Savings, Consumption and Real Assets of the Elderly in Japan and the U.S. — How the Existing-Home Market Can Boost Consumption

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1. Introduction

Attention on the savings behavior of elderly persons has been growing. The common perception that the elderly in Japan are excellent savers while their American counterparts dissave is only partially true — in reality, elderly Japanese households, most of whom are not working, have a negative savings rate of -6 percent. A major difference, however, is that elderly households in the U.S. draw down not only their financial assets but their real assets by moving into smaller owned or rented homes. What makes this possible is the robust market for existing homes in the U.S., where the frequency of transactions is ten times greater than in Japan. This paper compares the existing-home markets in the two countries, and considers what can be done in Japan to better satisfy the financial needs of elderly persons.

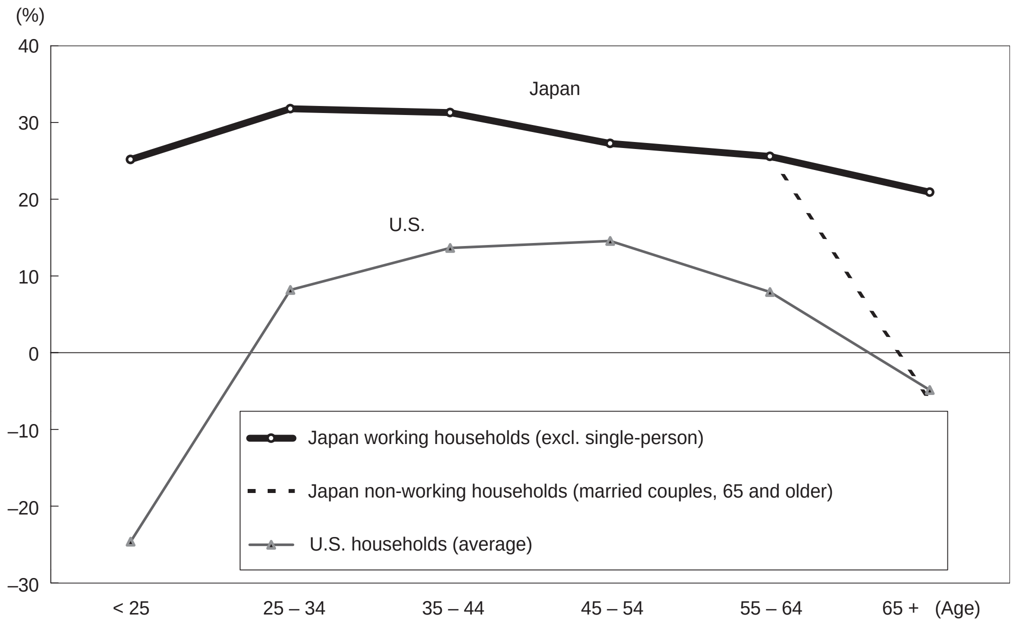
2. Japan-U.S. Comparison of Household Savings Rates by Age Group

We first compare savings behavior in Japan and the U.S.

(1) The Negative Savings Rate of Japan's Elderly

The life cycle hypothesis asserts that households accumulate savings in their working years when income is high, and then consume their savings after retirement. This hypothesis is often said to apply to the U.S. but not to Japan, where the savings rate remains high in old age.

Figure 1 Savings Rates by Age of Householder in Japan and the U.S. (1999)



Sources: MACA, *Annual Report on the Family Income and Expenditure Survey;* U.S. Dept. of Labor, *Consumer Expenditure Survey*.

Indeed, the savings rate remains above 20 percent for elderly *working* households aged 65 and older, which is not significantly lower than for younger age groups. On the other hand, the savings rate of *non-working* elderly households is –6 percent.

Figure 2 Proportion of Persons Aged 65 and Older (Japan 1999)

	Employed	Self-employed	Non-working
Individuals	9.8%	13.0%	76.8 %
Men	16.3%	17.9%	65.1%
Women	5.1%	9.5%	85.1%
Households	21.4%	13.9%	64.7%

Note: Non-working individuals is the sum of non-labor force population and unemployed persons.
Source: MACA, *Labor Force Survey* for data on individuals, *Family Income and Expenditure Survey* for data on households.

