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Japan considers raising its pension eligibility age further

~ the conditions necessary to raise the age to 67 ~

Mizuho Research Institute

<Summary>

1. Japan's pension system basically rests upon a pay-as-you-go system, even though it also holds a certain amount of accumulated funds. As a result, the government has carried out several reforms aimed at increasing contributions and curbing payments along with the aging of its population and declining birthrate. Measures for the latter include holding down benefits and extending the pension eligibility age. The eligibility age for the employees' old-age pension, which can be received as a special benefit between the ages of 60 to 64, is now being raised in stages. After the process is completed, men will start receiving pensions at 65 beginning in FY2025 and women in FY2030.

2. Since the old-age pension covers recipients until death, life expectancy at the time when recipients start to receive payments is approximately equal to the average eligibility period. Even after the eligibility age is raised, by 2050 the period is expected to extend from the current level because of longer life expectancies.

3. To prepare for Japan's rapidly aging society, raising the eligibility age further, above 65, is an option worth considering. Other countries plan to postpone retirement to above 66: 67 in the United States and Germany and 68 in the United Kingdom. Japanese society is aging comparatively faster and people are living longer. Moreover, Japanese senior citizens, especially men, tend to be more willing to stay in the workforce. Therefore, the feasibility of raising the eligibility age to at least 67 should be studied and discussed immediately.

4. One option that would have the maximum effect on pension finances with the minimum burden is this: bring forward the schedule (due to start in FY2013) for extending from 60 to 65 the portion of the pension proportionate to wages. The eligibility age for that portion is scheduled to be raised by one year every three years, but by revising it to every other year, retirees would eventually start receiving the pension at 65, beginning in FY2021 for men and in FY2026 for women. It would then further be raised by one year every other year from 65 to 67. Men would start receiving the pension at 67 beginning in FY2025 and women in FY2030. Extending the age to 67 would leave the average eligibility period in 2050 more or less the same as it was in 2000. Moreover, it would trim total benefits for 2050 by about seven percent.

5. Several conditions should be met first, however. Plenty of time should be given from decision to implementation as pension payments have a huge impact on the lives of the elderly. Employment for the elderly must be secured so they can get enough income until they start receiving the pension. Moreover, it is essential to develop an early payment system allowing people to receive reduced benefits in advance if they choose that option, and to expand private pension plans to supplement the public pension program.

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[Contents]

1. Introduction

Japan's pension system basically rests upon a pay-as-you-go system, even though it also holds a certain amount of accumulated funds. Therefore, a further decline in Japan's birthrate and the graying of the population will seriously affect the pension finances. In response, the government has carried out reforms, raising insurance and tax rates and curbing pension payments.

There are two major ways to curb pension payments: One is to hold down the amount of benefits, and the other is to extend the pension eligibility age. For the government-managed pension plan for corporate employees (employee pension plan), the eligibility age is now being raised from 60 to 65 in stages. In the United States, the age is already 65, and this is being further extended to 67. In the United Kingdom and Germany, the figure is 68 and 67 respectively. Japan has yet to thoroughly discuss these options. In this article, we study specific ways and conditions to put it into practice.

2. Pension eligibility age and its period

The public pension system is bound to be pressed for funds once the number of recipients surpasses that of the younger working population that supports it. Japan is rapidly aging due to the declining birthrate and the rising life expectancy, helping to push up the eligibility age for the employee pension plan in stages: from the original 55 to the soon-to-be 65.

(1) Major shifts in the pension eligibility age

When the pension plan for corporate employees was introduced in 1944, its eligibility age was 55 for both men and women. This subsequently started to be raised from 55 to 60 in 1954 for men, and in 1985 for women.

In 1994, the government decided to extend the eligibility age for the fixed portion from 60 to 65, and in 2000 for the portion proportionate to wages[1] (**Chart 1**). Following these changes, men are to start receiving the pension at 65 beginning in FY2025 (those who were born on and after April 2, 1961), and women in the FY2030 (those who were born on and after April 2, 1966).

As for the national pension plan, which started in 1961, the eligibility age remains unchanged at 65.

