

Social Security Pension Schemes in Japan After the Recent Financial and Economic Crisis and the Issues

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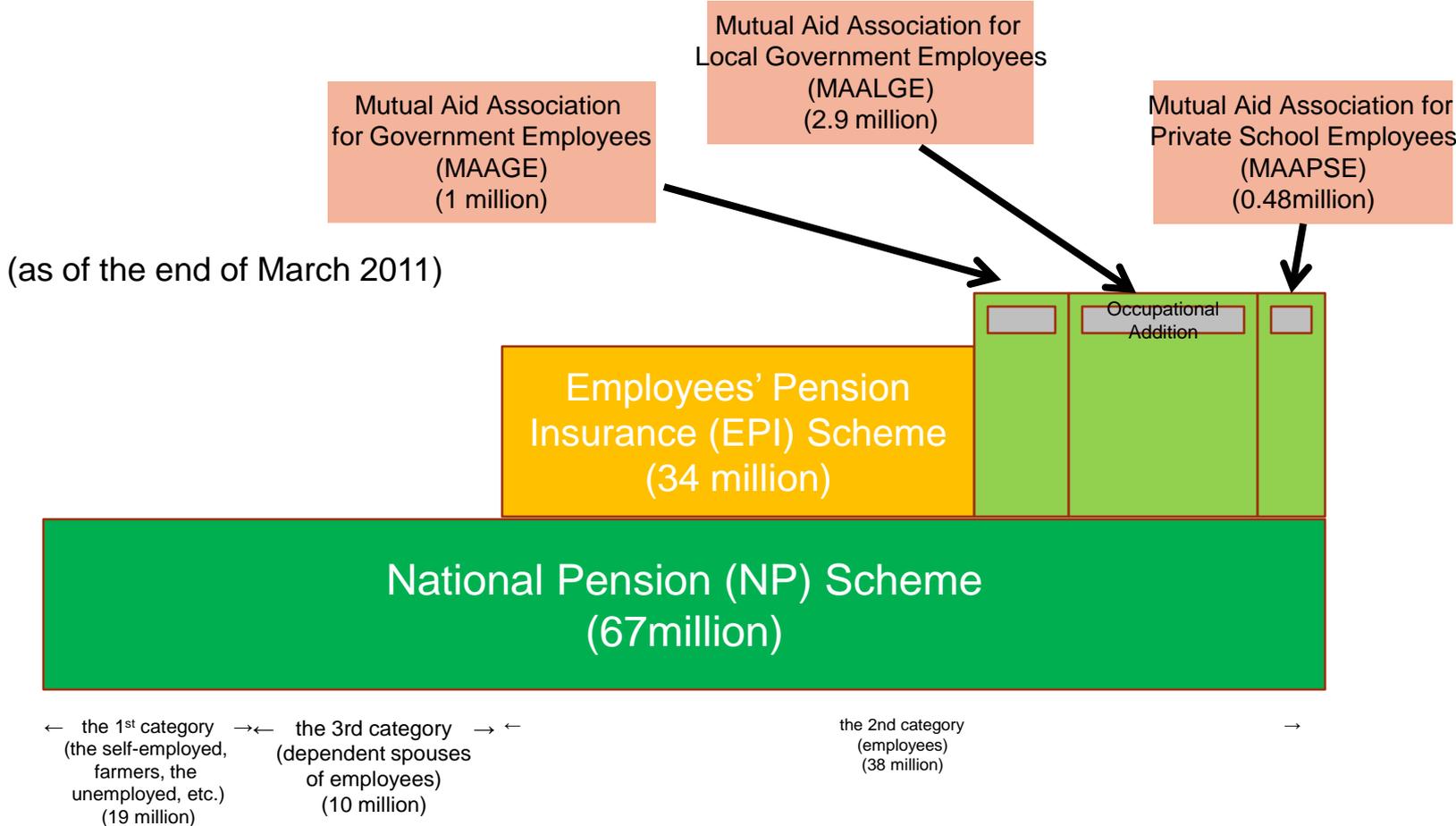
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Social Security Pension Schemes in Japan

Mutual Aid Associations are to be merged with the EPI Scheme in Oct. 2015 with the occupational addition converted into new occupational pensions.



