

Towards a More Resilient Society: Lessons from Economic Crises

Report of the Social Resilience Project 2011

Coordinated by

Japan National Committee for Pacific Economic Cooperation (JANCPEC)

 財団法人 日本国際問題研究所
The Japan Institute of International Affairs

Published in Japan in March 2012 by
The Japan Institute of International Affairs (JIJA)
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<http://www.jiia.or.jp/>

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ISBN978-4-8193-0211-1

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Foreword

Economic crises have hit our economies almost every ten years during the past two decades. Being aware that we must consider not only economic rescue policies in the short term but also the resilience of social infrastructure against frequent economic crises in the long term, the Japan National Committee for Pacific Economic Cooperation (JANCPEC) launched the Social Resilience Research Project (SR Project) in 2010 as a Pacific Economic Cooperation Council (PECC) International Project.

The SR Project is designed to shed light on the importance of social safety nets and to closely examine the mechanism of their roles in the domestic economy. Comparative research on the actual status of Asian social safety nets would definitely be useful if we are to make our society more resilient against economic crises that may occur again in the future.

The SR Project has a four-fold focus: the pension systems, health insurance systems, and unemployment insurance systems in the Asia-Pacific region, and a macro analysis. A working team was formed in each field, and research members on each team pursued studies, collaborating with each other while focusing on their own subjects.

This report is the final output of the SR Project's second year. An interim research report was made at PECC International Workshop on Social Resilience Project 2011 held in Tokyo on July 12, 2011. During the Workshop, the head of each working team as well as team members presented their research findings and received advice and suggestions from commentators and participants. Having summarized the discussions at the Workshop and recognized their next tasks and future directions, each working team continued its respective research and then this final report was completed.

The views expressed herein are the personal views of the individuals indicated, and do not necessarily reflect the views of PECC and Japan Institute of International Affairs (JIJA). I hope that these inputs will prove useful in illuminating the way ahead for the Asia-Pacific region. In closing, I would like to express my heartfelt gratitude to the SR Project members for their enthusiastic commitment to this study and their immense contributions to this project as well as to the many people who worked so hard in preparing this report.

March 2012

Yoshiji NOGAMI
Chair, JANCPEC
President, Japan Institute of International Affairs

Executive Summary

1. Pension System Team

The pension system team submitted two papers. The first paper is written by Professor Mukul Asher from the National University of Singapore, which explores the areas where the state can play a significant role in managing the costs of aging primarily relating to pensions and health care. The second paper is written by Professor Noriyuki Takayama of Hitotsubashi University, Japan, which deals with the pension issues in Japan with a special focus on coordination with employment.

Professor M. Asher highlights that the Asia-Pacific region is exhibiting rapid aging of population due to a combination of declining fertility rates and improving longevity. In 2010, Asia accounted for 54.4% of the global total of those above 60 years of age, and this is expected to increase to 59.9% by 2030. He explores the areas where the state can play a significant role in managing the costs of aging primarily relating to pensions and health care.

The context in which the state will need to play its role in managing the costs of aging is characterized by extreme complexity. This is because globalization had made countries economically weaker; many states are still re-anchoring domestic fiscal and macroeconomic policies in the aftermath of the 2008 financial crisis; there is less certainty among economists and among investment professionals about some of their long established analytical concepts and tools. This is further exacerbated by the limited fiscal space that many states currently operate in, or expect to be operating in.

He also discusses specific initiatives and measures, which the state could consider in managing the costs of aging in the Asia-Pacific. Each state will need to construct a package of measures which is appropriate for its context, objectives and ability to undertake complementary reforms in such areas as labor markets, fiscal policies, and administrative and governance reforms. These packages include initiating high-quality public debates on new social contracts for health care and retirement financing; initiating civil service and military pension reform to reduce the disproportionate resource costs they impose on the society; implementing reforms to improve the fairness and sustainability of the current health care and pension arrangements; initiating totalization agreements to improve the welfare for migrant workers; facilitating bequests; and harmonizing the tax treatment for various health care and pension products so as to ensure efficient contemporaneous and inter-temporal consumption choices.

Professor N. Takayama from Hitotsubashi University, Japan, takes up the pension issues in Japan with a special focus on coordination with employment. Pensions and employment have

different dimensions among varying groups: female workers, young workers and elderly workers. The paper first gives a brief sketch of current provisions of social security pensions in Japan and illustrates five types of non-contributory pension benefits which are designed to attain higher coverage and minimize the risks of elderly poverty.

Though the principal idea of a social insurance pension should be income security in old age without the need to depend on means-tested support, there are in fact a number of older persons who are not covered by the current pension system due to a failure to file applications or insufficient years of contributions. A social insurance system that promises old-age security to all members of the community has its own drawbacks. In particular, the current legislation mandating a basic pension is becoming virtually hollow for the increasing number of atypical employees and the non-employed.

Pension issues have to be reviewed carefully with a special focus on coordination with employment. Incentives, compliance and accountability are basic prerequisites for maintaining or expanding good coverage. A trustworthy government capable of competent and efficient implementation is required for broader coverage, as well. Heavy work still lies ahead but these Japanese experiences furnish valuable lessons for other aging countries on what to do and what not to do when reforming pensions.

2. Health Insurance System Team

The health insurance system team examined the health insurance systems of Japan and China. The first paper written by Professor Masako Ii gives an overview of the health care system in Japan and then discusses current challenges and lessons that can be drawn from the Japanese experience. Dr. Hiroko Uchimura wrote the second paper which examines the progress of health system reforms in China and attempts to provide policy advice on further reforms in the health sector. The third paper prepared by Dr. Yoko Ibuka analyses how health care expenditure evolved together with demographic changes in Japan and briefly discusses issues associated with predictions for future health care expenditure.

(1) Key Issues in Japanese Health Care (by Professor Masako Ii)

Fifty years have passed since universal insurance was implemented in Japan and, in the light of current institutional fatigue, today's health insurance system in Japan needs drastic reform. Currently, Japan's health care system is facing a financial crisis. Health care costs are increasing partly due to an aging Japanese society, the development and utilization of new health care technologies, and patients' increasing demand for quality and safety in health care.

A lack of differentiation of health care providers and the lack of an efficient primary care system are weaknesses of the Japanese health care system. Changing and enhancing the role of the insurer would be a core task in such a reform. Health sector reforms have been discussed for more

than a couple of decades; however, the reform made slow progress and was not very effective because the old decision-making process was preserved.

In Japan, with the free-access system, many patients with primary care problems tend to rush into secondary/tertiary care hospitals. This has affected the function of the hospitals so much that it has contributed to increasing the medical costs, particularly for the elderly. What the Japanese health care system needs in this aging era is a good collaboration between specialists in the hospitals and community-based primary care physicians. Japan does not have sound systems of primary care provided by well-trained family doctors who are specialists in primary care. An efficient primary care system is important for any economy at any development stage, since primary care usually covers more than 80% of health and medical problems.

Other critical issues for Japanese health care are to create sustainable financing mechanisms for the elderly, and to introduce economic incentives in order to assure quality and efficiencies, particularly in primary care systems, based on a solid database. It is also important to introduce a health register system for the whole population. After the Great East Japan Earthquake, a team from Fukushima Medical University attempted to find out which houses might need medical services within the 20-30 km zone around the nuclear power plant and discovered that determining this was incredibly difficult.

(2) Health System Reforms in the People's Republic of China: Progress and Further Challenges (by Dr. Hiroko Uchimura)

Most of the population was uninsured in the early 1990s in China. People had to bear considerable financial burdens to access health care services. In particular, rural people could scarcely access needed health care services. Facing those situations, the government has eventually initiated health system reforms since the late 1990s. The government first focused on the reestablishment of medical insurance systems. More recently, a comprehensive reform plan of health systems has been undertaken.

Medical insurance coverage has reached more than 90% in rural areas and more than 70% in urban areas. The progress contributes to reducing the financial burden for the insured to access needed health care services. However, there remain challenges in the health sector. One important challenge is a disparity in insurance coverage between localities. Strengthening fiscal capacity, especially capacity of local governments, is essential to expand insurance coverage in poor localities. Improving the physical condition of health facilities is also important to increase insurance coverage in rural areas.

In addition, aging will be a critical issue for the health sector in the near future. The share of those under 15 in total population in China is almost the same as that in high-income economies. Not only the increasing share of the elderly population but also the decreasing share of the working population in the total population will lead to substantial expansion of total health

expenditures in the near future. Those challenges require additional fiscal space for health in China.

There are several possible options for China to generate additional fiscal space for health. Further reforms in medical insurance schemes will reduce necessary fiscal subsidies for the insurance funds which can be allocated to further challenges in the health sector. In addition, fiscal expenditures can be reallocated between sectors, which will generate additional fiscal resources for the health sector. Improving tax administration is also an important means to increase fiscal revenues which can be allocated to health.

(3) A Brief Review on Health Care Expenditure in the Past, Present, and Future in Japan (by Dr. Yoko Ibuka)

In 1970, Japan's health expenditure as a percentage of GDP was 4.5% and showed a growing trend over the next 38 years. In 2008, it reached 8.5%. This is almost half of the corresponding value of the United States, and it ranked 20th among the Organization for Economic Co-operation and Development (OECD) countries. Despite the accelerated aging of the population, as well as other factors that are known to be related to high medical costs, the Japanese health care system has managed to control national health expenditure at a fairly low level, particularly compared to other OECD countries. The most recent statistics, however, show that the national health care expenditure increased by 3.4% between 2008 and 2009, a significant jump compared to the 2.0% increase seen between 2007 and 2008.

Projecting national health care expenditure is a quite challenging task. Projections are subject to several uncertainties, one of which is related to how morbidity and other epidemiological variables change in the future. Thus, projections on health care expenditure at the macroeconomic level are often conducted in practice by applying past observed trends in socioeconomic variables in a model. There has been growing attention on the future of health and health care system in Japan, and estimating current national health care costs and simulating the evolution of future health care expenditure are great concern for policy makers. Accordingly, a number of studies and government reports provided projections on health care expenditure. In those analyses, health care expenditure per person is often assumed to increase over time.

Health care expenditure of the nation is assumed to be correlated with the demographic structure of the society; however, further studies are needed for improved understanding of the mechanism of the connection between an aging population and health care expenditure.

3. Unemployment Insurance System Team

The unemployment insurance system team presented four papers. The first paper prepared by Dr. Giang Thanh Long and Ms. Nguyen Thi Xuan Thuy provides information about the unemployment insurance scheme in Vietnam and points out some policy challenges for Vietnam in terms of financial sustainability and fairness.

The concept of “unemployment” appeared in Vietnam about three decades ago when the economy began to transform from a centrally-planned to a market economy. Unemployment insurance (UI) has been put in place since late 2006 along with the first-ever Social Insurance Law, and started since 1 January 2009. Vietnam’s UI scheme resembles those in both developed and developing countries in terms of coverage, qualifying conditions, contribution responsibility, and benefit duration and amount. Up to December 2010, there were 7.1 million people joining the UI scheme, which accounted for merely 14% of the total labor force, and 75% of the total mandatory insured.

There are several policy challenges for the UI scheme in Vietnam in terms of its design and implementation as well as Vietnam’s labor market and economic conditions. To deal with unemployment challenges for the UI scheme, Dr. Giang and Ms. Nguyen propose the following policy recommendations.

First, we need to focus on creating employment rather than struggling with unemployment. Vietnam needs to improve labor productivity and efficiency since these factors have long-term impacts on economic growth and national competitiveness. As manufacturing industries will be acting as the key pillar for growth and job creation, vocational training for workers in these industries is an important policy action. At the same time, diversification of rural employment via appropriate structural changes will also help create jobs for rural areas.

Second, a large number of workers are still outsiders of the UI scheme. Most of them are vulnerable persons; therefore, promoting voluntary unemployment insurance should be considered an important policy action in preparing for unemployment risks for these groups.

Third, for the current UI scheme, some regulations should be revised or changed. It is necessary to consider different points of time for unemployment registration, submission of unemployment benefit application, and benefit delivery. It is also important to improve the administrative capacity of provincial bureaus of labor and social insurance organizations to avoid “fake” unemployment. Policy actions include monitoring and evaluation of labor contracts, wage and income auditing, and maintaining a list of current workers for all types of enterprises.

Last, but not least, information dissemination about the UI rights and responsibilities for all employers and employees is equally important as other policy actions. Without transparent regulations, it is obviously hard to have an efficient and influential UI scheme to protect workers from various risks, including job loss.

In the second paper, Professor Yukari Sawada examines China’s unemployment insurance system under the title of “What Makes Unemployment Insurance Funds Grow: China’s Challenge to Stabilize Workers and the UI Fund.

This paper first discusses elements that made huge UI Fund reserves possible, then explores some side effects of UI reserves for the contributors, and finally suggests some ideas to cope with the side effects to promote social protection among the unemployed.

At the end of the year 2010, UI fund reserves reached 175 billion RMB, which was more than double the amount in 2006. This means that even during the global financial crisis of 2008 and 2009, China's UI fund was growing faster than its GDP. Recent increases in wages and the number of newly covered workers surpassing that of beneficiaries are the obvious explanations. A low replacement rate has also been effective in keeping the UI fund away from debt.

