Ageing impact on pension spending has been relatively limited

Given low fertility rates since the 1990s, the size of the working-age population (aged 20-64) is projected to fall by 35% by 2060 compared to a decrease of 6% in the OECD on average. As life expectancy is the highest in the OECD, the number of people over 65 per 100 people aged 20-64 will be also be the highest in 2060. Rapid population ageing over the last decades is putting severe pressure on both financial sustainability and retirement income adequacy. Total public and private pension expenditure increased by 1.7% of GDP between 2000 and 2017, close to the OECD average Demographic changes alone are estimated to have directly raised pension expenditure by about 6.5% of GDP. Strong employment growth including through longer careers and reductions in the average pension benefit ratio offset more than half of the demographic impact.

Future replacement rates are low

Consistent with the fall of the average benefit ratio, the average income of people aged 66 and above is 15% lower than that of the total population, while it was 10% lower in 2000 and it is 12% lower in the OECD on average. The relative old-age poverty rate remains high: 20% of those aged 65 and over have incomes below half of median household disposable income. Future old-age income prospects from mandatory pensions are also weak, with a future net replacement rate of 39% for full-career average-wage workers against an OECD average of 62%. However, Japan has significant coverage of voluntary pensions, which may boost future pensions. During the pandemic, pension benefits were protected and future pension entitlements kept accruing, similar to most OECD countries. Low-income individuals, who were not covered by mandatory earnings-related pensions, could apply for a partial or full temporary contribution exemption to the basic pension.

Low future replacement rates from mandatory pensions
Net future pension replacement rates, full-career at average wage, %
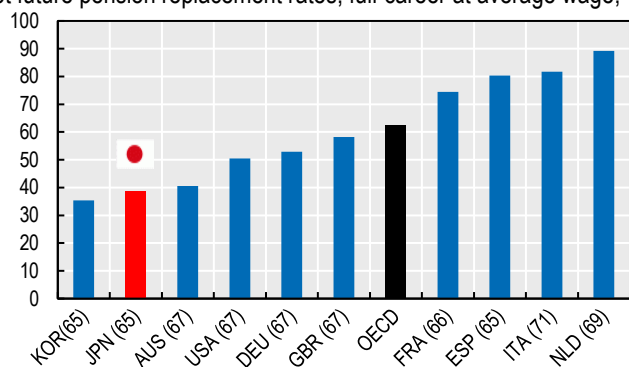
Source: **Figure 1.12**

Women are more at risk of old-age poverty than men, especially as in Japan there is a large difference between average pensions received by men and women. Women aged 65+ receive pension benefits that are on average 47% lower than men's, compared to 26% for the OECD average. About one-third of women work part-time – against one-fifth in the OECD – risking not being covered by mandatory pensions as working 20 hours per week and earning JPY 88 000 per month (20% of average earnings) are required.

Japan has been gradually expanding the pension coverage of part-time workers. Under the 2016 reform, coverage of mandatory earnings-related pensions was extended to those working at least 20 hours a week per month in large companies, rather than 30 hours previously. The 2016 reform only covered part-time workers in companies with more than 500 fulltime-employees and earning JPY 88 000 or more per month. In 2020, this was extended to companies with more than 100 fulltime-employees in 2022 and more than 50 in 2024. However, even after 2024, many part-time workers will not be covered by mandatory earnings-related pensions, as more than 90% of companies have less than 50 full-time employees in Japan.

The average labour market exit age is the highest in the OECD

Japan has the highest employment rate of older workers in the OECD, with 50% of 65-69 year-olds employed in 2020 compared to 23% on average in the OECD. The average age of labour market exit is the highest in the OECD, at 68.2 years for men and 66.2 for women. Yet, restrictions on combining work and pensions might act as a disincentive to continue working or at least an incentive to reduce work after age 60. In 2020, Japan decided to raise the total income threshold that reduces pension benefits JPY 280 000 to JPY 470 000 (109% of average monthly earnings) starting in 2022, but only for those aged 60 to 64.No change for those aged 65 and over is planned.

