Addressing the challenges of high government debt and population ageing in Japan

Category: Japan
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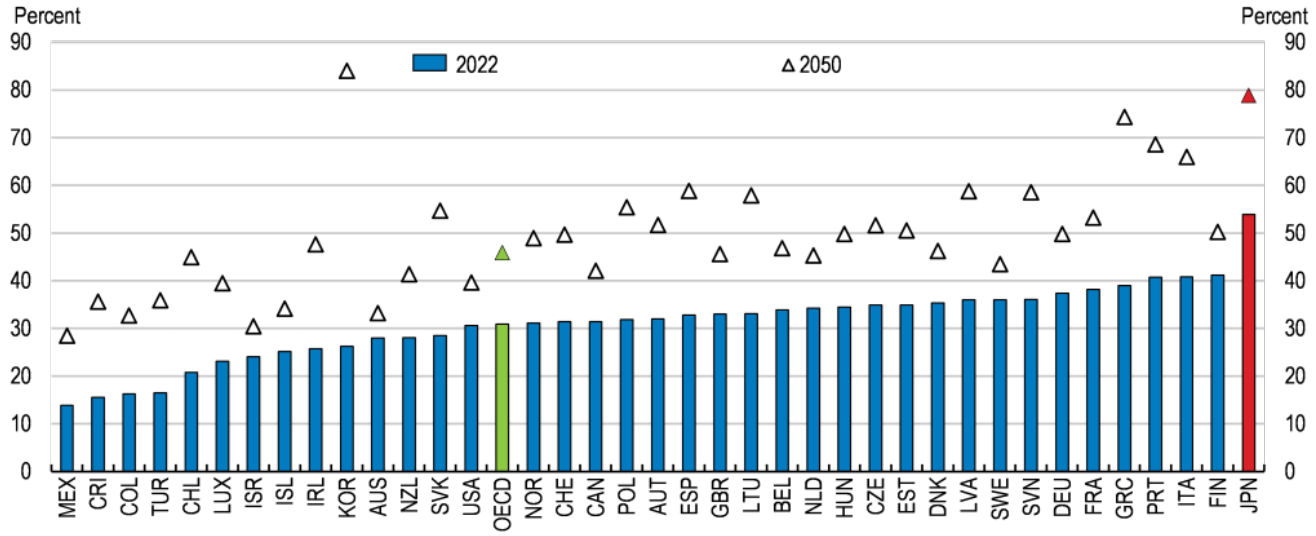
By **Müge Adalet McGowan**, OECD Economic Department

Japan has coped well with the pandemic and the energy crisis, but the fiscal support to help mitigate their impact has pushed up gross public debt to an unprecedented level of almost 245% of GDP in 2022. Demographic change will exacerbate these challenges. Japan's population is projected to decline from 135 million to around 96 million in 2060, while the elderly population will reach 79% of working-age population, one of the highest in the OECD (Figure 1). The government projects that with ageing, social security spending will rise from 21.5% of GDP in 2018 to around 24% by 2040. Without corrective action, this would substantially worsen long-term fiscal sustainability.

The *2024 OECD Economic Survey of Japan* discusses fiscal and structural reforms to bring debt levels down. Japan lacks a credible medium-term fiscal consolidation strategy to put public debt on a downward path and build fiscal buffers to increase resilience to shocks, which should include both revenue and expenditure measures. Containing spending growth requires health and long-term care reforms. Lengthy hospital stays and a high number of medical consultations suggest room

for efficiency gains in providing high-quality care to Japan's ageing population. Gradually raising tax revenues, including by increasing the consumption tax rate further in small increments, should be another element of broad fiscal reforms. Raising productivity and employment, particularly among women and older people, is also key to limit the effects of demographic headwinds.