Insured Persons in the 1st Category of the NP Scheme

- Insured persons in the 1st category of the NP scheme are:
 - the self-employed
 - farmers
 - fishermen
 - independent practicing doctors
 - lawyers
 - unemployed people (within the labour force)
 - non-working people (outside the labour force)
- **Flat-rate contributions and flat-rate benefits**
 - due to the difficulty in attaching the income of those in the category

Contribution Exemption System

- Recipients of social assistance benefits and disability pension benefits aged between 20 and 59 are unconditionally exempted from paying contributions (unconditional exemption)
- People with low income or no income are exempted from paying the whole or the part of the contribution due (conditional exemption)
- 4 grades of exemption
 - ① total exemption
 - The previous-year income of each member of the family should be equal to or below:
JPY 350,000 X {(the number of dependants) + 1} + JPY 220,000
 - ② three-quarter exemption
 - The previous-year income of the person should be equal to or below:
JPY 780,000 + (tax deductible amount for dependants) + (social insurance contributions)
 - ③ half exemption
 - The previous-year income of the person should be equal to or below:
JPY 1,180,000 + (tax deductible amount for dependants) + (social insurance contributions)
 - ④ quarter exemption
 - The previous-year income of the person should be equal to or below:
JPY 1,580,000 + (tax deductible amount for dependants) + (social insurance contributions)
- Benefits corresponding to the exempted period are $\frac{1}{2}$, $\frac{5}{8}$, $\frac{3}{4}$, or $\frac{7}{8}$ of the full benefit if the exemption is total, three-quarter, half or quarter respectively.

The 2004 Reform (1)

- The contribution programmes were fixed

- the EPI Scheme: 13.934% (2004) >>> 18.3 % (2017)

- the NP Scheme: JPY 13,580 (2005) >>> JPY 16,900 (2017)

(Note) The amount is in FY 2004 terms.

- Normal indexation

- up to the age of 65: indexed to the increase rate of disposable income

- after the age of 65: indexed to the CPI increase rate

- Modified indexation

- If the scheme is projected to be financially balanced under the normal indexation, the modified indexation is not activated

- If the scheme is projected to be financially imbalanced under the normal indexation, the modified indexation is activated

- The modified indexation is the indexation based on the rate of the normal indexation minus modifier

- The modifier is the sum of the annual decrease rate of the number of active participants in the social security pension schemes and the annual increase rate of life expectancy at the age of 65

(Note) The increase rate of life expectancy at the age of 65 is fixed at 0.3% in order to avoid fluctuations

- a sort of automatic balancing mechanism

(Note) To some extent it is very similar to German sustainability factor.

The 2004 Reform (2)

- Restrictions on the modified indexation

- If the increase rate of disposable income or the CPI increase rate is negative, the modified indexation is not activated
- If the rate of modified indexation becomes negative, it is replaced by zero.

(Note) Since the Japanese economy has been deflationary since the 2004 reform, the modified indexation has never been activated so far.

- Provision on the floor of the benefit level

- To remove anxiety from participants about the future benefit level, the government must monitor the replacement rate of the scheme and if the replacement rate is projected to fall below 50% before the next actuarial valuation, the government must review the benefits and the contributions and take necessary measures to keep adequacy of the benefits the schemes provide
- The replacement rate is defined as the rate of the total amount of benefits of a couple to the average disposable income of the active participants when they are 65 years old
- The couple consists of a husband and a wife with the same age and the husband works under the coverage of the EPI Scheme from the age of 20 to 59 always with the average salary and the wife is always a dependent housewife and a covered person the 3rd category under the NP Scheme

Brief History of Pension Reform in Japan

- 1942 Introduction of the EPI Scheme
- 1965 Recovery of benefit adequacy
 - After the World War II the EPI Scheme lost adequacy due to hyper-inflation
 - 1973 Indexation was introduced
- 1980 Improvement of longevity
- 1985 Benefit reduction
- 1990 Decline of fertility
- 1994 Indexation based on the increase rate of disposable income and raising of the pensionable age of the flat-rate part from 60 to 65
- 2000 Indexation based on the CPI increase after the age of 65, raising of the pensionable age from 60 to 65 and benefit reduction by 5% of the earnings-related pensions
- 1994 and 2000 Political fight
 - Automatic balancing mechanism was necessary on the 2004 reform

Unemployment Situation in Japan

Year	Number of unemployed persons (ten thousand persons)	Unemployment rate (%)
2000	320	4.7
2001	340	5.0
2002	359	5.4
2003	350	5.3
2004	313	4.7
2005	294	4.4
2006	275	4.1
2007	257	3.9
2008	265	4.0
2009	336	5.1
2010	334	5.1
2011	302	4.6

(Source) Ministry of Internal Affairs and Communications

Economic Conditions

Year	Rate of CPI increase (%)	Rate of salary increase (%)	Interest rate of newly- issued 10-year bonds (%)
2000	-0.7	0.1	1.7
2001	-0.7	-1.6	1.3
2002	-0.9	-2.9	1.3
2003	-0.3	-0.7	1.0
2004	0.0	-0.7	1.5
2005	-0.3	0.6	1.4
2006	0.3	0.3	1.8
2007	0.0	-1.0	1.7
2008	1.4	-0.3	1.5
2009	-1.4	-3.8	1.4
2010	-0.7	0.6	1.2
2011	-0.3	-0.2	1.1

(Source) CPI is based on "Consumer Price Index" by the Ministry of Internal Affairs and Communications.

