# The Key Questions on the 2004 Pension Reforms in Japan

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CENTRE FOR PENSIONS AND SUPERANNUATION Q1 By What Measures Is the Pension System Made Financially Sustainable?

Strategy:

Cut benefits; Increase contributions; Raise retirement age; Increase government subsidy

Questions:

- Labor force incentives: working longer
- Rate of return: Assumed 3.2% nominal seems high
- Real wage growth: 1% seems low

Suggestions:

- Financial governance of reserves may require attention
- Sensitivity analysis around projection parameters



Q3. Will not the ABM reduce the basic pension below subsistence level?

ABM Rule: if CPI <0.9% each year, then real benefits for 2005 retirees will be cut from 50% to 33% by 2030. Questions:

- Would it be better for this provision to be cumulative?
- Will this lead to widespread old age poverty?

Comments:

- A means-tested national safety net is necessary to support the 2004 reform
- PAYG should be integrated with a safety net
- Australia: 3% of GDP; RR 25% (single); 42% (married)
- Japan: 12% of GDP; average ~25% per retiree in 2004.
- Quantitative analysis needed for such a system in Japan to test its feasibility



Q4. The pension benefit/cost ratio keeps above 1 even for the younger generations. Is the intergenerational equity really preserved?

### Question:

How sensitive are the calculations to assumptions of the discount rate, investment return, CPI, wage growth?

### Suggestion:

Compare the current calculation with a pure saving model, earning long term bond rates. Is this a better benchmark?



Q5. To what extent can the adversarial effects of pension systems on the labor market be alleviated?

### Question:

- Why did the 2004 reforms not address the issue of labor force incentives? Especially secondary workers?

Suggestion:

Perhaps it would be possible to move towards the elimination of the the 3<sup>rd</sup> category. The current arrangement leaves the single worker (mostly male) treated unfairly from an actuarial viewpoint, and gives housewives no incentive to work



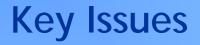
#### Q6. Other remaining problems?

- Social Security and income taxation are very tangled
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- The insurance and redistributive roles of social security are therefore also tangled
- Targets (of insurance and redistribution) should be associated with instruments (social security contributions and tax financed transfers)
- Because of low income taxation revenue, this is a special problem in Japan



- Q7. Why not NDC in Japan?
- These arguments are not persuasive
- NDC would clarify objectives of different parts of the social security system
- NDC would provide better labor force incentives to work longer





- Goals of the system: Should social security be the minimum pension supporter or a high replacement rate provider? Or both?
- Labor supply incentive effects of the reform
- Integration of social security with other policies, such as taxation
- Feasibility of a means-tested safety net



# **Thank You**

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