

Fourth Session (Macro Analysis)

Prof. Charles Horioka opened the meeting's second day at 9:35, thanking PECC and the Japan Institute of International Affairs for organizing the research project and conference. He gave a summary of the previous day's session and introduced the panelists for the fourth session.

Speaker 1: Dr. Zhou Yanfei (Japan Institute for Labor Policy and Training)

There was a positive relationship between pension uncertainty and the accumulated assets of close-to-retirement households and specifically, approximately 10% of net financial assets and 5% of gross financial assets are held by such households as a precaution to uncertainty.

The public pension system in Japan was a two-layer system, but both layers were operated as pay-as-you-go systems. Because of this, the transformation of Japan into an aging society meant that it was necessary to raise collection rates or cut benefits. This had led to a series of reforms in 1985, 1994, 1999 and 2004. Demographics suggested that there was no need to institute further reforms until 2050, but researchers had found that despite this uncertainty about the future would cause households to save more than was necessary against that chance that further reforms would occur.

Dr. Zhou and Prof. Suzuki had used data from a 2008 JILPT survey on the employment and working conditions of elderly people. They selected respondents that were working and had some income, had not yet received any pension benefits, and were the head of their household. 1.4% of those surveyed expected a rise in benefits in the future and 43.8% expected a drop. The average anticipated change was -9.3% and the average value change was -21.9 thousand yen. Measuring the amount that each household was saving in terms of gross and net assets, the two scientists had found strong evidence to support a precautionary savings model. It seemed that when people felt greater uncertainty about public pensions, they saved more and accumulated more wealth.

If that was the case, then public pensions were responsible for excessive saving. There were three major reasons for public pension uncertainty: 1) national distrust toward the management of the pension system; 2) anxiety about the sustainability of the public pension system; 3) irrational panic due to a lack of knowledge about the public pension system and pension reforms. The government could therefore ease pension security by providing reliable and easy-to-understand reform plans and working to improve the transparency and efficiency of management systems. Increasing trust of the pension

system could reduce excessive saving and increase consumption rates, helping to push the economy out of recession, although increasing consumption rates among elderly households may have only a limited effect on the economy.

Speaker 2: Prof. Charles Yuji Horioka (Professor, Institute of Social and Economic Research, Osaka University)

Prof. Horioka presented a paper he had written with Ting Yin. The purpose of the paper was to conduct a panel analysis of the determinants of household savings in OECD countries, analyzing the impact of the age structure of the population, social benefit levels, and credit availability on the household saving rate.

The life cycle hypothesis posits that people work and save when they are young and then retire and dissave when they are old. Therefore, the higher the ratio of the aged population to the working-age population, the lower the household savings rate should be. Social benefits should have a negative impact on savings as households will not need to save if they feel social benefits are adequate. Likewise, financial development should have a negative impact on saving as households would know that they could borrow freely when emergencies arose. Finally, social benefits and private borrowing are considered to be substitutes for one another in that they are both risk-coping mechanisms, and therefore, the coefficient of the cross-product of the two should be positive.

Prof. Horioka and Ting Yin analyzed data from 23 OECD countries for three years: 1995, 2000 and 2005. They found that the age structure of the population and the availability of credit were more important as determinants of cross-country difference in the household saving rate than the social benefit ratio. The data also suggested that credit availability and the social benefit ratio were indeed substitutes for one another.

What are the policy implications of these findings? 1) the unclear relationship between social safety nets and household saving rates implies that improving social safety nets would not necessarily improve consumption; 2) the finding that the availability of credit has a greater impact on household saving rates than the social benefit ratio suggests that developing capital markets could improve consumption.

Commentator: Dr. Robert Dekle (University of Southern California)

Dr. Dekle stated that he wished to put both papers in a broader macroeconomic framework. In particular, the Zhou-Suzuki paper had shown that eliminating uncertainty

regarding social benefits could reduce the wealth-income ratio by 10%. This would raise consumption in Japan between 0.4 and 1%. Assuming that investment and other factors did not change too much, this would increase the current account of Japan by about 1%. In terms of a monetary amount, the removal of uncertainty would increase Japanese consumption by about 50 billion yen.

The elderly held on to wealth for three reasons: 1) to give it to the younger generation; 2) to use it to receive attention from the younger generation; 3) to guard against unexpected contingencies such as diseases. Zhou-Suzuki had shown that increases in social insurance uncertainty increased savings and lowered consumption. A very interesting finding of the survey was that the average expectation of households was that pension benefits would decrease 9.6%. In contrast, the Japanese government was projecting that pension benefits would fall only 5%. This suggested that the public did not trust the government.

