PENSION POLICY NOTES

BETTER POLICIES FOR BETTER LIVES

JAPAN

December 2019 www.oecd.org/pensions/policy-notes-and-reviews.htm

- **Increase the accrual rate to raise earnings-related pensions.**

- **Increase the mandatory contribution rate, link retirement ages to life expectancy and apply the macroeconomic indexation mechanism.**

The mandatory pension system provides low benefits. The pension system consists of a basic and an earnings-related component. The full basic pension is achieved after 40 years of contribution and the benefit level is about 15% of gross average earnings. A pro-rated benefit is available after a minimum of 10 years of contribution. The mandatory earnings-related pension has an accrual rate of 0.55% for each year of contribution up to a ceiling of 2.3 times the average earnings. Overall, this generates future replacement rates that are low in comparison to the OECD average: low earners (50% of average) with a full career can expect a net replacement rate from mandatory schemes of 46%, and average earners 37%, compared to the OECD averages of 69% and 59%, respectively. When including voluntary components throughout the whole career, the replacement rate increases to 62% at the average wage in Japan. Overall, the average income of people aged over 65 is 12% lower than that of the whole population, similar to the OECD average. However, the old-age poverty rate is very high and four percentage points above the poverty rate for the total population. Older women are particularly vulnerable because of lower pension levels and longer lives living alone.

Key indicators: J APAN and OECD average

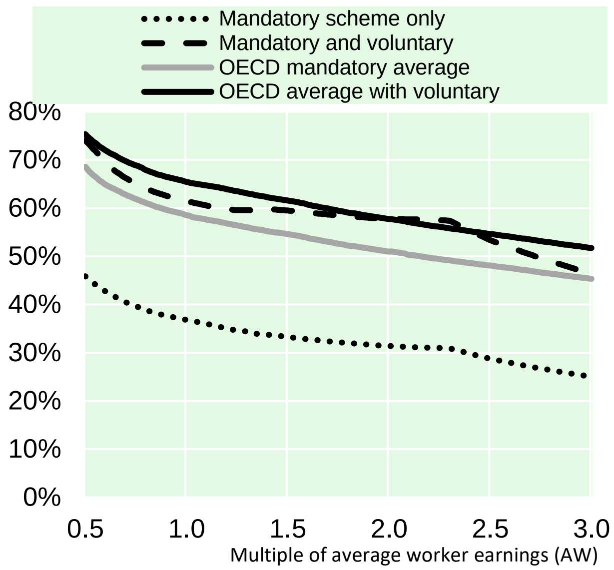
	Mid-1980s	Mid-1990s	Mid-2000s	latest available	latest OECD	long-term	long-term OECD
Normal retirement age for a full-time career starting at the age of 22	60 (55)	60 (58)	61 (60)	65 (64)	64.2 (63.5)	65.0	66.1 (65.7)
Statutory retirement age	60 (55)	60 (58)	61 (60)	65 (64)	64.5 (63.8)	65.0	66.5 (66)
Net replacement rate, average earner						36.8 (36.8)	58.6 (57.6)
Effective contribution rate (average earner)				18.3	18.4		
Total pension spending, % of GDP	4.8	6.4	11.8	13.9	10.0		
Public pension spending, % of GDP	4.7	6.1	9.2	11.2	8.4		
Public debt, % of GDP	72	90	158	224	80		
Employment rate 55-64, %	78.8 (44.4)	80.8 (47.5)	78.9 (49.4)	86.3 (64.4)	68.5 (54.8)		
Labour-market exit age	69.8 (66.0)	71.1 (66.1)	69.4 (66.2)	70.8 (69.1)	65.4 (63.7)		
Old-age poverty rate, %	23.1	23.0	22.0	19.6	13.5		
Life expectancy at 65, years	16.0 (19.6)	17.0 (21.7)	18.5 (23.6)	19.9 (24.7)	18.1 (21.3)	23.8 (28.8)	22.5 (25.2)
Old-age dependency ratio	0.17	0.23	0.32	0.52	0.31	0.83	0.58
Fertility rate	1.7	1.4	1.3	1.4	1.7	1.6	1.7

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-2019.