Among Japan’s population of persons 65 and older, 10 percent are still working, another 10 percent are self-employed, and the remaining 80 percent are non-working (out of labor force plus unemployed). By household, 65 percent of elderly households are non-working households. Thus most elderly persons have a negative savings rate.

(2) Elderly in U.S. Consume out of Real Assets

In addition to public pension benefits — their main source of income — the elderly also have interest and dividend income from financial assets, and allowances sent from family members. A negative savings rate means that consumption exceeds disposable income. The income shortfall must come either from realized capital gains or savings. Figure 3 estimates how the shortfall is augmented, and compares results for the U.S. and Japan.

Figure 3 Consumption Out of Assets in Households Age 65 and Over

(% of disposable income)

	Japan	U.S.
1. Dissaving rate (consumption – disposable income)	6.3	4.8
2. Dissaving rate from financial assets	5.6	–3.8
3. Dissaving rate from real assets	0.7	8.6

Notes: Data is for non-working married-couple households for Japan, and average of all households for U.S. Consumption out of real assets includes realized capital gains from financial assets. Negative value indicates increase in assets.
Source: U.S. Dept. of Labor, *Consumer Expenditure Survey;* MACA, *Family Income and Expenditure Survey (1999)*.

What emerges is the sharp contrast between elderly persons in the two countries. In Japan, elderly persons barely touch real assets such as housing and land, while those in the U.S. not only liquidate real assets, but also invest part of the proceeds in financial assets.[1]

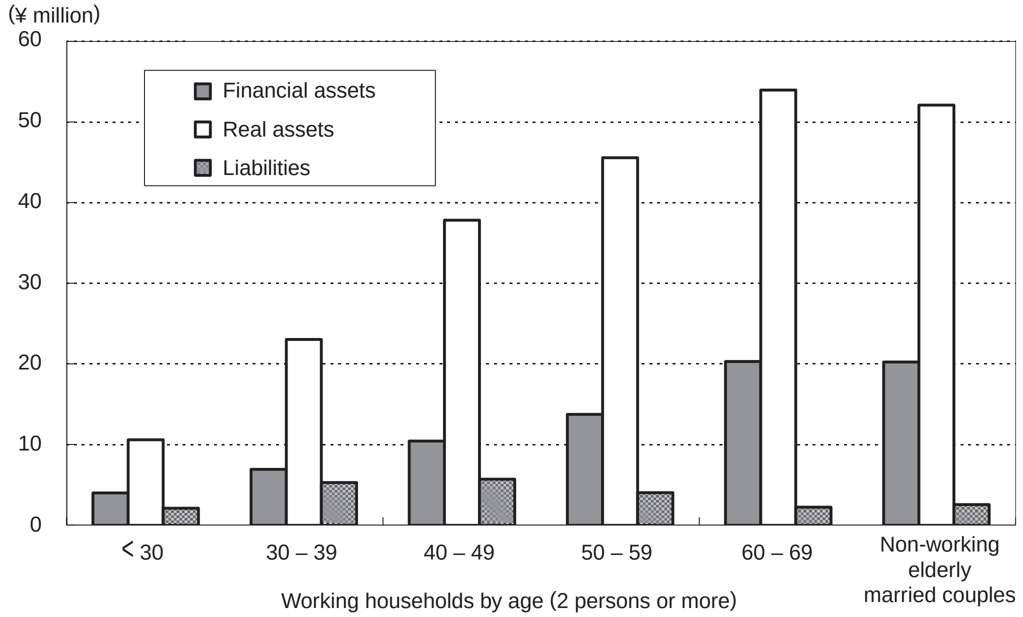
3. Japan-U.S. Comparison of Household Assets by Age Group

Next we compare elderly households in Japan and the U.S. on savings and consumption, and the amount being left as inheritance.