Rate of salary increase is based on the Monthly Labour Survey by the Ministry of Health, Labour and Welfare. Interest rate of newly-issued 10-year bonds is based on the press release by the Ministry of Finance.

Number of the Insured Persons of the EPI Scheme

Fiscal Year	Number of the insured persons of the EPI Scheme (in thousand)	Total amount of the annual pensionable salary (in JPY trillion)
2000	32,192	[124.1]
2001	31,576	[123.2]
2002	32,144	[123.4]
2003	32,121	145.9
2004	32,491	146.9
2005	33,022	148.7
2006	33,794	151.6
2007	34,570	154.8
2008	34,445	156.0
2009	34,248	149.2
2010	34,411	149.2

(Note 1) Until FY 2002 the pensionable salary did not include the bonuses. Until then contributions were imposed on the bonuses at the rate of 1%, but they were not reflected in the benefit amount.

(Note 2) A fiscal year starts on 1 April and ends on 31 March.

(Source) Actuarial Sub-committee, Social Security Council of the Ministry of Health, Labour and Welfare

Number of Non-regular Staff

Year	Number of employees excluding		
	company executives (in ten thousand)	Number of regular staff (in ten thousand)	Number of non-regular staff (in ten thousand)
2000	4,903	3,630	1,273
2001	4,999	3,640	1,360
2002	4,891	3,486	1,406
2003	4,941	3,444	1,496
2004	4,934	3,380	1,555
2005	4,923	3,333	1,591
2006	5,005	3,342	1,664
2007	5,128	3,399	1,728
2008	5,122	3,381	1,741
2009	5,105	3,400	1,704
2010	5,095	3,381	1,714
2011	5,154	3,334	1,819
2012	5,140	3,334	1,805

(Note) Until the year of 2001 the numbers are the average of February. From 2002 onwards, they are the average of the 1st quarter of the year.

(Source) "Labour Force Survey" by the Ministry of Internal Affairs and Communications

Historical Data of the Number of Exemptions and the Rate of Non-compliance of the Insured in the 1st Category

Fiscal Year	Number of the insured in the 1st category (in ten thousand)	Number of persons exempted				Rate of compliance (%)	
		unconditional (in ten thousand)	conditional				
			whole (in ten thousand)	three quarter (in ten thousand)	half (in ten thousand)		a quarter (in ten thousand)
2000	2,154	93	274	-	-	-	NA
2001	2,207	96	277	-	-	-	NA
2002	2,237	99	144	-	34	-	66.9
2003	2,240	106	165	-	38	-	67.4
2004	2,217	109	176	-	41	-	68.2
2005	2,190	113	216	-	53	-	72.4
2006	2,123	114	207	26	21	8	70.8
2007	2,035	113	202	27	19	8	68.6
2008	2,001	114	204	27	17	8	66.8
2009	1,985	120	215	25	16	7	65.3
2010	1,938	126	221	24	14	6	-
2011	1,904	131	230	25	14	6	-

(Note 1) Rate of compliance means the rate of the number of months in the year for which the contributions were paid to the number of months in the year for which the contributions were due.

The months for which the contributions are due do not include the months for which the contributions are exempted.

(Note 2) For fiscal years of 2010 and 2011, the rate of compliance has not been evaluated yet because their deadline of payment has not arrived yet.

(Source) Annual report of Japan Pension Service

What the Statistics Tell

- **Unemployment rate increased in 2009**
 - However, the number of regular workers and the number of the insured persons under the EPI Scheme were stable
 - The number of non-regular workers, on the other hand, stopped increasing
 - It is very likely that the unemployment happened mainly to the non-regular workers
 - In fact the number of exemptions of the NP contributions started to increase in 2009
- **Per-capita salary decreased in 2007-2009**
 - Furthermore the total amount of pensionable salary of the EPI Scheme
decreased in 2009

If the Trend Lasts for a Long Time

- Many of the non-regular workers would not receive adequate old-age benefits
- The future beneficiaries would receive less benefits than planned on the 2004 reform
- The floor of the benefit level might lose adequacy if the salary decreases faster than the CPI

What We Need to Do

- Extension of the coverage of non-regular workers under the EPI Scheme
 - The 2012 reform has slightly extended the coverage, but still there are many non-regular workers not covered under the EPI Scheme
- Enhancement of the government efforts to give publicity to the exemption system and its review for the insured persons in the 1st category of the NP Scheme
- Review of the pensionable age
- Removal of the restrictions on the activation of the modified indexation
- Review of the floor of the benefit level under the deflationary economy

Thank you very much for your attention!