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Comparison of Pension Financial Systems between China and Japan

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ABSTRACT
This article aims to analyse the differences between Chinese and Japan's pension systems and the social reasons for the divergence. Although attitude and cognition of residents in both Japan and China towards the Pension system are similar, two nations each face unique and characteristic challenges in their respective Pension Finance developmental stages due to different progress in the westernization process and distinct economic trajectory and outlook. The purpose of this research is to identify what part of Japan's pension reformation can be emulated by China.

Keywords: *Pension financial system, Social Welfare, Japan's westernization, China*

1. INTRODUCTION

Suffering from decades of turmoil after WWII, violent political upheavals between Mao and Jiang, and a series of profound social reformations in the late twentieth century, Chinese citizens finally seized the leisure to consider reforming social welfare policies; Advancing the current pension system became an imminent and formidable mission. With increasing investable assets of the general public and a surging population of high net worth individuals, a more progressive and capitalistic mentality has evolved and challenged the traditional policies, driving society forward against the inertia of the planned economics. Another robust economy in Asia, Japan, serves as both a pioneer and perfect counterpart regarding the issue of pension and financial products after retirement.

The research question will be centred at the differences between Chinese and Japan's pension systems and the social reasons for the divergence. In the following pages, a comparison between the current Chinese and Japanese pension systems and public's attitude towards retirement financing will be performed, and an analysis of the explanatory social causes will be conducted. Underneath the glittering facade of Chinese rapid economic development, some fundamental social system and government policies are left incomplete, and the Pension system is one of these gaps in finance that need to be filled. Japan, experienced the similar discontinuity between explosion of economic activities and incompleteness of system reformations in 1980s, serves as a comparable example for China to learn from. This article argues that the although attitude and cognition of residents in both Japan and China towards the Pension system are similar, two nations each face unique and characteristic challenges in their respective Pension Finance developmental stages due to different progress in the westernization process and distinct economic trajectory and outlook. The first part of this article is aimed to answer why pension system is necessary in China and what are the common challenges that both China and Japan face. The second part will illustrate the divergent structures of current pension systems in both China and Japan and the shortcomings in each nation. The last part identifies the social and political causes for the difference in pension systems and the theoretical gaps of the citizens in China and Japan. These differences explain why Japan's Pension reformation can only serve as a guide for reference than for direct imitations. The purpose of this research question is to understand the differences in two nations' social structures and historical backgrounds, and thus identify what part of Japan's pension reformation can be emulated by China.

2. BACKGROUND AND CURRENT CHALLENGES

2.1. Common Root Causes

Why is pension reformation necessary for both China and Japan and what incurs the problems? The rooted origin of the Pension problems in China and Japan is their successively surge of the aged population.

Although the increasing aging population is an inevitable result of extending life expectancy and improving living standards, a large number of elders shirks the employment rate, diminishes labor productivity, and adds more pressure onto social security, health insurance, and pension system in this case.

After the devastating WWII and series of political reformations, the Chinese government encouraged high birth rates in the 1980s and 1990s, the generation of "Chinese baby boomers," to realize the hoped-for economic resurgence with the fast expansion of the labor force. Since 2001, China's proportion of the population over 65 years old constantly grows and exceeds 7% of the total population, the world standard for an aging society. Starting from 2015, the census graph begun to show the trend of potential exponential growth in the aged population, tensing the nerve of China's government and economists. According to the prediction of the national Census Bureau, China's senior population will exceed 300 million by 2025 [1].