(1) Japanese Elderly Leave Behind at Least 20 Years Worth of Consumption

In Japan, the size of financial and real assets by age of householder peaks in the 60s age group. In addition, the amount of real asset holdings far exceeds financial assets for all age groups. For married-couple households age 65 and over, real asset holdings are 2.9 times net financial assets (financial assets minus liabilities), and 20.5 times annual disposable income.

Figure 4 Asset Holdings of Japan's Elderly Households by Age Group (1994)



Note: Includes only non-working married-couple households in which husband is at least 65 and wife 60.
Source: MACA, *1994 National Consumption Survey*.

After retirement, the elderly live by consuming out of both their assets (stock) and income (flow). Based on five years of data from 1995, the average non-working married-couple household aged 65 and above owns 8.2 times annual disposable income in net financial assets (financial assets minus liabilities), and consumes 6.3 percent more than disposable income each year.

Figure 5 Financial Assets and Consumption of Non-Working Households Age 65 and Over (as ratio to annual disposable income)

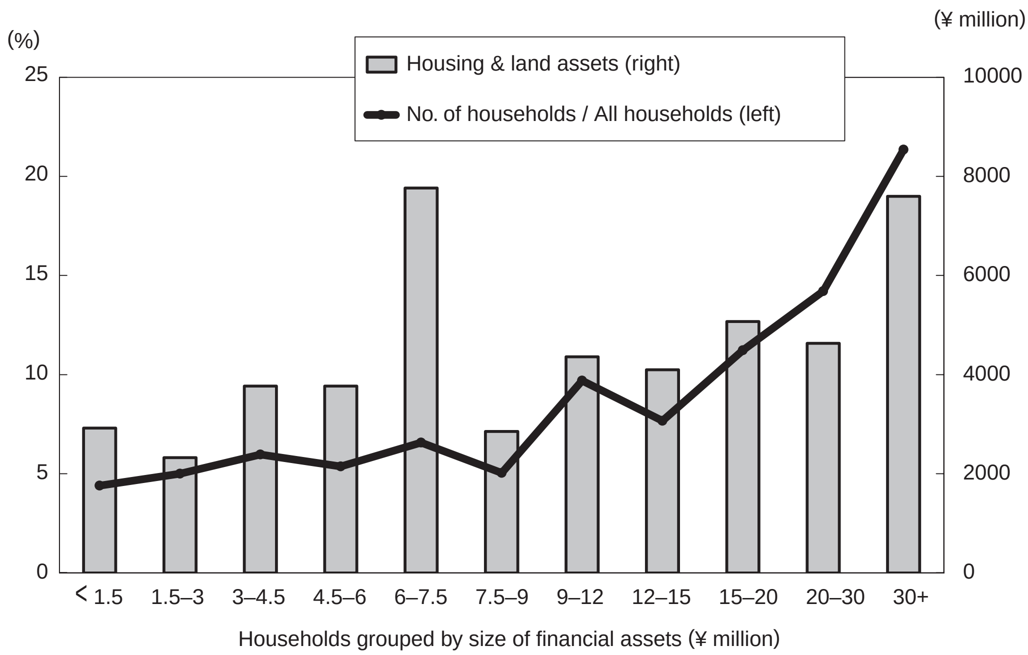
	Average	1995	1996	1997	1998	1999
Propensity to consume (%)	106.3	109.3	105.8	105.1	105.4	106.0
Savings rate (%)	–6.3	–9.3	–5.8	–5.1	–5.4	–6.0
Financial assets (multiple)	8.5	9.0	8.9	7.9	7.7	8.7
Liabilities (multiple)	0.3	0.3	0.3	0.2	0.3	0.2
Net financial assets (multiple)	8.2	8.7	8.6	7.7	7.4	8.6

Sources: Data on disposable income, consumption and savings of non-working elderly married-couple households are from MACA, *Family Income and Expenditure Survey;* financial assets data of non-working households age 65 and over is from *Survey of Savings Behavior*.

