Shared Responsibility for Retirement Income:

The Asian Perspective

by

Noriyuki Takayama

Professor of Economics, Hitotsubashi University
takayama@ier.hit-u.ac.jp
http://www.ier.hit-u.ac.jp/~takayama/

AARP’s Reinvesting Retirement Asia Conference, Workshop 2, Tokyo, 15 March 2007
Organization

- Major Asia-specific Characteristics
- Securing Adequate Retirement Income: A Challenge
- Pension Issues in Japan: the B/S Approach
- Some Discussions
- No Single Solutions
- Implications from Japanese Experience
Major Asia-Specific Characteristics in Securing Retirement Income (1)

- Higher LFPR in the Sixties (cf. PRC)
- Privileged Groups (Military and Civil Servants)
- The time of establishing the SS pension program for the private sector employees varied considerably country to country
- Many Asian countries have only a short history of SS pensions. Extending pension coverage is still quite important
Major Asia-Specific Characteristics in Securing Retirement Income (2)

- Pension programs are fairly different among Asian countries: Japan & South Korea (similar to Western Europe and North America); Singapore & Malaysia (the provident fund); Taiwan (mandated DC occupational pensions); Hong Kong (the 1994 World Bank approach); PRC (moved from the enterprise-protection systems to the state-protection ones); Australia & NZ (each, very unique)

- The mentality of lump-sum retirement benefits is still very persistent

- Annuitization issues
Providing an adequate income to older persons is a big challenge

- Drop-out Rate, Decreasing?
- uncovered people (self-employed, etc.)
- growing atypical workers and migrant workers
- Financially Sustainable?
- Incentive-compatible?
- Compliance, effectively enforced?
SS Pensions: A Zero-sum Game

- Under a PAYG system, early beneficiaries are winners; in contrast, younger actively working generations and future generations are losers.

- This is inescapable
  - a “legacy debt” problem
Pension Issues in Japan: The B/S Approach

- Balance Sheet describes the current financial status in stock terms by presenting assets and liabilities with their compositions.

- The B/S often suffers from huge excess liabilities even if income statement of SS pensions enjoys a surplus.
The major objective of the 2004 reform is to eventually eliminate the huge EL (legacy debt) in the B/S of SS pensions.

The reform is to generate a surplus by increasing C, increasing transfers from GR, and reducing benefits.

The policy measures adopted will induce huge excess assets of 420 trillion yen in Part Two of B/S, while offsetting EL of the same amount in Part One.
KNH Balance Sheet: After the 2004 Reform (as at 31st March 2005)

**Part One (PAST)**
- Assets: 320 Tr. Yen
- Liabilities: 740 Tr. Yen

**Part Two (FUTURE)**
- Contributions: 1200 Tr. Yen
- Transfers (GR): 190 Tr. Yen
- Pension Liabilities: 970 Tr. Yen

Excess A: 420 Tr. Yen
Excess L: 420 Tr. Yen
Incentive-compatible?

- Huge EA of Part Two imply that future generations will collectively receive pensions worth less than the contributions they will pay.

- The PV of future benefits will be around 80% of the PV of future contributions for younger generations.

  - incentive compatible?
Incentive-compatible?
Benefit/Contribution Ratio by Generation
Handling Legacy Debt in JPN

- **Reductions in Benefits**
- **Increasing Transfers from GR**
  - more income tax on pension benefits
  - strengthening inheritance tax
- **Still controversial is:**
  - increasing contributions vs introducing an ear-marked consumption-based tax
- **It is unclear why the burden of paying off the legacy debt should be shared in proportion to future earnings, while none is distributed in proportion to capital income or consumption**
The Second Tier: “An Empty Box”
merely an entitled accounting book

Deficit Financing from Increased GR
Recognition Bonds
Sales of SOEs (cf. Timing)
A Lottery
cf. Persistent Gov’t Deficit since 1979
Some Discussions (1)

- The PAYG, DB system
  a taxed-transfer system between generations

- political difficulty:
  Older people are strong voters while younger and future generations have weak or no political powers
Some Discussions (2)

- The benefits and contributions in PAYG DB plans need some flexibility to respond to changing and uncertain circumstances. Constant adjustments will be required to keep the system viable.

