



Key findings

- Old-age poverty is still a challenging issue. The relative poverty rate of older people aged over 65 years is 19% against 12.5% on average in the OECD.
- Important pension reforms were legislated in Japan in 2016 to improve financial sustainability and increase pension coverage.
- The future net replacement rate from mandatory schemes for a full-career average-wage worker is 40%, lower than the OECD average of 63%. When including voluntary components, the replacement rate increases to 64% in Japan, slightly lower than the OECD average of 69%.
- While the normal retirement age in the OECD will increase from 64 to 66 years by about 2060, the normal retirement age will remain at 65 in Japan.
- Japan provides large bonuses and penalties to incentivise older workers to work longer.
- Combining work and pension is restricted in several countries including Japan. If older workers earn more than a certain amount, the pension benefit is reduced, inefficiently limiting flexible retirement.

Overview – Recent reforms and flexible retirement

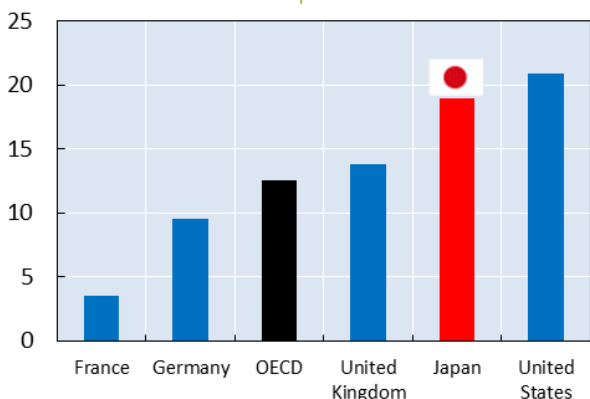
People aged over 65 years in Japan have an average income which is 11% lower than for the total population, similar to the OECD average. However, old-age poverty is still a challenging issue. Income poverty rate (percentage of people with incomes lower than 50% of the median household disposable income) of people aged over 65 years is 19%, compared to an OECD average of 12.5%.

Japan has been ageing fast. Among OECD countries, Japan has the highest life expectancy, especially for women, and the highest so-called old-age dependency ratio. Life expectancy at birth for women was 87.3 years in 2015-2020, and there were 46 individuals aged 65 and over for 100 persons of working age - between 20 and 64 - in 2015 against 13 in 1975, putting pressure on public spending. The trend is projected to continue with the old-age dependency ratio reaching 78 by 2050.

The very high level of government debt has put pressure on the pension system. As a result of successive pension reforms over the past decades in Japan, public spending on pensions is projected to decline slightly by 2050.

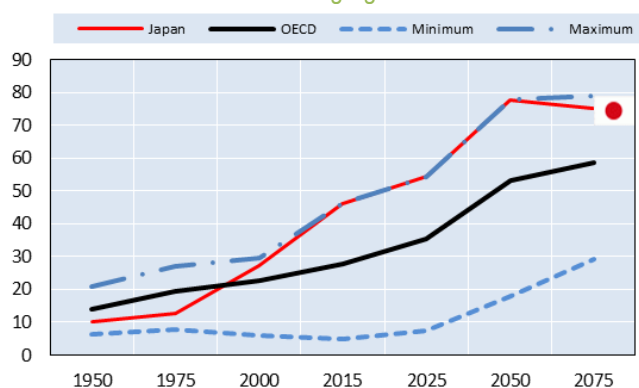
Japan introduced macroeconomic indexation scheme (the adjustment mechanism of pension benefits based on changes in the number of contributors and gains in life expectancy) in 2004. However, the government did not apply it when inflation was negative. Following the 2016 reform, deflation periods are included in the indexation rules through and a carry-over system (any unrealised benefit reduction because of a deflationary environment will be delayed in later years when the unused reduction can be applied with consumer price inflation) was introduced, which will be effective from April 2018. Furthermore, the wage/price indexation was revised. Pension benefits will be adjusted downwards when wage growth is negative from April 2021. In addition, mandatory pension contribution rate has been raised from 17.8% in 2015 (steadily up from 13.9% in 2004) to 18.3% in 2017.

Relative poverty rate of people aged over 65 is high
Percentage with incomes less than 50% of median household disposable income



Source: [Table 6.3].

Japan has the highest old-age dependency ratio
Number of persons aged 65 and over for 100 persons of working-age 20-64



Source: [Table 5.5].

