

## **1. Pension System**



# The Role of the State in Managing the Cost of Aging in Asia-Pacific

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## 1 Introduction

The Asia-Pacific region is exhibiting rapid aging of population due to a combination of declining fertility rates and improving longevity. According to the United Nations forecast in 2010, both the pace of aging and the share of aged in the population are projected to exceed corresponding global rates between 2010 and 2030<sup>1</sup>.

In 2010, Asia accounted for 54.4% of the global total of those above 60 years of age, and this is expected to increase to 59.9% by 2030. It is therefore the Asia-Pacific region which will be significantly impacting the dynamics of global demographic trends.

The rapid aging of the Asia-Pacific population has implications not just for pensions and health care, but also for broader economy and society, affecting such areas as employment and consumption patterns, technology generation and absorption capabilities, transport systems, planning of public amenities and voting patterns (Roy and Punhani, 2010; Hayashi et al., 2009).

This paper, however, has a narrower focus. It explores the areas where the state can play a significant role in managing the costs of aging primarily relating to pensions and health care. This is not to suggest that other entities, individuals and households, and businesses cannot also significantly contribute to managing health care costs. As an example, adoption of healthier lifestyles by individuals and greater understanding of how a body functions could help in managing the cost of aging.

The paper is organized as follows. The next section provides the global and domestic context in which the state will need to play a role in managing the costs of aging. This is followed by possible initiatives and measures which the state could consider, and which may help in managing these costs. Each economy, however, will need to construct a package containing a mixture of initiatives and measures which may help manage costs. This is because the Asia-Pacific region is heterogeneous in terms of income levels, economic and political structures, institutional development, state capacities, and demographic characteristics. The existing pension and health care systems also demonstrate significant variations in the Asia-Pacific region (Asher, 2010). The final section provides concluding observations.

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<sup>1</sup> In 2010, the population aged over 60 was 9.9% of the total population, lower than the corresponding share globally of 11.0%. However, by 2030, Asia's share at 16.7% is projected to exceed that of the world (16.5%). Similar trends are projected for the median age of the population. Life expectancy at birth in Asia is expected to increase from 70.3 in 2010 to 73.6 in 2030, with many Asia-Pacific economies exhibiting much higher levels (UNDESA, 2010).

## 2 The Context

The context in which the state will need to play its role in managing the costs of aging is characterized by extreme complexity.

First, due to globalization, particularly concerning financial and capital flows, "...countries are becoming spatially smaller, and cross-country connectivity, and externalities have become larger" (Tanzi, 2011). Even as the need for global economic coordination increases, as exemplified by the 2008 global financial and economic crisis, institutional mechanisms for such a role have been slow to evolve.

Second, while it is recognized that restoring economic growth in North America, Europe and Japan is essential, traditional policy instruments, particularly fiscal stimulus, and quantitative easing by the central banks to restore growth have diminished substantially. There is considerable uncertainty among the economists and policy makers on policies to pursue, resulting in policy drift. This is further accentuated by the geo-economic and geo-strategic shifts underway.

Third, fiscal sustainability has become a major issue particularly in the developed economies. Sovereign debt default is no longer inconceivable. The risk premium for rolling over existing debt and issuing new debt are rising for those economies that are perceived to manage public finances poorly. This implies difficult choices for the state in managing pension and health care costs as a combination of reduction in benefits, raising taxes and contributions for politically important groups, including the high income groups, and the financial sector is being debated particularly in Europe, the United States and the United Kingdom. In some economies, such as Japan, painful increases in consumption taxes may be necessary to manage the costs of aging.

Fourth, there is less certainty among economists and among investment professionals about some of their long established analytical concepts and tools. Rajan (2010) has analyzed recent global trends in financial intermediation which have resulted in inefficient allocation of global savings. These include growing importance of a shadow banking system comprising sovereign wealth funds, private equity and hedge funds; overly sophisticated and complex derivative instruments; light regulation of the financial sector; and the recent emergence of high frequency trading.

Managers of provident and pension fund assets, as well as individuals finding it increasingly difficult, in general, to generate above average returns as risks associated with almost every asset class have increased. As *The Economist* (October 15, 2011) states, "Equities have suffered two bear markets in just over a decade and remain vulnerable to rich-world recession; government bonds offer little protection against a resurgence of inflation; commodities are volatile and hostage to a possible drop in Chinese demand; property is still suffering indigestion after the past decade's boom"<sup>2</sup>.