Aside from the above explanations, one element that caused the large surplus is rather ironical but typical of developing economies. Social insurance is usually mandatory so as to avoid adverse choice and lessen risks. However, in developing economies, the well-established formal modern sector is likely to be a front runner in adopting newly introduced types of social insurance. As a result, the relatively stable and more well off than average employees are covered by UI before the rest.

In other words, limited coverage works favorably in keeping the UI fund's balance of payments in the black. In the case of China, a notable example is institutional organizations (IOs). IOs are organizations that engage in public services but are not part of the government. Typical examples are schools, hospitals, museums, publishers, and TV broadcasting stations.

In the face of huge surpluses of the UI fund, some local governments started to consider reducing the contribution rate to extend coverage and to encourage the reluctant formal sectors to continue paying the premium.

The Social Insurance Law was passed in October 2010 and was enforced from July 2011. In accordance with the law's passage, provinces and municipalities started to adjust their UI payment scheme for migrant workers. A frequently seen scheme is to pay properly the lump-sum UI benefits to dismissed peasant migrant workers.

It is still too early to say that China's strong administrative capacity may compensate other shortfalls. What is more important is to balance the demand for more benefits with the level of contribution. If the benefits are kept too meager to maintain a low level of premium, it might not be effective to support workers livelihood and to solve their anxiety over job loss, but too generous a benefit may bankrupt the fund.

One recommendation is to utilize migrant worker non-governmental organizations (NGOs). They consult workers to protect their labor rights and provide services to secure their livelihood. In Beijing, the municipality and district governments started to purchase their service to reach the grassroots.

The third paper documented by Professor Naoki Mitani provides an overview of the historical adaptation process of Japan's employment insurance (EI) to the structural changes in the labor market and the recommended future reform of employment insurance.

Long-term structural changes have been taking place in the Japanese labor market. The labor force population is aging and decreasing gradually, reflecting the demographic changes, accompanied by an increase in the female participation rate. Employment is decreasing in the

manufacturing and construction industries, while that in the service sector is increasing. The unemployment rate has become persistently high since the bursting of the bubble. Among others, the most salient structural changes are (1) increase in non-standard employment and (2) increase in long-term unemployment.

The ratio of recipients of unemployment insurance and social assistance to the working age population is fairly low (1.2%) in Japan, compared with the Organisation for Economic Cooperation and Development (OECD) average (nearly 7%). It may reflect the low coverage of EI and the low ratio of unemployment benefit (UB) recipients to unemployment as well as the fact that there is no unemployment assistance system. Thus, it is a challenge for EI to adapt to the structural changes in the labor market, especially the growing non-standard employment.

EI has been reformed consecutively to adapt to the growing non-standard employment since its start in 1975. The coverage of EI has been extended to cover more non-standard employees, by relaxing the conditions to be insured on the minimum earnings (abolished), the scheduled working hours before separation (shortened to 20 hours per week) and the condition of the expected length of employment (shortened from one year to 31 days). In addition, the Job Seekers' Support Program started in 2011. This is a new program to assist those unemployed who are not eligible for UB by providing training and employment support as well as a Professional Training Participation Allowance.

Although efforts have been made to cover more non-standard employees and to prevent any moral hazard, further reforms of EI are recommended to adapt to the current extended coverage of EI incorporating much of short-term employment, to further reduce the risk of frequent repeated unemployment, and to fill the chasm between EI and national assistance.

First, consideration must be given to applying a higher premium for fixed-term employees or introducing an experience-rated premium as practiced in the United States. A higher premium for the employers of non-regular workers may also contribute to mitigate the dualism of the Japanese labor market by moderating the growing number of non-standard employees.

Second, to avoid any moral hazard, efforts should be made to frequently monitor job search activities of UB beneficiaries or to make participation in training programs a condition for the payment of UB.

Third, it is recommended to require the payment of EI contributions on earnings from part-time work. EI covers only contracts with 20 or more standard hours per week, which, given that real hours can vary independently of standard hours, can lead to selective enrolment.

Fourth, regarding the conditions of benefit entitlement, it is proposed to extend the duration of penalty from one month to two months in the case of refusal of job offers by the Public Employment Service to prevent moral hazard.

Fifth, the duration of benefits should be lengthened with the introduction of a gradually decreasing benefit system. Because there is no unemployment assistance in Japan, the benefit is suddenly suspended after the expiration of the duration of benefit. Nonetheless, it must be taken

into consideration that, on the other hand, the extension of the length of benefit may increase the number of the long-term unemployed.

Sixth, in Japan, UB is suspended as soon as the recipient is employed, even if hours worked and earnings are very small. In other OECD countries, benefits continue to be paid to the recipient who is employed or partially unemployed, if earnings or hours worked are within certain thresholds. This might prevent decline in disposable income through part-time work and contribute to promoting early re-employment.

The fourth paper written by Mr. Yasuhiro Kamimura explores the characteristics of the labor market in East Asian economies, focusing on informal employment.

Wide variations exist in the characteristics of the labor market in East Asian economies. In order to upgrade and expand the existing social security system, it is necessary to base the institutional design of such system on an in-depth understanding of the characteristics of the labor market of each economy—in which the issue of informal employment is pivotal.

In the developing economies, it is particularly important to clarify and operationalize the concept of informal employment if they want to expand social security coverage for informal workers.

This paper provides a schema that explains how various forms of informal employment emerge from the interaction between state regulations and the labor market and examines strategies aimed at expanding social security coverage.

The first section of the paper presents an overview of unemployment in East Asia and maintains the necessity of focusing on various types of informal employment, such as the self-employed, migrant workers who shuttle between wage employment and self-employment, and workers who are not covered by unemployment insurance.

In the second section, the literature on informal employment and related discussions within the International Labour Organization (ILO) are reviewed. Then, the author explains the perspective that informal employment develops out of the interaction between the regulatory capacity of the government and the characteristics of the labor market.

In the last section, based on a review of the preceding sections, the author proposes a novel schema to capture the phenomenon and attempts to measure the scale of informal employment, and finally argues for the need for governments to enhance their capacity to formalize each type of informal employment.

4. Macro Analysis Team

The macro analysis team submitted two papers: (1) “Exploding Welfare Claims in Japan: A New Look through Long-Term Time Series Data” by Professor Wataru Suzuki and Dr. Yanfei Zhou, and (2) “Recent Trends in Consumption in Japan and the Other G7 Countries” by Professor Charles Yuji Horioka.

The number of welfare claims has almost doubled in the last decade. The first paper tries to provide an insight about why the welfare claims rose so rapidly and whether this was caused mainly by a temporary shock or by a permanent shock. Specifically, Suzuki and Zhou use the Blanchard and Quah (1989) decomposition method and long-term monthly time series data (April 1960 – March 2011) to separate these two shocks.

A permanent shock is shown to impose a continuously positive impact on the public assistance rate and is the main driving factor for the recent rise of welfare claims. The permanent shock accounts for only 52.0% of the gap between forecast and actual values before the Lehman crisis, but its share reaches as high as 82.3% now. The generous government stance toward welfare approvals is likely to be a major source of this permanent shock. The impact of the temporary shock will not disappear soon, either. It takes 64 months for the impulse of a temporary shock to converge to zero. Put differently, even if the public assistance rate rises due to a temporary shock such as a recession or an earthquake, it takes nearly 5 years to regain its normal level.

Anti-poverty is definitely an important policy target for any government. Allowing many healthy, working-age poor to live on welfare, however, cannot be justified. According to the projection of National Institute of Population and Social Security Research, Japan's old-age dependency ratio is going to increase from the current 26% to the 50% range in 2030. Japan obviously cannot afford to let more and more precious citizens capable of work shift from the "supporting groups" to the "supported groups". The proper way to help the working-age poor is not to provide easy welfare, but to encourage them to search for new jobs either through tax credits or by providing job search assistance and free vocational training.

In the second paper, Professor Horioka presents data on recent trends in private consumption growth in Japan and the other Group of Seven (G7) countries (Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States) during the 2002-09 period and explores the reasons why private consumption was stagnant in Japan compared to the other G7 countries. It was found that there has been significant variability among the G7 countries not only in their private consumption growth rates but also in the determinants of private consumption growth during the 2002-07 period, with the relative importance of GDP growth, household income growth, household saving rates, and household wealth varying from country to country.

With respect to Japan, it was found that private consumption has been relatively stagnant during the 2002-07 period and that the stagnation of private consumption has been due primarily to the stagnation of household income and due partly to the relatively stability of its household saving rate and the sharp decline in household wealth. This suggests that the best way of stimulating private consumption and of bringing about a recovery of the Japanese economy as a whole would be to boost household incomes.

Possible ways of doing this would be to increase wages, create more job opportunities (especially for young workers, whose unemployment rates are still very high), provide more opportunities for vocational training, increase the share of regular workers (whose share has been declining), and improve the wages and other benefits and working conditions of part-time and temporary workers (whose share has been increasing). Finally, since we found that the stability of household saving rates is a contributing factor to the stagnation of private consumption in Japan, improving social safety nets and improving access to consumer credit would also boost private consumption by reducing precautionary saving.

1. Pension System

The Role of the State in Managing the Cost of Aging in Asia-Pacific

Mukul G. Asher*

1 Introduction

The Asia-Pacific region is exhibiting rapid aging of population due to a combination of declining fertility rates and improving longevity. According to the United Nations forecast in 2010, both the pace of aging and the share of aged in the population are projected to exceed corresponding global rates between 2010 and 2030¹.

In 2010, Asia accounted for 54.4% of the global total of those above 60 years of age, and this is expected to increase to 59.9% by 2030. It is therefore the Asia-Pacific region which will be significantly impacting the dynamics of global demographic trends.

The rapid aging of the Asia-Pacific population has implications not just for pensions and health care, but also for broader economy and society, affecting such areas as employment and consumption patterns, technology generation and absorption capabilities, transport systems, planning of public amenities and voting patterns (Roy and Punhani, 2010; Hayashi et al., 2009).

This paper, however, has a narrower focus. It explores the areas where the state can play a significant role in managing the costs of aging primarily relating to pensions and health care. This is not to suggest that other entities, individuals and households, and businesses cannot also significantly contribute to managing health care costs. As an example, adoption of healthier lifestyles by individuals and greater understanding of how a body functions could help in managing the cost of aging.

The paper is organized as follows. The next section provides the global and domestic context in which the state will need to play a role in managing the costs of aging. This is followed by possible initiatives and measures which the state could consider, and which may help in managing these costs. Each economy, however, will need to construct a package containing a mixture of initiatives and measures which may help manage costs. This is because the Asia-Pacific region is heterogeneous in terms of income levels, economic and political structures, institutional development, state capacities, and demographic characteristics. The existing pension and health care systems also demonstrate significant variations in the Asia-Pacific region (Asher, 2010). The final section provides concluding observations.

* Professor, National University of Singapore.

¹ In 2010, the population aged over 60 was 9.9% of the total population, lower than the corresponding share globally of 11.0%. However, by 2030, Asia's share at 16.7% is projected to exceed that of the world (16.5%). Similar trends are projected for the median age of the population. Life expectancy at birth in Asia is expected to increase from 70.3 in 2010 to 73.6 in 2030, with many Asia-Pacific economies exhibiting much higher levels (UNDESA, 2010).

2 The Context

The context in which the state will need to play its role in managing the costs of aging is characterized by extreme complexity.

First, due to globalization, particularly concerning financial and capital flows, "...countries are becoming spatially smaller, and cross-country connectivity, and externalities have become larger" (Tanzi, 2011). Even as the need for global economic coordination increases, as exemplified by the 2008 global financial and economic crisis, institutional mechanisms for such a role have been slow to evolve.

Second, while it is recognized that restoring economic growth in North America, Europe and Japan is essential, traditional policy instruments, particularly fiscal stimulus, and quantitative easing by the central banks to restore growth have diminished substantially. There is considerable uncertainty among the economists and policy makers on policies to pursue, resulting in policy drift. This is further accentuated by the geo-economic and geo-strategic shifts underway.

Third, fiscal sustainability has become a major issue particularly in the developed economies. Sovereign debt default is no longer inconceivable. The risk premium for rolling over existing debt and issuing new debt are rising for those economies that are perceived to manage public finances poorly. This implies difficult choices for the state in managing pension and health care costs as a combination of reduction in benefits, raising taxes and contributions for politically important groups, including the high income groups, and the financial sector is being debated particularly in Europe, the United States and the United Kingdom. In some economies, such as Japan, painful increases in consumption taxes may be necessary to manage the costs of aging.

Fourth, there is less certainty among economists and among investment professionals about some of their long established analytical concepts and tools. Rajan (2010) has analyzed recent global trends in financial intermediation which have resulted in inefficient allocation of global savings. These include growing importance of a shadow banking system comprising sovereign wealth funds, private equity and hedge funds; overly sophisticated and complex derivative instruments; light regulation of the financial sector; and the recent emergence of high frequency trading.

Managers of provident and pension fund assets, as well as individuals finding it increasingly difficult, in general, to generate above average returns as risks associated with almost every asset class have increased. As *The Economist* (October 15, 2011) states, "Equities have suffered two bear markets in just over a decade and remain vulnerable to rich-world recession; government bonds offer little protection against a resurgence of inflation; commodities are volatile and hostage to a possible drop in Chinese demand; property is still suffering indigestion after the past decade's boom"².