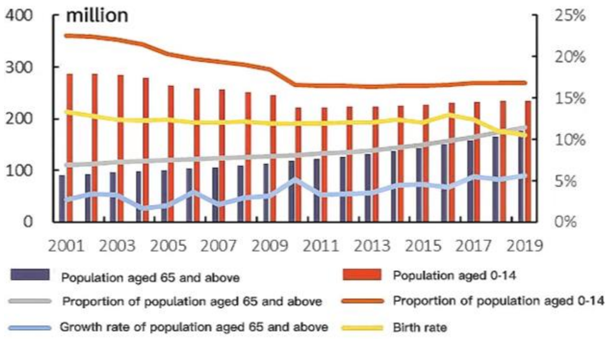

Figure 1 The number and growth of the elderly and children in China

Japan, considered the oldest society globally by many observers, faces an even more severe demographic developmental challenge. The data from the Allianz Global Investors indicates, "The current old-age dependency ratio stands at 30 and will worsen to 74 in 2050," meaning the ratio of economically inactive individuals will astonishingly reach 74 in every 100 citizens. By that time, the economy of Japan will not only freeze but also contain an extremely high population who demands social security, welfare, and healthcare, almost dooming an inevitable recession and deficits in government spending. Besides the natural aging process, Japan's fertility rate and average life expectancy continuously aggravate the grim situation: "Japan's population will decrease from 128 million to 102 million [by 2025]. The fertility rate of 1.26 children per woman lies considerably below the rate of 2.1 that is needed to maintain the population. At the same time, Japan's life expectancy is among the highest in the world. [2]" A greater pension system sustainability is an urgent palliative antidote.

2.2 Different Challenges

Although the aging population acts as a common root cause for the loopholes in China and Japan's pension systems, the two nations' current pension structures and shortcomings differ.

The World Bank and its 1994 report generally categorized the world current pension systems into three "Pillars": Pillar 1 refers to a flat, subsistence pension; Pillar 2 represents earning-related pensions; and Pillar 3 are voluntary retirement savings.

With the third Pillar of the pension system largely incomplete, high risks in domestic investment, and the inertia of the planned economy, China needs to step on an arduous yet necessary journey to complete the pension reformation. On the customers' side, Chinese investors' distrust in the long-term investment and their FAs undoubtedly adds another layer of difficulty.

China's pension finance services and products are indeed in their infancy when the whole financial environment in China has just embarked on the world stage. China's pension system heavily relies on the first and second pillars, which are determined by the government and welfare policies. According to the Everbright Securities Insurance Industry Series Report III, the market scale for all three pillars of China's pension system reaches 10.76 trillion yuan in 2019. Yet, the first Pillar plays a dominant role by accounting for 78% (8.35 trillion yuan) of the total. The second Pillar only covers 254.8 million people, less than 2% of the national population, and the total substitution rate is less than 50%. Financial products for the aged in the third Pillar are limited in variety, loosely targeted, and lack efficiency without any beneficial policies from the government. These products, essentially low-risk wealth management products, combine a large proportion of funds with a small number of stocks and fail to provide financial security specific to retirement life and the aged group. Moreover, the safety of investment in China also discourages individuals from entering the market. Explaining, "On the demand side, institutional investors represent not more than 3 percent of the market, and on the supply side, few public companies have stellar corporate governance records," Li, Shaoguang in his article "CHINA'S 'Pension Reform" indicates that lack of accumulative experience and mature managing system for the investment institutions reduce the credibility for investing and frighten the investors off [3]. Moreover, the scarcity of expertise in managing and operating pension funds continuously diminishes potential investors' confidence in their FAs. As a result, in 2019, the market scale of the third Pillar was 1.24 billion yuan, accounting for only 0.01% of the total assets, where the third Pillar in other developed countries, such as Japan and America, obtain a market share of about 30%.

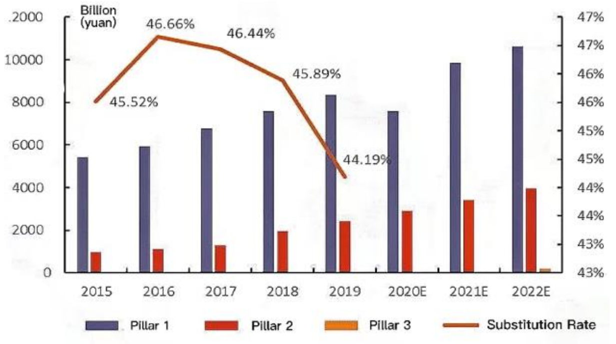

Figure 2 Capital scale of the three pillars of China's pension system and total pension substitution rate

* 1 billion yuan approximately equals to 0.1547 billion USD

Besides the undeveloped third pillar, the legacy of Mao's policies and inertia of the planned economy remain, constraining the freedom of the market. As Li points out, "The long-term challenge for China is to recognize that the proper pension system is one that eventually keeps the balance between economic growth and social justice, not by means of government intervention, but by the market mechanism itself, [3]" the Chinese government should step out and leave more space and trust for the market to run itself.

