Public Pension

On the Possibility of Pension Revision in 2009

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In the past, the public pension system was revised at least once every five years based on a "financial recalculation" and census projections. But the 2004 pension reform introduced a new "financial verification" process starting in 2009, and decoupled census projections from pension revision. As a result, there is a view that pension revision will be unnecessary in 2009. However, we argue that mounting pressures from the 2004 reform will compel revision.

Based on the October 2005 national census, the Ministry of Health, Labor and Welfare released a census projection in December 2006. In the past, the census projection was instrumental to the financial recalculation of the public pension, a process conducted at least once every five years to revise the contribution-hike plan, benefit multiplier, and pensionable age. But the 2004 pension reform has made it uncertain whether the census projection will lead to pension revision in 2009.

The 2004 pension reform introduced several important changes: (1) contribution hikes will be fixed (fixed contribution method); (2) benefits will be adjusted automatically under new rules (macro-economy indexation); (3) financial recalculation will be replaced in 2009 by a financial verification process, which will determine whether to end the macro-economy indexation of benefits; (4) if projected benefits fall below the minimum guaranteed level in the five-year period to the next financial verification, further reforms will be considered. As a result of these changes, when the new census projection is applied in the 2009 financial verification, projected benefits will likely exceed the minimum benefit guarantee in next the five-year period to 2014. Thus in one view, pension revision will be unnecessary in 2009.

However, we take the opposite view, and argue that pension revision will be necessary for the following four reasons. First, pension rules for non-full-time workers are expected to change. Currently, participants in the Employees' Pension and Mutual Aid Pension plans (Category 2 insured persons) must have a stable employment relationship in which "scheduled work hours per day or per week, and scheduled work days per month, are at least three-fourths that of regular employees." Assuming a normal 40-hour work week, this puts the threshold level at 30 hours per week. All other persons aged 20–59 who do not belong to Category 2 are classified as either Category 3 or Category 1—dependent spouses of Category 2 participants

Exhibit 1 Proposed Change in Public Pension Participation

○ Now

<table>
<tr><td rowspan="2">Annual income</td><td colspan="2">Scheduled work hours・days compared to regular workers</td></tr>
<tr><td>< 75%</td><td>75% +</td></tr>
<tr><td>Less than ¥1.3 million</td><td>Category 3</td><td rowspan="2">Category 2</td></tr>
<tr><td>At least ¥1.3 million</td><td>Category 1</td></tr>
</table>

○ Study Group proposal

<table>
<tr><td rowspan="2">Annual income</td><td colspan="2">Scheduled work hours per week</td></tr>
<tr><td>< 20</td><td>20 +</td></tr>
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</table>

Note: Category 3 refers to dependent spouses of Category 2 insured persons. All other insured persons fall under Category 1. Category 1 insured persons may be eligible for a 50% or 100% exemption on contributions.

belong to Category 3 if their annual income is less than ¥1.3 million; and anyone not in either Category 2 or 3 belongs to Category 1. In a June 2003 report, the Study Group on Employment and Pensions (chaired by the head of the Pension Bureau of the Ministry of Health, Labor and Welfare) proposed lowering the hurdle for the Employees' Pension so that employees could participate with "at least 20 scheduled work hours per week, or else an annual income of at least ¥650,000." In doing so, the Study Group cited the aim of enhancing social security benefits for non-full-time workers, and making the pension system more neutral with respect to employment type. The Study Group estimated that the proposed change would increase the ranks of Category 2 participants by as many as 600,000 persons from Category 1, and 3.4 million persons from Category 3 (Exhibit 1).

Although put forward in the 2004 pension reform debate, this proposal was defeated by strong opposition from retail and other industries, who rely heavily on part-time workers. However, under a supplementary provision of the 2004 law, "Five years after the law takes effect, a comprehensive examination shall be made, and necessary actions taken based on the results." This provision strengthens the argument for pension revision in 2009.

Second, we see some form of revision in store when the fragmented public pension system is unified in the future. The 2004 law contains a supplementary provision mandating the study of unification, and the Cabinet approved a basic policy in April 2006. But while the policy calls for gradual unification of Employees' Pension and Mutual Aid Pension contributions and benefits, it does not project future pension finances. The 18.3% final contribution rate and minimum benefit guarantee (50% income replacement rate) established by the 2004 law are premised on the pension system prior to unification, and deemed achievable under the standard scenario. Thus it remains unclear whether these levels can be achieved after pension unification. Advocates argue that because the next financial verification must address pension unification, contribution and benefit levels will be put up for debate once again, thus increasing the possibility of revision.

Third, it is possible that the pensionable age will be raised. Based on decisions made in the 1994 and 2000 revisions, the pensionable age is now being gradually raised to 65. Meanwhile, other countries with less advanced population aging than Japan have already—or are now considering—raising the pensionable age to 67 or 68 (Exhibit 2). This suggests that Japan may later need to follow suite. Notably, while the 2004 reform set out rules for contributions and benefits, the pensionable age was not addressed—perhaps intentionally, as an adjustment valve for future pension finances.

Exhibit 2 Pensionable Age in Other Countries

U.S.	Pensionable age will increase in stages to 67 by 2027 (was 65)
Germany	Now 65; Cabinet has approved raising the pensionable age to 67 by 2029
U.K.	Now 65 (pensionable age for women will increase in stages); government proposes to raise the pensionable age to 68 by 2050

Note: Shows standard pensionable age; start of benefits may be early or delayed start of benefits

Fourth, the 2004 law poses a potential problem by stating: "In the five-year period to the next financial verification, if benefits are projected to fall below the minimum guaranteed level, reforms shall be considered." The problem is that five years is not enough advance notice to avert this contingency. Discussion needs to start as soon as the contingency becomes evident.

As things now stand, the outlook for a pension revision in 2009 remains clouded. Going forward, the focus will be on how the above problems, left over from the 2004 reform, will be addressed—or postponed again.