Figure 1. Japan's elderly dependency ratio is high and will continue rising



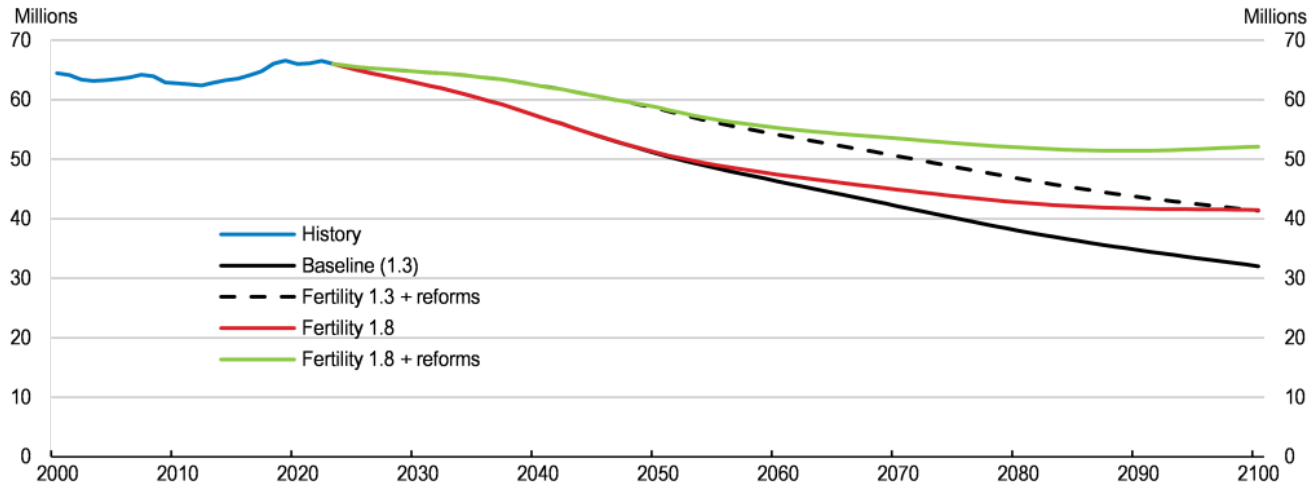
Note: Ratio of population aged 65 and above to population aged 20-64. Projections are based on medium fertility variant.
Source: OECD Demography and Population Statistics database.

Under current fertility, employment and immigration rates, employment would fall by 52% by 2100 (Figure 2). The government aims to increase the fertility rate from 1.3 to 1.8, which would help mitigate the decline in employment. One priority is to strengthen the weak financial position of youth, which leads many to delay or forgo marriage and children. Making it easier to combine paid work and family is also critical so that women are not forced to choose between a career and children. Increasing the take-up and duration of parental leave by fathers can also boost fertility rates. Policies should also cut the cost of raising children, the key obstacle to couples achieving their desired number of

children.

Given the difficulty of raising fertility, which partially reflects changing social norms, and the decades-long wait for a pay-off from higher fertility, it is essential to prepare for a low-fertility future, in part by raising labour force participation. Hence, Japan should also continue to remove obstacles to the employment of women and older persons and make greater use of foreign workers, which would have a more immediate impact on labour shortages. Breaking down labour market dualism, which disproportionately affects youth, women, and older people, is a priority. Abolishing the right of firms to set a mandatory retirement age (usually at 60) and raising the pension eligibility age would also promote employment. These reforms should be accompanied by measures to re-skill older workers, whose participation in lifelong learning is relatively low. Offering long-term residency to workers and their families and broad policies to increase the integration of foreign workers would boost foreign worker inflows.

Figure 2. Reforms to boost fertility, employment rates and foreign worker inflows would mitigate the decline in employment



Note: The reforms include; *i)* a doubling of inflows of foreigners to 200 000 per year; *ii)* a convergence of female employment rates to those of men by 2050; and *iii)* the employment rate for each five-year cohort from 60-64 to 70-74

converges to that of the preceding cohort (i.e., the rate for the 60-64 group would rise to the 2021 rate for the 55-59 age group, etc.) by 2050.
Source: OECD calculations based on the OECD Long-term Model.

References

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Population ageing and government revenue: It is not all bad news

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Population ageing should increase government revenue, but not enough to outweigh the higher public spending. Cutting spending and raising taxes would be needed to keep debt stable.

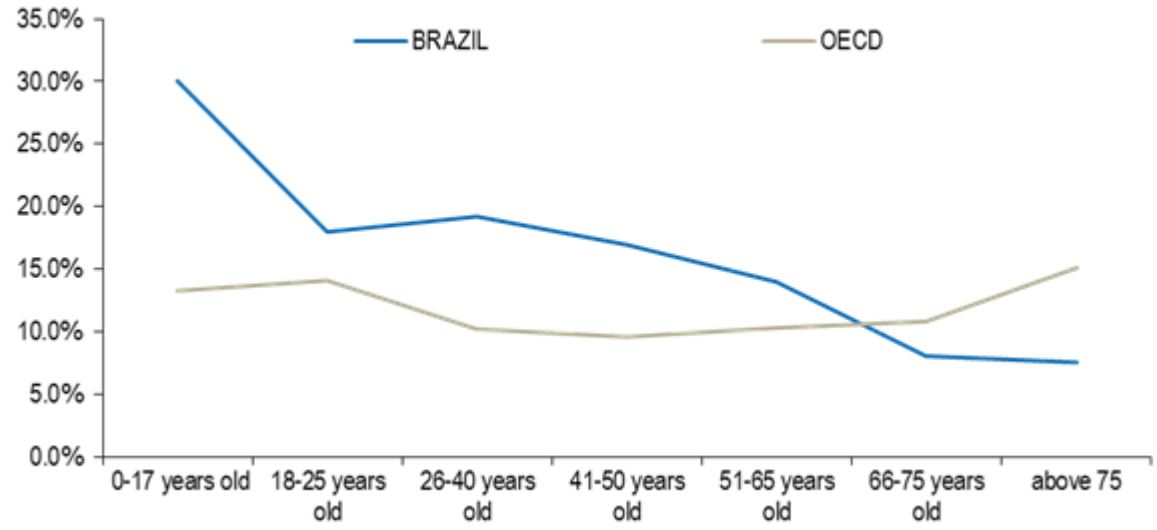
Reforming Brazil’s old-age pension system to ensure its sustainability