Chart 1: Shifts in the eligibility age for the employee pension plan

	Men	Women
When the system started in 1944	Age 55	Age 55
Revised in 1954	From 55 to 60 (Raised in phases from FY1957 over a 16-yr period)	—
Revised in 1985	—	From 55 to 60 (Raised in phases from FY1987 over a 12-yr period)
Revised in 1994	From 60 to 65 for fixed portion (Raised in phases from FY2006 over a 12-yr period)	From 60 to 65 for fixed portion (Raised in phases from FY2006 over a 12-yr period)
Revised in 2000	From 60 to 65 for portion proportionate to wages (Raised in phases from FY2013 over a 12-yr period)	From 60 to 65 for portion proportionate to wages (Raised in phases from FY2018 over a 12-yr period)

Note: The workers' pension plan, the predecessor of the employee pension plan, was enacted in 1941 and took effect in 1942. It was originally designed to cover male laborers at factories. In 1944, the name was changed to *kosei nenkin*, or the employee pension plan, extending the coverage to office workers and women.

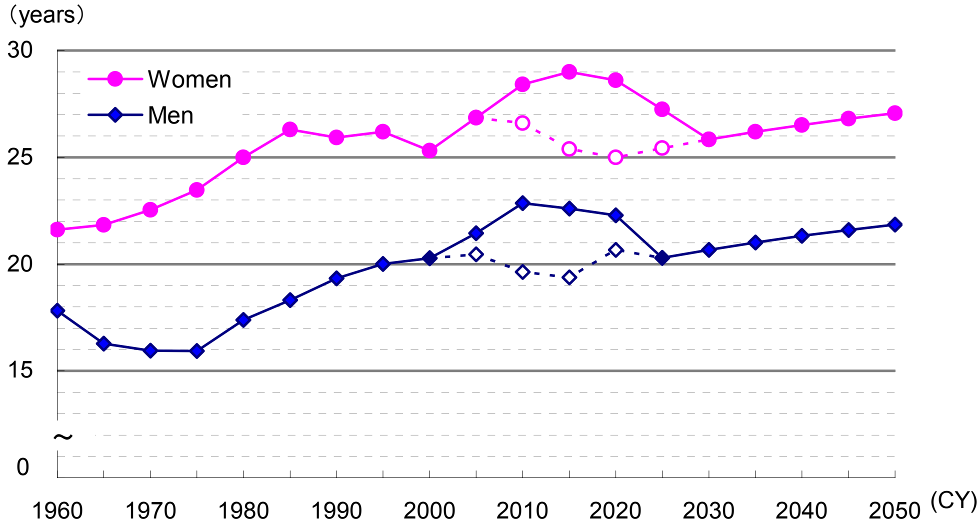
Source: The Ministry of Health, Labor and Welfare

(2) Average eligibility period

Since the old-age pension covers recipients until death, life expectancy at the point in time when recipients start to receive payments is approximately equal to the average eligibility period. Looking at the changes in life expectancy on a five-year basis from 1960 to 2050, the average eligibility period is lengthening because people are living longer, even though the eligibility age has been raised. (**Chart 2**)

The average eligibility period is temporarily shortened because of the phased raise from 60 to 65 starting in FY2001, but after 2025 (2030 for women) when the process is completed, it is expected to grow longer again. In 2050, the eligibility period will be 22 years for men and 27 years for women, continuously getting longer than the current level (in 2005). (**Chart 2**)

Chart 2: Average eligibility period for the employee pension



Note: The average eligibility period equals life expectancy at the point of starting to get the pension. The solid line shows life expectancy at the point of starting to get the pension for the portion proportionate to wages and the dotted line for the fixed portion, after the eligibility age for special benefits of the employees' old-age pension is raised.