Recent reforms in Japan have improved pension coverage as well. The minimum qualifying period for the old-age basic pension decreased from 25 to 10 years. In addition, Japan removed contribution restrictions to defined contribution schemes to allow contribution from non-working spouses, public-sector workers, and individuals currently covered only by private defined benefit plans from January 2017. It also extended the pension coverage of part-time workers who work at least 20 hours per week and earn JPY 88000 (i.e. 21% of the average wage) or more per month from April 2017.

Securing adequate incomes of older people is key as future old-age income prospects are weak. The future net replacement rate from mandatory schemes for a full-career average-wage worker is 40%, lower than the OECD average of 63%. When including voluntary components, the replacement rate increases to 64% in Japan, slightly lower than the OECD average of 69%.

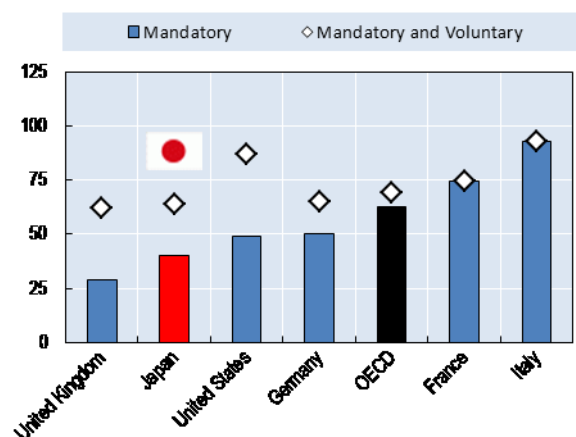
It is therefore critical to continue to achieve high employment rates among older workers. In Japan, work accounts for 39% of the income source of older people, well above 24% of the OECD average.

Over the past years, many OECD countries have been active reforming their retirement schemes. While the normal retirement age in the OECD will increase from 64 years in 2016 to 66 years by about 2060, the normal retirement age will remain at 65 in Japan.

Longer lives, the increasing diversity of work trajectories and the growing desire for more autonomy in the retirement decision are motivating calls for rules that allow individuals to decide when and how to retire. In Japan, people can choose to work longer with higher deferred pensions, to early retire with a pension penalty or to combine work and pension after the normal retirement age. Working and deferring pension increase pension levels significantly, and the large bonuses are actually costly for the pension system. In Japan, both the basic and earnings-related components are increased by 8.4% for each year of deferral; adding in the effect of extra contributions and indexation of pension in payments results in an overall increase of around 11.5%, which is the highest among OECD countries. On the other hand, retiring before the retirement age has a negative impact on annual total benefits of around 8%, more in line with actuarial neutrality. These bonus-penalty schemes provide large incentives for older workers to work longer in Japan.

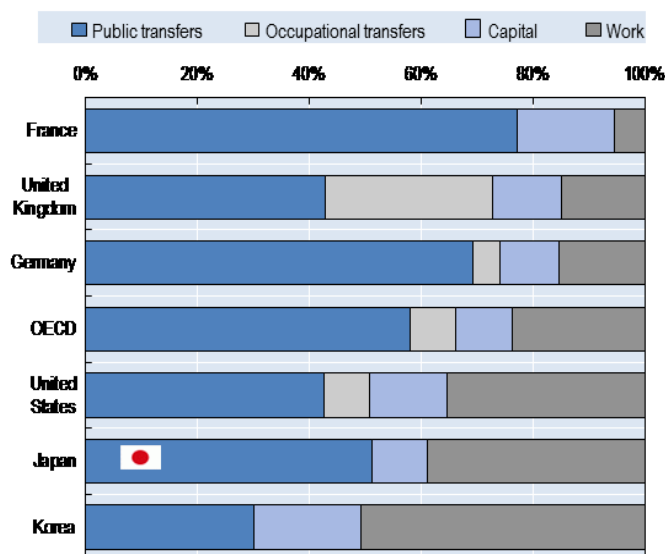
Although people can combine work and pension, there is an obstacle. If older workers earn beyond certain amount, the pension benefit will be reduced. For ages 60-64, when the total income of monthly pension and standard remuneration exceed JPY 280 000 (two-thirds of average earnings), pension benefits start to be reduced. For people older than 65, when the total income exceed JPY 460 000 (108% of average earnings), pension benefits starts to be reduced. These might be disincentives for the older workers to continue to work and obstacles to flexible retirement.

Replacement rates from mandatory schemes are below the OECD average
Net pension replacement rate, average earners, %



Source: [Figure 4.9] and [Table 4.11].

Work accounts for a large share of the income of older people in Japan
share of income sources of people aged over 65



Source: [Figure 6.2].