PENSION SYSTEM IN JAPAN: ISSUES FOR REFORM

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Abstract. The aim of this article is to define the actual construction of the Japanese pension system influenced by the economic and social challenges and implemented pension system reforms. In this article, the development of Japanese pension system reforms is analysed, as well as legal, economic, social environment is identified.

Until recently, it was a common perception that Japan has managed economic success without worsening the income inequality and pension benefits, but since the economic recession in the 1990, the Japanese pension system faces a new challenge. Moreover, the Japanese population is ageing rapidly (low birth rate, long life expectancy), therefore, ageing influences the entire society and requires more complex and pressing pension system reforms.

Analysis of scientific literature, legal acts, documents, historical methods was used. It may be used as methodical literature studying the actual processes in the field of the pension system reforms in Asian countries.

Keywords: pension system, reform, crisis, ageing, Japan.
Introduction

The exclusivity of the Asia-Pacific region hides the fact that in this region the world’s largest population is concentrated, the rapid increase of older population growth is expected, life expectancy is increasing, but the fertility rate is decreasing. Ageing in this region will be at its most rapid between 2010 and 2030. Given the long lag in pension-policy planning, there is now a narrow window for many Asian economies to avoid future pension problems.\(^1\) Japan is also confronting with the global economic downturn, but the Japanese pension system, however, can be identified as a welfare state pension system (in comparison to other Asian countries).

Design of the pension systems in Asia and the Pacific region is sufficiently heterogeneous: pension systems in Japan and South Korea are the closest to the continental European model (with some elements of the Southern European model) or to the liberal model (the first pillar - universal pension), pension schemes in Hong Kong - a classic three-pillar pension system (first pillar - the pay-as-you-go social security pension; the second pillar - occupational pensions system; the third pillar - voluntary pension savings), in Taiwan - defined contribution compulsory occupational pension scheme; in Singapore and Malaysia - a compulsory savings system in the provident funds, the essential element of pension organisation in Chinese People’s Republic is state social insurance pensions, in Australia and New Zealand we could identify the liberal model (with a certain exclusivity). However, this region is different with regard to the level of economic development: in industrial countries (Japan, S. Korea, Australia, New Zealand) pension coverage and benefits are higher, other countries (India, Pakistan, Sri Lanka) are characterised by high unemployment and relatively low pension coverage.

New economic and social trends encourage the countries of this region to reform their pension systems. The World Bank report on the Asia-Pacific pension systems indicates the need to reform pension systems in order to avoid European mistakes: it is necessary to expand the scope of the system, to reduce an early retirement, to promote savings in private funds (which is actually not sufficient) and to index pensions by life expectancy formula.\(^2\) Pacific Economic Council notes the following Asian countries’ pension system policy trends: a population ageing, expansion of atypical employment relationships, the need for the pension accumulation system, increasing of pension coverage, growing industrialisation and urbanisation (it requires extra income for persons living, higher costs for health care and pension income) and increasing demand for cross-border social security agreements (because of the migration of workers).\(^3\) International Social Security Association emphasises that people use early retirement pension schemes, the Asian and Pacific countries pension coverage is relatively low, and the actual pension amount is not index-linked according to the standard of living.\(^4\)

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Thus, the international organisations identified the essential social security reform strategies in the Asian region: to prolong the active working life, to ensure the security of personal income from inflation, to review models of income redistribution, to ensure protection against poverty, to ensure the financial sustainability of pension systems and to ensure labour market efficiency.

Financial sustainability and growth of the public debt is a problem not only in the Asian region but also in Europe or in USA. In particular, we could note a significant public sector debt in Japan: according to the OECD (Organisation for Economic Cooperation and Development) data, the public sector debt in Japan reached 198 percent of GDP (in 2010), which was much more than the USA (93 percent of GDP), United Kingdom (81 percent of GDP), France (92 percent of GDP) and more than in Greece (129 percent of GDP). Japan’s debt started increasing since 1990 because of the reduction in asset prices. Despite government efforts to achieve the fiscal consolidation, the level of debt did not decrease, but also significantly increased. Until recently, it was a common perception that Japan has managed economic success without worsening the income inequality and that Japan’s poverty rate is one of the lowest among the developed nations, but since the economic recession in the 1990, there has been a fierce debate on whether or not Japan’s so-called equality is a myth.

The need to strengthen the pension system and seeking for the financial sources in Japan is related to the other global world economic crisis (Asian financial crisis in 1997–1998 and world economic crisis in 2008), as well as the spread of atypical employment relationships, the growth of self-employment, the increasing of the migration of workers, the need to strengthen pension system management, low incentives to participate in the private voluntary pension accumulation funds and mistrust of people in pension system. The Japanese population is ageing rapidly (low birth rate in the 1990, long life expectancy). Ageing influences society and requires more difficult and more pressing reforms of the pension system in Japan. Of course, the Japanese government is looking for new ways to stop pension system deficit growth, not only by reducing benefits or increasing contributions, but trying to change other pension system parameters. For example, in 2004 a modified indexation (automatic change in the pension amount, depending on the demographic processes) has been introduced, the minimum pension has been established, the retirement age has been extended and so on. Social and economic changes in Japan require not only a comprehensive pension system reform, but reforms in other related areas (fiscal policy, labour market, management and capital markets).

1. Economic and Social Assumptions for the Pension Reform

Analysis of recent pension reforms shows that today pension systems are more vulnerable to the economic shocks and shifted part of financial and economic risks on


individuals. However, we should emphasize that over recent decades most of the reform debates were implicitly analysed on the basis of the perceived or real need for financial stabilisation and not on social stabilisation. Social stabilisation implies that pension levels are not allowed to fall below a certain minimum benchmark—for example article 65 (1) of International Labour Organisation Convention 102 requires a pension to be at 40 percent of the total of the previous earnings of the beneficiary after 30 years of service.

Social expenditure for pensions in Japan is rising: in 1970 it was only 1.1 percent of GDP, but in 1990 it was already 5.3 percent of GDP and in 2005 it was 9.2 percent of GDP. Forecast show the same trend for pension expenditure: in 2015 the level of pension expenditure will amount to 9.5 percent of GDP. After implementing reforms (raising the retirement age, raising the level of contributions, decreasing the level of pension benefits), in 2025 the level of pension spending will decrease by 8.3 percent of GDP. In 2006, the level of tax (personal income, corporate income, consumption, property) and the level of social insurance contributions in Japan was the smallest (27.9 percent of GDP), compared to France (44.2%), Germany (35.6%), Sweden (49.1%), United Kingdom (37.1%) and USA (28%).