Japan has a large gender pension gap
Relative difference between men and women aged 65+ (among pension beneficiaries), %
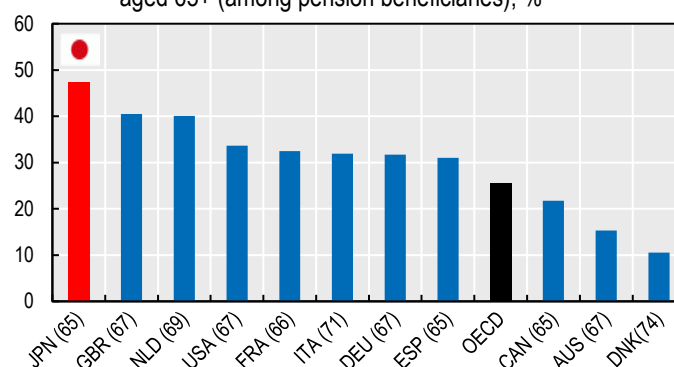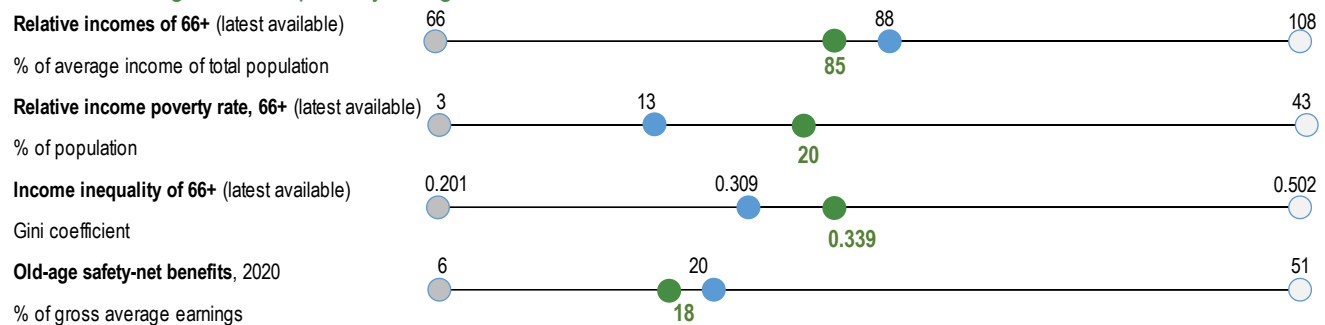

Source: **Figure 6.9**

"Macroeconomic indexation" help deal with ageing pressures

Japan introduced "macroeconomic indexation" in 2004, an automatic adjustment mechanism meant to improve pension financial sustainability given rapid population ageing, through an adjustment of pension benefits. The mechanism applies a correction both to price indexation of mandatory earnings-related pensions in payment and, for new pensions, to the uprating of past wages. Both are adjusted by the sum, if negative, of the growth rate in the total number of contributors to public pensions minus a factor that is in principle a proxy for life-expectancy gains at 65. This factor has been fixed at 0.3% since its introduction in 2004 based on long-term life-expectancy projections. By fixing the factor at 0.3%, it no longer accounts for uncertainties in changes in life expectancy. Indeed, 0.3% was about half of actual gains in life expectancy since 2004. Moreover, negative price inflation or negative wage growth limit the full application of the mechanism. The same indexation mechanism also applies to the basic pension.
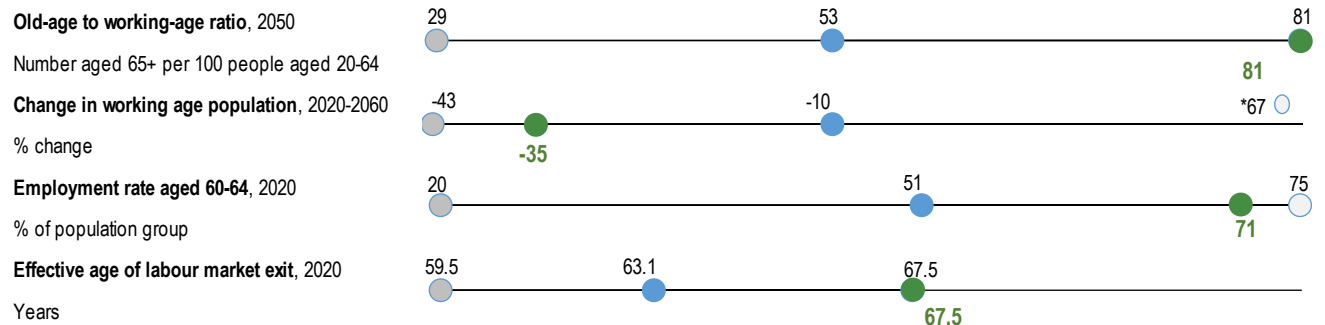
© OECD 2021