Population ageing is putting considerable financial pressure on Japan's pension system. Japan has the highest old-age to working-age ratio in the OECD: 52 persons aged 65 and over per 100 aged between 20 and64 years in 2020, projected to increase to 80 by 2050. Japan has the highest government debt level (over 224% of GDP in 2018). Many workers in Japan work beyond the normal retirement age, with the average effective labour market exit age being six (five) years higher than the legal retirement age of 65 (64) for men (women). In 2018, 86% of men aged 55-64 were employed against 70% in the OECD on average. The employment rate of women in this age group is much lower at 64%, suggesting that there is room to increase women's employment among this age group, even though it is about ten percentage points above the OECD average. The mandatory retirement age is very low at 60 years, legally, even though the key binding reference is 65 in practice. A 2004 reform, required that employers either got rid of the mandatory retirement age for the firm, raised the mandatory retirement age to at least 65 or re-employ workers in a different type of job function at the same firm.

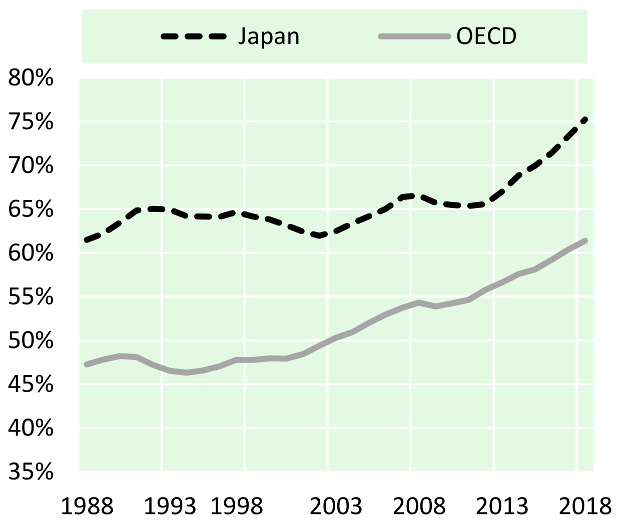
Some measures have recently been taken, in particular to reduce spending and improve pension coverage. In order to improve financial sustainability, the mandatory pension contribution rate was steadily raised from 13.9% in 2004 to 18.3% in 2017. In addition, the sustainability factor ("macroeconomic indexation") adjusts pensions in payment based on the sum of two components: a life-expectancy index and the average change in the number of contributors over the past 3 years. However, it is not applied at times of negative inflation. Hence, a carryover system was introduced in 2018, activated in 2019, to enable catch up of the indexation part that was not applied. The indexation rule will change in 2021: if wage growth is lower than CPI inflation, pensions will be indexed to wage regardless of the pensioners' age, whilst currently pensions are indexed to wages until age 67 and price-indexed thereafter. In addition, since 2017, non-working spouses, public-sector workers and individuals previously covered by private occupational plans have only been allowed to contribute to individual voluntary funded defined contribution schemes. The coverage of mandatory earnings-related pensions has also been extended to part-time workers, under the condition, however, that they work at least 20 hours a week and have a monthly wage of at least JPY 88 000 (20% of the average earnings). There are on-going discussions to

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



Source: OECD pension models.

Employment rate for those aged 55-64



Source: OECD Employment Outlook.

expand this further by including workers who do not meet these thresholds. Moreover, the government plans to increase the 65 binding reference retirement age to 70 years.

Further policy action is still needed to improve future pensions in a financially sustainable way. The accrual rate from the earnings-related component is very low in comparison with other countries, even when taking into account contribution levels. This directly leads to low earnings-related benefits. Currently, a contribution of 18.3% of earnings is associated with an effective accrual rate of only 0.50%. By comparison, a contribution rate of 12.4% results in an accrual of 0.85% in the United States, and a 18.6% contribution rate in Germany gives a long-term accrual of 0.86%. Moreover, given population ageing in Japan, the mandatory contribution rate is relatively low. Increasing the contribution rate would improve financial sustainability or allow financing of higher pensions, or both. Linking the pension eligibility age to life expectancy and applying the macroeconomic indexation mechanism would also enhance pension finances. Moreover, removing both stringent minimum earnings and working-time requirements for pension entitlement would expand coverage.

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