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The average net pension amount (excluding private pensions) in Japan is about 39.7% of a person’s former salary (average of OECD countries - 50%). However, Japanese people under the age of 65 have lower incomes than the average of OECD countries: about 14.9% (OECD average is 10.6%).

The level of social security contributions in Japan (for people working in a company under a contract of employment) in 2010 was 15.4% (contributions are paid in equal parts by the employee and the employer and the maximum contribution limit is fixed in the law), while the OECD average was 19.6%.

Japanese pension system accumulates a reserve. In 2009, 25.2% of GDP was accumulated in Japan’s pension reserve (in OECD countries – 67.6% of GDP).

Japan, as well as other industrial countries is facing ageing processes. In 1975-1980, the fertility rate in Japan was 1.83 children per woman (OECD average – 2.26). In the period of 2005-2010, the fertility rate fell to 1.27 (average of OECD – 1.69), but in 2050 the fertility will increase up to 1.6 (average of OECD – 1.8).

Japan’s life expectancy (at the retirement age) in 2010 was 19.8 years for men (OECD average – 18.5 years). Meanwhile, life expectancy for women in Japan was 26.7 years (OECD average was 23.3 years). According to the demographic projections,

8 The average annual earnings in Japan in 2009 were 5.000.500 Japan yen. Source: OECD. Pensions at a glance: Asia/Pacific, supra note 1.
9 The method of the calculation of income: less than half of the national average.
life expectancy in Japan will increase up to 21.6 years for men and up to 27.7 years for women. The first table shows life expectancy and fertility rate change in Japan.\(^{11}\)

**1 table.** Life expectancy and fertility rate change in Japan

<table>
<thead>
<tr>
<th>Year</th>
<th>Life expectancy (years)</th>
<th>Total fertility rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Men</td>
<td>Women</td>
</tr>
<tr>
<td></td>
<td>From birth</td>
<td>At 65 years</td>
</tr>
<tr>
<td>1947</td>
<td>50.06</td>
<td>10.16</td>
</tr>
<tr>
<td>1960</td>
<td>65.32</td>
<td>11.62</td>
</tr>
<tr>
<td>1970</td>
<td>69.31</td>
<td>12.50</td>
</tr>
<tr>
<td>1980</td>
<td>73.35</td>
<td>14.56</td>
</tr>
<tr>
<td>1990</td>
<td>75.9</td>
<td>16.22</td>
</tr>
<tr>
<td>1995</td>
<td>76.38</td>
<td>16.48</td>
</tr>
<tr>
<td>2000</td>
<td>77.72</td>
<td>17.54</td>
</tr>
<tr>
<td>2005</td>
<td>78.56</td>
<td>18.13</td>
</tr>
</tbody>
</table>

Because of life expectancy and pension system deficit, the retirement age in Japan is increasing and for the first pillar pension will reach 65 years (retirement age for men is increasing during the period 2001-2013 and for women – during the period 2006-2018). The retirement age in the second pillar occupational pension is also increased up to 65 years (for men, the retirement age will be reached in 2025 and for women – in 2030). However, Japan’s real retirement age is much longer. The second table shows the real retirement age (2009) in Japan.\(^{12}\)

**2 table.** Real retirement age in Japan (2009)

<table>
<thead>
<tr>
<th>Year</th>
<th>Men</th>
<th>Women</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>71.4</td>
<td>65.8</td>
</tr>
<tr>
<td>1990</td>
<td>70.4</td>
<td>66.4</td>
</tr>
<tr>
<td>2000</td>
<td>70.1</td>
<td>66.2</td>
</tr>
<tr>
<td>2009</td>
<td>69.7</td>
<td>67.3</td>
</tr>
</tbody>
</table>

Japanese people can use an early retirement pension (at the age of 60), but the pension amount will be reduced by 6% annually. If a person continues to work after 65, the additional supplement to their pension will be applicable (8.4% per year, but the maximum limits are applicable). In Japan, a part of persons under the age of 65 and

\(^{11}\) Source: Lakayra. *Demographic ageing and Japan’s public pension system*. Nomura Research Institute, 2009, vol. 54.

more comprises 35.5% of the total number of employees (and it exceeds the OECD average, which is 23.6%).

2. Japanese Pension System and Reforms

About 85% of persons are involved in the public social insurance in Japan, but pension system is in deficit because of the worsening demographic characteristics and social insurance system management problems. As a result, the Japanese pension system is reforming by constantly searching for the new ways of its organisation.

2.1. Organisation of the Pension System

In 1985, Japan created a modern social security and pension system, consisting of three pillars: basic national pension (flat rate), additional mandatory occupational pension (depending on the payment of contributions and level of earnings) and the private savings system. There is also a disability pension and widow’s (orphans) pensions. In 2004, the automatic payment adjustment factor has been introduced (which depends on the demographic and macroeconomic factors).

The first pillar is the national basic pension (Kokumin Nenkin). The pension amount (if contributions are paid during the period of 40 years and the retirement age is 65 years) is 788,900 yen\(^{13}\) per year (in 2011), which corresponds to 15% of the average wage in the country.

This pillar is based on the current benefits or pay-as-you-go principle (defined benefit scheme), the benefit level is universal flat-rate, not depending on personal earnings. Payment of contributions to the basic national pension scheme is mandatory (however, there is a possibility to be fully or partially exempted from the contributions). Participation in the national basic pension and in the occupational pension scheme is mandatory for the public and private sector employees. Farmers, self-employed persons, students, the unemployed, as well as widows (orphans) are participating only in the national basic pension scheme (paying contributions from 20 to 60 years).

The level of social security contributions to the national pension is constantly increasing (this increase will end in 2017). The level of contributions in 2012 is 15,020 yen per month (if a person is involved in the occupational pension system, the amount is different). If a person has low income (or students under 30 years), they may contact the local municipality office and apply for an exemption from paying a part of or all contributions and this does not reduce the amount receivable of the national pension at the age of retirement. In addition, there is a possibility to be exempted from payment of contributions for the employee’s non-working spouse (because of traditions, most of the married women in Japan are not working).

