

# **Shared Responsibility for Retirement Income: The Asian Perspective**

**by**

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# 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**

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**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**

# KNH Balance Sheet:

After the 2004 Reform

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)

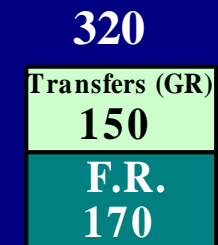
(Tr Yen)  
1,500

1,000

500

0

**Excess L : 420 Tr. Yen**



Assets



Liabilities

**Part One (PAST)**

(Tr Yen)  
1,500

1,000

500

0

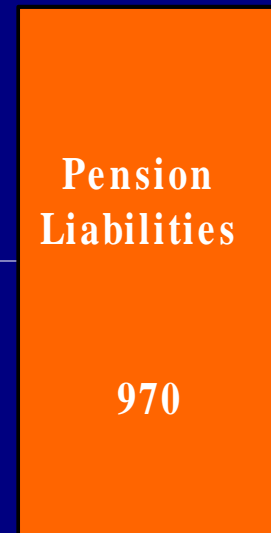
**Excess A : 420 Tr. Yen**

1,390



Contributions  
1200

Assets



Pension Liabilities

Liabilities

**Part Two (FUTURE)**

# Incentive-compatible?

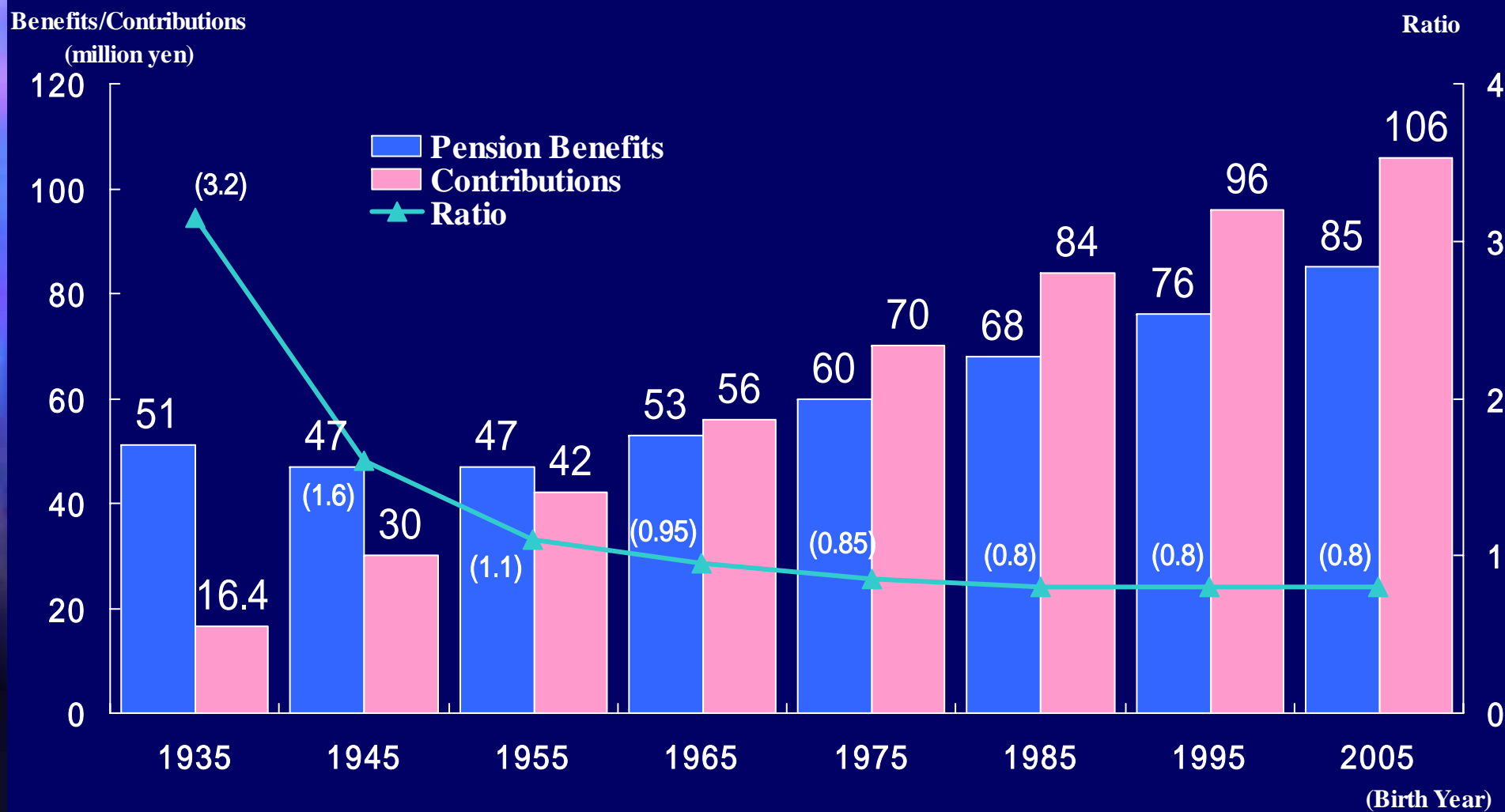
**Huge EA of Part Two imply that future generations will collectively receive pensions worth less than the contributions they will pay**

**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**

# Handling Legacy Debt in PRC

## 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



# Some Discussions (4)

## “Taste of Pie”

**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**

# No Single Solution (1)

## Assignment Problem

**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**

## No Single Solution (3)

**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**

## **Implications from Japanese Experience (1)**

**The majority of Japanese people have already recognized the gravity of SS financing issues. They can forgive and forget. Never-ending reforms of SS pensions are inevitable in Japan, where only fine-tuning of SS 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**

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