

# The Key Questions on the 2004 Pension Reforms in Japan

John Piggott

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Email: [j.piggott@unsw.edu.au](mailto:j.piggott@unsw.edu.au)

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# 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



# Key Issues

- 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

Faculty of Commerce and Economics  
University of New South Wales  
Australia

Contact: [j.piggott@unsw.edu.au](mailto:j.piggott@unsw.edu.au)

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