Source: The Ministry of Health, Labor and Welfare, *Complete Life Table* (each annual edition), The National Institute of Population and Social Security Research, *Population Statistics of Japan 2006*. Compiled by Mizuho Research Institute

3. Possibility of further extending the pension eligibility age

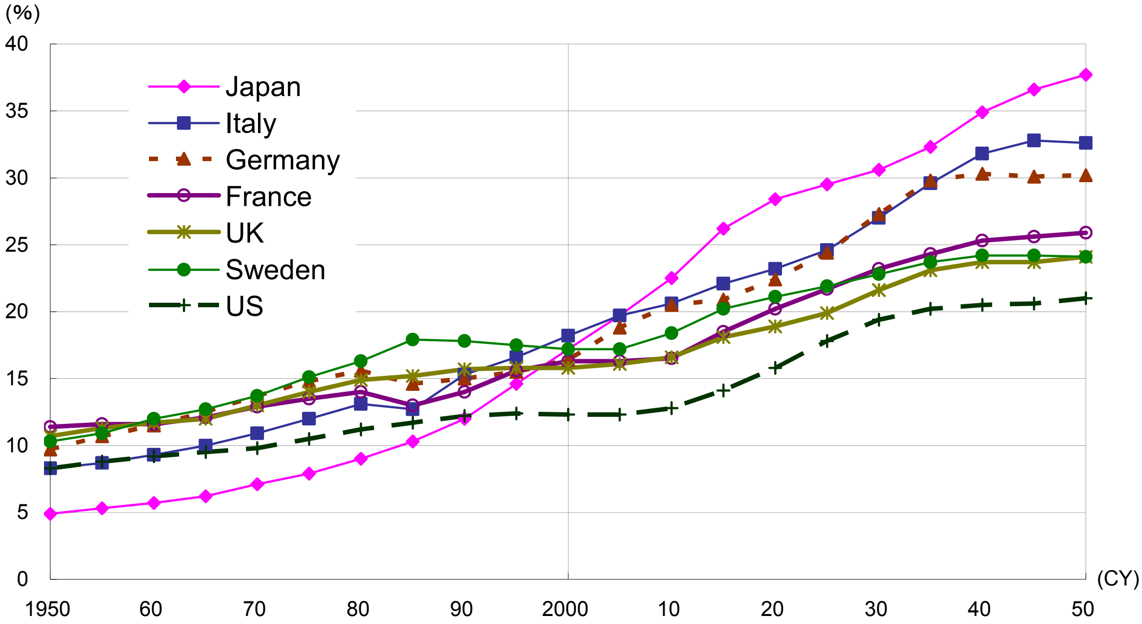
As already mentioned, even if the pension eligibility age is raised as currently debated, the eligibility period would rise above the current average eligibility period by 2050 because of the rise of life expectancy. Thus, while benefits are being cut and the pension eligibility age is now being raised to 65 in a bid to prepare for Japan's graying society, a further raise could be an option.

Here we consider how Japan compares with major western countries in terms of life expectancies and the desire of older people to remain in the workforce.

(1) Prospects of lengthening life expectancy

The aging of the population is a problem shared by all developed nations, but in Japan this phenomenon is progressing more rapidly (**Chart 3**). The aging of society is caused by declining birthrates and rising life expectancy: Declining birthrates mean fewer people to support future pension finances and rising life expectancy leads to longer eligibility periods in the future.

Chart 3: Shifts of aging rates (The percentages of the population over 65) in Japan and major western nations



Source: United Nations, *World Population Prospects: The 2006 Revision.*

(2) National desire to keep working into old age

Comparatively, Japanese senior citizens are more likely to stay on in the workforce. The actual retirement age (the average age at which people have left the workforce with no intention to return) in Japan is the late 60s compared to the early 60s in the UK and Germany.

The official retirement age (the minimum age at which people can receive the full public old-age pension), is 65.3 in the US, 65 in the UK (for men) and Germany, and 60 in Japan and the UK (for women). The actual retirement age in Japan is plus 9.3 years for men and plus 6.1 for women. In Germany, the actual retirement age is far below the official retirement age at minus 3.7 years for men and minus 4.4 for women, showing a marked tendency to retire early **(Chart 4**).

Chart 4: Actual retirement age and official retirement age

	Actual retirement age A (From 1999 to 2004)		Official retirement age B (2004)		B minus A	
	Men	Women	Men	Women	Men	Women
Japan	69.3	66.1	60.0	60.0	+9.3	+6.1
US	64.2	63.1	65.3	65.3	−1.1	−2.2
UK	63.0	60.6	65.0	60.0	−2.0	+0.6
Germany	61.3	60.6	65.0	65.0	−3.7	−4.4

Note: The actual retirement age is the average age at which people have left the workforce with no intention to return. The official retirement age is the minimum age at which people can receive the full public old-age pension.