² "I would start from here", *The Economist*, October 15, 2011.

Not only are the demographic trends more adverse from the perspective of the cost of aging, but there is considerably less certainty among the economists and among investment professionals about some of their long established analytical concepts, tools and practices. Geo-economic and geo-strategic shifts underway accentuate the complexity.

The sovereign debt default is no longer inconceivable, and at the least, risk premium for rolling-over of existing debt and of new debt would rise significantly for those economies or sub-national governments that are perceived to manage their public finances poorly. Fiscal sustainability has therefore become a major issue, complicating the response of the state, particularly in redirecting fiscal policies toward enhancing good quality growth.

3 The Role of the State: Specific Initiatives and Measures

This section discusses specific initiatives and measures which the state could consider in managing the costs of aging in the Asia-Pacific. As emphasized, each state will need to construct a package of measures which is appropriate for its context, objectives and the ability to undertake complementary reforms in such areas as labor markets, fiscal policies, and administrative and governance reforms. All states, however, will need to pursue macroeconomic and financial stability which are essential for generating sustaining long-term growth.

Initiating Public Debate

The most important initiative which only the state can launch is to promote high quality, expertise and empirical evidence based debate among all the stakeholders on new social contracts for pensions (and health care) financing and related aspects. It should focus on demand, supply, social and political norms, administrative and governance structures, and regulatory aspects. With longevity often increasing faster than the capacity of the political system to address it, and close interlinkages between pension and health care expenditure, it is now essential to explore ways to jointly minimize the combined pension and health care expenditure for a desired level of provision.

In many low and middle income economies in Asia-Pacific, episodes of ill health will be an important reason why households may fall into poverty. Low health insurance coverage and high health care inflation are contributory factors for this phenomenon. As pensions are often indexed, correlation between high health care inflation and overall inflation will increase pension costs. This is yet another reason why pension and health care policies need to be coordinated.

Shifting thinking along these lines, with willingness to make organizational changes and fund solid empirical research to achieve coordination and minimize the joint costs of pensions and health care, should be an important component of this debate.

The legacy pension (and health care) issues arising from promises already made to existing beneficiaries, need to be separated from the future social contract affecting future liabilities. This

has been recognized in some Asia-Pacific economies such as Japan, Korea, and to an extent China, but greater efforts in this direction merit consideration in the Asia-Pacific region.

Civil Service and Military Pension Reform

Another area where the state can play a role concerns what public finance economists call horizontal equity. In the literature, intra-generational equity issues have received relatively less attention. This area is particularly relevant where the coverage of formal pension schemes is low, confined to civil servants and employees of large public and private sector organizations as is the case in many highly populated Asian economies such as India, Indonesia and China.

In many Asia-Pacific economies, civil servants and military personnel constitute around 5% to 6% of the labor force, and are overrepresented in the formal sector pension and health care systems. Moreover, due to relatively more generous provisions and coverage of longevity, inflation and survivors' risks, this group appropriates a disproportionate share of current and future resources devoted to pensions. As opportunity costs limit the share of gross domestic product (GDP) that can be devoted to pensions, and by implication to health care, this arrangement leaves a disproportionately smaller share of GDP for those who do not belong to this group.

The intra-generational inequities arising from the above arrangements need to be addressed by the state initiating measures which result in a less uneven spread of resources devoted to pensions and health care.

In the United States, for example, there are attempts under way in the state and municipal pensions (Independent Public Service Pension Commission , 2011) where credibility of pension promise is under severe threat) to explore constitutional ways to change accrual rates and other parameters for pensions for existing beneficiaries³.

The Hutton Commission Report in the United Kingdom has formed the basis for civil service pension reforms (. These include a shift from final salary to career average revalued earnings, and linking normal pension age to state pension age (with special provisions for uniform services) (Williams, 2011). Through these measures the government aims to reduce the proportion of adult life spent in retirement of public service workers to about one-third, the same proportion existing in the 1980s. The proposals will also help to limit the impact of contribution increased across public sector retirement schemes, and thereby help manage the share of GDP devoted for civil service pensions. To be effective, this should not be done in isolation, but with complementary changes in labor markets and other areas.

Many economies in Asia-Pacific, particularly those with fragmented pension and health care systems along public-private sector spectrum, need to initiate civil service and military pension reforms. This will not be politically easy. But without such reforms, fairness and

³ *The Economist* (October 15, 2011; p.70) reports that most recent estimates suggest that pension deficits of state and local governments in the United States amount to US\$4.4 trillion, higher by US\$1.3 trillion in just two years.

sustainability objectives will be more difficult to attain. The current post-crisis period is an opportunity to initiate reforms in this process.

Enhancing Fairness and Sustainability of Pension and Health Care Systems

There is a strong case to review the fairness and sustainability issues of current pension and health care arrangements in better managing the costs of aging. As income increases, individual and societal expectations have also increased. There have also been greater demands across the globe for greater political voice, participation, transparency and accountability. As reconfiguration of pension and health care systems will generate winners as well as losers, at least in the short term, fairness and sustainability of the reconfiguration will require consent of the better informed public.

The state can improve fairness in managing the costs of aging by harmonizing the differing pension and health care provisions amongst civil servants, military personnel, and those employed in the private sector. Sustainability of the various programs to manage the costs of aging, not only require matching of assets and liabilities but also include addressing the adequacy and coverage of the social security program.

For those that are life-time poor, the state will have to play a more active role in financing their costs of aging through social pensions, and other retirement income transfers. Further, in many low and middle income economies, the state can help strengthen public delivery systems for social pensions (and other social services); in constructing and maintaining relevant databases; and in encouraging good quality policy relevant pension and health policy research. If social sector policies such as pensions and health care are to be integrated into development strategies, then more rigorous rationale and assessment of their long-term development impacts are needed.

Among the high-income Asian economies, Australia, Japan and Korea have instituted social pensions. Means testing does not have to be direct. Thus, if social pensions are included as taxable income, the level will vary according to income tax bracket, even if the design proposes universal pension. Fiscal space and other poverty programs would be relevant in setting the social pension level.

Persistent gender imbalance in favor of males has been observed in many Asia-Pacific economies (Kurlantzick, 2010). To the extent that such imbalances affect the dynamics of family formulation and relationships, and impact the functioning of the labor markets, it has implications for pensions and health care.

Government policies can play a role in addressing this imbalance, though there is considerable uncertainty about the appropriate measures and their impact due to the interconnected nature of the current economic, social, political and perhaps security issues arising from the gender imbalance.

Totalization Agreements

There is considerable cross-border flows of workers within Asia-Pacific, and with outside the region. The state authorities should consider giving greater priority to totalization agreements, with key economies. Such agreements rationalize taxes and benefits relating to social security, just as Double Tax Agreements (DTAs) perform similar functions for the income tax. Such agreements could facilitate cross-border flows of people, while enabling cross-border workers to avail of a degree of retirement income security. Where totalization agreements are not feasible, the state should bilaterally or multilaterally negotiate better working conditions for the cross-border workers.

Addressing retirement income needs of cross-border workers will require regional cooperation among sending and receiving economies. As such cooperation is state-led, there is a role for regional organizations in evolving norms and codes of conduct, and in facilitating exchange of information.

Facilitating Bequest

The current arrangements in some economies, e.g. Japan, have made pensioners relatively better off than the younger cohorts, even as they have less promising “good” job prospects and higher social security burdens. Bequest is one of the instruments to manage inter-generational transfer. Another area where state can make useful contribution concerns fiscal arrangements surrounding bequest is by reducing fiscal and regulatory arbitrage possibilities between pension products, pension providers, and pension regulators.

The current and prospective challenging investment environment makes it even more difficult to earn higher than normal returns consistently on pension savings.

Converting pay-as-you-go (PAYG) schemes into even conventionally funded schemes is complex. Weak fiscal situations are not ideal to convert implicit pension debt into an explicit one. Moreover, as noted, the issue of whether the accumulated funds could be intermediated through financial and capital markets to raise core rate of growth needs to be addressed. In defined contribution (DC) schemes, the pay-out phase has received relatively less attention. Annuity markets are unlikely to be organized on a large scale while addressing longevity and inflation risks in an affordable manner without the role of the state. More debate and research on product and process innovations and on risk sharing among the stakeholders during the pay-out phase of the DC schemes are needed.

4 Concluding Remarks

The above discussion while not exhaustive, nevertheless, suggests that the effectiveness with which the state manages the cost of aging in individual Asia-Pacific economies will have an impact on their broader international competitiveness and on domestic social cohesion.

One of the important policy implications is the greater weight to be assigned to the precautionary principle in pension and health care policies. This principle suggests that any restructured pension and health care architecture should be such that a country is not locked into it, leading to high reversibility costs. The difficulties of reconfiguration of overly ambitious pension and other promises which cannot be kept, but which have acquired legal, or in the case of civil service pensions constitutional, backing, are well known.

By 2050, China will have 430 million persons, India 330 million persons and Indonesia 75 million persons above 60 years of age (UNDESA, 2010). Moreover, there will be significant regional and urban-rural differences. Any hasty nationwide pension or health care schemes which lock in such a large number of persons could be very costly economically and fiscally. The mixture of national and decentralized local pension and health care schemes, with requisite degree of reversibility, will however be a major challenge. At the minimum, a shift from welfare to effectiveness orientation will be needed in reforming the pension and health care systems.

The measures and their sequencing will depend on the context, capacities and specific economic, social, and political objectives and constraints of individual economies. If pension and other social policies are to be integrated into mainstream economic growth and development strategies, much more rigorous analysis of their design, and interactions with other policies will be needed. A shift from welfare-orientation of pension and health care policies to greater professionalism using modern management and governance techniques or practices will be essential in any Asia-Pacific economy.

Rapid aging in many Asia-Pacific economies and the current context has increased the relevance of innovations in design, delivery, process, financing, and governance arrangements concerning pension and health care costs. In many economies, as both health care and pension programs are intermediated through state financing, coordinating health care and pension financing arrangements merits consideration. Such coordination can take advantage of economies of scale and lower transactions costs, and thus better manage the combined resource costs devoted to health care and pension expenditures.

High quality, empirical evidence-based public policy debates on pensions and health care are essential both in individual Asia-Pacific economies and for the region as a whole. This process will assist in the emergence of a new social contract within which the state and other stakeholders can pursue specific initiatives and measures to help manage the costs of rapid aging.

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Pension Issues in Japan: With a Special Focus on Coordination with Employment

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1 Introduction

Japan has mandated social insurance pensions for all residents, with the primary objective of ensuring adequate income in old age. A contribution-based social insurance pension, however, has some disadvantages. Collecting contributions from small companies, atypical employees and informal sector workers is not easy, since compliance, administrative and enforcement costs are relatively high. This may leave low-income workers, in particular, outside the social insurance umbrella. In view of these difficulties, Japan also provides several non-contributory pensions to attain higher coverage and minimize the risks of elderly poverty.

This paper describes Japan's current social insurance pension system, with special emphasis on coordination with employment. Pensions and employment have different dimensions among varying groups: female workers, young workers and elderly workers. Before going into discussing these issues, this paper gives a brief sketch of current provisions of social security pensions in Japan. The Japanese experience furnishes a valuable lesson on what to do and what not to do when reforming pensions.

2 Current Provisions of Social Security Pensions: A Brief Sketch

Japan already has the oldest population in the world. The proportion of the elderly aged 65 and older was more than 23% in 2010 and will have risen to more than 40% by 2050.

Japan has a long history of social security pensions, dating back to 1875, when the pension system was established for military servants.¹ Currently, we have the Kosei-Nenkin-Hoken (KNH) for private sector employees and the Kokumin Nenkin (KN) for the non-employed and for full-time housewives.² Benefits consist of two tiers. The first-tier flat-rate basic benefit is paid to all participants in the social insurance pension system, and the second-tier earnings-related benefit applies only to employees. The system operates largely as a pay-as-you-go defined benefit program.

A person is required to contribute for no less than 25 years to receive basic old-age benefits. The full basic old-age pension is payable after 40 years of contributions. The maximum monthly

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¹ At the outset, it was called "On-Kyu" entitled without paying any contributions.

² For detailed explanation of the Japanese Public Pension System, see Takayama (1998, 2003). For civil servants, Japan has the Kyo-Sai-Nenkin (KSN).

pension of 66,000 yen³ at 2011 prices (based on the maximum 40 years of contributions) is payable from age 65. The benefit was previously indexed automatically each fiscal year (beginning April 1) to reflect changes in the consumer price index (CPI) from the previous calendar year. Since 2004, this indexation formula has been provisionally suspended and a new indexation that takes demographic factors into account has been introduced (Takayama 2004, 2006). The pension may be claimed at any age between 60 and 70 years of age, with an actuarial reduction or increase in benefit.

All employees receive earnings-related benefits. The accrual rate for the earnings-related component of old-age benefits is 0.5481% per year. Thus, 40 years of contributions will earn 28.5% of career average real monthly earnings.⁴

As a transitional measure, the full earnings-related pension is payable to a fully retired employee beginning at age 60. (Normally, it would start at age 65). An individual who has reached age 60 but has not fully retired can receive a reduced pension. The current replacement rate (including basic benefits) is close to 62% for a typical male retiree (with an average salary earned during 40 years of coverage) and his dependent wife.⁵ It will decrease to 50% by 2023 under a provisional indexation formula.