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<sup>2</sup> "I would start from here", *The Economist*, October 15, 2011.

Not only are the demographic trends more adverse from the perspective of the cost of aging, but there is considerably less certainty among the economists and among investment professionals about some of their long established analytical concepts, tools and practices. Geo-economic and geo-strategic shifts underway accentuate the complexity.

The sovereign debt default is no longer inconceivable, and at the least, risk premium for rolling-over of existing debt and of new debt would rise significantly for those economies or sub-national governments that are perceived to manage their public finances poorly. Fiscal sustainability has therefore become a major issue, complicating the response of the state, particularly in redirecting fiscal policies toward enhancing good quality growth.

### **3 The Role of the State: Specific Initiatives and Measures**

This section discusses specific initiatives and measures which the state could consider in managing the costs of aging in the Asia-Pacific. As emphasized, each state will need to construct a package of measures which is appropriate for its context, objectives and the ability to undertake complementary reforms in such areas as labor markets, fiscal policies, and administrative and governance reforms. All states, however, will need to pursue macroeconomic and financial stability which are essential for generating sustaining long-term growth.

#### ***Initiating Public Debate***

The most important initiative which only the state can launch is to promote high quality, expertise and empirical evidence based debate among all the stakeholders on new social contracts for pensions (and health care) financing and related aspects. It should focus on demand, supply, social and political norms, administrative and governance structures, and regulatory aspects. With longevity often increasing faster than the capacity of the political system to address it, and close interlinkages between pension and health care expenditure, it is now essential to explore ways to jointly minimize the combined pension and health care expenditure for a desired level of provision.

In many low and middle income economies in Asia-Pacific, episodes of ill health will be an important reason why households may fall into poverty. Low health insurance coverage and high health care inflation are contributory factors for this phenomenon. As pensions are often indexed, correlation between high health care inflation and overall inflation will increase pension costs. This is yet another reason why pension and health care policies need to be coordinated.

Shifting thinking along these lines, with willingness to make organizational changes and fund solid empirical research to achieve coordination and minimize the joint costs of pensions and health care, should be an important component of this debate.

The legacy pension (and health care) issues arising from promises already made to existing beneficiaries, need to be separated from the future social contract affecting future liabilities. This

has been recognized in some Asia-Pacific economies such as Japan, Korea, and to an extent China, but greater efforts in this direction merit consideration in the Asia-Pacific region.

### ***Civil Service and Military Pension Reform***

Another area where the state can play a role concerns what public finance economists call horizontal equity. In the literature, intra-generational equity issues have received relatively less attention. This area is particularly relevant where the coverage of formal pension schemes is low, confined to civil servants and employees of large public and private sector organizations as is the case in many highly populated Asian economies such as India, Indonesia and China.

In many Asia-Pacific economies, civil servants and military personnel constitute around 5% to 6% of the labor force, and are overrepresented in the formal sector pension and health care systems. Moreover, due to relatively more generous provisions and coverage of longevity, inflation and survivors' risks, this group appropriates a disproportionate share of current and future resources devoted to pensions. As opportunity costs limit the share of gross domestic product (GDP) that can be devoted to pensions, and by implication to health care, this arrangement leaves a disproportionately smaller share of GDP for those who do not belong to this group.

The intra-generational inequities arising from the above arrangements need to be addressed by the state initiating measures which result in a less uneven spread of resources devoted to pensions and health care.

In the United States, for example, there are attempts under way in the state and municipal pensions (Independent Public Service Pension Commission , 2011) where credibility of pension promise is under severe threat) to explore constitutional ways to change accrual rates and other parameters for pensions for existing beneficiaries<sup>3</sup>.

The Hutton Commission Report in the United Kingdom has formed the basis for civil service pension reforms (. These include a shift from final salary to career average revalued earnings, and linking normal pension age to state pension age (with special provisions for uniform services) (Williams, 2011). Through these measures the government aims to reduce the proportion of adult life spent in retirement of public service workers to about one-third, the same proportion existing in the 1980s. The proposals will also help to limit the impact of contribution increased across public sector retirement schemes, and thereby help manage the share of GDP devoted for civil service pensions. To be effective, this should not be done in isolation, but with complementary changes in labor markets and other areas.