Source: The Ministry of Health, Labor and Welfare: *The World's Labor and Welfare 2007.* Compiled by Mizuho Research Institute

In Japan, extending the eligibility age can be put on the list of future pension reforms, on condition that older people can keep working and earn enough income until they start getting pensions. Given that aging in Japan is proceeding much faster than elsewhere and that future citizens are expected to live much longer, the feasibility of raising the eligibility age to at least 67, (the same as the US and Germany) should be studied and discussed immediately. This reform would help maintain Japan's pension system, which rests upon a pay-as-you-go system where the older-generation depends upon the younger generation.

(3) Plans for further raising the eligibility age

How would such a schedule proceed? In the following we explore some options which would have the maximum effect with the minimum burden upon pension finances and ascertain the shifts in the eligibility period after the raise is implemented.

a. Moving up the schedule for raising the eligibility age for the portion proportionate to wages

As we said, one option that would have the maximum effect on pension finances with the minimum burden is this: Bring forward the schedule (due to start in FY2013) for extending from 60 to 65 the portion of the pension proportionate to wages. This would lighten the financial burdens on younger people who support the pension system at an early stage.

While the government plans to extend the eligibility age (for pension proportionate to wages) by one year every three years after FY2013, an alternative plan would be to revise it to every other year. By accelerating the raise, people would eventually start receiving the pension for that portion at 65 beginning in 2021 for men and in 2026 for women, applying to men born on or after April 2, 1957 and to women born on or after April 2, 1962.

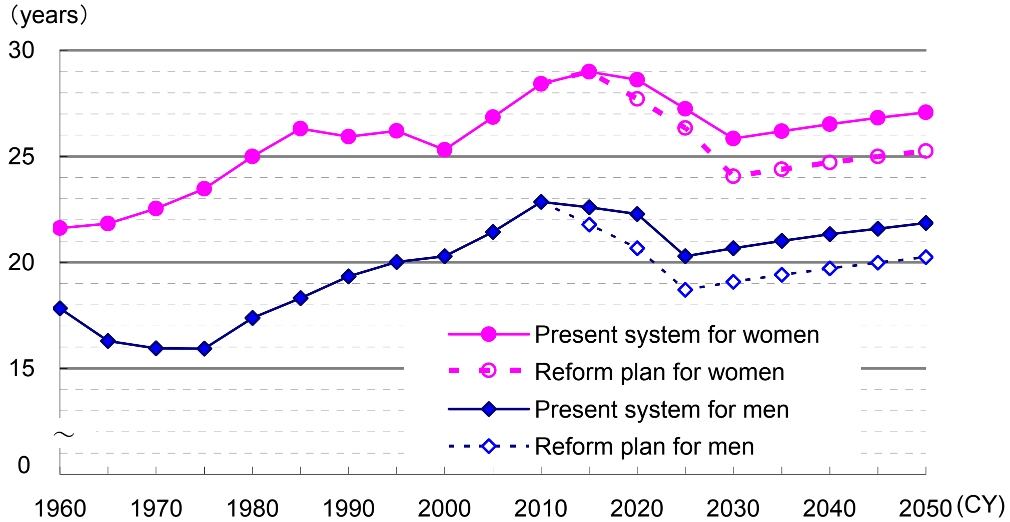
b. Raising the eligibility age from 65 to 67

Next, we consider extending the eligibility age further to 67, after moving forward the schedule to raise the eligibility age to 65.

The eligibility age for the portion proportionate to wages (currently paid from the age 60 to 64) would be raised by one year every other year to 65 as mentioned above. After it is completed, it would further be raised by one year every other year from 65 to 67 in four years. For women, it would be conducted five years later than for men. So, beginning in FY2025 for men (born on or after April 2, 1959) and FY2030 for women born on or after April 2, 1964, the pension would start at 67.