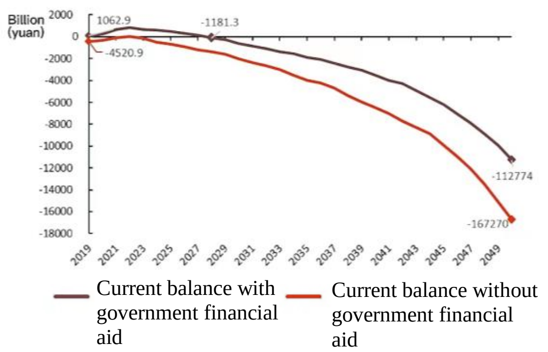

Figure 3 Pension gap forecast

In Japan, pension financial systems are well developed with various pension services and products to serve personalized needs, but the National Pension Service is experiencing a significant deficit since the 1970s. In 1983, Japanese economist Noguchi Yukio predicted that "the rate of contribution of the employees' Pension will be forced to rise from the current rate of 10.6 percent to 30.6 percent in the year 2010 and to 34.9 percent in 2025", according to the data from the Ministry of Welfare [4]. Although the real contribution rate nowadays is 14.64% of wages, which is equally split between the employers and employees, Noguchi's prediction nevertheless raises a red flag to warn a pension level that extends far beyond the tolerable limit and could potentially bankrupt the whole system. This issue of the high rate of contribution stretches for many decades in Japan's history due to their fast-aging population and puts Japan's government in a dilemma of balancing national expenditure and social welfare.

The third pillar of Japan's pension system is primarily controlled by a few oligopolistic companies and mainly composed of the Target-date Mutual Funds. By January 2021, there are 141 funds in Japan's third Pension Pillar with a scale of 134.696 billion USD, controlled by 16 different companies. One similar shortcoming of both China and Japan's third Pillar financial system is the low trust of customers towards their Financial Advisor, for both China and Japan lack the experts with a high proficiency level in finance and investment banking to accurately and precisely estimate the risk and outlook of stock and fund markets [5].

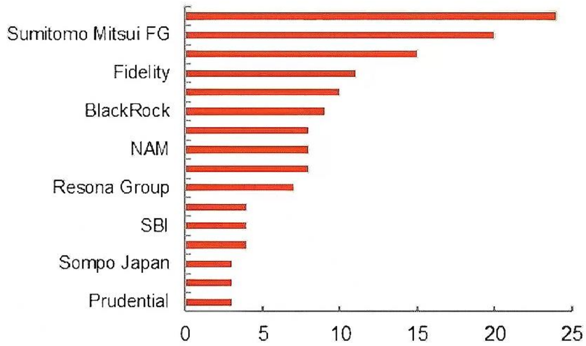

Figure 4 Japan Target-date Mutual Fund Issuer

3. ANALYSIS: THE HISTORICAL AND SOCIAL CAUSES FOR THE SIMILARITIES AND DIVERGENCE

The citizens of both China and Japan maintain a conservative investment risk preference, a saving rate substantially higher than the world average, and low trust in Financial Assistance for the well-off. These similarities originate from both countries' common problems of the aging population, similar social hierarchy and distribution of high net worth population, and analogous cultural backgrounds, emphasizing the significance of mutual learning and salutary reference. Yet the essential divisions lays in the distinct social and political structure: China is still recognized as a developing country with socialist society with weak individual property rights and over-risky financial market; Japan, on the contrary, adopted westernization centuries ago, contains a freer market and more complete financial system, but faced a challenge of huge National Pension Service deficit.

Many previous study in the field also compares China's pension system with the one of Japan, but they do not offer a complete, consistent logical chain for why should China emulate Japan's developmental path, what to emulate, and how to emulate. In Aiqun Hu's article, "The Global Spread of Neoliberalism and China's Pension Reform since 1978," he detailed analyze the significant influence of international organizations and foreign experts in China's pension reform [6]. Yet, his article focuses heavily on the result of the foreign influence and does not mention why these influences happened in the first place or why the foreign organizations and experts are applicable to Chinese market environment around 1980s. Other studies focus too much on two nations' similarities and omit the difference in social and political environment that make them inapplicable to China. In Patrick J. Regan's paper, "Pension Fund Perspective: China Syndrome Hits Japan," the author indicates many similarities and common challenges of two nations, but overlook the fundamental differences of capitalism and socialism [7].