Many economies in Asia-Pacific, particularly those with fragmented pension and health care systems along public-private sector spectrum, need to initiate civil service and military pension reforms. This will not be politically easy. But without such reforms, fairness and

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<sup>3</sup> *The Economist* (October 15, 2011; p.70) reports that most recent estimates suggest that pension deficits of state and local governments in the United States amount to US\$4.4 trillion, higher by US\$1.3 trillion in just two years.

sustainability objectives will be more difficult to attain. The current post-crisis period is an opportunity to initiate reforms in this process.

### ***Enhancing Fairness and Sustainability of Pension and Health Care Systems***

There is a strong case to review the fairness and sustainability issues of current pension and health care arrangements in better managing the costs of aging. As income increases, individual and societal expectations have also increased. There have also been greater demands across the globe for greater political voice, participation, transparency and accountability. As reconfiguration of pension and health care systems will generate winners as well as losers, at least in the short term, fairness and sustainability of the reconfiguration will require consent of the better informed public.

The state can improve fairness in managing the costs of aging by harmonizing the differing pension and health care provisions amongst civil servants, military personnel, and those employed in the private sector. Sustainability of the various programs to manage the costs of aging, not only require matching of assets and liabilities but also include addressing the adequacy and coverage of the social security program.

For those that are life-time poor, the state will have to play a more active role in financing their costs of aging through social pensions, and other retirement income transfers. Further, in many low and middle income economies, the state can help strengthen public delivery systems for social pensions (and other social services); in constructing and maintaining relevant databases; and in encouraging good quality policy relevant pension and health policy research. If social sector policies such as pensions and health care are to be integrated into development strategies, then more rigorous rationale and assessment of their long-term development impacts are needed.

Among the high-income Asian economies, Australia, Japan and Korea have instituted social pensions. Means testing does not have to be direct. Thus, if social pensions are included as taxable income, the level will vary according to income tax bracket, even if the design proposes universal pension. Fiscal space and other poverty programs would be relevant in setting the social pension level.

Persistent gender imbalance in favor of males has been observed in many Asia-Pacific economies (Kurlantzick, 2010). To the extent that such imbalances affect the dynamics of family formulation and relationships, and impact the functioning of the labor markets, it has implications for pensions and health care.

Government policies can play a role in addressing this imbalance, though there is considerable uncertainty about the appropriate measures and their impact due to the interconnected nature of the current economic, social, political and perhaps security issues arising from the gender imbalance.

### ***Totalization Agreements***

There is considerable cross-border flows of workers within Asia-Pacific, and with outside the region. The state authorities should consider giving greater priority to totalization agreements, with key economies. Such agreements rationalize taxes and benefits relating to social security, just as Double Tax Agreements (DTAs) perform similar functions for the income tax. Such agreements could facilitate cross-border flows of people, while enabling cross-border workers to avail of a degree of retirement income security. Where totalization agreements are not feasible, the state should bilaterally or multilaterally negotiate better working conditions for the cross-border workers.

Addressing retirement income needs of cross-border workers will require regional cooperation among sending and receiving economies. As such cooperation is state-led, there is a role for regional organizations in evolving norms and codes of conduct, and in facilitating exchange of information.

### ***Facilitating Bequest***

The current arrangements in some economies, e.g. Japan, have made pensioners relatively better off than the younger cohorts, even as they have less promising “good” job prospects and higher social security burdens. Bequest is one of the instruments to manage inter-generational transfer. Another area where state can make useful contribution concerns fiscal arrangements surrounding bequest is by reducing fiscal and regulatory arbitrage possibilities between pension products, pension providers, and pension regulators.

The current and prospective challenging investment environment makes it even more difficult to earn higher than normal returns consistently on pension savings.

Converting pay-as-you-go (PAYG) schemes into even conventionally funded schemes is complex. Weak fiscal situations are not ideal to convert implicit pension debt into an explicit one. Moreover, as noted, the issue of whether the accumulated funds could be intermediated through financial and capital markets to raise core rate of growth needs to be addressed. In defined contribution (DC) schemes, the pay-out phase has received relatively less attention. Annuity markets are unlikely to be organized on a large scale while addressing longevity and inflation risks in an affordable manner without the role of the state. More debate and research on product and process innovations and on risk sharing among the stakeholders during the pay-out phase of the DC schemes are needed.