Supposing that the husband and wife live for 20 years after retirement, and consume the additional 6.3 percent out of their net financial assets, they would still leave behind financial assets worth 6.9 years of disposable income.[2] Moreover, real assets worth 20.5 years of disposable income would be left intact. Thus even if income drops to zero, they will still leave behind an estate equivalent to 25.8 years of consumption. In real life, of course, people need to save for contingencies such as illness and hospitalization. Even so, most of the assets accumulated over their working career is being left behind as an inheritance.

The size of financial holdings is widely distributed among elderly households. Whereas the average size is over 20 million yen, approximately 10 percent of households own less than 3 million yen. Consuming at the average pace — by dissaving 6.3 percent per year, which corresponds to 200,000 yen — they would deplete the 3 million yen in 15 years. However, even these households own real assets of over 26 million yen. If they could manage to reduce their consumption to three-fourths the average pace, they will be able to leave behind their real assets intact. Of course, the average elderly household will leave behind substantial financial assets in addition to all of its real assets.

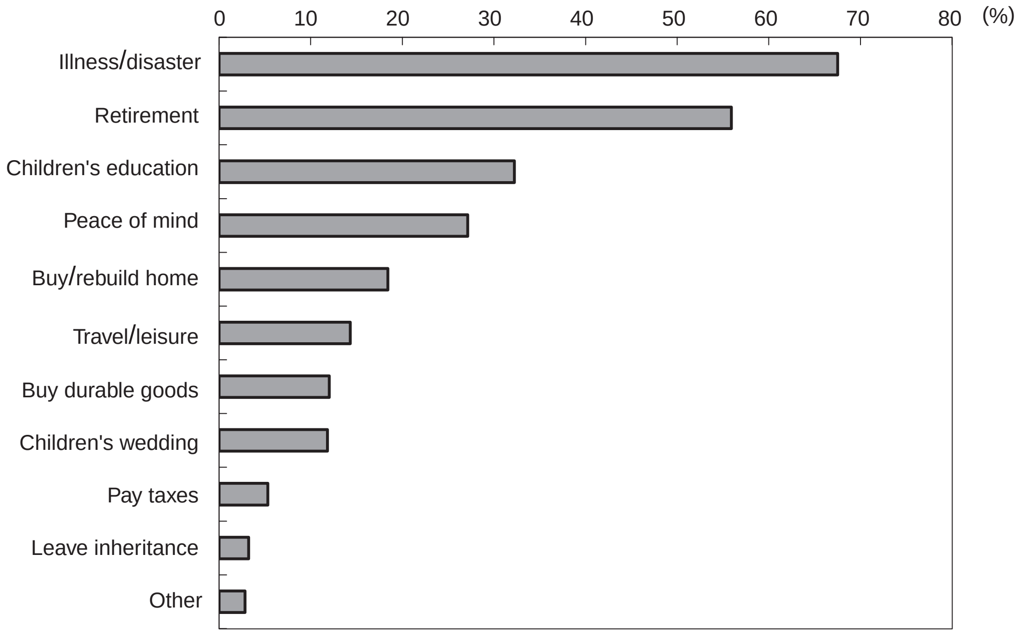
Figure 6 Real Assets of Non-Working Elderly Households — By Size of Financial Assets



Note: For married couples with husband at least age 65 and wife 60.
Source: MACA, *National Survey of Family Income and Expenditure (1994)*

The question then arises as to whether this savings behavior is intentional to begin with. According to a survey by the Central Council for Savings Information (*Opinion Survey on Savings and Consumption*, September 2000), the primary objectives of savings are to prepare for illness and disaster, followed by preparing for living expenses after retirement; leaving an inheritance is tenth on the list.