According to this schedule, the average eligibility period in 2050 would be, as **Chart 5** shows,20.2 years for men and 25.3 years for women; more or less the same as 2000.

Chart 5: Prospects for the average eligibility period under the plan



Source: Compiled by Mizuho Research Institute

What would be the impact of raising the pension eligibility age to 67 on the total amount of benefits?

Here, we calculate the impact upon total penefit payments at the time of 2050 on the basis of certain assumptions. Supposing that the current system is maintained and pension benefits start to be paid at 65, total benefits (excluding the mutual aid pension, same for below) would be around 132.2 trillion yen, out of which the amount included in the old-age pension for people aged 65 and 66 (benefit cuts in the event of the age being raised to 67) is estimated at around 8.8 trillion yen. To convert that into 2004 values, according to the rate of pay raise, the total benefits will be around 54.0 trillion yen (for reference; benefits for FY2004 totaled 37.9 trillion yen), out of which 3.6 trillion yen would go on old-age pensions for those aged 65 and 66. In other words, extending the age to 67 would trim total benefits for 2050 by about seven percent (**Chart 6**).

Meanwhile, to look at the benefit-to-burden ratio (total benefits divided by the total shares of burden, or how many times as much benefits one can receive) in the model household of the employee pension[2] where both husband and wife were born in 1985, it is 2.2 to 1, assuming that the couple start receiving the employee pension at 65 and live to be 80 (the average current age of life expectancy). But if the eligibility age is 67, the ratio is down to 2.0 to 1 (**Chart 6**).

Chart 6: Effects on total pension benefits in the event the eligibility age is raised to 67

		Eligibility age from 65	Eligibility age from 67	Benefit cuts (percentage)
Total benefits as at 2050	(2050 value)	132.2 trillion yen	123.4 trillion yen	8.8 trillion yen (6.7%)
	(2004 value)	54.0 trillion yen	50.4 trillion yen	3.6 trillion yen (6.7%)
Benefit-to-burden ratio in the model household		2.2 to 1	2.0 to 1	–

Notes: 1. Total benefits for both employee and national pensions set at 65 are calculated by the Ministry of Health, Labor and Welfare. Benefits starting at 67 are calculated by deducting those for people aged 65 and 66 from the Ministry figures.
2. Pension benefits for those aged 65 and 66 are calculated under the current system by multiplying the number of recipients by the model amount of benefits on a sliding pay scale.
3. The number of old-age pension recipients aged 65 and 66 is calculated by provisionally multiplying the percentage of the over-65 population by the estimated population for the future.

Sources: The Ministry of Health, Labor and Welfare: Official website of the Pension Bureau
The Social Insurance Agency, *the Outline of Social Security Business 2004, the 2006* edition
The National Institute of Population and Social Security Research, *Population Statistics of Japan 2006*.
Compiled by Mizuho Research Institute

4. Terms and conditions for further raising the eligibility age in Japan

In consideration of Japan's future pension finances, it would be an effective step to raise the pension eligibility age as soon as possible. However, several preconditions must be met before the eligibility age can be raised. In the following section, we shall examine the conditions which need to be met before the eligibility age can be raised above 65.

(1) Early decision

First of all, it is necessary to allow ample time from the decision to implementation. Elderly households depend heavily on the public pension and extending the eligibility age will have a major impact on financial planning after retirement.

According to the *Fundamental Inquiry into National Life* by the Ministry of Health, Labor and Welfare, the public pension accounts for around 70 percent of the income in elderly households[3]. Around 60 percent of these households depend solely on the pension.

Previous changes to the eligibility age took anywhere from 14 to 30 years in Japan. In other countries, the extension from 65 to 67 took longer: 44 years in the US, 39 years in the UK and 22 years in Germany. In each case, they avoided hasty implementation (**Chart 7**).

If Japan were to decide in 2008 to extend the age based on the above-mentioned schedule, completing the process in 2025 for men and 2030 for women, it would require 17 years from decision to completion for men and 22 years for women. Even though it would be advisable to complete the whole process to raise the eligibility age to 67 as early as possible in consideration of its impact on pension finances, Japan cannot afford much time for procrastination if a further extension were to be implemented in accordance to the above-mentioned schedule.