The minimum contribution period is 25 years, the pension in the first pillar can be obtained at the age of 60 (early retirement). However, the full amount of pension

\(^{13}\) 1 euro is about 103 Japanese yen.
is payable only after 65 years of age and if contributions have been paid for at least 40 years. The government subsidises the first pillar pension system (half of all the necessary expenses), pensions are indexed according to the consumer price index and the net average wage change.

The second pillar is an additional occupational mandatory pension, the level of which depends on the person’s salary (there is a maximum level of social insurance contributions). Participation in this pension system is mandatory for employees (Kosei Nenkin Hoken) and civil servants (Kyosei Nenkin). The disability pension (three disability levels) and widow’s (orphan’s) pensions are covered by this pension scheme. This second pillar pension system is organised as follows:

The first scheme is an occupational pension and the system operates on the basis of pay-as-you-go principle (previously, the system operated on a cumulative basis). Employees and employers pay social insurance contributions in equal parts (in 2017, contributions will be increased progressively to 18.3%). If a person pays contributions to an additional second pillar pension, there is no need to pay contributions to the basic pension scheme. In this scheme, there is no contribution relief for low income persons (excluding maternity leave until the child turns one). Benefits of the second pillar pension depend on the occupation period and the amount paid.

The second pillar has a pension reserve fund, but its capital is invested in the social welfare programs (construction of highways, bridges, railways, airports and in other public projects) and not only used for pension payments.\(^{14}\) In 2000, the second pillar pension expenses amounted to 4.1% of GDP.

The minimum required period for the payment of contributions is 25 years, and the maximum period is 40 years. The average pension (including the basic pension) depends on the person’s earnings over the contributions period and is about 28.5% of the average wage (if a person begins paying contributions at 20 years and the contribution period is 40 years).\(^{15}\) Pensions are indexed by the average net wage and inflation change (a special modifier, depending on life expectancy, is applicable from 2004 as well). If a person retires at 60 to 65 years, their pension will be reduced. If a person continues to work in the period from 65 to 70 years, the pension will be increased.

Pensions are calculated based on the following formula: the annual benefits = average amount x 5.481 / 1000 x contribution months. In this formula, the average amount means value of the net wages and consumer prices change, the change of real disposable income and the modifier (which depends on life expectancy tables for men and women).\(^{16}\) The following figure is divided by the number of months (when contributions have been paid). If a person continues working after 65 (until they turn 70), the level of pension increases.


\(^{16}\) Lakayra, supra note 11.
The maximum level of contributions in the second pillar pension system in 2009 was 620,000 yen and the minimum pension was 98,000 yen. The maximum pension amount, if a person continues working after 65, will be 1.5 million yen.\textsuperscript{17}

The second scheme is an optional supplementary pension paid by the pension fund company. The pension is paid after a person terminates professional activity, however, it depends on the period of participation in this system. The system is based on a defined-benefit approach and has been operating since 1965 (as foreseen in the Employee Pension Fund Act). On the basis of 2001 legislation, the Government started to promote defined-contribution plans. Self-employed persons are involved in industrial or regional pension funds.

The third pillar consists of funded private pension plans. Many large companies (with more than 30 employees) have one or more additional pension plans. The pension level depends on the amount of contributions paid, the period and return on investment. Benefits from private pension plans could be received in the lump-sum or on annuity basis.

If contributions are paid by the employer for private employee’s pension, the maximum contribution amount will be 36,000 yen per month. Employees can pay 4 percent of their salary to the pension fund (the maximum contribution amount is 15,000 yen and 68,000 yen for self-employed persons).\textsuperscript{18} Participation in private funds is promoted by tax incentives, however, there is no indexation rule. A person can start participating in a private pension fund from 25 to 65 years of age.

Japan offers early and late pension options. Early retirement is possible from 60 to 65 (both for basic and second pillar pension). Benefits are reduced by 0.5 percent each month by the moment when a person turns 65. Pension benefits are indexing according to the average wage change and only to 65 years. If at the age of 65 a person continues working, they can receive an increased pension (0.7 percent per month). The pension is increased only (except for the basic pension) if a person does not exceed the monthly maximum salary of 480,000 yen. Working pensioners under the age of 70 are exempted from payment of social insurance contributions. It should also be noted that the Japanese Government has been subsidising the work of elderly people (Zaishoku program) since 1995. The Government pays a subsidy for persons aged 60 to 64 if they work in the same company and receive a wage, the amount of which is less than 64% of an early retirement pension.\textsuperscript{19}

2.2. Pension System Reforms before 1985

Before the Second World War, the pension system functioned on the basis of professional companies’ funds, there were strong traditional family relationships and the pension system was based on the Bismarck tradition.

\textsuperscript{17} Lakayra, \textit{supra} note 11.
\textsuperscript{18} Chia, N.; Kitamura, Y.; Tsui, A., \textit{supra} note 15.
\textsuperscript{19} Oshio, T.; Oishi, A. S.; Shimizutani, S., \textit{supra} note 5, p. 249–271.
Until the 1985 reform, three pension schemes were in place: occupational pension scheme (for those working in companies, the pension depended on the payment of contributions), the National Pension Scheme (not universal, fixed benefits, only applied to self-employed, fishermen, farmers and forest workers) and public employees scheme.

The first Japanese social insurance scheme appeared in 1890 and was designated for soldiers (without paying social security contributions, however). Later on, a social insurance scheme was created for civil servants. Social insurance system was financed from the general government revenue and the amount of pension depended on a person’s salary. In 1905 the law on accidents at work for coal mine workers was adopted, and in 1911 similar provisions were introduced for factory workers. In 1922, the law on health insurance for workers was adopted, and the Board of Social Affairs under the Ministry of Interior was created the same year. 1931 saw the adoption of the law on the compensation of accidents at work, and in 1936 the law on occupational pension funds was adopted. In 1941, employees were entitled to pension, disability and death benefits. In 1944, a new welfare pension law was adopted.\(^{20}\) In 1938, the National Health Insurance Act (applicable to all persons) was passed and in 1939 the right to social security for seafarers was provided for.