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By Jens Arnold, Head of Brazil Desk at the OECD Economics Department and Hervé Boulhol, Head of Pensions and Population Ageing at the OECD’s Directorate for Employment, Labour and Social Affairs

Pensions have been successful in reducing old-age poverty well below the population-wide average, and below the OECD average (Figure 1). At present, all pension recipients – and this includes around 90% of those aged 65 and above – receive at least the minimum wage, which is more than 5 times as much as the poverty line of BRL 170 (equivalent to USD 55).

However, Brazil’s old-age pension system already costs more than 10% of GDP, despite the country’s young – but rapidly ageing – population. The combined annual shortfall of the pension schemes is close to 4.5% of GDP, contributing substantially to the budget deficit. If the current parameters of the system remain unchanged, spending on pensions for private-sector workers alone would increase by almost 3% of GDP by 2030, and by almost 5% of GDP by 2040. Taking into account the public sector amplifies imbalances, which will make the system financially unsustainable. An in-depth reform is necessary and inevitable.

Figure 1. Poverty by age group

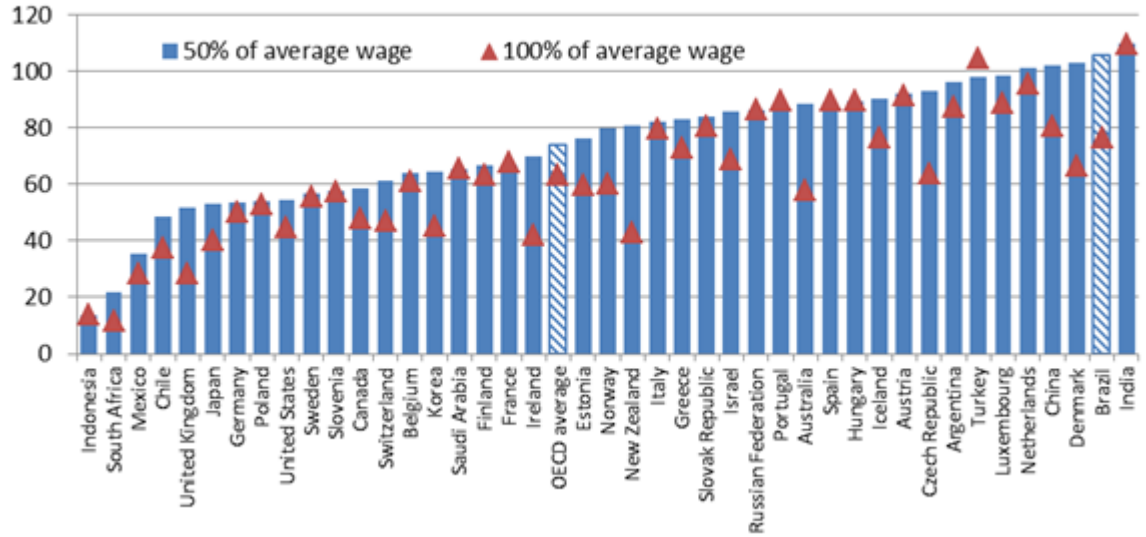


Source: OECD Income Distribution Database (IDD).

Several policy measures could contribute to containing pension expenditures. Raising Brazil's low average retirement ages of 56 years for men and 53 years for women appears urgent, by introducing a binding minimum retirement age. Many OECD countries are now gradually moving their normal retirement ages beyond 65 years for men and women. In contrast to Brazil's pension system, all public pension schemes in OECD countries include a minimum retirement age.

Brazil also stands out for high pension benefits relative to working-age incomes, in particular for low-wage earners, paid at low retirement ages (Figure 2). In the OECD, an average-wage full-career worker will get a pension paying 53% of pre-retirement earnings at the age of 65.5 years, compared to 70% for men and 53% for women in Brazil at age 55 and 50, respectively. Moreover, the minimum pension benefit is equal to the minimum wage, which has led to real increases in the minimum pension of almost 90% over the last 10 years. The minimum pension is available after 35 years of contribution or from age 65 after only 15 years of contribution.

Figure 2. Net replacement rate for full-career worker having entered the labour market in 2014



Source: OECD Pensions at a Glance (2015)

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OECD (2017). Pension Reform in Brazil. OECD Policy Memo, Paris: OECD, available at http://www.oecd.org/eco/surveys/reforming-brazil-pension-system-april-2017-oecd-policy-memo.pdf