## **4 Concluding Remarks**

The above discussion while not exhaustive, nevertheless, suggests that the effectiveness with which the state manages the cost of aging in individual Asia-Pacific economies will have an impact on their broader international competitiveness and on domestic social cohesion.



One of the important policy implications is the greater weight to be assigned to the precautionary principle in pension and health care policies. This principle suggests that any restructured pension and health care architecture should be such that a country is not locked into it, leading to high reversibility costs. The difficulties of reconfiguration of overly ambitious pension and other promises which cannot be kept, but which have acquired legal, or in the case of civil service pensions constitutional, backing, are well known.

By 2050, China will have 430 million persons, India 330 million persons and Indonesia 75 million persons above 60 years of age (UNDESA, 2010). Moreover, there will be significant regional and urban-rural differences. Any hasty nationwide pension or health care schemes which lock in such a large number of persons could be very costly economically and fiscally. The mixture of national and decentralized local pension and health care schemes, with requisite degree of reversibility, will however be a major challenge. At the minimum, a shift from welfare to effectiveness orientation will be needed in reforming the pension and health care systems.

The measures and their sequencing will depend on the context, capacities and specific economic, social, and political objectives and constraints of individual economies. If pension and other social policies are to be integrated into mainstream economic growth and development strategies, much more rigorous analysis of their design, and interactions with other policies will be needed. A shift from welfare-orientation of pension and health care policies to greater professionalism using modern management and governance techniques or practices will be essential in any Asia-Pacific economy.

Rapid aging in many Asia-Pacific economies and the current context has increased the relevance of innovations in design, delivery, process, financing, and governance arrangements concerning pension and health care costs. In many economies, as both health care and pension programs are intermediated through state financing, coordinating health care and pension financing arrangements merits consideration. Such coordination can take advantage of economies of scale and lower transactions costs, and thus better manage the combined resource costs devoted to health care and pension expenditures.

High quality, empirical evidence-based public policy debates on pensions and health care are essential both in individual Asia-Pacific economies and for the region as a whole. This process will assist in the emergence of a new social contract within which the state and other stakeholders can pursue specific initiatives and measures to help manage the costs of rapid aging.

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# **Pension Issues in Japan: With a Special Focus on Coordination with Employment**

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## **1 Introduction**

Japan has mandated social insurance pensions for all residents, with the primary objective of ensuring adequate income in old age. A contribution-based social insurance pension, however, has some disadvantages. Collecting contributions from small companies, atypical employees and informal sector workers is not easy, since compliance, administrative and enforcement costs are relatively high. This may leave low-income workers, in particular, outside the social insurance umbrella. In view of these difficulties, Japan also provides several non-contributory pensions to attain higher coverage and minimize the risks of elderly poverty.

This paper describes Japan's current social insurance pension system, with special emphasis on coordination with employment. Pensions and employment have different dimensions among varying groups: female workers, young workers and elderly workers. Before going into discussing these issues, this paper gives a brief sketch of current provisions of social security pensions in Japan. The Japanese experience furnishes a valuable lesson on what to do and what not to do when reforming pensions.

## **2 Current Provisions of Social Security Pensions: A Brief Sketch**

Japan already has the oldest population in the world. The proportion of the elderly aged 65 and older was more than 23% in 2010 and will have risen to more than 40% by 2050.

Japan has a long history of social security pensions, dating back to 1875, when the pension system was established for military servants.<sup>1</sup> Currently, we have the Kosei-Nenkin-Hoken (KNH) for private sector employees and the Kokumin Nenkin (KN) for the non-employed and for full-time housewives.<sup>2</sup> Benefits consist of two tiers. The first-tier flat-rate basic benefit is paid to all participants in the social insurance pension system, and the second-tier earnings-related benefit applies only to employees. The system operates largely as a pay-as-you-go defined benefit program.

A person is required to contribute for no less than 25 years to receive basic old-age benefits. The full basic old-age pension is payable after 40 years of contributions. The maximum monthly

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<sup>1</sup> At the outset, it was called "On-Kyu" entitled without paying any contributions.