In 1942, a modern occupational pension scheme was launched. According to that scheme, the amount of benefits depended on the seniority and paid contributions, but payment of benefits was suspended after the Second World War to 1954 (accordingly, the amount of contributions was reduced from 11 to 3%).\(^{21}\) This is explained by the fact that Japan was severely damaged during the Second World War - around 9 million persons were left homeless after the nuclear bomb attacks on Hiroshima and Nagasaki and about 6 million Second World War refugees returned to their homeland. Japan’s economy was destroyed and the primary task of the government was to provide social assistance for its people.

The pension in the second pillar could be obtained at the age of 60. The amount of pension depended on contributions paid (the number of months) multiplied by 2.050 yen (maximum number of months - 420). It was foreseen that additional 15 thousand yen per month was to be added for the non-working spouse, additional 5 thousand yen per month for the first and second child (per child) and 2 thousand yen was to be added for the third child and successive children). In 1983, the average second pillar pension amounted to 113.040 yen (or 44% of the national average wage).\(^{22}\)

Article 25 of the Japanese Constitution (adopted in 1946) states that people shall have the right to maintain the minimum standards of wholesome and cultural living. In all spheres of life, the State shall use its endeavours for the promotion and extension of social welfare and security, and of public health. This means that people are entitled to social security and welfare, and the state must ensure this. In 1946, the law establishing

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21 Pacific Economic Council, supra note 3, p. 71-81.

22 Takahashi, T.; Someya, Y., supra note 20.
social assistance system was adopted, in 1947 the Unemployment Insurance Act was adopted and in 1949 the Disability Welfare Act was passed.\textsuperscript{23}

Immediately after the Second World War, the government established five-year economic objectives, based on economic independence and full employment. Those objectives are related to the future economic planning, determination of the economic policy, forecasts of economic development, search for the optimal direction of economic development, economic activity of business and individuals and to the coordination of various interests of economic groups. In 1965, a medium-term economic plan was approved, which marked for the first time the need for social development, in order to remove and balance inequalities (resulting from economic growth).

The main objective of social policy in Japan is stable and healthy society, equal and fair redistribution of goods and services. The Board of Economic Welfare has identified ten social goals: health, education, learning and culture, employment and work culture, recreation, income and consumption, physical environment, crime and policing issues, strengthening the family, quality of community life, social classes and social mobility. It also noted the importance of public participation in decision-making in the social policy field.\textsuperscript{24}

Until 1985, there was no modern universal first pillar pay-as-you-go pension system in Japan. Only in the 1980s of the last century a pension reserve was launched, the minimum pension guarantee was introduced and social security coverage level expanded. This is explained by the fact that after the post-war period socio-democratic movements seeking to create welfare state were lacking, trade unions were fragmented (the strikes demanding for better social security began only in 1960), large corporate paternalism was dominating (each company had its own pension system). In 1985, the level of pension expenditure was only about 7\% of the national budget.\textsuperscript{25}

1961 was significant in terms of development of the Japanese public social security system: two laws establishing mandatory health insurance (the law adopted in 1958) and mandatory first pillar national pension insurance (the law adopted in 1959) were enforced. We could emphasize that starting from 1961 the entire working population of Japan was covered by a public pension system, but it was not a universal coverage because of different systems: employee pension insurance for private sector employees; national pension for self-employees and farmers; mutual associations for public servants.

The new National Pension Act provided for a minimum monthly payment of pensions (10,000 yen) for farmers, small business companies (up to 5 persons), employees and other persons not involved in the pension retirement insurance (after evaluation of the International Labour Organisation standards, from 1969 the minimum pension amount increased to 20,000 yen). The national pension was related to the paid contributions period and pensions were indexed by decision of the Government. In 1983, the average of the first-pillar pension amount was relatively small (25,621 yen

\textsuperscript{23} Takahashi, T.; Someya, Y., \textit{supra} note 20.
\textsuperscript{24} OECD. \textit{Towards an integrated social policy in Japan}. OECD publishing, 1973, p. 7–9.
per month) and this relatively small pension was only a supplement to the income of pensioners. It was possible to receive the full pension only after 25 years of payment of social security contributions and if the period was shorter (5-10 years), the special reduction was applied.\textsuperscript{26}

In 1961, the second pillar pension was reformed. According to the new law, participation became mandatory. Until 1961, there was no possibility for self-employed workers, fishermen, foresters, farmers, the unemployed, employees of small businesses to participate in the second-pillar pension system.

In 1976, the Government adopted a plan (prepared by the Economic Council), which provided: price stabilisation and full employment, creation of a pleasant living environment and life stability, participation in the global economy, economic security, long-term economic development. This plan also provides measures for social development (increasing of living standard, health and social welfare programmes).\textsuperscript{27}

After the Second World War, Japanese economy grew very fast (in 1955, net domestic product per person was 151 thousand yen, in 1965 - 293 thousand yen, in 1970 - 463 thousand yen). Accordingly, the population income levels grew rapidly, rapid urbanisation continued, the number of employees working in enterprises increased. However, social policy (social services, social insurance and social infrastructure) was developed inadequately to the economic growth. The early 1970s saw the beginning of economic recession and ageing. After rapid economic growth, public dissatisfaction with regard to external factors of economic growth (pollution, lack of social support infrastructure, urbanisation) increased.\textsuperscript{28} Moreover, despite of urbanisation and industrialisation in Japan, the traditional approach to family and work (the man is working, the woman is not working and is taking care of the children) remains. It explains the specific social relations in the Japanese society: the existence of a social security scheme for the non-working spouse and late retirement.

Under economic development, pension payments increased depending on the economic situation (special increase rate). From the oil crisis in 1973, pensions were automatically indexed based on consumer price changes (due to inflation). Second pillar pension replacement rate increased from 40\% (1965) to 60\% in 1973. The rate of social security contributions increased from 3\% (1954) to 7.8\% in 1973.\textsuperscript{29}

In addition, the Japanese Prime Minister Tanaka Kakuei informally announced that the year 1973 will be the pension year and during that year the minimum occupational pension increased to 50.000 yen. From 1972 to 1981, pension spending increased almost five times. In 1965, the average pension was 10.000 yen (36.1\% of the average wage), in 1974 it was 52.242 yen (61.6\% of the average wage), in 1980 it was 136.050 yen (67.5\% of the average wage), and in 1984 it amounted to 173.000 yen (61.8\% of the average wage).\textsuperscript{30} It should be noted that in Japan all costs of social welfare programmes (social

\begin{footnotesize}
\begin{enumerate}
\item Takahashi, T., Someya, Y., \textit{supra} note 20.
\item OECD. \textit{Towards an integrated social policy in Japan}, \textit{supra} note 24, p. 15–39.
\item Ibid., p. 7–9, 38.
\item Pacific Economic Council, \textit{supra} note 3, 71–81.
\end{enumerate}
\end{footnotesize}
insurance, social assistance payments to victims, assistance for housing, health system) increased significantly during the economic boom: whilst in 1955 welfare expenditure was 5.4%, in 1982 it reached 16.2% of the total national budget revenue.\footnote{Takahashi, T.; Someya, Y., \textit{supra} note 20.}

However, the rising pension expenditure, low fertility, longer life expectancy and structural developments in the labour and economic markets led to the revision of the social security system. In 1980, attempts were made to extend the retirement age, but unsuccessfully.