Equal percentage contributions are required of employees and their employers. The contributions are based on earnings (which include semi-annual bonuses). The total percentage in effect beginning in September 2011 is around 16.4% for the principal program for private sector employees (KNH). Non-employed persons between the ages of 20 and 60 pay flat-rate individual contributions as category 1 persons under the KN program. The current rate, since April 2011, is 15,020 yen per month. For those who cannot afford that, exemptions will be permitted. The flat-rate basic benefits for the period of exemption will be one-half of the normal amount in fiscal 2011.

Since fiscal 2009, the government has been subsidizing half of the total cost of the flat-rate basic benefits. There is no subsidy for the earnings-related part. The government pays administrative expenses as well.

3 Non-Contributory Pensions

Japan currently has five types of non-contributory pension benefits.

Basic disability pensions for those qualified as mentally or physically disabled before age 20

Those who become mentally or physically disabled before age 20 can receive the basic disability pension from age 20, subject to a generous income test. A thorough medical checkup is

³ ¥1,000 = US\$10.18 = £ 6.69 = €7.45 (as of August 1, 2008).

⁴ A semiannual bonus equivalent to 3.6 months' salary is typically assumed.

⁵ The couple's monthly amount of old-age benefits would be 232,000 yen in 2011.

carried out before the person is qualified for the pension. The budget is fully financed by transfers from general revenue.

Basic old-age pensions for low-income groups

Those in low-income groups can be exempted from paying a part or all of the KN flat-rate pension contribution. The upper annual income limit for full or partial exemption varies depending on household size. In a single-member household, for example, the 2011 amount for partial exemption is 1.89 million yen or less. In 2010, 5.95 million people were exempted. Once exempted, they are still qualified to receive half of the full basic old-age pension, which is financed by transfers from general revenue.

Two-tier old-age benefits for those on parental leave

Japanese parents can enjoy a parental leave of one year (for husband and wife combined) each time they have a baby. During parental leave, they are exempted from paying KNH pension contributions but still receive credit toward old-age pensions as if they had continued to earn the same salary that they had just before taking leave. In 2007, 111,000 employees were exempted through this scheme. No special funding arrangement has been made, and consequently these persons' old-age pension benefits accrued during parental leave are ultimately shouldered by contributions made by other participants.

Pension entitlements resulting from a contribution gap

Employers withdraw their employees' pension contributions from their monthly salaries. A small number of employers fail to transfer the contributions to the Japan Pension Service (JPS), the government body that collects contributions, because of financial difficulties or bankruptcy. The recovery rate at JPS is usually less than 100%, and the contribution-gap remains. Contributions made by other participants compensate for the gap by enabling the full payment of KNH pension benefits once the withdrawal of contributions is certified. This arrangement generates moral hazard among employers.

Welfare pensions for aged low-income groups at the start of the program

The flat-rate basic old-age pension is normally payable to those who have contributed for no fewer than 25 years. When the KN first started, however, those who were between the ages of 36 and 49 in 1961 were specially entitled to receive a smaller amount of basic pension with shorter contribution periods, ranging between 10 to 24 years. Those aged 50 and over in 1961 were not entitled to receive basic pensions. Instead, "welfare pensions" were provided to them when they reached age 70, with an income test. Welfare pensions have been financed wholly by transfers from general revenue, and the current monthly benefit is around 34,000 Japanese yen.

They are a transitory sunset scheme, and the number of recipients is currently very small, around 20,000 persons in March 2007.

4 Non-Beneficiaries of Social Security Pensions

In April 2007, around 420,000 people aged 65 and over (1.6% of those in the 65+ age group) received no social security old-age pension benefits, and it is estimated that 1.18 million persons, including those now under age 65, will be non-beneficiaries in the near future. The main reasons for non-coverage are failure to file applications and insufficient years of contributions.

In 2005, 556,000 persons among the elderly aged 65 and over (2.2% of the age group) received means-tested public assistance. Around 65% of the elderly with no social insurance pension benefits were forced to receive public assistance. Others among the elderly drew both social insurance pension benefits and public assistance, mainly because of their lower benefit level.

5 Increasing Dropout Rate

The descriptions given above are just half the story. Several coverage, implementation⁶ and social adequacy problems still confront Japan's social insurance pensions.

The first-tier basic benefit is not yet universal. Nearly 100% of regular employees are currently covered by the social insurance pension programs, but atypical employees and non-employees are not necessarily covered, although their enrollment is mandatory. In March 2007, around 54%⁷ of category 1 persons under the KN (independent workers, atypical workers, the self-employed and persons with no occupation) dropped out from the basic level of protection as a result of exemption (5.84 million persons), delinquency in paying contributions (5.19 million persons) or shunning of the program (363,000 persons). The dropout rate had increased from 35% in 1992.

Those who have dropped out will receive a smaller pension or none at all in old age, so they are likely to rely on the means-tested public assistance program. The principal idea of a social insurance pension should be income security in old age without the need to depend on means-tested support. A social insurance system that promises old-age security to all members of the community has its own drawbacks. The current legislation mandating a basic pension is becoming virtually hollow for atypical employees and the non-employed.

The current KNH system does not directly apply to employees who work fewer than 30 hours per week (three-fourths of the normal work week.) These part-time employees are obliged

⁶ Distrust of government pension commitments increased in 2007, mainly because of the unexpected announcement of 50 million "floating" pension records. These pensions had not been integrated into the unified personal pension numbers, which were introduced in 1997. Social insurance pension implementation proved to be still quite weak in Japan, inducing a higher dropout rate in the future (see Takayama and Kitamura, 2010).

⁷ This figure of 54% for all dropouts is equivalent to around 19% of all mandatory contributors. The administrative cost of the KN was about 7.7% of the aggregate amount of contributions in 2006, mainly because of the high dropout rate.

to participate in the KN instead. If they are the spouses of regular employees and their annual pay is less than 1.3 million Japanese yen (US\$10,000), they are treated like full-time homemakers, but if their annual pay exceeds 1.3 million yen, they lose the right to be treated as dependent spouses. They are then forced to pay flat-rate pension contributions as category 1 persons.

This arrangement tends to encourage part-time jobs that pay less than 1.3 million yen per year. Critics say that this is the main reason why part-timers remain low-income earners. One solution would be to reduce the upper earnings limit of 1.3 million yen to a negligible level, as in the United States and Germany. Employers in Japan, however, are strongly against this kind of program change because they would rather continue to avoid the higher compliance costs associated with social security. If this solution were implemented, employers might begin to lower part-time workers' wages, since non-wage costs, including the employers' share of social insurance contributions, would be increased.

6 Pensions for Women

Flat-rate basic pensions for full-time housewives

Under the current system, dependent spouses of regular employees—typically, full-time housewives—are *automatically* entitled to the flat-rate basic benefits, without being required to make any direct individual payments to the social insurance pension system. In 2010 there were about 10.1 million such persons, equivalent to about 15% of the total number of insured persons.

This entitlement raises contentious issues. The number of dual-income couples and single women has been steadily increasing, to such a degree that full-time housewives no longer constitute a majority of working-age women. Single women and dual-income couples have often attacked the current provisions geared toward full-time housewives as unfair. The policy bias is clear, but the issue lies in ideologically contested ground. A purely individualist approach would, for example, logically lead to the abolition of survivors' benefits, even though married women earn far less than their husbands. An alternative solution is to assign some share of husbands' earnings to non-working wives. The implicit income share of full-time housewives is currently assumed to be 50%. But this, in turn, could act as a disincentive for men to marry a full-time homemaker.

7 Growing Numbers of Atypical Employees and Pensions for Young Workers

In 2007 there were 32 million male and 23 million female employees in Japan, and the proportions of regular employees were 82% for males and 47% for females. These proportions have been gradually declining. Outsourcing, replacement of workers by contracts with outside staffing agencies, and increasing dependency on part-time, temporary and seasonal workers have all become common. In 2010 about one-third of workers were not regular employees. A majority of female employees are now non-regular, with most of them engaging in part-time jobs.

The social insurance coverage of earnings-related pension benefits has been on the decline. The reason is that the existing KNH system only covers regular employees and does not apply to such workers as temporary staff members under labor contracts of not more than two months, seasonal employees working not more than four continuous months, or those engaged on contract work for no more than six months—in addition to part-timers, as noted above. Such labor contracts are often made fictitiously to evade paying social insurance contributions, in collusion with employees who want to have higher take-home pay on the spot.

In addition, employers of small business establishments are often reluctant to participate in the compulsory KNH. Typical examples are those who work in restaurant, lodging, cleaning, barber, beauty salon, amusement and construction businesses. KNH coverage in these industries is currently around 50%,⁸ and the remaining employees, including regular ones, are obliged to participate only in the KN.

At first, the KN was supposed to apply mainly to self-employed and non-employed people, but today it also covers around 9 million atypical employees. Their share in the KN was 37% in 2005, making that the highest of all categories. (The shares of non-employed and self-employed persons were 31 and 18%, respectively.) Critics say that the KNH for employees is beginning to decline to mere form.

Many younger people in Japan are currently “atypical” workers and their working status is quite unstable. The majority of them are not likely to step up to “typical” ones. They are not assured that they will enjoy adequate and stable income during their prime working age. They will face the “Bad Start, Bad Finish” problem. Consequently, their pension benefits will be less than the adequate level. Higher employability with stable income is badly missing for them.

8 Pensions for Elderly Workers

The labor force participation rate of male workers in their early 60s was 70.6% in 2010. This proportion is relatively high in the world.

In Japan, we have an earnings-test for elderly workers to apply for their social security pension benefit. The marginal tax rate for their earnings is basically 50% (and 100% for high-salary earners). Theoretically, the earnings-test stated above will discourage their labor supply.

However, it should be remembered that the test does not apply to employment with less than 30 hours per week. This current provision gives a great incentive to employees and their employers to limit their working hours less than 30, inducing a big change in working hours from age 60.

On the other hand, pension benefits are virtually equivalent to “wage subsidies” for elderly employees, thereby encouraging labor demand for persons in their 60s.

⁸ The enforcement abilities of the JPS remain relatively poor compared with those of tax authorities.

Two factors stated above operate in different directions. Further empirical work is required to verify the net effect.⁹

9 Conclusion

Japan has devoted considerable effort to achieving coverage of all residents by social insurance pension systems. Coverage, overall, is among the highest in the world, with only 1.6% of the elderly currently not receiving social security old-age pension benefits.

Because of its rapidly aging population, Japan has been raising contributions to finance social insurance pensions, and this has induced an increased dropout rate from the basic protection scheme. Weak implementation has aggravated lower coverage. Growing numbers of atypical and irregular employees are losing their entitlement to an earnings-related pension through social insurance programs. Pension issues have to be reviewed carefully with a special focus on coordination with employment.

Incentives, compliance and accountability are basic prerequisites for maintaining or expanding good coverage. A trustworthy government capable of competent and efficient implementation is required for broader coverage, as well. Heavy work still lies ahead.

⁹ See Haider and Loughran (2008) for more details.

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2. Health Insurance System

Key Issues in Japanese Health Care

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I. Introduction

Economies around the world are anxiously searching for better health care systems. The development of health care systems has followed different routes in various economies around the world, influenced by the different cultures, histories, and ideas of each economy. A distinction that is particularly vital when developing a health care system is whether health care is considered to be a merit good (a good that everyone should receive) or a general resource, which should be allocated depending on the ability of the users to pay for it. Since 1961, Japan's health insurance system has been predicated on the first of these two approaches.

National experience shows that when a health system works well, it produces good results. Japan has achieved the world's best health indicators, with low infant mortality rates and very long average life expectancy. Weaknesses of the Japanese health care system include an inefficient primary care system, and a lack of differentiation of health care providers and of standard clinical guidelines.

Both the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD) have recently commended Japan's health care system. In its report entitled *Macro-Fiscal Implications of Health Care Reform in Advanced and Emerging Economies*, the IMF said, "The use of market mechanisms in Germany and Japan is an important factor explaining the low excess cost growth observed in these economies—both of which score relatively high in the indices for choice of insurer, choice of provider, and private provision." Likewise, in the report *Health Care Systems: Efficiency and Institutions*, the OECD stated, "Although estimates of health care spending efficiency should not be taken at face value, Australia, Korea, Japan and Switzerland perform best in transforming money into health outcomes." These were quite surprising quotes for those who know the Japanese health care system. Part of the reason for these quotes is that Japan's health care expenditure is underestimated, which we will discuss in more detail in this report.

Currently, Japan's health care system is facing a financial crisis. Health care costs are increasing partly due to an aging Japanese society, the development and utilization of new health care technologies, and patients' increasing demand for quality and safety in health care. Health sector reforms have been discussed for more than a couple of decades; however, the reform was slow in progress and not very effective because the old decision-making process was preserved. Meanwhile, Korea in 1989 and Chinese Taipei in 1995 adopted national health insurance

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following the Japanese health insurance system and have been moving ahead of Japan through various reforms such as integration in managing health insurance and the introduction of IT infrastructure.