Chart 7: Raising the pension eligibility age – the time span from the initial decision to its implementation

	Details of raises	Year of decision	Starting year	Finishing year	Years from decision to completion
Japan	From 55 to 60 (men)	1954	1957	1973	19
	From 55 to 60 (women)	1985	1987	1999	14
	From 60 to 65 (fixed portion for men)	1994	2001	2013	19
	From 60 to 65 （fixed portion for women）	1994	2006	2018	24
	From 60 to 65 (portion proportionate to wages for men)	2000	2013	2025	25
	From 60 to 65 (portion proportionate to wages for women)	2000	2018	2030	30
US	From 65 to 67	1983	2003	2027	44
UK	From 65 to 68	2007	2024	2046	39
Germany	From 65 to 67	2007	2012	2029	22

Note: The raise in the UK is based upon estimates.
Sources: Compiled by Mizuho Research Institute

(2) Promotion of employment for the elderly

The second condition for raising the eligibility age is to ensure employment for older people until they start receiving pension benefits.

Even though the retirement age is required to be over 60 in Japan, the government required companies in FY2006 to raise the retirement age in gradual steps to 65 since the pension eligibility age is being raised in stages to 65 since FY2001,. Nevertheless, there are companies in which many workers retire at 60 because companies are not obligated to extend employment for all those who wish to work on until later and to ensure full-time employment.

Thus it would be necessary to consider establishing a work environment where everyone wishing to keep working can retain their jobs until 67 by raising the mandatory retirement age beyond 65 and extending employment until 67.

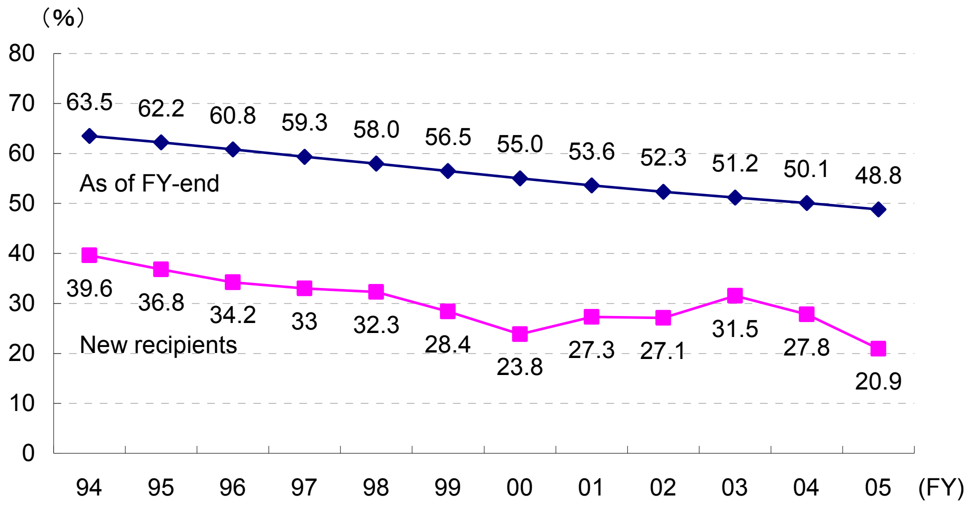
(3) Improving the early payment system

There would be no problem if the elderly can earn enough income until the pension eligibility age as a result of the government's measures to ensure their employment. However, it is essential to improve the"early payment" system as a way to secure income for those who retire early for health and other reasons.

Under the public pension system in Japan, the basic old-age pension is paid from 65. However, recipients can opt for early payment to receive benefits before that from age 60. In that case, however, the benefit is cut by 0.5 percent per month[4] according to the period and that reduced amount is paid throughout their lifetime.

The percentage of advanced receipt as of the end of FY2005 is 48.8 percent. Although the percentage for new recipients tends to decline year by year, which pushes down the percentage of overall early payments as of the end of every fiscal year, the percentage for new recipients has been rising slightly since 2001[5] (**Chart 8**).