Before the first universal social insurance reform (in 1985), the Japanese social security programme included income security, health and medical care and social welfare programmes. Income security was related to the social support services and pension benefits. Basic pension insurance was concentrated in professional funds, there were also special schemes for fishermen, soldiers, civil servants and self-employed persons.\footnote{OECD. \textit{Towards an integrated social policy in Japan, supra} note 24, p. 20–23.}

The following social transformations in the Japanese social insurance system could be noted before the reforms of 1985: economic crisis (limited possibilities to increase social benefits and inflation); ageing population (which requires more resources to provide social benefits and ensure health protection); declining birth rate (directly related to the future sustainability of the pension system); the aggravation of other social problems (unemployment, environmental protection, quality of life); public pressure to ensure adequate income security and social protection; requirements of the trade unions; absence of a clear social policy.

In conclusion, it could be stated that during the period at issue, the right to the adequate level of social security benefits was ensured if a person was employed and participated in the second pillar pension scheme. However, retirement in Japan is late (the level of salary and bonus depends on the number of years worked). This means that a person will receive their pension benefit only after they turn 70. It could also be noted that before 1985, the entire working population in Japan was covered by a public pension system, however, this coverage was not universal because of different systems. The long-term provisions related to the demographic and economic impact on the pension system were not adopted. It led to the future growth of pension system deficit.

2.3. Pension System Reforms in 1985–2000

In 1985, the increasing pressure from the trade unions, society and the media led to the introduction of a national universal basic pension of the first pillar and to other reforms.

The objectives of the pension system reform were: (a) the unification of the civil servants pension system and the second pillar occupational pension; (b) the establishment of basic income guarantees (a national universal basic pension system was created with a full amount of 50 thousand yen per month); (c) creation of the social insurance guarantees for dependent non-working spouse; (d) the establishment of the same level of basic pension for all categories of persons (employees or self-employed); (e) the
regulation of the pension replacement rate. It was estimated that without the reform, the pension replacement rate in the second-pillar pension system would be around 83% (if a person paid contributions for 40 years and had dependent non-working spouse).\textsuperscript{33}

In 1985, the National Pension System Reform Act was adopted and the national basic pension was introduced. This pension is paid to all persons turned 65. The adjustments of the reform in 1985 reduced payments and introduced a widow’s (orphan’s) pension scheme.

In 1986, the second pillar occupational pension scheme was reformed and the mandatory 40 years period of contributions to receive an occupational pension was fixed (with a special scheme for persons contributing for a period of 25 years and having paid a special bonus for the missing period). It was also laid down that dependent non-working spouse was to be insured for the first pillar pension without paying any additional contributions. In 1986, a provision for the disabled (if a person became disabled before turning 20) was also introduced, which meant that disabled persons were insured for the national basic pension.

The deteriorating demographic situation and the growing deficit in the pension system resulted in the new reforms in 1994: (a) the National Population and Social Security Institute began analysing the demographic projections; (b) it was suggested to increase the retirement age; (c) it was laid down that pension indexation will be based on the average net wage change (before 1994, it was based on overall earnings); additional 1% contribution from bonuses was introduced and it was laid down that persons on maternity leave were to be exempt from contributions (the employee’s part). The new reforms also related to the fact that the Liberal Democratic Party lost its political power (that party ruled from the Second World War to 1994).

In 1994, it was determined that the retirement age for the first pillar pension will be consistently extended to 65 (from 2001 to 2013 for men, from 2006 to 2018 for women) and the retirement age in the second pillar could not be less than 60.

Prior to 2000, the most serious problems of the second pillar pension insurance were the level of eventual contribution rate in order to maintain the present benefit level and the degree of inter-generational inequality in the contribution-benefit relation due to the pay-as-you-go financing system.\textsuperscript{34} Another problem was the increasing number of atypical workers (short-term workers, temporary workers, subcontractors). Due to low economic growth, companies started cutting personnel costs (restructuring their full-time staff and searching for possibilities to avoid payment of social insurance contributions). It was estimated that the rate of contributions for the second pillar pension insurance would increase from 13.6% in 2002 to 23% in 2025 without further reform.\textsuperscript{35} The 1990s were sometimes called the ‘lost decade’ for the Japanese economy and society in general.

with some sense of self-scorn and this ‘lost decade’ also represented loss of confidence among the policy makers.\(^3^6\)

The aim of the pension system reform in 2000 was financial sustainability, raising the retirement age and efforts to reform the second pillar pension system:\(^3^7\)

1. From 2000, the second pillar pension benefits were reduced by 5\%, the accrual rate was reduced from 0.75\% to 0.7125\%.
2. The retirement age in the second pillar gradually increased from 60 to 65 years (retirement age will increase from 2013 to 2025 for men, and from 2018 to 2030 for women).
3. Persons retiring in second pillar system aged from 60 to 64 will receive a reduced pension (reduction is 0.5\% per year). If a person retires at 60, he will receive only 70\% of the total amount of the pension at the age of 70).
4. The income test was introduced for persons retiring from 65 to 69. If a person’s income exceeds the defined threshold, the pension supplement for active professional life is no longer paid.
5. From 2000, persons on maternity leave are exempt from all contributions, as well as from the employer’s part.
6. From 2000, the monthly maximum level of social security contributions was increased from 98,000 yen to 620,000 yen.
7. The unemployed started to pay reduced social security contributions (50\%) for the first pillar pension insurance. Students (turned 20) may suspend payment of contributions for a maximum period of ten years.
8. It was decided that in 2025 the first and second pillar pension benefits will be reduced by 20\% and the level of second pillar pension contributions in 2025 will be increased to 25.4\%;
9. The level of government subsidies (for the first pillar pension system) was increased from one third to half of the total expenditure.

