OECD

2015 Pension Policy Notes

JAPAN

- **Increase the accrual rate to raise earnings-related pensions.**
- **Increase the retirement age and link it to life expectancy gains.**

The mandatory pension system provides low benefit levels. The pension system consists of a basic and an earnings-related component, with a social assistance benefit for the most vulnerable. The full basic pension amounts to about 16% of average earnings and it is reduced pro-rata for contribution periods below 40 years, with a minimum of 25 years being reduced to 10 years from April 2017; eligibility does not require stopping work. The second tier, mandatory earnings-related pension has an accrual rate of 0.55% for each year up to a contribution ceiling around 150% of average earnings. The combination of these two pillars generates future replacement rates that are low in comparison to the OECD average across all earnings levels. Low earners (50% of average) with a full career can expect a gross replacement rate of 49%, and average earners 35% compared to the OECD averages of 65% and 53%, respectively. Overall, the relative average income of people aged over 65 (versus that of the whole population) is above the OECD average based on late 2000s data. However, the old-age poverty rate is the sixth highest in the OECD and is 3.4 percentage points above the poverty rate for the total population.

Key indicators: Japan and OECD average

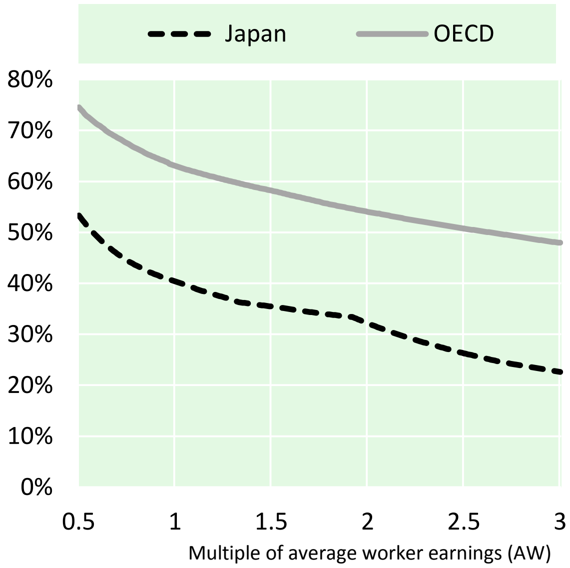
	Mid-1980s	Mid-1990s	Mid-2000s	latest available	latest OECD	long-term	long-term OECD
Pensionable age for a full-time career starting at the age of 20	65.0	65.0	65.0	65.0			
Retirement age	65.0	65.0	65.0	65.0	62.9 (61.8)	65.0	64.6 (64.4)
Net replacement rate, avg earner						40.4	63.2 (62.7)
Total mandatory contribution rate		16.5	13.9	17.5	19.1		
Total pension spending, % of GDP	4.9	6.6	12.4	15.1	10.3		
Public pension spending, % of GDP	4.8	6.3	9.8	11.8	8.4		
Public debt, % of GDP	71	88	170	229	115		
Employment rate 55-64, %	78.8 (44.4)	80.8 (47.5)	78.9 (49.4)	81.5 (56.1)	66.1 (49.1)		
Labour-market exit age	69.8 (66.0)	71.1 (66.1)	69.4 (66.2)	69.3 (67.6)	64.6 (63.1)		
Old-age poverty rate, %	23.1	23.0	22.0	19.4	12.6		
Life expectancy at 65, years	16.0 (19.6)	17.0 (21.7)	18.5 (23.6)	19.5 (24.5)	18.4 (21.5)	23.8 (29.0)	22.9 (25.9)
Old-age dependency ratio	0.17	0.23	0.32	0.47	0.28	0.79	0.57
Fertility rate	1.7	1.4	1.3	1.5	1.7	1.7	1.8

Note. The figures for women appear in parenthesis where they differ from those for men.
Long-term: Around 2060 based on all legislated reforms up to mid-2015.

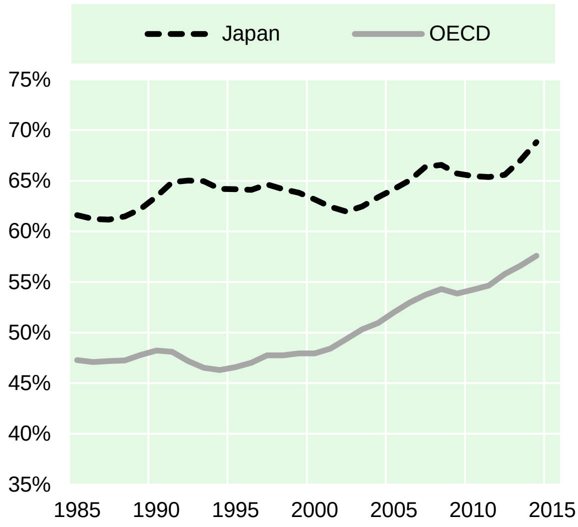
The government has passed legislation to prevent the formation of new employee pension funds. It has been possible for employers with more than 1,000 employees to contract out of the public earnings-related scheme since 1966 and establish their own employee pension fund. Whilst one objective was to achieve high returns, around 40% of these funds have been underperforming and cannot reach the target of paying 150% of the minimum reserve, i.e. the amount offered by the public earnings-related scheme. Under the April 2014 law these underperforming funds must dissolve, whilst the others will have to pass an annual performance test with employers having 30 years if needed to make up any shortfall. In addition, legislation passed in 2011 encourages further participation in the voluntary defined-contribution scheme. Employees can now make increased contributions up to the level of contributions chosen by their employer, and coverage has been expanded up to age 65 rather than age 60 previously.

Financial sustainability issues of the pension system remain. With contribution rates increasing to 9.15% for both employees and employers more revenue will be gathered. However government debt has increased to over 220% of GDP and pension expenditure is about 12% of GDP, though it is projected to fall to 10% by 2025. Recent debate has suggested raising the level of taxes paid by pensioners, thereby increasing revenues and improving generational fairness. But with replacement rates being low compared to other OECD countries pension adequacy would be reduced even further.

Long-term net replacement rates (%), by earnings level



Employment rate for those aged 55-64



Sources: OECD pension models; OECD Employment Outlook

Higher pension eligibility age with increased benefits will be required to ensure an adequate income for pensioners. Many workers in Japan already continue to work beyond the normal retirement age; the effective age of labour market exit is four years above the pension age for men and three years higher for women. As it is possible to combine being employed and receiving pension benefit, subject to income tests, government expenditure could be reduced by increasing the retirement age beyond age 65. This may not require substantial changes in labour market practice as there is already a culture of employing older workers. Currently 82% of men aged 55-64 are employed compared to 66% in the OECD on average. The share of women in this age group working is much lower at 56%, suggesting that there is room to increase women's labour market participation, even if it is seven percentage points above the OECD average. An initial increase in the retirement age to 67, and further changes in line with life expectancy gains would bring the retirement age in line with many OECD countries and would further reduce public expenditure. Furthermore the accrual rate from the earnings-related component is very low in comparison with other countries, even when taking into account contribution levels. Currently a contribution of 17.5% of earnings while financing half of the basic pension is associated with an annual accrual rate of only 0.55%. By comparison a contribution rate of 12.4% results in an accrual of 0.75% in the United States, and a 18.9% contribution rate in Germany gives a long-term accrual of 0.97%. In Japan, earnings-related benefits are low because the accrual rate is low given the rate of contributions.

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