Chart 8: Shifts in the percentage of early payment



Note: The chart shows the percentage of early payment of the national pension (old-age pension). This covers the recipients of the basic pension who are not entitled to the employee pension and the recipients eligible for the old national pension (excluding the five-year pension).
Sources: The Social Insurance Agency, The annual business report

This is due to the effect of the raised eligibility age for the fixed portion of the employee old-age pension as a special payment to 61 starting in FY2001.

When establishing an early payment system, the percentage of early payment depends upon the amount of reduction. To compare the rates of reduction in Japan, the US and Germany, the percentage is the more or less the same in Japan and the US, both 30.0

percent for a five-year acceleration. In Germany, on the other hand, the rate is 18.0 percent for the same period, a little lower than in Japan and the US (**Chart 9**). Lower reduction rates tend to stimulate early payment whereas high reduction rates would serve as a disincentive to opt for advance payment. The amount of reduction should be decided based on life expectancy and rates of yield. In any event, the rate of reduction must be determined carefully since a reduction rate leading to the rise of recipients opting for early payment could serve as an adverse effect upon pension finances and may also discourage the elderly from working.

Chart 9: Reduction rates in early payment plans in Japan, the US and Germany

	Years accelerated				
	1 year	2 years	3 years	4 years	5 years
Japan	6.0%	12.0%	18.0%	24.0%	30.0%
US	6.7%	13.3%	20.0%	25.0%	30.0%
Germany	3.6%	7.2%	10.8%	14.4%	18.0%

Note: In Japan, the rate is different for those born before April 2, 1941.
Source: Compiled by Mizuho Research Institute from various information sources.

(4) Expansion of private pension plans

Raising the pension eligibility age means scaling down the public pension plan after retirement. If so, private pension plans (corporate and personal) that can supplement the public pension program need to be expanded to guarantee security in old age. In the US, private pension plans are already widely used, and in the UK and Germany, new private pension plans are being designed with government backing.

One option for Japan is to newly establish a private pension system that is more accessible, or simply expand existing programs such as the defined-contribution pension scheme.

The scheme was introduced in 2001 as a new private pension plan that supplemented the public pension, for employees of small companies and the self-employed who were not covered by the defined-benefit corporate pension plan[6].

The existing defined-contribution pension scheme includes a corporate plan that companies introduce for their employees and a personal plan that individuals take out voluntarily. To look at specific measures to expand the scheme, one option for the corporate plan is to approve of matching contribution by employees—which is not allowed under the current system—to supplement the contribution by business owners. Another option is to raise the maximum amount of contribution.

Currently, the maximum amount of contribution is 23,000 yen per month if companies hold other corporate pension plans, and 46,000 yen if they don't. In some cases, however, even if they hold other corporate pension plans, the amount of supplemented benefits is small if they are covered by a comprehensive employee pension fund.

For the personal plan, currently it is only for company employees who are not covered by any corporate pension and the insured of the first kind of the national pension such as the self-employed. It could be expanded to company employees who are covered by other corporate pensions, or the maximum amount of contribution (currently 18,000 yen per month for employees) could be raised (**Chart 10**).

Chart 10: Plans to expand the defined-contribution pension scheme

		Current system	Expansion plans
Corporate plan	Contributors	・Business owners	・Approval of matching contributions by employees
	Maximum amount of contribution	・23,000 yen per month if there are other corporate pension plans ・46,000 yen per month if there are no other corporate pension plans	・Raising the maximum amount (Reference) The US 401k plan: the maximum amount is $15,500 per year (2007) – roughly 142,000 yen per month at an exchange rate of 110 yen/dollar
Personal plan	The eligible	・Category I insured persons of the national pension (the self-employed etc.), company employees not covered by other corporate pensions (note)	・Include company employees covered by other corporate pensions
	Maximum amount of contribution	・68,000 yen per month for Category I insured persons of the national pension (same as the maximum amount of the national pension fund) ・18,000 yen per month for company employees	・Raise maximum amount for company employees

Note: Employee pension fund, Defined-benefit corporate pension, Qualified employee retirement pension, Coal mining pension fund, Mutual aid pension for private school teachers and staff
Source: Compiled by Mizuho Research Institute

To see how things stand for the defined-contribution pension scheme, 9,418 companies have introduced the corporate plan (as of the end of Sept. 2007), which covers 2.49million people (preliminary figures as of the end of Aug. 2007), about half the number for the employee pension plan (5.25 million). On the other hand, the numbers of people covered by the personal plan are 35,116 for Category I insured persons (the self-employed, etc) and 51,112 for the Category II insured persons (company employees), totaling just 86,228 (as of the end of Aug, 2007). It has yet to spread among the self-employed or company employees who are not covered by any corporate pension.