Figure 7 Objectives of Saving (up to 3 choices)



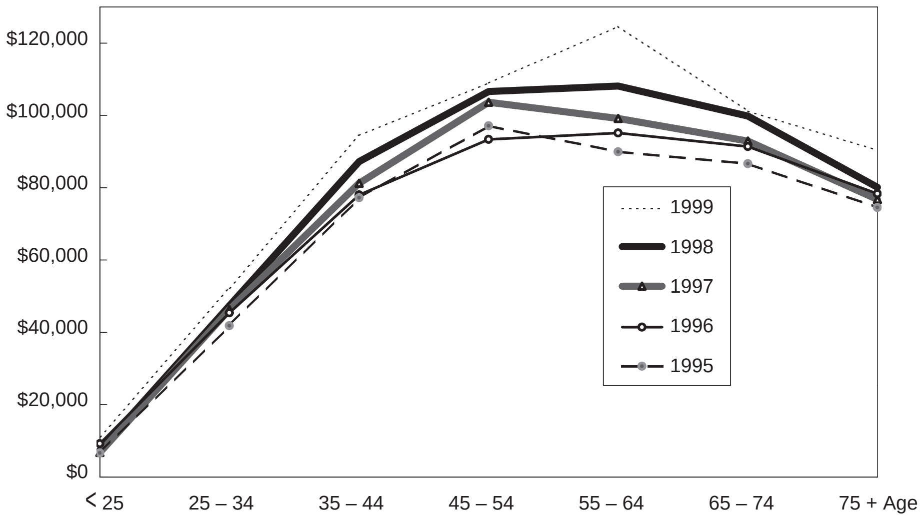
Source: Central Council for Savings Information, *Opinion Survey on Savings and Consumption,* September 2000.

In other words, inheritance appears to be largely an unintended consequence. Obviously, people need to prepare for future uncertainties with extra savings. But it would be very sad indeed if they are forced to leave behind most of their savings as large inheritances simply because they could not convert real assets into income. As for people's concern that they may outlive their savings, the use of lifetime pension insurance can alleviate the need to save. Once people feel secure enough to consume more, they will probably reduce the size of their unintended inheritance.

(2) Elderly in the U.S. Leave Behind the Equivalent of 5 Years of Consumption

According to the *Survey of Consumer Finances* (FRB, 1998), the median net assets (financial and real assets, minus liabilities) of the elderly in America are equivalent to 6.6 years of disposable income. Performing the same calculations as above on the assumption that consumption exceeds disposable income by 7.9 percent each year, we find that the elderly leave behind an inheritance equivalent to 5 years of consumption — which is only one-fifth that of Japan's elderly.

Figure 8 Market Value of Owner-Occupied Homes by Age of Household in the U.S.

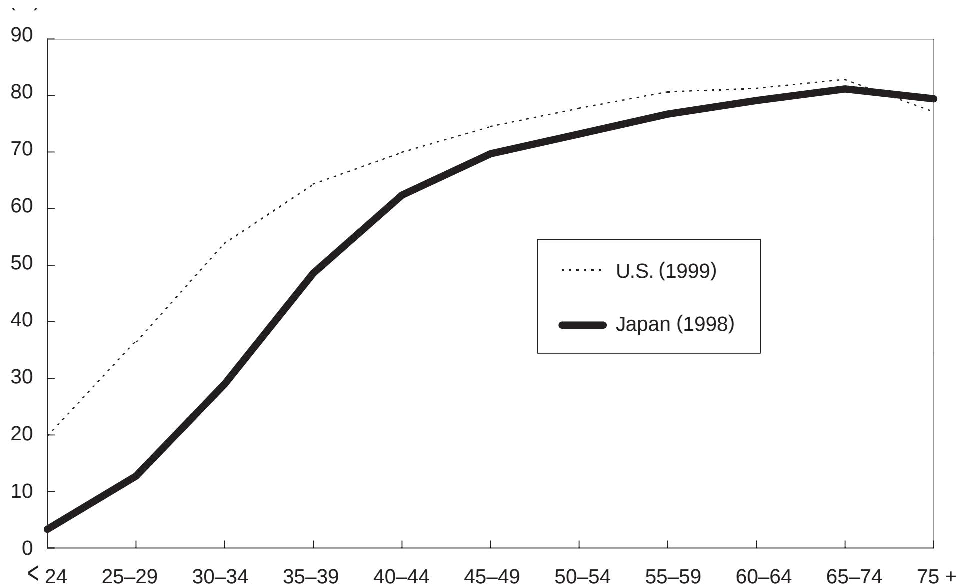


Source: U.S. Dept. of Labor, *Consumer Expenditure Survey*.

