

Tax Literacy and Retirement Planning in Japan

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Abstract

Facing the decreasing benefit of the public pension system in an aging society, the Japanese government offers various tax advantages to encourage personal pension investments. However, the effects of these tax breaks on individual decisions depend on the level of tax literacy as well as behavioral characteristics such as time and risk preference. While previous studies demonstrate that financial literacy plays an important role in increasing the probability of having retirement saving plans, tax literacy has not been included in measurements of financial literacy, and thus the role of tax literacy has not been well investigated either. Using our unique data of middle-aged people in Japan, we measure tax literacy separately from financial literacy and investigate their role in various investment decisions. Employing parental educational attainment and experience of having different types of welfare plans for retirement planning by a company one has worked for as instruments for endogenous variables of tax and financial literacy, we conduct instrumental variables estimations. We find that tax literacy plays a significant role in increasing the probability of having personal pension investments with tax benefits, while we find no significant effect of tax literacy on increasing the probability of having individual brokerage accounts without any tax benefits. On the other hand, we find no significant impact of financial literacy on increasing the probability of having personal pension investments after controlling for its endogeneity.

Keywords: Tax literacy, Financial literacy, Retirement planning, Time preference, Risk preference

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