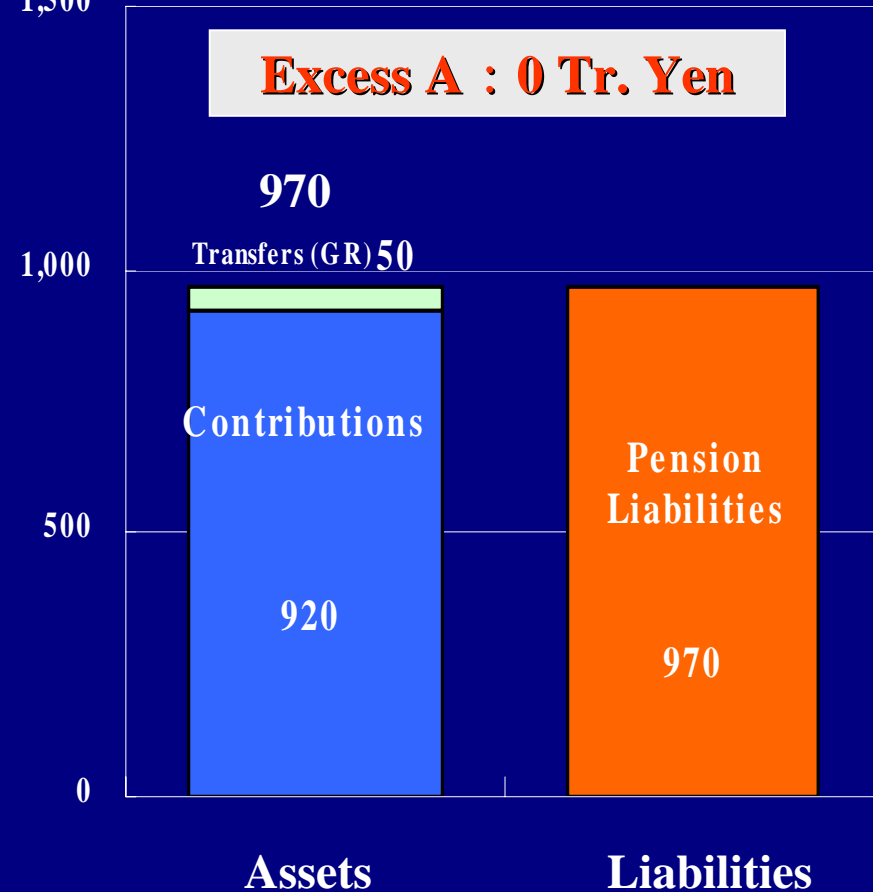
(as at 31st March 2005)

(Tr Yen)
1,500



Part One (PAST)

(Tr Yen)
1,500



Part Two (FUTURE)

Conclusions (1)

Importance of the Balance Sheet

- describe the current financial situations
- imply how smoothly SS benefits are financed in the future
- assess impacts of alternative policy measures on future financing
- The BS will be in a huge deficit even if the income statement of SS pensions enjoys a surplus

Conclusions (2)

- **How to provide adequate income to older persons, while keeping the SS pension schemes financially sustainable?**

Theory of Policy Assignment

Automatic Balancing Mechanism

What Matters is the Taste of Pie

References

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