3.1 Similarities

On the pensioners' side, China and Japan display great similarity in citizens' investment preferences, availability of residents' investable assets and nationally demographic distribution of wealth as the results of the homologous cultural backgrounds and comparable social structures.

China and Japan contain the largest numbers of high net worth individuals in the Asia Pacific, occupying dominant positions in the world's financial stage. With the rise of the real estate market at the beginning of the 21st century, the first group of high net-worth population emerged in China and started to focus more on managing asserts than accumulating wealth. Based on the China Private Wealth Report released by China Merchants Bank and Bain on June 5, 2019, the number of Chinese high net worth people with domestic investable assets of more than 10 million yuan reached 1.97 million, surpassing Japan and marking China the region with the largest number of high net worth people in the Asia Pacific. The considerable total investable property that both China and Japan possess breeds strong financial investment vitality if efficiently managed and an optimistic outlook in the future.

However, bank services and products are the most preferable investment strategies for pension consumers in China currently. With professional financial knowledge inaccessible and stock markets overly risky, Chinese investors lose confidence in funds and stocks and are generally unfamiliar with private offering funds and trust companies. Over 30% of the Chinese citizens choose deposits as their top investment instruments, and 20.5% of the population prioritizes the insurance products in the banks or other products with low but steady long-term interests. Both Japan and China share a conservative and low-risk investment preference.

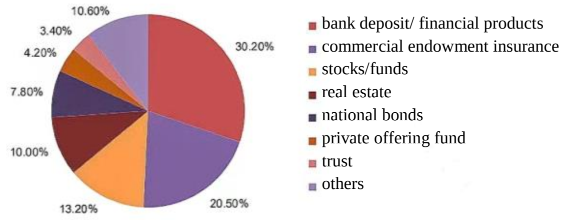

Figure 5 Chinese pension consumers' investment and financial management preference

Moreover, the savings rates of the two countries exceed substantially beyond the world average. Although China's proportion of deposit currency progressively declined from about 60% to around 35% since 2000, China's personal savings rate is still higher than twice the US's. Similarly, the Japanese also store most of their wealth in the form of cash. From 2000 to 2019, the average proportion of asserts that Japanese held in cash fluctuated between 53% and 54%, about five times as much as the one of Americans. Both nations' citizens recognize pensions more as a family responsibility and financial sustainability instead of an individual investment decision. They rather guarantee long-term security than making profits in order to resolve family emergencies when needed, so they prefer to store their wealth most tangibly. Thus, the lack of liquidity and flexibility in China's and Japan's markets constrain the investment expansion and diminish the multiplier effects in money exchanges.

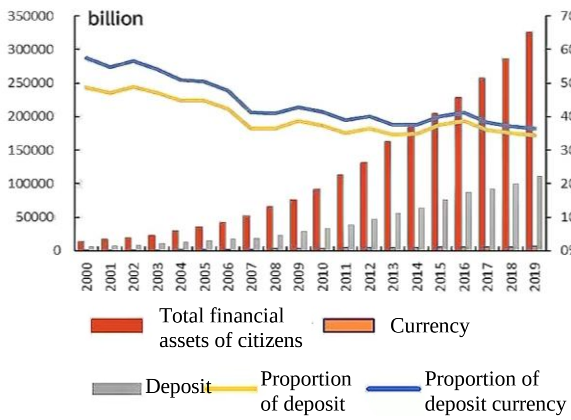

Figure 6 Chinese citizens' financial assets, bank deposits, currency scale and total financial assets ratios