In order to put the function of the defined-contribution pension scheme to full use as an option to help create funds after retirement, one task for the future is to review the feasibility of expanding the scheme to cover more people and raising the maximum amount of contribution[7].

5. Conclusion

What reforms are necessary to create a sustainable public pension system in Japan, with its falling birthrate and aging population? There is no easy solution. To date, there have been many initiatives to halt the plummeting birthrate but even if these initiatives produce the greatest results, their influence will be limited. They have no chance of dramatically turning around the future demographic structure and improving pension finances.

Nevertheless, since the public pension plays a hugely important role in life after retirement, to maintain the system into the future is crucial. The social security system including the public pension can take several shapes: from high-quality high-fee welfare, medium-quality medium-fee welfare to low-quality low-fee welfare. But given the conditions in Japan, it will be almost impossible to choose high-quality high-fee welfare that can cover all living expenses after retirement or low-quality low-fee welfare based on much less benefits than the present level. That is to say, the practical choice is medium-quality, medium-fee welfare services that can cover a certain degree of living expenses after retirement without placing an excessive burden on the younger generations. The chief measures to curb the amount of benefits that have been taken so far in the pension reforms are a five percent benefit cut in the portion proportionate to wages, curbing the rate of change in benefits[8] and raising the pension eligibility age to 65. As more and more people are expected to enjoy longevity in the future, to shorten the average eligibility period by further raising the pension eligibility age can be a highly practicable option to keep paying a fixed amount of benefits. Given that other nations where the level of aging is lower than Japan such as the US, the UK and Germany have already planned to raise the eligibility age to 67 and older, and that Japanese people's desire to keep working into their old age is stronger, it is not that unfeasible to raise the eligibility age to 67 or even later.

As stated earlier in this article, however, such comprehensive measures as to encourage employment for the elderly and to expand the private pension plans are vital to implement the raise. Also, since it should have a great influence on life after retirement, it is necessary to give enough time to complete the whole process after the raise is decided. Given these points, it is best to start considering the raise as early as possible.

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Notes

1 Citizens are eligible for the old-age pension (both fixed portion and the portion proportionate to wages) as a special benefit between the ages of 60 to 64. After 65, they are eligible for the basic old-age pension (national pension) and the employees' old-age pension (employee pension).

2 A household where the husband has served 40 years as a company employee on average earnings and his spouse has been a full-time housewife for the same period

3 An elderly household is defined in this survey as one composed of people aged 65 and older, or including unmarried children under 18.

4 This applies to those born on and after April 2, 1941. The receipt from 60 is subjected to a 30 percent cut. The percentage is different for those who were born before April 2, 1941. For instance, the receipt from 60 is subjected to a 42 percent cut.

5 In 2005, the percentage for new recipients takes a downward turn again.

6 Another reason for the introduction of the scheme is that, under the defined-benefit corporate pension plan, the portability of pension income when switching jobs is challenged.

7 Concerning the expansion of the defined-contribution pension scheme, Requests for tax reform by the Ministry of Health, Labor and Welfare 2008 adds the following proposals: 1) For the corporate plan, approve of contributions by individuals—as deductions from their income—within the limit of both the current maximum amount and contributions by business owners; 2) Allow employees of companies that hold other corporate pensions but not the corporate plan for the defined-contribution pension scheme to take out the personal plan; 3) Raise the maximum amount of contribution for the personal plan by employees of companies with no corporate pensions from the current 18,000 yen to 23,000 yen per month

8 After 65, the benefits will be linked to consumer prices instead of wages, and the macroeconomy-linked system will be adopted. They all help to curb the sliding rate.

- End -

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