It is estimated that these reform measures would reduce total pension spending in 2025 by about 20\% (keeping the final contribution rate at 20\% of annual earnings).\(^3^8\)

In summary, it can be stated that fundamental reforms were implemented during the period at issue: the national basic pension was introduced, the reform of the second pillar pension was started, the contributions were consistently increased and the benefits reduced, the increase of pension coverage and pension guarantees was implemented, the increase of the retirement age continued, new rules for the indexation of pensions was introduced. However, the demographic situation deteriorated and pension system deficit continued growing. Furthermore, it could be noted that no sufficient changes were made to improve the administration of the pension system (the high rate of exemption, non-participation in the system decreases the universality principle and results in the instability of the whole pension system), the general pension system database was not

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created. The increased level of social security contributions for the second pillar pension resulted in various atypical employment relationships, however, the pension system was not adapted to the changes in the labour market.

2.4. Pension System Reform in 2004

Further increase in the pension system deficit and deterioration of the demographic indicators determined the series of new reforms in 2004. The third table shows population change (from 2010 to 2030) and the dependence ratio (between persons aged 65 (and more) and persons aged from 15 to 64).39

3 table. Population change and the dependence ratio

<table>
<thead>
<tr>
<th></th>
<th>Total number of population (million)</th>
<th>Persons aged 60 years and more (millions)</th>
<th>Persons aged 80 years and more (millions)</th>
<th>Dependence ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>2010 127</td>
<td>2030 117</td>
<td>2010 38.7</td>
<td>2030 44.5</td>
</tr>
</tbody>
</table>

The fourth table shows total life expectancy (from birth) and fertility rate (children per woman) (during the period from 2010 to 2030).40

4 table. Total life expectancy and fertility rate

<table>
<thead>
<tr>
<th></th>
<th>Total life expectancy (from birth)</th>
<th>Fertility rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>2010 83.7</td>
<td>2030 85.3</td>
</tr>
</tbody>
</table>

In order to reduce the level of benefits and evaluate life expectancy projections, the Government decided to introduce an automatic pensions balancing mechanism in 2004. This automatic pension balancing mechanism depends on demographic situation - life expectancy (cohorts of people reaching the retirement age). On average, after introduction of this mechanism, the amount of pension will additionally decrease by 0.6 percent each year.

The Government decided to fix the timetable for the increase of social insurance contributions from 2004 to 2017 (pensions in the first and second pillars). The reason was low income to the pension system and ageing issues. In 1999, the exempt rate of the national pension was more than 20%, indicating that one of the five persons did not pay into the system. Another serious concern was the increase of the number of people

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39 Source: Pacific economic council, supra note 3, p. 28−30.
40 Ibid.
not exempt, but not paying the premiums (i.e. defaulters): in 2001, as much as 30% of the total expected premium revenue was defaulted. Therefore, after governmental decisions a person could be exempted from social security contributions only in two cases: if the exemption related to disability and if it related to the public assistance system.

The monthly contribution level in the first pension pillar increased from 13,300 yen to 13,580 yen in 2004. By 2017, the increase will be 280 yen per year (in 2017, the annual contribution level will be 16,900 yen per month).

The level of contributions in the second pillar in 2004 increased from 13.58% to 13.934% and in 2017 it will reach 18.3%. If a person’s monthly income exceeds 360,000 yen (plus annual bonus amount, exceeding the amount of 3.6 monthly salaries), the average increase of annual contributions is 20,000 yen per year (from 2004 to 2017). It will be about 1 million yen per year more or about 35% more contributions than in 2004. Employed persons turning 70s were exempted from all contributions and any income test applied (however, in 2007 the maximum amount of 480,000 yen was fixed). Such a person pays half of the contributions above the amount exceeding 480,000 yen).

The legislation of 2004 introduced the rules for dividing the retirement benefits in case of divorce (the number of divorces began to increase). From 2007, the principle of division of the retirement pension (in case of divorce or in case of death of a spouse) was introduced. The retirement pension issues could be foreseen in a separate agreement or they could be decided by the court. According to the general rule, the total pension amount is divided in equal parts. In 2008, the regulation was adopted establishing the right to receive half of the pension in case of divorce (if the spouse was not working).

Because of increased contributions and seniority rules (higher salary in case of work in a single company), more and more companies began to apply part-time work. From 2007, part-time workers (working less than 20 hours per week) were included in the social security system (about 100,000 employees).

In 2009, the new Government of the Democratic Party decided that the new pension system reforms will be launched in 2013. It is estimated that pension system will be financed additionally from consumption tax, and all earnings-related pension schemes will be integrated into one system.

It could be concluded that in 2004 the systematic elements in the pension reform were introduced: (a) automatic pension balancing mechanism (based on the experience of Sweden and Germany); (b) raising the retirement age; (c) encouraging savings in individual private pension plans; (d) time-table for the contributions increase. However, the automatic pension balancing mechanism in the pension system promotes inequality between different cohorts (because generations under the same conditions will receive different amounts of pension). Another observation is that persons under 70 are

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41 Abe, A. K., supra note 6, p. 59−70.
exempt from social security contributions and this means that the Japanese government encourages longer employment (which is already one of the longest in the world).

It should also be noted that constant increase of contributions and benefit reductions have negative impact on confidence in the social security system and encourage companies to pay lower wages (therefore, persons will get lower pensions in future). Due to the increased contributions and general taxes, development of information technologies and other economic transformations, the Japanese companies have already changed their employment policy: they employ young persons (because of the possibility to pay lower salary) and avoid long-term contracts (because of the obligation to increase wages depending on the number of years).

According to the demographic projections, the Japanese Government should continue with pension reforms because the increase of fertility rate will be slight, life expectancy is growing, and the number of retiring persons with long professional career is increasing.


The Japanese pension system has three weaknesses: the budget deficit, ineffective management and demographic challenges.

Since 2002, the deficit of the pension system has been compensated from the reserve fund. The deficit has been increasing significantly from the moment when the Japanese economy started growing. Despite the increased social security contributions and value added tax (the pension system deficit is financed from this tax), the pension system deficit is projected by 2050.