By age, the size of both financial and real assets generally peaks in the 50s. Moreover, the value of owner-occupied homes clearly declines from age 65. Since this pattern has not changed for the past 15 years, the decline cannot be attributed to variations in the date of purchase. As mentioned earlier, the direct cause is that the elderly are liquidating their assets to use for consumption.

However, the home ownership ratio in both Japan and the U.S. peaks in the age 65-74 group, and does not drop significantly thereafter. Taken together, the facts suggest that the elderly in the U.S. start moving into smaller, less expensive homes when they reach the age of 50.

Figure 9. Home Ownership Rates by Age Group in Japan and the U.S.



Sources: MACA, *Housing and Land Survey;* U.S. Census Bureau, *Housing Vacancy Survey*.

While real assets comprise 70 percent of total assets in Japan and 60 percent in the U.S., the elderly in the U.S. are better able to convert real assets into income and enhance consumption.

4. Existing-Home Markets in Japan and the U.S., and the Housing Needs of the Elderly

Below we examine the moving trends of the elderly in the U.S. and Japan, and how this relates to the housing market.

(1) Elderly Move One-Fourth as Often in Japan as in U.S.

Patterns of moving among the elderly in Japan and the U.S. show some similarities. First, moving rates among the elderly are lower than for other age groups. Second, moving rates of renter households are higher than those of owner households.

Figure 10 Moving Rates of Owner Households Age 65 and Over (%)

	Japan (1998)	U.S. (1997)
Owner households who moved	0.72%	2.90%
– to another owner-occupied home	0.45%	1.67%
– to rented home	0.26%	1.22%
Renter households who moved	3.75%	8.16%

Notes: Shows number of households who moved during period divided by number of households at end of period, annualized. Period is 1 year for U.S. and 4 years 9 months for Japan.
Sources: MACA, *Survey of Housing and Land;* U.S. Census Bureau, *American Housing Survey*.

In the U.S., however, the moving rate from owner-occupied home to either owner-occupied or rented home is 2.9 percent, which is four times greater than in Japan. This means that during a five-year period, approximately 15 percent of elderly households in the U.S. move for various reasons.

Housing needs change as people enter new life stages. After retirement, there is no need to live near the workplace, nor is a large home needed once children grow up and leave. Moreover, a spacious home is not necessarily the most comfortable for the elderly.

But without a housing market that can accommodate these changing needs over the life cycle, people will have great difficulty moving once they have grown old.[3] In Japan, the common pattern of home ownership is to become a first-time owner in one's 30s, and then to purchase a larger home in one's 40s or 50s; people rarely go in the opposite direction. Since social values appear to be converging with the U.S. in many respects — for example, the number of elderly living apart from their children has doubled in the last two decades to 45 percent, compared to 55 percent in the U.S. — the difference in moving patterns between Japan and the U.S. appears to be less a matter of different values than of differences in the housing market.

Figure 11 Percent of Elderly (Age 65 and Over) Living Apart from Children

	1980		1998	
	Japan	U.S.	Japan	U.S.
Live with children	73.1 %	—	54.9 %	44.3 %
Live apart from children	26.9 %	—	45.1 %	55.7 %
– with spouse	16.2 %	—	26.7 %	24.7 %
– alone	10.7 %	30.3 %	18.4 %	30.9 %

Source: MHW, *Basic Survey on National Life;* U.S. Census Bureau, *Current Population Report.*

(2) Japan's Existing-Home Market is One-Tenth as Active as in the U.S.

A comparison of existing-home markets in Japan and the U.S. reveals some important differences.

Figure 12 Existing-Home Markets in Japan and the U.S.