Dr. Dekle asked why female household heads and more educated households had higher saving rates.

Moving on to the Horioka-Yin paper, Dr. Dekle said that he found the finding that a 1% increase in credit availability lowered household savings by 0.35% to be interesting. The paper suggested that demographics had a strong impact on savings. He noted that the results of the first paper and the second paper were not always consistent, and he suggested that some reconciliation be done. He asked Prof. Horioka how he reconciled his findings with papers that showed that increases in the social security-wealth ratio caused social security saving to fall.

Commentator: Dr. David S. Hong (President, Taiwan Institute of Economic Research / CTPECC)

Regarding the Zhou-Suzuki paper, Dr. Hong said that he had a few observations. Public pension uncertainty had been described as anticipated change in the paper, and Dr. Hong wondered if the authors could clarify this. It was stated that lower levels of anticipated benefits would cause a rise in household savings. However, this implication was inconsistent with the results of the 1994 reforms, following which household savings declined. This contradiction may have been due to the paper only considering the behavior of households near retirement. It would be advisable to extend the analyses to other age groups. While those near retirement could anticipate lower future incomes

because of cuts in benefits, younger age groups would conversely expect lower social security taxes and therefore a higher future incomes.

On the Horioka-Yin paper as well, Dr. Hong said that he had some observations. The authors failed to take into account cross-product terms when estimating the impact of the social benefit ratio. In emerging countries, a higher social benefit ratio should lead to a lower household savings rate where credit availability was low. In advanced countries where credit availability was high, the opposite should be true.

Dr. Zhou responded to the commentators. In response to Dr. Dekle's question regarding why more educated households had higher saving rates, Dr. Zhou admitted that the results were confusing. People with higher wealth should be less motivated to save. The fact that the results Dr. Zhou and Prof. Suzuki had found suggested the opposite was indicative of the general aversion to risk to Japan.

On Dr. Hong's questions, regarding the drop in retirement savings following the 1994 pension reforms, she agreed that the reforms had given people greater confidence in the system and therefore savings should have fallen. She welcomed the idea to extend the study to other age groups.

Prof. Horioka then responded. Regarding Dr. Dekle's comments, he stated that one possible reason for any inconsistencies was that he had used only one measure of social benefits instead of breaking down social benefits into types. He thanked Dr. Hong for his questions and said they were interesting.

Q&A

Mr. Takashi Omori (Policy Advisor, Cabinet Office / Chair, Economic Committee, APEC / SR Project Advisor) asked about the timescale for the decline expectation of -9.3%. He suggested that if one thought that they were living 20 years more, -9.3% was a reasonable expectation, but it depended on the time horizon. Secondly, Mr. Omori asked how much of an increase in consumption could be expected by a government announcement of higher pension benefits. To Prof. Horioka, Mr. Omori stated that he did not think that the credit situation in Japan was really comparable with the credit situation in other countries. He also asked if Prof. Horioka had thought about including unemployment as an explanatory variable.

Mr. Dambadarjaa requested to know who ran the Japanese pension fund. Second, he asked what was the total amount a Japanese retiree usually expected to receive at the time of retirement.

Mr. Taisuke Mibae (Senior Coordinator for APEC, Economic Affairs Bureau) asked why there was a link in Japan in between uncertainty regarding the pension system and the household saving rate.

Prof. Zhou responded to each question. To Mr. Omori, she stated that the time horizon chosen was based on the assumption that people would live until 85 years old. Close-to-retirement households held approximately 30 trillion yen in precautionary wealth. If this money was consumed, Japan's GDP would increase 1%.

To Mr. Dambadarjaa she stated that public agencies run pension funds. Typical Japanese retirees expected to receive up to 66,000 yen per month if they qualified for the first layer of pensions, and 150,000 yen per month if they qualified for the second layer. Thus, the typical benefit for a salaryman-housewife household was 216,000 yen per month.

To Mr. Mibae, she suggested that Japan in particular reacted to public pension insecurity because of the way that the typical family structure had been changing in Japan since World War II. More and more, elderly people were not relying on their children after retirement, and this meant that public pension were often the only source of income for them. Secondly, Japanese people were very risk adverse compared to the people of other countries. She noted that Japanese people tended to put savings into bank accounts, and did not invest much into bonds or risky assets.

Prof. Horioka responded to Mr. Omori that he agreed that the definition of the availability of credit used in his paper was not the best but that he could not find a superior measure for the full set of countries. He agreed that unemployment rate was something to take into account.