This paper first gives an overview over the health care system in Japan and then discusses current challenges and lessons that can be drawn from the Japanese experience.

II. Overview of the Health Care System

A. Health Care Provision and Financing

One of the characteristics of the Japanese health care system is the high number of hospital beds per capita; therefore, employee-bed or nurse-bed staffing ratios are lower than the OECD average and to maintain the utilization rate of all these beds, hospital stays are also longer than the OECD average (Table 1).

Table 1 International Comparison on Health Care System (OECD Health Data 2010)

	Number of hospital beds per 1,000 people	Number of physicians per 1,000 people (% of GP)	Number of nurses per 1,000 people	Average length of stay in hospital: acute care (days)	Number of doctor visits as outpatient (times/year)	CT per 1 million	MRI per 1 million
U.S.	3.1	2.43 (12%)	10.75 ²⁾	5.5	4	34.3	25.9
Japan	13.8	2.15 (-)	9.54	18.8	13.4	97.3	43.1
Germany	8.2	3.56 (18%)	10.68	7.6	7.8		
U.K.	3.4	2.61 (29%)	9.52	7.1	5.9	7.4	5.6
France	6.9	3.34 ¹⁾ (49%)	7.93 ²⁾	5.2	6.9		
Canada	3.5	2.27 ¹⁾ (48%)	9.2	7.5	5.7	13.9	8
Korea	7.8	1.86 (37%)	4.36	10.6 ³⁾	13	37.1	19
Netherlands	4.3	2.88 (24.9%)	11.24	5.9	5.9	10.3	10.4
Australia	3.9	2.97 (51%)	10.08	5.9	6.4	38.8	5.9

1) Professionally active physician

2) Professionally active nurse

3) 2003

Source: OECD Health Data 2010, WHO.

Most of the OECD nations greatly reduced the number of acute care hospital beds, the average length of acute hospital stay, and the number of acute care hospital per capita during the 1990s. In Japan, the figure is decreasing, but still is the highest. Japanese hospitals are defined as any medical facility with at least 20 beds, including long-term geriatric care facilities. A lack of differentiation of health care providers and of standard clinical guidelines contribute to this rather high figure.

Another characteristic is a free-access system that allows people to be examined and treated at the medical institutions of their choice, regardless of their symptoms. This has led to the

problem of excessive demand from patients who visit doctors too often. The frequency of doctor visits per patient in Japan far outstrips the average for OECD countries.

In Japan, private hospitals dominate the hospital system, accounting for 80% of the hospital market and 70% of the total hospital beds in 2009. Government control over prices for all procedures, drugs, and devices applies uniformly to all physicians and hospitals, both public and private.

Hospitals operate as a closed system, and clinic-based doctors do not have visiting privileges at them. Exclusive specialty board certification is nonexistent and doctors practice in any specialty they choose. Hospitals and physicians freely choose their practice mode and are paid on a fee-for-service basis. Referrals and an organized distribution of functions between facilities have been sorely lacking. Clinics frequently provide both primary and more specialized care. A lack of differentiation of health care providers and a lack of an efficient primary care system are weaknesses of the Japanese health care system. Since Japan does not have a sound system of primary care provided by well-trained family doctors (note that the number of general practitioners [GPs], or family doctors, in Table 1 is missing for Japan), it is quite common for the patients to visit general hospital or even university medical center for minor illnesses without referral.

Japan has no postgraduate training system for primary care. Traditionally, primary care in Japan has been managed by specialists who are self-trained to be generalists. The Japan Medical Association, which represents mainly the doctors working at clinics, has a strong vested political power and this has delayed various health care reforms, including establishing formal training in family practice.

Sophisticated medical technology has spread to small clinics and general hospitals, both of which compete for outpatients. Fee-for-service payment further induced demand for new medical technologies such as computed tomography (CT) and magnetic resonance imaging (MRI) causing its wide proliferation. Although bureaucratic control helps the Japanese government contain health care expenditure, high endowments for CTs and MRIs are extraordinary (Table 1).

The remuneration system is fundamentally a fee-for-service system, but a diagnosis-based per-diem payment system, called diagnostic procedure combination (DPC) in Japan, has gradually been introduced in acute hospital beds. The payments doctors receive for medical services are the same nationwide, with rates set by the central government. Therefore, there are few incentives for quality improvement and little competition among providers on quality (Tatara and Okamoto, 2009).

A comparison of health expenditure data (Table 2) revealed a variation in the ratio between public and private expenditure in health care with Japan at the high end of public expenditure (81.3%), while Korea committed less to public funding (54.7%).

A more detailed breakdown of the sources of health care financing shows that while public expenditure is made up of general taxation and social health insurance, private expenditure is a mix of out-of-pocket spending for coinsurance, and services not covered by health insurance and premiums paid by families and individuals for private health insurance. As shown in Table 2, the share of total health spending that is privately financed varies considerably across the countries. The range is as high as 45.3% in Korea to as low as around 18% in Japan, the United Kingdom, and Sweden.

Table 2 Proportion of Health Care Expenditure by Funding Source

	Japan	Germany	France	Korea	UK	USA	Sweden	Canada
Public Spending on Health (%)	81.3	76.7	78.4	54.7	81.9	45.3	81.6	69.9
General Taxation (%)	15.4	9.2	5.1	12.9	81.9	32.6	81.6	68.5
Social Health Insurance (%)	64	67.5	73.4	41.8		12.7		1.4
Private Spending on Health(%)	18.7	23.3	21.6	45.3	18.1	54.7	18.4	30.1
Out-of-Pocket (%)	15.1	13.4	7	36.5	11.4	12.3	16.2	14.9
Private Health Insurance (%)	2.6	9.2	12.9	3.8	1.4	35.1	0.1	12.3

Expenditure on prescription drug / total health care expenditure	17.3	13.3	13.5	16.4		10.3	9.7	14.3
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Total health care expenditure / GDP	8.3	11.3	11.7	6.5	9.3	16.2	9.9	10.9
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Source: OECD Health Data 2010, WHO.

The aging of Japan's population is causing severe problems for the country's public finances. Elderly often suffer from several symptoms and with lower copayment for the elderly, they often visit specialists for each episode of illness.

Japanese elderly people use up a significant portion of health care expenditure; people aged 65 or over who make up 22% of the total population use 54.6% of the total expenditure, and per capita health expenditures among the elderly are almost four times as much as the amount spent for the 0-64 age group in 2008¹. The health insurance system, in particular, is structured such that fiscal resources are transferred from workplace-based insurance (whose members tend to be younger and have higher incomes) to the national (many of whose members are elderly or unemployed) and public corporation-run health insurance systems.

B. Organizational Structure of Health Insurance Programs in Japan

The most important health care policy in postwar Japan was the establishment of equality, through free health care access for all Japanese. Under the universal public insurance system, people can receive universal medical service anytime, anywhere throughout Japan at a relatively low cost. In addition, since 1997, the coinsurance rate for employees' health insurance and community health insurance became equal, the insured pay 30% and insurers pay 70% of medical costs. Benefits are uniform nationally.

However, there are large regional differences in the actual amount of health care services that people receive, which are reflected in medical expenses, as well as differences in the amount of public insurance premiums. Unequal contributions are one of the most serious issues in the health care insurance system.

¹ Since 2000, Long-Term Care Insurance took effect, and benefits offered under this insurance are not included in these statistics.

Japan's universal health insurance system is composed of four main insurance systems, i.e., community health insurance for the self-employed and unemployed (National Health Insurance: NHI), employees' health insurance (Society-Managed Health Insurance), public corporation-run health insurance, and the medical system for the elderly aged 75 and over. Each system comprises multiple insurance plans or sub-schemes with differing premium rates. Insurance premiums are calculated based on the insured person's income (ability-to-pay) regardless of their risks and the amount of benefits paid out to them. The method of calculating the premium rate for each system is different, depending on its insurers. The number of such insurers in Japan now exceeds 3,000 (Table 3).

Table 3 Japanese Health Care Insurance Programs

	National Health Insurance	Society-managed health insurance	Public corporation run health insurance	Medical system for the elderly aged 75 and over
Number of insurers (2009)	1,788	1,497	1	47
Number of members (2009)	35.97 million	30.34 million (Insured:15.91 million) (Dependent:14.43 million)	34.7 million (Insured:19.5 million) (Dependent:15.22 million)	13.46 million
Average age of members (2008)	49.2	33.8	36.0	81.8
Average income (total compensation) (2008) (Note 1)	¥0.79 million yen per member (former provisory income)	¥2.93 million per member (total compensation)	¥2.18 million per member (total compensation)	¥0.758 million per member (former provisory income)
Health care expenses per member (2008)	¥282,000	¥126,000	¥145,000	¥865,000
Premium per member (2008)	¥83,000	¥91,000 (¥203,000 including the employer's payment)	¥89,000 (¥177,000 including the employer's payment)	¥64,000
Proportion of public subsidies	50%	---	16.4%	50%
National budget (2010)	¥3,027.4 billion	¥2.4 billion	¥1,044.7 billion	¥3,734 billion

Source: Ministry of Health, Labour and Welfare, Japan.

Note 1) The former provisory income is worked out by subtracting the basic exemption (330,000 yen) from the total income (subtracting the amount of the employment income exemption

from earnings). It is used when the premium for the municipality-controlled National Health Insurance is calculated.

The employees' health insurance programs have relatively high ratios of healthy and wealthy enrollees. The Society-Managed Health Insurance is a program for employees of large corporations and their dependents (1,497 insurers). Employers deduct the employees' premiums directly from their paychecks and bonuses. Premium contributions are typically borne equally by employers and employees. However, for Society-Managed Health Insurance, many companies pay more than half of their employees' premiums. In 2009, premium rates for the Society-Managed Health Insurance ranged from 3.12% to 10% of employee (indexed) monthly earnings, and the average premium rate was 7.45%. The employer paid 55% of the total premiums. In the same year, the average premium rate for public corporation-run health insurance, covering employees of small- and medium-sized firms and their dependents, was 9.34% of an employee's monthly salary, with half the contribution paid by the employer.

The National Health Insurance (NHI) covers the self-employed, the unemployed, workers of companies with less than five employees and retirees. This insurance is managed by the municipalities and the 1,788 insurers all over Japan. The NHI has a relatively high ratio of ill and poor enrollees. Most of the self-employed declare their own earnings, and the NHI premiums are collected on the basis of household income, fixed assets, and other wealth. Premium rates vary among insurers. On average, the NHI enrollees have the lowest incomes, followed by public corporation-run enrollees and society-managed enrollees, respectively. The government subsidizes 16.4% of public corporation-run health insurance benefit expenditures and subsidizes 50% of NHI benefit expenditures.

III. Issues Facing the Japanese Health Care System

A. Issues Related with Health Care Insurance

Since the national universal insurance system was introduced in 1961, medical expenditure has expanded rapidly due to increased access to medical care, provision of benefits for high-cost medical care², and free medical care for the elderly (since 1973). This has increased pressure on the country's finances. It took almost 30 years to correct the 1973 policy, and since 2002, the elderly have been required to pay 10% (or 20% based on income) of their medical costs with a relatively low payment limit.

The NHI system's coverage has changed dramatically since 1961. The NHI was targeted at farmers when universal insurance was introduced. In 1965, two-thirds of the workforce was either self-employed or in the agriculture, forestry, or fishery industries. Further, lifetime employment and seniority-based corporate structures were a norm, and employees' health insurance systems were established with the corporation as a unit. However, the aging of the population and changes

² If total co-payment to a hospital/clinic exceeds the payment limit, the excess amount will be reimbursed.

in the industrial structure fundamentally altered the situation in subsequent years. Currently, more than half of the people insured by the NHI are unemployed, 24% are employees of offices with less than five employees or part-time workers, and 19.3% are self-employed or farmers (Ministry of Health, Labour and Welfare). For the NHI, each municipality operates as the insurer. Since 2000, mergers have led to a decrease in the number of municipalities from over 3,200 to 1,788 in 2009.

The aging of the population, which started around the time when the universal insurance system was established, also placed increased pressure on the finances of the NHI system. Those who were insured under the employees health insurance were then turned over to the NHI upon retirement, and this entailed a decrease in income and increase in medical expenses for the retirees. The Japanese government established a new medical system for the elderly aged 75 years or older in April 2008. The insurers in this new medical insurance system for the elderly are designated as an extended association joined by all municipalities in their prefectural governments. Government subsidy becomes available, but it is impossible to cover the medical expenses of everyone. Every time a financial crisis occurs, new financial support measures are adopted in order for the system to keep up with the changes. With the NHI and health insurance for the elderly combined, the insurance premiums cover only one-third of the operating cost, and only a small amount of municipal financing is used to cover the revenue shortages created by the NHI. This trend is more pronounced in rural areas compared to urban areas.

Since 1988, the National Health Insurance Law has been amended several times, and various ad hoc financial assistance measures have been introduced. As a result, the mechanism for financing the costs of the NHI system has become extremely complicated and involves joint subsidies between national and local governments. This system includes an insurance-based stability system for people with low incomes, a joint project to mitigate the effect of high medical expenses, and financial measures to stabilize municipal finances.

