

Comments on “Enhancing the Financial Sustainability of Japan’s Pension System”



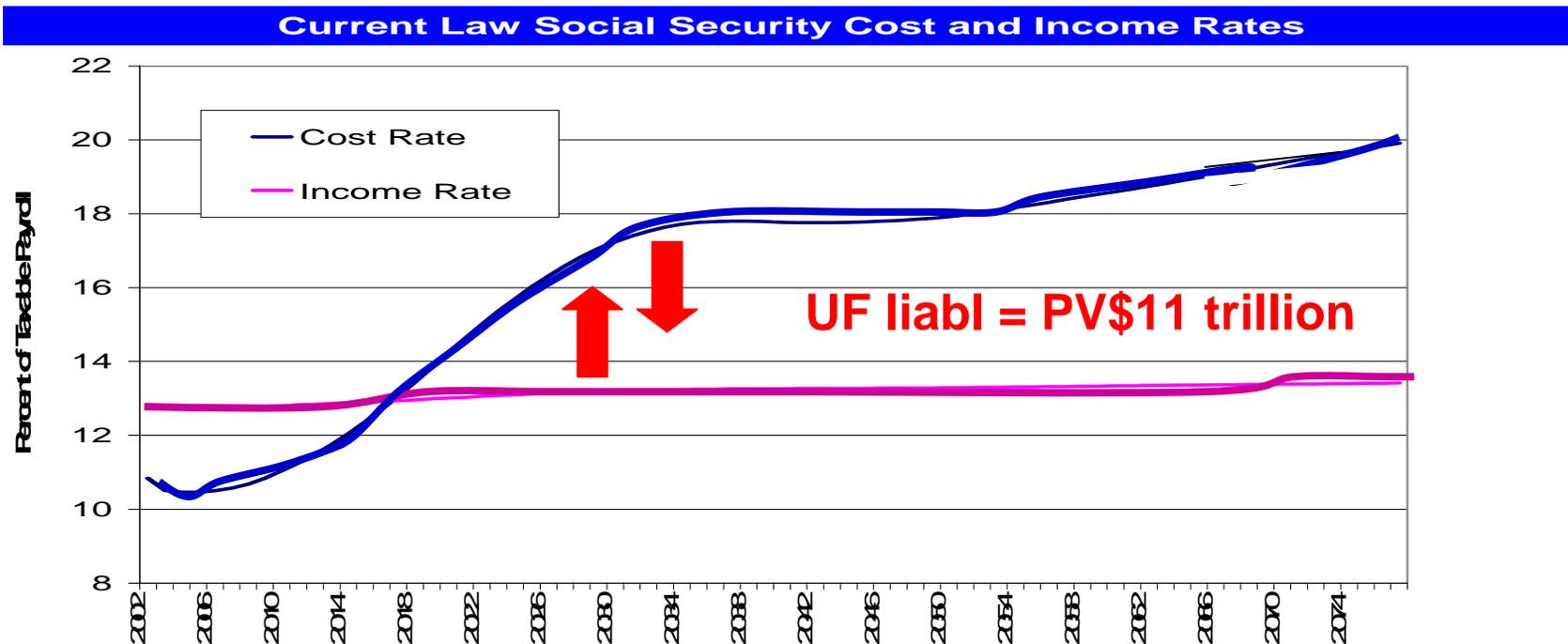
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A sustainable retirement system:

- Secures long-term viable promises for adequate, affordable, secure retirement income;
- Is transparent;
- Is politically and economically resilient;
- Mitigates negative incentive effects:
 - Coverage: evasion, work, retirement
 - Saving and consumption



Long-term Sustainability is a tricky concept:



- Assumptions: Policymakers need a broad range of outcomes, preferably stochastic models.
- Time horizon: We *must* represent our grandchildren and beyond.

Sustainability definitions include:

- Cash flow PAYGO equivalence – without general revenue transfers...
 - Can plan cover 1-year benefits
 - How much beyond?
- “Actuarial solvency” (e.g. $PVB \leq PBT$)
 - Often incompatible with cashflow solvency;
 - Often manipulated by accounting assumptions;
 - Must take account of general revenue requirements:
Where from? How much?
- What about assets in the Trust Fund...
 - Can they really be dedicated to the pension plan
 - Or are they at risk to be spent?



Adequacy: What minimum benefit?

- Absolute versus relative poverty?
 - Absolute defines consumption bundle that can be purchased (e.g. US \$13K/year for couple);
 - Relative has many definitions:
 - Replacement rates varied - compared to own lifelong salary? own final pay? economy-wide pay during worklife? Future average pay in retirement?
 - No agreement...and produce VERY different costs and outcomes.
- Special groups?
 - Those contributing <40 years
 - Women (longer lived, lower income, many unmarried)
- Need micro-panel dataset to do policy analysis

Cautions on IRR

- IRR is discount rate that equates *ex ante* PV benefits and PV taxes
- Must take into account FULL REVENUE COST of paying for promised benefits:
 - In US case, benefits must fall by 1/3 or taxes must rise 50-80% to close the gap
 - These adjustments dramatically affect return calculations
 - They also dramatically affect distributional conclusions by cohort and income group.

Resiliency:

What to do when revenue and benefits out of synchrony?

- **Claims on benefits:** earlier retirement, more divorce, more longevity and disability claims, more poverty.
 - **Revenue surprises:** more evasion, lower taxable base/wage growth, earlier retirement, lower returns on invested assets.
- Fully specified adjustment formula will take ALL these into account, not just 1-2 of them...

Many countries' national pension reserves are not resilient...

- Off-budget surpluses often not saved/invested well.
- Unclear whether gov't pension reserve represents net saving.
- Many political repercussions of a large fund: SRI/governance issues, need the money now...
- All reasons to favor personal accounts.



Mitigating bad incentive effects

- Tax/Contribution evasion
- Early retirement, part-time work, self-employment
- Concentrating assets in non-countable forms (for means testing purposes) or passing assets to children to become entitled
- Dissaving strategically.

Conclusions (A):

- Japan has taken an important step forward in its 2004 reforms
- But much work remains:
 - Compute national pension debt *in perpetuity* under range of scenarios;
 - Assess cash flows and cohort results including ALL transfers and benefit adjustments;
 - Design tax and benefit adjustments to avoid sudden big changes (& incorporate range of economic/social factors)
 - Develop database for distributional analysis.

Conclusions (B):

- Re-focus on two-tier old-age system:
 - Minimum subsistence for indigent;
 - Contribution-linked system for workers, possibly NDC;
- With due consideration for incentive effects;
- Greater transparency and simplicity so better understood; and...
- Start now factoring in healthcare and LTC costs and benefits.

Thank you!

For more information:

- Wharton's Pension Research Council:

<http://prc.wharton.upenn.edu/prc/prc.html>

- Books and working papers:

<http://rider.wharton.upenn.edu/~prc/publication.html>