<sup>2</sup> For detailed explanation of the Japanese Public Pension System, see Takayama (1998, 2003). For civil servants, Japan has the Kyo-Sai-Nenkin (KSN).

pension of 66,000 yen<sup>3</sup> at 2011 prices (based on the maximum 40 years of contributions) is payable from age 65. The benefit was previously indexed automatically each fiscal year (beginning April 1) to reflect changes in the consumer price index (CPI) from the previous calendar year. Since 2004, this indexation formula has been provisionally suspended and a new indexation that takes demographic factors into account has been introduced (Takayama 2004, 2006). The pension may be claimed at any age between 60 and 70 years of age, with an actuarial reduction or increase in benefit.

All employees receive earnings-related benefits. The accrual rate for the earnings-related component of old-age benefits is 0.5481% per year. Thus, 40 years of contributions will earn 28.5% of career average real monthly earnings.<sup>4</sup>

As a transitional measure, the full earnings-related pension is payable to a fully retired employee beginning at age 60. (Normally, it would start at age 65). An individual who has reached age 60 but has not fully retired can receive a reduced pension. The current replacement rate (including basic benefits) is close to 62% for a typical male retiree (with an average salary earned during 40 years of coverage) and his dependent wife.<sup>5</sup> It will decrease to 50% by 2023 under a provisional indexation formula.

Equal percentage contributions are required of employees and their employers. The contributions are based on earnings (which include semi-annual bonuses). The total percentage in effect beginning in September 2011 is around 16.4% for the principal program for private sector employees (KNH). Non-employed persons between the ages of 20 and 60 pay flat-rate individual contributions as category 1 persons under the KN program. The current rate, since April 2011, is 15,020 yen per month. For those who cannot afford that, exemptions will be permitted. The flat-rate basic benefits for the period of exemption will be one-half of the normal amount in fiscal 2011.

Since fiscal 2009, the government has been subsidizing half of the total cost of the flat-rate basic benefits. There is no subsidy for the earnings-related part. The government pays administrative expenses as well.

### **3 Non-Contributory Pensions**

Japan currently has five types of non-contributory pension benefits.

#### ***Basic disability pensions for those qualified as mentally or physically disabled before age 20***

Those who become mentally or physically disabled before age 20 can receive the basic disability pension from age 20, subject to a generous income test. A thorough medical checkup is

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<sup>3</sup> ¥1,000 = US\$10.18 = £ 6.69 = €7.45 (as of August 1, 2008).

<sup>4</sup> A semiannual bonus equivalent to 3.6 months' salary is typically assumed.

<sup>5</sup> The couple's monthly amount of old-age benefits would be 232,000 yen in 2011.

carried out before the person is qualified for the pension. The budget is fully financed by transfers from general revenue.

### ***Basic old-age pensions for low-income groups***

Those in low-income groups can be exempted from paying a part or all of the KN flat-rate pension contribution. The upper annual income limit for full or partial exemption varies depending on household size. In a single-member household, for example, the 2011 amount for partial exemption is 1.89 million yen or less. In 2010, 5.95 million people were exempted. Once exempted, they are still qualified to receive half of the full basic old-age pension, which is financed by transfers from general revenue.

### ***Two-tier old-age benefits for those on parental leave***

Japanese parents can enjoy a parental leave of one year (for husband and wife combined) each time they have a baby. During parental leave, they are exempted from paying KNH pension contributions but still receive credit toward old-age pensions as if they had continued to earn the same salary that they had just before taking leave. In 2007, 111,000 employees were exempted through this scheme. No special funding arrangement has been made, and consequently these persons' old-age pension benefits accrued during parental leave are ultimately shouldered by contributions made by other participants.

### ***Pension entitlements resulting from a contribution gap***

Employers withdraw their employees' pension contributions from their monthly salaries. A small number of employers fail to transfer the contributions to the Japan Pension Service (JPS), the government body that collects contributions, because of financial difficulties or bankruptcy. The recovery rate at JPS is usually less than 100%, and the contribution-gap remains. Contributions made by other participants compensate for the gap by enabling the full payment of KNH pension benefits once the withdrawal of contributions is certified. This arrangement generates moral hazard among employers.