Because of the practice of being provided with new financial support measures, municipalities now expect new support measures to be implemented whenever new crises arise, which creates a moral hazard for the NHI system. Thus, overly supportive financial measures have reduced the incentives for municipalities to ensure the collection of insurance premiums and to improve the efficiency of the health care services. As a result, the municipalities' responsibility as insurers remained ambiguous. Also, people have accepted the system without clearly understanding who actually pays for their medical expenses. As a result, the government's share of medical expenditures has continued to increase over the years.

Many of the problems facing the Japanese health care system today are due to the incapacity of the insurers. Insurers and health care providers should act as the main actors in insurance contracts which involve the delivery of health care, in matters such as determination of the insurance premium and benefit package, review and approval of the benefits, and selection of health care facilities. However, in the current system, the government appoints health insurance

hospitals and health insurance doctors without adequate evaluations, physician service fees are determined in line with administrative guidance, and the original purpose of the insurance contract is ignored. It should be possible for insurers to exclude inefficient health care providers individually from the list of health insurance service providers such as in the Netherlands or Germany. However, the Japanese system makes that impossible, and such a system is rare in the world. It is difficult to encourage competition between health care providers and to evaluate them under such a system.

The strong correlation between the number of hospital beds and inpatient health care cost has been repeatedly pointed out by researchers and government officials. Lack of standardization has led to excess investment in expensive medical equipment. It is important that insurers, as a responsible party, become more than just the payers and become involved in responding to their area's medical needs.

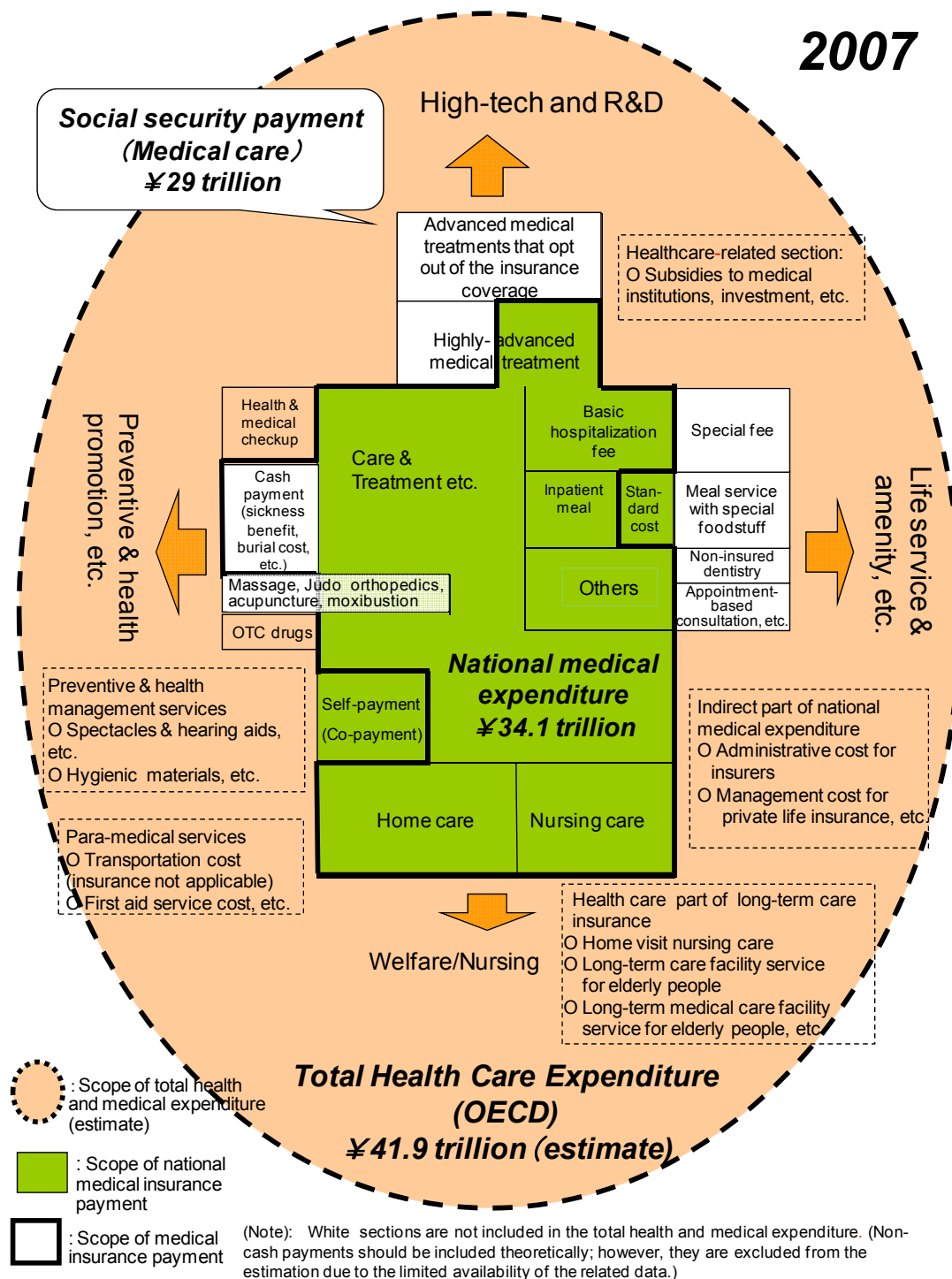
Currently, financial support for the NHI and medical system for the elderly comes from national and local governments. In the current system, insurers receive reductions or exemptions. However, people with low incomes should receive such subsidies. In other words, individuals with low incomes pay insurance contributions; then, they will be financed by a fixed amount from the national or local government.

B. Issue with Health Care Statistics

The Japanese health care system is often considered to be efficient since the Japanese people enjoy longevity with relatively low health care expenditures among OECD country. However, it is important to note that Japan's total health care expenditure is underestimated since Japan's "national health care (or medical) expenditure" published by the Ministry of Health, Labour and Welfare (MHLW) is an estimate of the expenditure under Japan's public medical insurance system, and the scope of the estimate is limited to treatment costs for injuries and diseases. The figure is essentially an estimate only of the health care expenses covered by public insurance, and expenditures that are not covered by public insurance are excluded from the total expenditure (Figure 1). Therefore, there are some items that are included in the health care costs of other economies but are not included in the health care costs of Japan, for example, the costs associated with normal pregnancies and birth, non-insured dentistry, health checkups, vaccinations, and other procedures aimed at maintaining and promoting health, excess room charges when hospitalized, elective therapy charges, the costs related to nonprescription drugs (over-the-counter medicines) and to operation of medical insurances, the capital costs of local government-run hospitals, and transfers from the general account of local government to local government-run hospitals. While the current estimate of the "national health care expenditure" may be adequate as an explanation of the range of activities under the jurisdiction of the MHLW, it is wholly inadequate for gaining a clear understanding of the use of health care services by Japanese citizens. This is particularly important when we compare the health sector expenditure

internationally. Every year, the OECD reports the health care expenditure for each member country using the System of Health Accounts. However, because of the unavailability of the data as described above, the figures for Japanese health care expenditure are underestimated.

Figure 1: Relationship between national medical expenditure, social insurance payment and total health & medical care expenditure (OECD)



For example, in 2007, national health care expenditure reported by the MHLW was ¥34.1 trillion, while total health care expenditure reported by the OECD was ¥41.9 trillion³. According to the Japanese National Accounts in 2007, economic activities in the health sector were ¥47.1 trillion. This number is the total of the government's general final consumption expenditure for the health sector (¥35.3 trillion) and households' final consumption expenditure for the health sector (¥11.9 trillion)⁴. With this simple calculation, it is clear that Japan's national health care expenditure is underestimated, approximately by one-third.

It is important that health care policy is based on a solid understanding of the current reality. However, it is hard to claim that health care policies to date have been formulated and implemented on the basis of solid, readily acceptable evidence. To get beyond the current situation, it is vital for the Japanese government to take responsibility in conducting statistical studies and publicly disclosing the resulting data.

IV. Conclusion

Fifty years have passed since universal insurance was implemented in Japan and, in the light of current institutional fatigue, today's health insurance system in Japan needs drastic reform. Changing and enhancing the role of the insurer would be a core task in such a reform.

One of the major issues that the Japanese health care system is facing is how to contain the escalating medical costs for the elderly. Health care for the elderly has received substantial subsidies from both central and local governments and transfers from other insurers. They are more than 80% of the total cost.

In Japan, with the free-access system, many patients with primary care problems tend to rush into secondary/tertiary care hospitals. This has affected the function of the hospitals so much and has contributed to increasing the medical costs, particularly for the elderly. What the Japanese health care system needs in this aging era is a good collaboration between specialists in the hospitals and community-based primary care physicians. Japan does not have sound systems of primary care provided by well-trained family doctors. A family doctor is a specialist in primary care. Such countries as Canada, Australia, the UK, the Netherlands, Singapore, and Malaysia have a strong system to train family doctors as key players to provide continuous, comprehensive, person-centered care in the community (WHO, 2008). An efficient primary care system is important for any economy in any development stages, since primary care usually covers more than 80% of health and medical problems.

Another critical issue for Japanese health care is to create sustainable financing mechanisms for the elderly. In 1983, the central government established the elderly insurance, a common fund for elderly medical care to transfer burdens from poorer community health insurance to

³ Total health expenditure is estimated using the OECD's System of Health Accounts (SHA) by the Institute for Health Economics and Policy.

⁴ It does not include the fixed capital formation for the health sector since the fixed capital formation is not available for the health sector.

corporation-based workers' insurance, through pooled contributions from all the insurance schemes and tax revenues. In 2008, the Japanese government introduced a medical system for the elderly age 75 and over. However, the basic financing structure remains the same. (About 50% is financed by government subsidy and about 40% from contributions of National Health Insurance and Employee's Health Insurance.) Rapid population aging challenges the sustainability of this financing system.

Among several challenges for the Japanese health care system is the introduction of economic incentives to assure quality and efficiencies, particularly in primary care systems, based on a solid database. Japanese health care relies heavily on hospital care. Health care reforms have been focusing on hospital reforms and aim to control costs of hospitals. Without introducing an efficient primary care system, it is not possible to maintain our health care system under this rapid aging population.

Another challenge is introducing a health register system for the whole population. After the Great East Japan Earthquake, a team from Fukushima Medical University attempted to find out which houses might need medical services within the 20-30 km zone around the nuclear power plant and discovered that determining this was incredibly difficult.

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Health System Reforms in the People's Republic of China: Progress and Further Challenges

Hiroko Uchimura*

Introduction

Health systems have been improved significantly in recent years in China. The present government has given priority to health. In addition, the 12th five-year plan (2011-2015) indicates that health also will be a focal issue for next five years. Reforms in the health sector, however, have not progressed steadily along with the economic reforms started in the late 1970s. The government rather directed less attention to the health sector until the late 1990s, which consequently deteriorated availability and affordability of health care services critically.

Most of the population was uninsured in the early 1990s in China. People had to bear considerable financial burdens to access health care services. In particular, rural people could scarcely access needed health care services. Facing those situations, the government has eventually initiated health system reforms since the late 1990s. The government first focused on the reestablishment of medical insurance systems. More recently, a comprehensive reform plan of health systems has been undertaken.

The primary purpose of this study is to examine the progress of health system reforms in China, and attempt to provide policy advice on further reforms in the health sector. The next section gives an overview of China's health system before the economic reform started. The progress of health system reforms is reviewed in Section 2. This section focuses on the reestablishment of medical insurance systems and the health system reform plan launched in 2009. Following this, Section 3 examines remaining challenges in the health sector of China and provides the analyses of further reforms in the health sector. The final section summarizes the conclusion.

Health Systems before the Economic Reform

Health systems have differed between urban areas and rural areas in China since before the economic reform started in the late 1970s. More precisely, the system of health service provision for the rural population has widely differed from that for the urban population in China.

Health care services were provided for the urban population based on the Labor Insurance System (LIS) and Public Insurance System (PIS) in an era of a planned economy (World Bank, 1997; Wong, Lo and Tang, 2006). The former system was basically financed through state-owned enterprises (SOEs) and provided health care services for employees as well as retirees of SOEs,

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whereas the latter system was publicly financed and provided health care services for personnel as well as retirees of public institutions. Both systems financed assigned health institutions and the health institutions provided health care services for the insured basically free of charge.

Meanwhile, health service provision was based on the cooperative medical scheme (CMS) in rural areas. The administrative and financial foundation of the CMS was people's communes (World Bank, 1997; Li, 2004). However, unlike the urban health systems, the establishment of the CMS was not based on laws, and the governments, particularly the central government, did not provide fiscal subsidies for the CMS (Li, 2004). Members of the CMS needed to pay contributions to the funds and co-payment for receiving the services. In this sense, the CMS was similar to a community-based insurance system, of which administrative and financial characteristics greatly differed from those of urban health systems. The difference in the health systems between urban and rural areas has been one of the most critical features of China's health systems since before the economic reform.