- Automatic balance mechanism (Sweden)
- Sustainability factor (Germany)
- Demographic factors (Japan)
Some Discussions (3)

- Supporting an increasing number of retired persons is possible if output grows.
- Economic output depends on the supply of workers, and thus increasing the labor force participation will be required to maintain this supply.
- Economic growth can mitigate the difficulties in financing pensions. Overall, Asian countries still luckily have high potentials for economic growth, while their social security pensions are relatively new. Pension reform in Asia can hopefully be on a right track.
The most important question is whether or not SS pensions are worth buying. The basic design should be incentive-compatible.

Contributions should be much more directly linked with old-age pension benefits, while an element of social adequacy should be incorporated in a separate tier financed by other sources.

Rather than invoking more vigorous action of ultimate authorities, providing appropriate incentive mechanisms will be more effective to meet higher coverage and fuller compliance in social security pensions.
Some Discussions (5):
Accountability and Private Initiatives

- There are still much room for higher transparency and accountability in all Asian countries. They are the key prerequisites for better pension governance.

- The majority of people are reluctant to accept further increases in taxes and/or SS contributions. People must be encouraged to become self-reliant after retirement.

- With stronger tax incentives, private initiatives will grow in due course.
Each Asian country faces a dilemma that too many targets are sought to be achieved through a virtually single policy instrument of pensions. Each policy objective can be best attained only if it is matched with each different policy instrument of comparative advantage. For example, mind-set of policy makers in Singapore which insists on relying on a single-tier CPF to finance old age has to be changed.
No Single Solution (1) – cont’d
Assignment Problem

- **Separate Handling** is required to achieve different policy objectives
  - Legacy Pension Problem
  - Incentive-compatibility Problem for younger generations
  - Poverty-relief Problem
Appropriate Policy Measures

- **Legacy Pensions:**
  - Consumption-based Tax
  - Inheritance Tax, Tax on Pension Benefits,
  - Recognition Bonds, Sales of SOEs, A Lottery

- **Incentive-compatibility:**
  - Is NDC a possible answer?

- **Poverty relief:**
  - Guarantee Pensions financed by a transfer from general revenue
No Single Solution (2)
Competing Objectives

- Promoting later retirement may induce higher unemployment for younger people
- Encouraging occupational and individual pensions can lead to early retirement
- Tax smoothing or advance increases in C rate for long-term sound financing will cause short-term higher unemployment
- Financial sustainability vs income adequacy in retirement
  - Solutions will be different depending on which objective is more important
For an aging society, increased costs are inevitable to secure a stable income for people after retirement. No painless solutions. The type of pain will be different:

- potential of economic growth
- balance between solidarity and self-reliance
- perceptions about income disparity
- understanding of intergenerational equity
- credibility of the Gov’t commitment
- regulatory competence
- development of the capital market
The majority of Japanese people have already recognized the gravity of Social Security financing issues. They can forgive and forget. Never-ending reforms of Social Security pensions are inevitable in Japan, where only fine-tuning of Social Security programs in the face of changing circumstances is acceptable in the political arena.
Implications from Japanese Experience (2)

- **Assignment Problem**
  Separate the legacy pension problem from re-building the future system

- **Automatic Balance Mechanism**
  flexible adaptation to a changing and unpredictable world
Implications from Japanese Experience (3)

- Taste of Pie rather than Size or Distribution
- Balance sheet approach recommended
  indispensable for understanding the long run financial sustainability of SS pensions and for evaluating varying financial impacts of different reform alternatives
- Strengthen Private Initiatives
References


*The Balance Sheet of Social Security Pensions*, available on the PIE website below (Proceedings no.6 and no.7).


PIE Website: [http://www.ier.hit-u.ac.jp/pie/English/index.html](http://www.ier.hit-u.ac.jp/pie/English/index.html)
Retirement From the Consumer Perspective. This research is structured to determine how the decision makers or people who contribute to financial decision making plan to tackle the challenges of retirement. Accordingly, it surveyed those who are primary decision makers or those who contribute equally in making financial decisions. Japan shares a family culture that is quite similar to other Asian markets. Historically, much like other Asian markets, Japan has gradually, though not entirely, moved away from three-generation households. Results from the survey showed that half of the respondents depend on their spouses financially. Indeed, many Asian™s retirement income systems are not prepared for rapid population ageing. Many of the more prosperous Asian countries are having fewer babies, shorter marriages, and longer lives. Combined with generally low retirement ages, this demographic transition is already leading to the number of pension recipients outnumbering the number of contributors in certain developed Asian economies. The situation is further aggravated by the fact that responsibility for retirement income security is increasingly falling on the shoulders of individuals besides that of the state.