Given the sharp drop in the working-age population over the next decades, the "macroeconomic indexation" mechanism is expected to significantly reduce pension replacement rates over time. But Japan has a safeguard allowing for the suspension of adjustments if pensions would fall below a certain level of pension adequacy over the next five years. Based on baseline government's projections, the safeguard will not need to be used. "Macroeconomic indexation" ends if estimates suggest that financial sustainability is ensured over the long term. "Macroeconomic indexation" is activated separately for the basic and the mandatory earnings-related pension depending on separate financial assessments. Hence, the OECD pension model applies these

adjustments up to 2047 for basic pensions and up to 2025 for the earnings-related component, which overall lead to a reduction of future pensions for people entering the labour market now by 13%. "Macroeconomic indexation" thus improves financial sustainability of the pension system though reducing replacement rates. As in Japan, Estonia adjusts pension benefits to the size of the working population, but complements this measure with a retirement age linked to life expectancy. In Finland, the life expectancy coefficient adjusting benefits to changes in life expectancy is complemented with a link of the statutory retirement age to life expectancy.
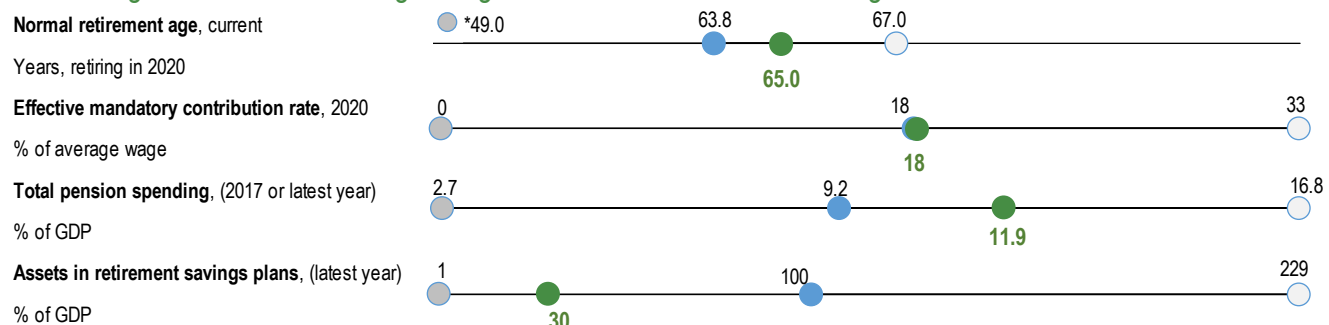
| | Japan ● | OECD ● | Min ● | Max ○ |

Relative old-age income poverty is high

Relative incomes of 66+ (latest available)
% of average income of total population
66 — 88 — 108 — **85**

Relative income poverty rate, 66+ (latest available)
% of population
3 — 13 — 43 — **20**

Income inequality of 66+ (latest available)
Gini coefficient
0.201 — 0.309 — 0.502 — **0.339**

Old-age safety-net benefits, 2020
% of gross average earnings
6 — 20 — 51 — **18**

High old-age employment help deal with fast ageing

Old-age to working-age ratio, 2050
Number aged 65+ per 100 people aged 20-64
29 — 53 — 81 — **81**

Change in working age population, 2020-2060
% change
-43 — -10 — *67 — **-35**

Employment rate aged 60-64, 2020
% of population group
20 — 51 — 75 — **71**

Effective age of labour market exit, 2020
Years
59.5 — 63.1 — 67.5 — **67.5**

The average labour market exit age is higher than the normal retirement age

Normal retirement age, current
Years, retiring in 2020
*49.0 — 63.8 — 67.0 — **65.0**

Effective mandatory contribution rate, 2020
% of average wage
0 — 18 — 33 — **18**

Total pension spending, (2017 or latest year)
% of GDP
2.7 — 9.2 — 16.8 — **11.9**

Assets in retirement savings plans, (latest year)
% of GDP
1 — 100 — 229 — **30**

Future replacement rates from mandatory pensions will be low

Normal retirement age, future
Years, starting career at age 22 in 2020
62.0 — 65.8 — 74.0 — **65.0**

Future net replacement rate, average earner
% of average wage
31 — 62 — 103 — **39**

Pension loss from 5-year unemployment
% of full career pensions, average earner
-12 — -6 — 0 — **-8**

Future net replacement rate, low earner
% of average wage for low earners
39 — 74 — 125 — **49**