### ***Welfare pensions for aged low-income groups at the start of the program***

The flat-rate basic old-age pension is normally payable to those who have contributed for no fewer than 25 years. When the KN first started, however, those who were between the ages of 36 and 49 in 1961 were specially entitled to receive a smaller amount of basic pension with shorter contribution periods, ranging between 10 to 24 years. Those aged 50 and over in 1961 were not entitled to receive basic pensions. Instead, "welfare pensions" were provided to them when they reached age 70, with an income test. Welfare pensions have been financed wholly by transfers from general revenue, and the current monthly benefit is around 34,000 Japanese yen.

They are a transitory sunset scheme, and the number of recipients is currently very small, around 20,000 persons in March 2007.

#### **4 Non-Beneficiaries of Social Security Pensions**

In April 2007, around 420,000 people aged 65 and over (1.6% of those in the 65+ age group) received no social security old-age pension benefits, and it is estimated that 1.18 million persons, including those now under age 65, will be non-beneficiaries in the near future. The main reasons for non-coverage are failure to file applications and insufficient years of contributions.

In 2005, 556,000 persons among the elderly aged 65 and over (2.2% of the age group) received means-tested public assistance. Around 65% of the elderly with no social insurance pension benefits were forced to receive public assistance. Others among the elderly drew both social insurance pension benefits and public assistance, mainly because of their lower benefit level.

#### **5 Increasing Dropout Rate**

The descriptions given above are just half the story. Several coverage, implementation<sup>6</sup> and social adequacy problems still confront Japan's social insurance pensions.

The first-tier basic benefit is not yet universal. Nearly 100% of regular employees are currently covered by the social insurance pension programs, but atypical employees and non-employees are not necessarily covered, although their enrollment is mandatory. In March 2007, around 54%<sup>7</sup> of category 1 persons under the KN (independent workers, atypical workers, the self-employed and persons with no occupation) dropped out from the basic level of protection as a result of exemption (5.84 million persons), delinquency in paying contributions (5.19 million persons) or shunning of the program (363,000 persons). The dropout rate had increased from 35% in 1992.

Those who have dropped out will receive a smaller pension or none at all in old age, so they are likely to rely on the means-tested public assistance program. The principal idea of a social insurance pension should be income security in old age without the need to depend on means-tested support. A social insurance system that promises old-age security to all members of the community has its own drawbacks. The current legislation mandating a basic pension is becoming virtually hollow for atypical employees and the non-employed.

The current KNH system does not directly apply to employees who work fewer than 30 hours per week (three-fourths of the normal work week.) These part-time employees are obliged

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<sup>6</sup> Distrust of government pension commitments increased in 2007, mainly because of the unexpected announcement of 50 million "floating" pension records. These pensions had not been integrated into the unified personal pension numbers, which were introduced in 1997. Social insurance pension implementation proved to be still quite weak in Japan, inducing a higher dropout rate in the future (see Takayama and Kitamura, 2010).

<sup>7</sup> This figure of 54% for all dropouts is equivalent to around 19% of all mandatory contributors. The administrative cost of the KN was about 7.7% of the aggregate amount of contributions in 2006, mainly because of the high dropout rate.

to participate in the KN instead. If they are the spouses of regular employees and their annual pay is less than 1.3 million Japanese yen (US\$10,000), they are treated like full-time homemakers, but if their annual pay exceeds 1.3 million yen, they lose the right to be treated as dependent spouses. They are then forced to pay flat-rate pension contributions as category 1 persons.

This arrangement tends to encourage part-time jobs that pay less than 1.3 million yen per year. Critics say that this is the main reason why part-timers remain low-income earners. One solution would be to reduce the upper earnings limit of 1.3 million yen to a negligible level, as in the United States and Germany. Employers in Japan, however, are strongly against this kind of program change because they would rather continue to avoid the higher compliance costs associated with social security. If this solution were implemented, employers might begin to lower part-time workers' wages, since non-wage costs, including the employers' share of social insurance contributions, would be increased.

## **6 Pensions for Women**

### **Flat-rate basic pensions for full-time housewives**

Under the current system, dependent spouses of regular employees—typically, full-time housewives—are *automatically* entitled to the flat-rate basic benefits, without being required to make any direct individual payments to the social insurance pension system. In 2010 there were about 10.1 million such persons, equivalent to about 15% of the total number of insured persons.