	Japan (1998)	U.S. (1998)
① Total housing units	26,468,000	117,282,000
② Existing-home purchases	116,000	5,589,000
③ ② ÷ ①	0.44%	4.77%
④ Housing starts	724,000	1,617,000
⑤ ② ÷ ④ (multiple)	0.16	3.46

Note: Includes owner-built and built-for-sale homes for Japan, and owner-occupied and rented homes for the U.S.
Sources: MACA, *Housing and Land Survey;* U.S. Dept. of Commerce, *Statistical Abstract of the United States*.

In the U.S., approximately 5 percent of existing homes are sold each year — 3.5 times as many as new homes. By comparison, less than 0.5 percent of existing homes are sold in Japan, or one-tenth the level of the U.S. Moreover, since one-fifth as many existing homes are sold as new homes, Japan's housing market is heavily weighted toward new homes. Thus a typical 40-year old home would have been sold twice in the U.S., and only 0.2 times in Japan.

The low activity level of Japan's existing-home market is due to the following major problems.

First, the market for rented homes does not function effectively as a substitute for existing homes. If homes could be bought and sold efficiently, then the following options would be equivalent: (a) buying a home, living there, and then selling after a certain period, and (b) renting a home for the same period of time. If the rental market had an abundance of attractive homes suited to the needs of each life stage, many homeowners would likely sell their home and rent instead. As a result, existing homes would compete in the market with rented homes.

However, due to land lease laws and rent laws, rented homes have consistently been smaller and inferior to owned homes over the years.

Figure 13 Relative Size of Rented Homes in Japan and the U.S.

	Japan (1998)	U.S. (1997)
Owner-occupied home	123 m^2	164 m^2
Rented home	44 m^2	115 m^2
(rented / owner-occupied)	36%	70%

Note: Shows mean values for Japan and median values for U.S.
Source: MACA, *Housing and Land Survey;* U.S. Census Bureau, *American Housing Survey.*

The second problem concerns the tax treatment of home purchases. For example, in 1999 and 2000, homebuyers who took out loans became eligible for up to 5.875 million yen in tax credits over 15 years; this was revised to 5 million yen over 10 years in 2001. Thus a loan for 60 percent of the purchase price saves the homebuyer approximately 6 percent.[4] However, homebuyers must also pay a real estate purchase tax, registration and license tax, consumption tax, and recurring property tax. Thus despite the tax credit, purchasing and holding costs for housing and land are still higher than for financial assets.[5]

On the other hand, real assets are advantageous to financial assets with respect to assessment for the inheritance tax. These characteristics of real assets — disadvantageous for purchasing and short-term holding, but advantageous for inheritance purposes — impede transfer of ownership except by inheritance even for the finest and most convenient homes.

Figure 14 Tax Measures Proposed for Home Purchase and Ownership in 2001

	Tax rate	Special provisions for new homes	Provisions for existing homes
Additional expenses			
Real estate purchase tax	3.0%	¥12 million deduction from tax base	Deduction according to time of construction
Registration & license tax (new home)	0.6%	0.15%	None
Registration & license tax (existing home)	5.0%	0.30%	Same as for new home
Consumption tax	5.0%	–	Same tax rate as for new home (transactions between individuals are tax exempt)
Property tax	1.4%	Tax amount reduced 1/2 (3 years for ordinary homes, 5 years for medium & high rise)	None
Preferential measure			
Income tax credit		1% of outstanding loan of up to ¥50 million (for 10 years)	

Note: Stamp duty varies with value of home and is thus omitted.

Third, given the shortage of buyers and sellers, and lack of accurate quality assessments for existing homes, it is difficult to obtain fair prices for properties. In any resale market, buyers have less access than sellers to detailed information on quality. Unless some form of quality guarantee exists and parties can be held accountable, high-quality properties are not likely to become available on the market in significant quantities.

Presently, existing home prices are set based on comparable transactions and market conditions, and quality assessments and disclosure methods are left up to real estate agents.