In Japan, the public debt continues to increase: in 2011 it reached 205% of the GDP (in 1993 the debt was 74% of the GDP, in 2003 it increased to 158% of the GDP, in 2009 it was 193% of the GDP). Because of the economic crisis, in 2011 Japan’s budget deficit exceeded 8% (in 2006 it was below 2%).

Japanese Ministry of Economy, Trade and Industry forecasts that the increased social security contributions (in 2017) will lead to the loss of about 1 million jobs, unemployment will increase by 1.3% and the level of consumption will fall. It should be noted that in 2009 the Government has already subsidised half of the pension system (first pillar), which means that half of the pension system is financed from general taxes.

Another problem of the Japanese social security and pension system is management efficiency. The Japanese pension system administration costs are relatively low. However, serious problem is avoiding payment of social security contributions. This results not only from the complexity of the system, but is also related to the efficiency of

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44 Pacific Economic Council, supra note 3, p. 78–81.
management and creation of the central database. In 2002, 8.3 million people had arrears of contributions and 12 million people did not participate in the pension system.\textsuperscript{45}

Miscarriage of pension files could be set as an example of inefficient management, when about 50 million pension beneficiaries’ files were lost. There are no social security numbers or personal codes in Japan, and the benefits are calculated on the basis of employment books (issued at first employment). In 1998 it was finally decided to create a centralised information system.

In 2004, some of the highest-level politicians declared that they did not pay social security contributions for several years and they had to resign from their political positions.

Despite the reforms or reform proposals, trust in the social security system is further decreasing. It is undeniable that every time population projections have changed in Japan, public pension schemes have also been revised so as to raise premiums and lower the benefits. This has led to public scepticism over the veracity of the schemes, and hence, more positive solutions are now required to ensure the sustainability of public pension schemes.\textsuperscript{46} The basic concepts of the first and second pillar pension system were so different in so many ways (individual vs. household as a unit of the coverage, flat-rate contribution vs. wage proportional contributions, flat-rate benefit vs. wage proportional plus flat-rate benefit etc.) that these reforms brought about a public pension system which was excessively complex and not transparent, the basic rules of which and the relation of whose burden and benefits almost nobody could understand and it caused people’s mistrust in the public pension system and discouraged their willingness to pay contributions.\textsuperscript{47}

Japan is one of the fastest ageing countries in the world. Population projections show that in 2055 the number of pensioners will exceed 40%.\textsuperscript{48} Japanese National Institute of Demographic Studies predicts that in 2050 the population will fall by 32 million (from 128 million to 95 million) and the fertility rate will fall to 1.26 children per woman. But Japan, in particular and traditionally, has an advantage of promoting the employment of older people given their high motivation to participate in the labour market. And this positive situation in the labour market could partially balance the budget deficit.

Thus, the Japanese scientists and international organisations raise confidence in the state social insurance system, better management, pension system reforms, flexibility of pension system, and adaptation of pension system to the labour market changes. Definitions of social justice, equity between generations, solidarity and the pension system model are analysed as well.

\textsuperscript{45} Chia, N.; Kitamura, Y.; Tsui, A., \textit{supra} note 15.
T. Yamada proposes cancelling second pillar pensions and suggests that first pillar basic pension could be financed directly by the consumption tax (the tax payers are the wealthiest part of the society) and income tax (because pensions are related to personal earnings). T. Yamada research showed that it was thus possible to achieve greater welfare of future retirees.\(^{49}\)

T. Fukawa emphasized that it was necessary to make the system less vulnerable to economic and demographic changes, to reduce the intergenerational inequality in the contribution-benefit relation due to the pay-as-you-go financing system. It is important to increase the normal pension age beyond 65 years, change the benefit structure (departure from flat-rate benefit, benefit accrual rate according to income level) and adjust the pension system to the changing labour market.\(^{50}\) Future reform of the Japanese tax and transfer system would have to pay more attention to (a) deploying measures that enable younger parents to combine child raising and work; (b) changing the structure of social spending inevitably biased towards the elderly and refocusing on younger generations; and (c) making social systems neutral to the individual’s life style. It is rather obvious that a new form of solidarity is needed in Japanese society, and each member should bear the proper burden.\(^{51}\)

N. Takayama believes that because of the ageing population, ongoing pension reform is inevitable. Pension system reforms should be oriented to promote private initiatives, using the potential of the economy and capital markets, finding the balance between solidarity and individual responsibility, to understand equality between generations, the government’s commitments. The first pillar pension should be financed from general taxes.\(^{52}\)

The Pacific Council experts emphasize that the level of social security contributions in Japan already exceeds the amount of tax revenue. The increasing number of companies is facing difficulties in paying the higher social security contributions and average overall wages decline because the newly recruited employees receive lower wages than the already employed middle-aged workers. Government is increasing contributions and reducing benefits, but this means that people pay into the pension system more than they will get and this reduces the confidence in the system.\(^{53}\)

The OECD notes that pension system should be reformed in accordance with the following principles: to prolong working life and the retirement age, to apply dependency ratio between pension benefits and life expectancy, to cancel early retirement system, to reduce the redistribution in pay-as-you-go system, to promote the incentives for private savings, to increase the confidence in the pension system and to diversify the pension

\(^{49}\) Yamada, T., *supra* note 48.

\(^{50}\) Fukawa, T., *supra* note 35, p. 131–143.


system (pension system should work in two ways: pay-as-you-go system and funded savings).\textsuperscript{54}

The International Labour Organisation does not have a specific pension model, but it does have a set of basic requirements for pension systems: (i) universal coverage; (ii) benefits as a right; (iii) equity and fairness; (iv) protection against poverty; (v) replacement of lost income; (vi) collective actuarial equivalence of contributions and pension levels; (vii) guarantee of a minimum rate of return on savings (the real value of contributions paid into savings schemes should be protected wherever these are part of the national pension systems); (viii) sound financing and fiscal responsibility (schemes should be financed in such a way as to avoid uncertainty about their long-term viability); (ix) policy coherence and coordination (providing affordable access to essential health care and income security to all those in need); (x) state responsibility (the state should remain the ultimate guarantor of the right to affordable retirement and access to adequate pensions, such guarantees can be applied to both PAYG and fully funded pension schemes).\textsuperscript{55}

In conclusion, it is definitely clear that the Japanese Government should continue pension system reforms. Declining fertility rate, longevity and other facts of ageing population challenged the need to increase the social security contributions, revise the level of benefits and raise the retirement age. However, the budget deficit is still considerable and ageing is significant.

