*Column3*

# The Public Pension System in Japan

Retirement income security in Japan is supported by a universal public pension system, established in 1961 and restructured in 1985. This is a two-tier mandatory scheme, financed on a pay-as-you-go basis.

### *1st tier: Basic Pension (Mandatory)*

#### *Contributions*

The Basic Pension, "Kiso Nenkin," requires "flat-amount" contributions from all residents aged 20-59. The monthly per person contribution of 14,690 yen (as of April 2009) will increase annually until 2017 when it will reach its upper limit (16,900 yen). Contributions can be reduced for low-income individuals.

#### *Benefits*

Individuals with a minimum of 25 years of contributions are eligible to receive old-age benefits at 65. The full amount, approximately 66,000 yen as of April 2008, requires over 40 years of contributions. Kiso Nenkin also provides benefits for disability and surviving dependents.

### *2nd tier: Employer-based Pension (Mandatory)*

The second tier, called the Employee Pension Insurance (EPI) for private-sector employees and the Mutual Aid Association (MAA) for public-sector employees, comprises employer-based schemes with "earnings-related" contributions and benefits.

#### *Contributions*

As of September 2008, the contribution rate for EPI is 15.35% (this includes the contribution for the Kiso Nenkin portion). EPI will increase annually until 2017 when it will reach its upper limit (18.3%). Contributions are equally shared between employers and employees.

#### *Benefits*

Benefits vary according to the income level and contribution period. As of April 2008, an individual with an average income and 40 years of contributions can receive a monthly benefit (including Kiso Nenkin portion) of approximately 167,000 yen. The entitlement age, currently being raised from 60 to 65, varies according to the beneficiaries' birthdays. EPI and MAA also provide benefits for disability and surviving dependents.

### *3rd tier: Corporate pensions and others (Optional)*

In addition to the mandatory tiers, some form of corporate pension plan, usually defined benefit pension plans, are provided for most employees.

Japanese corporate pension plans have evolved from retirement severance pay packages, but many companies still provide both corporate pensions and lump sum severance. The self-employed can voluntarily participate in the tax-preferred "National Pension Fund Scheme."

### *Challenges*

The 2004 reform introduced a unique financial mechanism called "Macro-economic Adjustment" to stabilize the system faced with rapid demographic change. This mechanism automatically adjusts benefits to compensate for a changing demography by offsetting two factors: (1) the decline in the number of active participants and (2) the increase in longevity. Under this system, the replacement rate (i.e., the ratio of the post retirement earnings to pre-retirement earnings), currently about 60%, can be reduced to its lower limit of 50%. The 2004 reform also increased the subsidy rate from general revenue from the current 1/3 to 1/2 by 2009. However securing tax revenues for this subsidy increase will be a major political agenda item in the next few years.