(3) Existing-Home Market Holds Key to Reverse Mortgages

The present tax system favors sellers over buyers of existing homes, as seen by the capital gains tax exemption of 30 million yen for sellers. Nonetheless, the elderly cannot readily sell their homes unless they can find buyers and receive a fair price. The efficient functioning of the existing-home market is thus crucial for the elderly to take advantage of their real assets.

This problem also explains why reverse mortgages are not used more often than they are. A reverse mortgage is a contract to receive cash installments while one is alive in exchange for transferring home ownership at the time of death. For the elderly, who own ample assets but need current income, it is a very sensible method to secure income for living expenses. Nonetheless, reverse mortgages are being impeded by the underdeveloped existing-home market.

In the U.S., where the existing-home market is considerably more liquid, people have the choice of selling their home — that is, converting real assets easily into financial assets — or using a reverse mortgage.

(4) Measures to Invigorate the Existing-Home Market

In a report entitled “Housing and Land Policies to Support a Prosperous Life in the 21st Century” (June 2000), the Housing and Land Deliberation Council proposed the following measures to invigorate the existing-home market. A fully functioning performance labeling system for new homes has already been initiated as of last October.

1. Develop a performance labeling system for existing homes that accurately reflects maintenance and reform conditions.
2. Create a registration system for condominiums.
3. Standardize methods for providing performance assessment and property history information.

In addition to these measures, tax reforms are needed to reduce taxes on housing and land transactions to a level comparable to that of financial products.[6]

5. Conclusion

In sharp contrast to the elderly in America, who enjoy their wealth while alive, Japan’s elderly leave behind assets equivalent to 20 years of consumption. This would not be a problem if they were doing do so voluntarily. But it would indeed be sad if they are somehow being prevented from consuming more of their wealth.

From the perspective of financial security after retirement, Japan’s elderly do not enjoy an environment in which they can effectively take advantage of their wealth. That is, they are not truly free to choose to consume more of it. For greater freedom, what the elderly need is an invigorated market for existing homes, one in which working generations can participate fully. The more methods that are available for tapping into their real assets, the more securely can the elderly expand consumption and enjoy life.

Notes

(Names of Japanese government entities are current as of December 2000.)

1. For the 1995-99 period, consumption exceeded disposable income by 7.9 percent, of which consumption out of financial assets accounted for -1.3 percent, and consumption out of real assets accounted for 9.3 percent.

2. Under the assumptions that the husband lives 15 years after retirement and the wife another five years, and that after the husband's death income declines to 50 percent and consumption to 60 percent, the household will leave behind 6.6 years worth of disposable income in financial assets.

3. According to a study by the Ministry of Finance Policy Research Institute (*Decline in Children, Aging, and Prospects for the National Economy and Society*, November 2000), half of elderly households live in large homes with at least 100 square meters of floor space.

4. Cost of capital refers to the opportunity cost of purchasing a home, including taxes.
   Cost of capital = (Real interest rate + Housing depreciation rate)
   × (1 − Cost savings effect + Effective real estate purchase tax rate)
   + Effective property tax rate

   Assuming a 3.5 percent real interest rate, and 6.5 percent housing depreciation rate, a 6 percent cost savings effect reduces the cost of capital by 0.6 percent.

5. Assuming a tax base of 0.7 of market value, for a ¥30 million home, the real estate purchase tax is ¥270,000, and the registration and license tax is ¥31,500. Add to this a ¥15,000 stamp duty and ¥1.5 million consumption tax, deduct the cost savings of ¥1.8 million, and the increase in tax burden amounts to ¥16,500. However, there is also a 3 percent commission paid to real estate agents. Moreover, compared to the effective property tax rate of 0.98% (= 1.4% × 0.7), the tax burden on savings interest income is 20 percent of the interest rate. Thus if the interest rate is below 4.9 percent, the tax burden of ownership is heavier for housing than for financial assets.

6. The Research Group on Revising Land Taxation to Reflect Structural Changes in the Economy and Society (Ministry of Construction, October 2000) proposed neutralizing taxation, including the capital gains tax.