Along with the economic reform, both urban and rural health systems decayed. With the penetration of the market economy, SOEs began to suffer from deficits. A main reason for the deficits was the heavy financial responsibility of SOEs to provide health care services for their employees and retirees (Nakagane, 1999; Zhu, 2004; Li, 2004). SOEs, suffering from the deficits, eventually came to be unable to finance health service provision (Liu, 2002; Wong, Lo and Tang, 2006). Another result of introducing the market system was an increase in non-SOE types of enterprise, such as private or foreign-affiliated companies. The conventional system, i.e., LIS, did not cover employees of those non-SOEs. Those situations brought about a malfunction of health systems in urban China.

Along with the economic reforms in rural areas, the rural health system, i.e., the CMS, also began to malfunction. Agricultural production, administrative or social services were based on people's communes in rural areas. However, economic reforms moved the production base from collectives to the household by initiation of the household production responsibility system (Kojima, 1988). This brought about the disbandment of people's communes that was the organizational and financial basis of the CMS, which ultimately weakened the function of the CMS (World Bank, 1997; Li, 2004; Zhu, 2004).

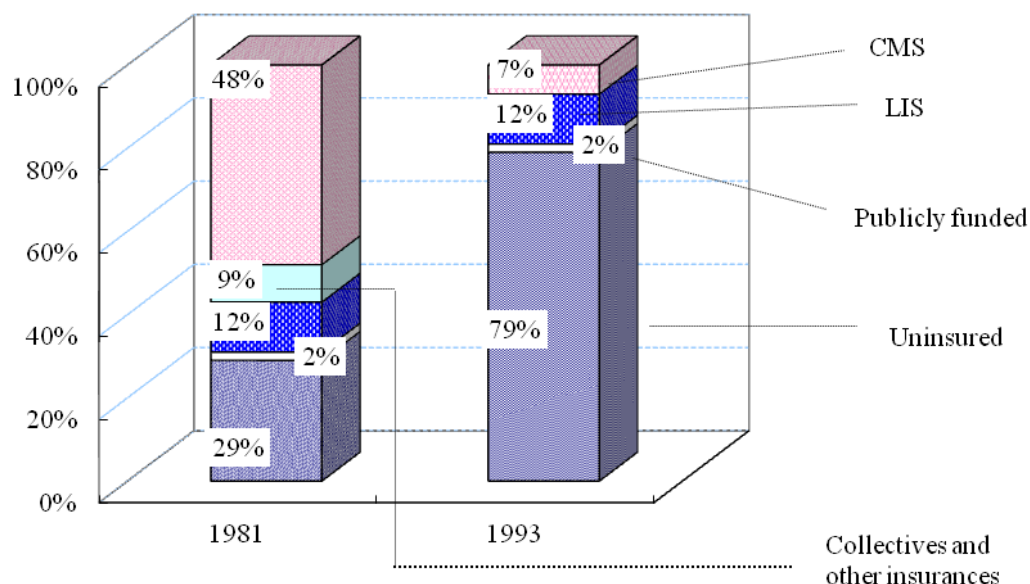
Health System Reforms

- Reestablishment of medical insurance systems

Along with the economic reforms started in the late 1970s, socioeconomic conditions have considerably changed both in urban and rural areas. Those changes caused a malfunction of the conventional health systems in urban and rural China. The health systems needed to be reformed in line with changes in the socioeconomic conditions, and instead of SOEs or people's communes, governments needed to take major responsibilities for financing the health systems. However, the government did not initiate health system reforms accordingly until the late 1990s.

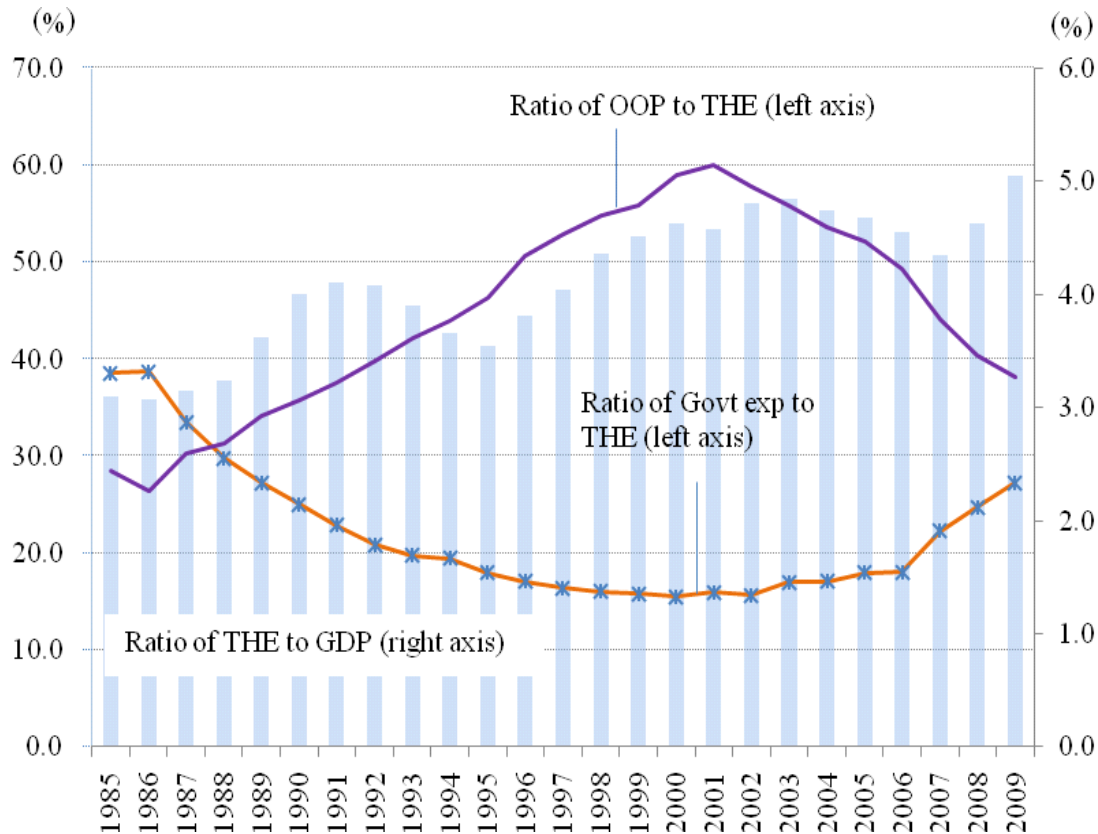
Almost 80% of total population was uninsured in the early 1990s (Figure 1). People had to bear considerable financial burdens to access health care services. In fact, the ratio of out-of-pocket payment (OOP) to total health expenditure (THE) acceleratingly increased in the 1990s, and reached 61% in 2001 (Figure 2). The OOP level is substantially high even compared with other developing economies.

Figure 1. Changes in Medical Insurance Coverage Ratio (%)



Note: Author's compilation based on data from *Financing Health Care: Issues and Options for China*, p. 15, World Bank, 1997.

Figure 2. Out-of-Pocket Payment and Government Expenditure Ratios to Total Health Expenditure (%)



Note: Author's compilation based on data from *Health Statistical Yearbook of China*.

Against the deteriorated conditions in the health sector, the government has eventually initiated health system reforms since the late 1990s. Urban Employee Basic Medical Insurance (UEBMI) was established in 1998 (Ministry of Labour and Social Security, 1998). This insurance targeted formal employees who had urban *hukou* (urban register). Therefore, rural migrants who emigrated from rural areas to urban areas were originally ineligible to enroll in UEBMI, because they did not have urban registers but rural registers. The separation of rural migrants from the urban insurance system critically hindered them from benefiting from the insurance to access needed health services. Of recent, the central government has come to take this matter seriously and begun some attempts to include rural migrants in urban health systems.

Another critical feature of UEBMI is that the enrollment unit is an individual employee. Consequently, family members of an employee are ineligible to enroll in UEBMI. In order to include them in the insurance system, the government has piloted programs of medical insurance for urban residents other than urban formal employees, i.e., Urban Resident Basic Medical Insurance (URBMI), since 2007 (Ministry of Labour and Social Security, 2007). URBMI targets not only family members of urban formal employees but also other urban residents who are not included in UEBMI such as self-employed and informal urban workers.

Regarding rural health systems, the new Cooperative Medical Scheme (the new CMS) was established in 2003 (Ministry of Health, 2003). The enrollment unit of the new CMS is a household, and all family members are required to enroll in the new CMS en mass. In order to expand the insurance coverage, the central and local governments subsidize insurance funds of URBMI and the new CMS. In particular, the central government concentrates its subsidies in central-western regions in order to support the insurance systems in the poor regions.

Of recent, the government has intensively endeavored to expand insurance coverage both in urban and rural areas. Accordingly, the insurance coverage has dramatically expanded and reached more than 90% in rural areas and 70% in urban areas (Table 1). Such expansion of medical insurance both in urban and rural areas is an important achievement of health sector reforms in China. However, there remain other critical issues in order to improve availability and affordability of health care services for those in need.

Table 1. Medical Insurance Coverage (%)

	Rural population		Urban population		
	New CMS		Total	UEBMI	URBMI
	coverage (%)		coverage (%)	enrollment (10,000 persons)	enrollment (10,000 persons)
2004	9.1			12,404	
2005	20.0			13,783	
2006	46.0			15,732	
2007	82.7		51.8	18,020	4,291
2008	92.4		72.4	19,996	11,826
2009	94.3				

Note: Author's compilation based on data from *Health Statistical Yearbook of China*.

- 2009 health system reform plan

Medical insurance coverage has dramatically expanded in recent years in China, which is conducive to lessening financial burdens for the insured to access health care services. However, there remain critical problems in the health sector which hinder certain people from accessing needed health care services. One of the most critical issues is a rapid increase in the costs of health care services as well as pharmaceuticals, which closely relates to the financial management system of health institutions and payment schemes for hospital doctors in China. Another important issue is quality and quantity of lower-level of health institutions, particularly in rural areas.

In order to deal with those issues, the government launched a comprehensive reform plan of health systems in April 2009 (National Development and Reform Commission, 2009). The plan aims at improving financial and physical accessibility to needed health care services. It is a three-year reform plan from 2009 to 2011, and a total of CNY850 billion (US\$125 billion) fiscal

investment is scheduled for the plan (Alcon and Bao, 2009; Yip and Hsiao, 2009). The five targets are listed on the plan: the national essential medicine system, public hospital reforms, health services at grass-root levels, basic public health services, and medical insurance systems (National Development and Reform Commission, 2009).

Managing the costs and rationalizing the use of pharmaceuticals have been critical issues of China's health system. In other words, the climbing cost and the overuse of drugs have escalated people's financial burdens in the health sector. Hospitals heavily rely on revenues from pharmaceutical sales in China (World Bank, 2010). Table 2 shows that more than 40% of total revenue is generated by pharmaceutical sales at each level of health institution in China. The scheme of markups on pharmaceuticals, particularly on branded drugs, enables health institutions to generate such revenues.

Table 2. Revenue Structure of Health Institutions (%)

	2005	2006	2007	2008	2009
Public hospital					
Govt subsidies			8.5	8.4	8.8
Operating revenues	92.6	91.6	91.5	91.6	91.2
Revenues from medicine	43.0	41.3	41.3	42.1	42.1
(Ratio of medicine rev. to operating revenues)	46.4	45.1	45.1	45.9	46.1
Urban community health center					
Govt subsidies			17.8	23.3	23.6
Operating revenues			82.2	76.7	76.4
Revenues from medicine			50.2	51.4	51.3
(Ratio of medicine rev. to operating revenues)			61.1	67.0	67.1
Township health center					
Govt subsidies			25.9	18.7	20.2
Operating revenues			74.1	81.3	79.8
Revenues from medicine			39.0	43.2	43.9
(Ratio of medicine rev. to operating revenues)			52.7	53.1	55.0

Note: Author's compilation based on data from *Health Statistical Yearbook* of China.

The government attempts to solve a part of the problems by reestablishing the national essential medicine system. The government particularly focuses on securing the supply system and improving utilization of essential drugs (National Development and Reform Commission,

2009). For that purpose, under the national essential medicine system, all the essential medicines are included in the drug reimbursement list of the medical insurance mentioned above and the reimbursing rate of essential drugs will be higher than that of non-essential drugs. In addition, the government has piloted a zero-markup scheme in order to amend the markup scheme and has scheduled budget support in the 2009 reform plan. The budget support is intended for compensating the reduction in hospital revenues due to implementing the zero-markup scheme. As mentioned above, the issues on pharmaceutical costs closely relate to the financial management system of health institutions. In this sense, the government also gives priority to public hospital reforms in the 2009 plan, and has initiated pilot programs. The pilot programs focus on reforms in management and supervision mechanism as well as compensation schemes of public hospitals.

Other focal issues on the supply-side of health systems are primary care and public health. Quantity and quality of primary care have been considerably limited at lower-tiers of health institutions in China. Those institutions have not provided sufficient or reliable services, which caused a malfunction of referral systems in the health sector. To improve the situation, the government attempts to restructure the primary health care system by constructing grassroots-level health institutions, providing training for practitioners working at grassroots-level institutions, and reforming compensation mechanism for the personnel at the grassroots level. Those attempts are included in the 2009 reform plan. In addition, the government has become conscious of the importance of preventive care, and has been working on expansion of vaccination and an increase of funds for the specialized public health institutions. Those attempts are essentially important to improve people's accessibility to needed health care services and contain total health expenditures.