This entitlement raises contentious issues. The number of dual-income couples and single women has been steadily increasing, to such a degree that full-time housewives no longer constitute a majority of working-age women. Single women and dual-income couples have often attacked the current provisions geared toward full-time housewives as unfair. The policy bias is clear, but the issue lies in ideologically contested ground. A purely individualist approach would, for example, logically lead to the abolition of survivors' benefits, even though married women earn far less than their husbands. An alternative solution is to assign some share of husbands' earnings to non-working wives. The implicit income share of full-time housewives is currently assumed to be 50%. But this, in turn, could act as a disincentive for men to marry a full-time homemaker.

## **7 Growing Numbers of Atypical Employees and Pensions for Young Workers**

In 2007 there were 32 million male and 23 million female employees in Japan, and the proportions of regular employees were 82% for males and 47% for females. These proportions have been gradually declining. Outsourcing, replacement of workers by contracts with outside staffing agencies, and increasing dependency on part-time, temporary and seasonal workers have all become common. In 2010 about one-third of workers were not regular employees. A majority of female employees are now non-regular, with most of them engaging in part-time jobs.

The social insurance coverage of earnings-related pension benefits has been on the decline. The reason is that the existing KNH system only covers regular employees and does not apply to such workers as temporary staff members under labor contracts of not more than two months, seasonal employees working not more than four continuous months, or those engaged on contract work for no more than six months—in addition to part-timers, as noted above. Such labor contracts are often made fictitiously to evade paying social insurance contributions, in collusion with employees who want to have higher take-home pay on the spot.

In addition, employers of small business establishments are often reluctant to participate in the compulsory KNH. Typical examples are those who work in restaurant, lodging, cleaning, barber, beauty salon, amusement and construction businesses. KNH coverage in these industries is currently around 50%,<sup>8</sup> and the remaining employees, including regular ones, are obliged to participate only in the KN.

At first, the KN was supposed to apply mainly to self-employed and non-employed people, but today it also covers around 9 million atypical employees. Their share in the KN was 37% in 2005, making that the highest of all categories. (The shares of non-employed and self-employed persons were 31 and 18%, respectively.) Critics say that the KNH for employees is beginning to decline to mere form.

Many younger people in Japan are currently “atypical” workers and their working status is quite unstable. The majority of them are not likely to step up to “typical” ones. They are not assured that they will enjoy adequate and stable income during their prime working age. They will face the “Bad Start, Bad Finish” problem. Consequently, their pension benefits will be less than the adequate level. Higher employability with stable income is badly missing for them.

## **8 Pensions for Elderly Workers**

The labor force participation rate of male workers in their early 60s was 70.6% in 2010. This proportion is relatively high in the world.

In Japan, we have an earnings-test for elderly workers to apply for their social security pension benefit. The marginal tax rate for their earnings is basically 50% (and 100% for high-salary earners). Theoretically, the earnings-test stated above will discourage their labor supply.

However, it should be remembered that the test does not apply to employment with less than 30 hours per week. This current provision gives a great incentive to employees and their employers to limit their working hours less than 30, inducing a big change in working hours from age 60.

On the other hand, pension benefits are virtually equivalent to “wage subsidies” for elderly employees, thereby encouraging labor demand for persons in their 60s.

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<sup>8</sup> The enforcement abilities of the JPS remain relatively poor compared with those of tax authorities.



Two factors stated above operate in different directions. Further empirical work is required to verify the net effect.<sup>9</sup>

## **9 Conclusion**

Japan has devoted considerable effort to achieving coverage of all residents by social insurance pension systems. Coverage, overall, is among the highest in the world, with only 1.6% of the elderly currently not receiving social security old-age pension benefits.

Because of its rapidly aging population, Japan has been raising contributions to finance social insurance pensions, and this has induced an increased dropout rate from the basic protection scheme. Weak implementation has aggravated lower coverage. Growing numbers of atypical and irregular employees are losing their entitlement to an earnings-related pension through social insurance programs. Pension issues have to be reviewed carefully with a special focus on coordination with employment.

Incentives, compliance and accountability are basic prerequisites for maintaining or expanding good coverage. A trustworthy government capable of competent and efficient implementation is required for broader coverage, as well. Heavy work still lies ahead.

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<sup>9</sup> See Haider and Loughran (2008) for more details.

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