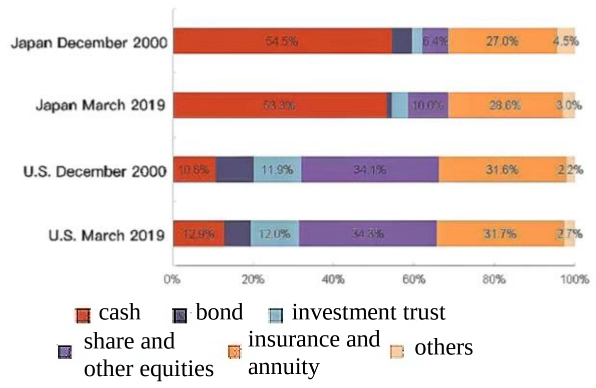

Figure 7 Distribution of household savings and investment ratio in Japan

3.2 Divergence

Conversely, on the governmental institution side, Japan and China differ in the macroeconomic scope. Different degrees of westernization, whether voluntarily or not, and opposite economic trajectories determine the unique characteristics of two countries' pension systems and the necessary divisions in their developmental paths.

On a macroeconomic scale, disparate historical factors and distinct progress in capitalist economies place China and Japan in different economic developmental stages. Japan embraced industrialization and westernization as early as 1868, the implementation of the Meiji restoration. Besides political and military reforms, Emperor Meiji vigorously promoted the "Shokusan-Kogyo" policy at that juncture to foster private capital and promote the development of private enterprises. To accelerate the process of industrialization, the Japanese government issued the "official decentralization order" in 1880 [8]. The order disposed the majority of government-owned enterprises to the privileged prominent capitalists such as Mitsui, Mitsubishi, Kawasaki, and Guhe at a low price. "Shokusan-Kogyo" policy reversed the direction of financial power from the state-owned enterprises to private capitalists, accelerated the accumulation of original capital with treasury funds, and boosted domestic technological innovation [9]. Moreover, the Meiji restoration legalized land sales and acknowledged private ownership, fundamentally changing Japan's economic structure, paving the path towards the robust financial mechanism we see today. On the contrary, the Chinese government's insensitivity to western influence and fear of decentralizing the power slowed the step of China's financial development, making China the few non-capitalist societies among the strongest economies in the world.

Nevertheless, the side effects of Japan's overheated economy in the 19th and 20th centuries were reflected by the economic bubble bursts and the chronic recession in recent decades [10]. In 1999, Japan was forced to reduce pension benefits because of unsustainable government deficits. As stated in The 1999 Pension Reformation, "Aggregate pension benefits will be reduced by 20 percent by 2025 for the system to have a healthier financing basis," Japan suffered from the pressure of long-lasting economic dormancy and had to conduct a similar reduction in benefits in 2004 again [5]. By contrast, China's overall economic displays a skyrocketing increase, and further market expansion is a certainty. The continuous increases in citizen's investable assert and wealthy population, the perfection of the financial market, and the dissemination of basic economic knowledge to the general public are predictable, but the future of China's pension system lies on government interference and the degree of market freedom. The general orientation of Chinese politics destines whether Chinese citizens' money becomes "dead wealth," the public asserts, or a vital component and input into the world's investment current.

4.CONCLUSION

In conclusion, Japan serves as a guiding example for Chia's Pension system reformation because the citizens from the both country embraces a conservative investment tendency, adore similar family cultures and social backgrounds, and hold large amount of investable assets. The psychology of high net-worth population is both nation is similar, characterized by low trust in financial analysts. However, China's reformation needs to be modified according to China's own market and social characteristics, updating public cognition of private investment, enhancing the Third Pillar for pension products and services, and stabilize the stock market to attract more potential investors. The shortcoming of Japan's Pension system should also signal a red flag to China. China need to be cautious in avoiding the pitfall of heavy national deficits and the potential risk of an oligopoly financial market. Yet, overall, this article is a simplification of the real situation, Chinese government need to consider large wealth discrepancy across different cities domestically, increasing age of the labor force, and the forecastable impact of pension reformation in employment, taxation, and social security. As Noguchi, Yukio remarks in his article "Problems of Public Pension in Japan," "The burden of future generations cannot be alleviated even if the benefits are successfully reduced or even if the programs are entirely eliminated, because in those cases elders must be taken care of by individual households or by public assistance programs. Future generations cannot escape from increases in burden of some form, given the changes in the age structure of the population." The journey of pension reformation in both China and Japan is determined to be a lengthy, arduous, and ongoing process.

AUTHORS' CONTRIBUTIONS

All research was conducted and written by Yu Zhou. I read and approve of the final manuscript.

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