At present, the main focus of the Japanese Government reform should be on the question how to raise the number of employment and contributors (especially women), reduce exemptions, improve collection of contributions and increase confidence in the system. Employment and labour market system reform issues should be considered in the field of pension system reform. Excessively high tax and social security contributions can reduce the burden of Japan’s competitiveness in a globalised world and demotivate participation in the pension system.

Conclusions

The Japanese pension system model could be classified as a conservative welfare model (according to the classical G. Esping-Anderssen classification types) because of state functions (guarantor of the pension system), state employment-related policy, earning-related pensions and mandatory contributions. Some elements (basic national pension) could be treated as elements of a liberal model. The largest practical challenge in designing or realigning national social security systems is the interplay between social insurance schemes, universal benefit schemes, social assistance schemes and private benefit systems as well as integrating social security policies closely with other sectors (particularly education, health and employment).

\textsuperscript{54}  OECD. \textit{Pensions at a glance}, supra note 10, p. 9–11.

In the past, the Japanese Government several times decided to raise social insurance contributions and cut benefits. In the future, the Japanese Government should apply new policy regarding financial sustainability. Because of the impact on international competitiveness, it could be difficult to raise the contribution level again from 2017 and reconcile growth based on high labour productivity.

The analysis presented in the Article leads to the following conclusions:

1. The pension reforms will never receive the full support of the society. However, the key policy in Japan is to rebuild the trust in public pension schemes. Participants of the first and second pillar pension system should be constantly and clearly notified of the obtained rights to the state social security pension.

2. It is necessary to maintain the role of the state as the main pension rights guarantor in the Japanese pension system. The state should guarantee the national basic pension and adequate pension level from the second pillar (which guarantees adequate standard of living).

3. Therefore, the concept of social security in Japan should cover state social security pension schemes, occupational pensions and private-funded pension schemes.

4. Today, the Japanese society is one of the oldest in the world. The challenges for the Japanese pension system are the further ageing population (especially low fertility rate, rising number of elderly people and life expectancy) and economic transformations.

5. The pension system has to respond directly to changes in the structure of the society and must be very closely related to the flexibility of labour relations. Social policy should be more oriented towards flexible working time arrangements provided by employers. It is especially important to balance work and family life (supporting the balance between work and family life).

6. The Japanese government should encourage a third pillar voluntary pension, assigning a certain part of liability for their own welfare to a person himself.

7. The Japanese pension system should be reformed by preventing the possible future economic crises, seeking for the financial sustainability and fighting against worsening demographic situation. Pension system reforms must be accompanied by reforms in labour law, regulation of capital markets and strengthening of fiscal policy.

8. In the pension system, the diversity of benefit sources should be foreseen (pension funds, guarantees of the state social insurance pension), the financial incentives for individuals to continue longer employment should be increased, the requirements for early retirement should be revised.

9. Pension management and administration capacities must be improved (creating databases and improving customer service), analytical and forecasting work should be organised.

10. Due to the increasing of migration of workers, the international treaties in the field of social security should be concluded (aggregation of pension rights, export of benefits and etc.).

11. Persons should be encouraged working longer. In particular, social policy that discourages women (guarantees of social insurance for the non-working-spouse) and elderly persons (possibility of early retirement) from employment should be reformed.
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**PENSIJŲ SISTEMA JAPONIJOJE: REFORMOS KLAUSIMAI**

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**Santrauka.** Šio straipsnio tikslas yra nustatyti faktinę Japonijos pensijų sistemos struktūrą bei pensijų sistemos reformas, kurioms įtakos turėjo ekonominiai ir socialiniai iššūkiai. Šiame straipsnyje analizuojama Japonijos pensijų sistemos plėtra, taip pat identifikuojama teisinė, ekonominė, socialinė reformų aplinka. Dar palyginti neseniai buvo manoma, kad Japonija yra ekonominės sėkmės sėkmės pavyzdys, kur išvengiama didesnės pajamų nelygybės ar pensijų išmokų mažinimo, bet nuo 1990 m. ekonominio nuosmukio Japonija susiduria su iššūkiais pensijų sistemoje. Be to, Japonijos visuomenė sparčiai sensta (mažas gimstamumas nuo 1990 m., ilga gyvenimo trukmė), o visuomenės senėjimo procesai turi įtakos ir pačiai visuomenėi bei reikalauja vis sudėtingesnių ir greitesnių reformų.

Japonijos pensijų sistemos reformų analizė yra aktuali tema, nes visose industrinėse pasaulio valstybėse susiduria su visuomenės senėjimo ir pensijų sistemų finansinio tvarumo klausimais. Po 1985 m. reformos, Japonijos pensijų sistemų uždavinys yra užtikrinti kiekvienam dalyviui pakankamas ir nuolatines pajamas senatvėje, išgyvenant socialinį teisingumą bei solidarumą, taip pat svarbus ir valstybės vaidmuo pajamų garantijų srityje. Straipsnyje apžvelgiama visų trijujų Japonijos pensijų sistemos pakopų reformavimo priežastis, problematika ir šiuolaikinės pensijų sistemos teisinės reglamentavimės, pateikiama Japonijos pensijų sistemų struktūros vertinimai. Japonijos pensijų sistema grindžiama visų trijujų pakopų plėtra, siekiant sistemos tvarumo ir finansinio stabulumo. Pensijų sistemos veikimas priklauso ir nuo to, kaip lanksčiai bus reglamentuojami darbo santykiai, pasikeitus ekonominėms sąlygom.
Audrius Bitinas. Pension System in Japan: Issues for Reform

Straipsnyje taikyti mokslinės literatūros analizės, teisės aktų analizės, dokumentų analizės ir istorinis metodai. Straipsnyje pateikiama medžiaga gali būti naudojama kaip metodinė literatūra, padedanti įvertinti vykstančius procesus Japonijos pensijų sistemoje.

Reikšminiai žodžiai: pensijų sistema, reforma, krizė, visuomenės senėjimas, Japonija.

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