Regarding the medical insurance, the government attempts to improve benefits of insurance by scaling up the insurance fund. For that purpose, both the central and local governments plan to increase their subsidies to the funds of URBMI and new CMS. In addition, the importance of portability and continuity of insurance across localities is clearly mentioned in the 2009 plan. Relating to this, Social Insurance Law (SIL) has become effective in July 2011, which stipulates that the portability of medical insurance across localities should be secured for the insured. The portability of medical insurance is particularly important in order for rural migrants/mobilizing population to benefit from the insurance practically. Thus, it will be a great step for improving effectiveness of medical insurance in China if the 2009 plan and SIL will be enforced smoothly.

Further Challenges in the Health Sector

- Disparity in health

As observed above, reforms in the medical insurance have progressed significantly in recent years. It improves in controlling people's financial risks associated with health matter. However,

disparity in the medical insurance system is still critical in China, especially in the context of equity in health.

There are three types of disparity in China's medical insurance system: disparity in benefits between the three insurance (UEBMI, URBMI, the new CMS), disparity in insurance schemes between localities, and disparity in insurance coverage between localities. As explained above, basic designs of the schemes differ among the three types of insurance. In general, benefits of UEBMI are the most generous among the three types of insurance. In addition, benefits and contribution of the respective insurance might differ among localities. The central government presents the grand design of the respective insurance, i.e., UEBMI, URBMI, and the new CMS, whereas each local government adjusts the grand design to implement the insurance practically at the local level. Therefore, the actual scheme of the insurance might differ among localities. It means that contribution and benefits of the insured might differ between localities even if they are members of the same insurance scheme such as URBMI or the new CMS. In this context, benefits and contribution of medical insurance differ among people depending on their *hukou*, employment status, or their registered localities.

As observed in the previous section, overall coverage of medical insurance has expanded substantially both in urban and rural areas; however, the coverage varies between localities. Table 3 shows that some provinces have already achieved 100% coverage of the new CMS, whereas the coverage is still below 70% in some other provinces. Regarding the medical insurance for urban population, the insurance coverage highly differs between provinces. The coverage is still less than 50% in some provinces.

Table 3. Difference in Coverage of Medical Insurance

	Rural population				Urban population	
	New CMS				UEBMI + URBMI	
	2007	2008	2009		2008	2009
Total (%)	82.8	92.5	94.4		51.8	72.4
Std. Dev. (between provinces)	12.0	10.2	10.3		15.7	15.5
The highest province (%)	100.0	100.0	100.0		99.8	100.0
The lowest province (%)	62.9	68.2	68.9		34.2	49.0

Note: Author's compilation based on data from *Health Statistical Yearbook* of China.

In general, the household income level has a positive effect on differences in insurance coverage (Martins and de la Maisonneuve, 2006). In addition, local fiscal capacities for health may have an important effect on the insurance coverage in China, because local governments play a significant role in the health sector. Local health service availability may also have an important impact on differences in insurance coverage. In the following, we conduct simple estimations in

order to examine effects of those possible factors on the difference in insurance coverage. The estimation model is as follows:

$$Y_{it} = \alpha + \beta X_{it} + \varepsilon_{it} \quad Y_{it} = \alpha + \beta X_{it} + \varepsilon_{it}, (1)$$

where i denotes the province, t denotes time (year), and ε is an error term. Y_i is the dependent variable, i.e., the insurance coverage in a province (i), whereas X denotes independent variables, i.e., the household income level, local fiscal expenditures for health, and availability of local health services. We use panel data covering 31 provinces over a three-year period (2007-2009) for the case of rural areas and 31 provinces over a two-year period (2007-2008) for the case of urban areas, and employ a random effects model for our analyses.

For the analysis of rural areas, following variables are applied to the above model. The dependent variable (Y) is coverage of the new CMS in a province. Regarding independent variables (X), the household income level is measured by rural household net income on a per capita basis. The local fiscal expenditure for health used in the model is provincial *per capita* fiscal expenditure for health. Availability of local health services are measured by the number of rural health center beds on a per capita basis and the number of health personnel at the county level on a per capita basis. In addition, the time dummy for 2007 is included in the estimation model for the case of rural areas.

For the case of urban areas, the following variables are applied to the above model. The dependent variable is insurance coverage for the urban population in a province which includes UEBMI and URBMI. The household income level is urban household disposal income on a per capita basis. The local fiscal expenditure for health used is provincial *per capita* fiscal expenditure for health. The number of hospital beds *per capita* and the number of health personnel *per capita* are used as variables for local health availability.

Table 4. Estimation Results for the Case of Rural Areas

Dependent variable		Coverage of the new CMS									
		(a)		(b)		(c)		(d)		(e)	
Independent variables											
per capita rural household net income (ln)		0.14	(0.04)*			0.09	(0.05)*	0.14	(0.04)*	0.15	(0.06)*
per capita fiscal health expenditure (ln)				0.08	(0.02)*	0.06	(0.02)*				
per capita rural health center beds								0.02	(0.00)*		
per capita health personnel at county level										-0.02	(0.12)
time dummy for 2007		-0.06	(0.01)*	-0.04	(0.01)*	-0.04	(0.02)*	-0.03	(0.01)*	-0.06	(0.01)*
No. of observation		93		93		93		93		93	
R2		0.50		0.56		0.55		0.66		0.50	

Notes: Numbers in parentheses are standard error.

* indicates significance at the 5% level. ** indicates significance at the 1% level.

Table 5. Estimation Results for the Case of Urban Areas

Dependent variable		Insurance coverage (UEBMI + URBMI)									
		(a)		(b)		(c)		(d)		(e)	
Independent variables											
per capita urban household disposal income (ln)		0.82	(0.10)*			0.48	(0.12)*	0.71	(0.12)*	0.81	(0.13)*
per capita fiscal health expenditure (ln)				0.38	(0.05)*	0.23	(0.05)*				
per capita hospital beds								0.58	(0.42)		
per capita health personnel										-0.04	(0.21)
No. of observation		62		62		62		62		62	
R2		0.84		0.82		0.85		0.85		0.84	

Notes: Numbers in parentheses are standard error.

* indicates significance at the 5% level. ** indicates significance at the 1% level.

Table 4 summarizes the estimation results for the case of rural areas, whereas Table 5 summarizes the results for the case of urban areas. The coefficient of the household income level is positive and statistically significant both in urban and rural areas, which means that the household income level has a positive effect on insurance coverage. In addition, as expected, the coefficient of local fiscal expenditure for health is positive and statistically significant both in urban and rural areas. It means that the insurance coverage is higher in provinces where the provincial fiscal expenditure for health is higher. Regarding availability of health services, the number of rural health center beds (per capita) has a positive and statistically significant effect on coverage of the new CMS, which means that coverage of the new CMS is higher in provinces where rural health center beds are more available. The estimation results suggest that local fiscal capacity for health needs to be strengthened in poor localities in order to increase insurance coverage there and to reduce the disparity in insurance coverage between localities. In addition, it

is also important to improve the physical condition of rural health centers in order to increase insurance coverage in rural areas.

- Aging and health

Aging is a critical challenge in China's health sector in the near future. The ratio of those over 65 years of age to total population is 8.5% in 2009 (Table 6). The over 65 ratio is predicted to be 14% by 2027, and the pace of aging is almost same as that of Japan (Xiao, 2007). In addition, the level of under 15 to total population in China is close to that in high-income economies (Table 7). It suggests that the share of the working generation in total population will turn and decrease in the near future in China. Those changes in the demographic structure might have a considerable impact on the health system in China.

Table 6. Demographic Structure in China (%)

	1990	1995	2000	2005	2009
Total population (10,000 persons)	114,333	121,121	126,743	130,756	133,474
	Ratio to total population (%)				
0 - 14	27.7	26.6	22.9	20.3	18.5
15 - 64	66.7	67.2	70.1	72.0	73.0
over 65	5.6	6.2	7.0	7.7	8.5

Note: Author's compilation based on data from *China Statistical Yearbook*.

Table 7. Demographic Features of Economies by Income Level, 2008 (%)

	Median age	Age under 15
Japan	44	13
Lower middle income economies	27	27
Upper middle income economies	30	25
High income economies	39	18

Source: World Health Statistics 2010, WHO.

In general, an increase in the elderly population causes total health expenditures in an economy to expand (Martins and de la Maisonneuve, 2006). Table 8 summarizes the estimation results that examine impacts of the demographic structure on total health expenditures in China.

Table 8. Estimation Results: Impact of Demographic Structure on Health Expenditures

Dependent variable		Per capita total health expenditure in real terms (ln)			
		(a)		(b)	
Independent variables					
	per capita provincial GDP in real terms (ln)	1.04	(0.17)**	1.08	(0.17)**
	ratio of over 65 to total population	0.06	(0.02)**		
	ratio of from 15 to 64 to total population			-0.03	(0.01)**
	time dummy:				
	2003	-0.71	(0.14)**		
	2004	-0.66	(0.13)**	0.07	(0.03)**
	2005	-0.64	(0.11)**	0.09	(0.05)**
	2006	-0.57	(0.08)**	0.19	(0.07)**
	2007	-0.33	(0.06)**	0.45	(0.10)**
	2008	-0.24	(0.04)**	0.54	(0.13)**
	2009			0.80	(0.15)**
No. of observation		217		217	
R2		0.96		0.96	

Notes: The unit of variables is a province. A fixed effects model is employed for the analyses by using panel data covering 31 provinces over a seven-year period (2003-2009). The number in parentheses is standard error.

** indicates significance at the 1% level.

Total health expenditures generally increase along with expanding the economic level. In this sense, as expected, per capita provincial GDP in real term has a positive and statistically significant effect on total health expenditures in a province (Table 8). It means that health expenditure is higher in a province whose economic level is relatively high. The coefficient of the ratio of those over 65 to total population is also positive and statistically significant, and that of those between 15 and 64 is negative and statistically significant. The results indicate that the increasing elderly population will lead to expansion of total health expenditures, whereas an increasing working population will be conducive to containing total health expenditures. The ratio of working population to total population is predicted to decrease in the near future in China. Changes in the demographic structure in China will lead to further expansion of total health expenditures in the near future.

- Fiscal space for further challenges

Challenges in the health sector require further fiscal support for health in China. To meet the responsibility of facing them, the government needs to find fiscal resources for health; that is, fiscal space for health. Fiscal space is defined as “the availability of budgetary room that allows a government to provide resources for a designed purpose without any prejudice to the sustainability of a government’s financial position” (Heller, 2005). In particular, the possible fiscal space for health is as follows: increase tax revenues, reprioritize fiscal expenditures, establish social insurance schemes, and increase receipt of grants (UNICEF, 2009; Heller, 2005).

Increasing receipt of grants might be a desirable option for least developing economies, but not a possible option for China. As discussed above, social insurance (medical insurance) systems have been established in China, but reforms in the insurance schemes may generate fiscal space for health. An option is to include dependent family members of formal employees in UEBMI. At present, they are ineligible to enroll in UEBMI, but experiences of OECD countries such as Japan indicate that it is possible to include them in UEBMI. Including rural migrants in UEBMI is also an important option. The insurance fund of UEBMI is financed by contributions of employees and employers, and it is the most stable among the three types of insurance. By contrast, the insurance fund of URBMI or the new CMS is financed by contributions of the insured and subsidies from the central and local governments. Transferring insurance members from URBMI and the new CMS to UEBMI would reduce necessary fiscal subsidies for the fund of URBMI or the new CMS, which would generate fiscal space for the further challenges.

Reprioritizing fiscal expenditure between sectors would also be an important option for China to generate fiscal space for health. Based on the calculation using data from *China Statistical Yearbook*, the ratio of fiscal health expenditure to total fiscal expenditure is about 5% in 2009. Even in low income economies, around 7% to 8% of total fiscal expenditure is allocated for health (Hay and Williams, 2005). In this sense, an additional 3% to 5% of fiscal expenditures can be allocated for health in China. In addition, improving tax administration would also generate additional fiscal resources which can be allocated for health.

Conclusion

After the economic reforms started in the late 1970s, the conventional health systems decayed both in urban and rural China. The government did not direct much attention to the health sector in the 1980s and 1990s, which seriously hindered people from accessing needed health care services. The government has eventually initiated the reestablishment of medical insurance since the late 1990s, and health system reforms have progressed significantly in recent years.

Medical insurance coverage has reached more than 90% in rural areas and more than 70% in urban areas. The progress contributes to reducing the financial burden for the insured to access needed health care services. However, there remain challenges in the health sector. One important

challenges is disparity in insurance coverage between localities. Strengthening fiscal capacity, especially capacity of local governments, is essential to expand insurance coverage in poor localities. Improving the physical condition of health facilities is also important to increase insurance coverage in rural areas.

In addition, aging will be a critical issue for the health sector in the near future. The share of those under 15 in total population in China is almost the same as that in high-income economies. Not only increasing the share of the elderly population but also decreasing the share of the working population in total population will lead to substantial expansion of total health expenditures in the near future. Those challenges require additional fiscal space for health in China. There are several possible options for China to generate additional fiscal space for health. Further reforms in medical insurance schemes will reduce necessary fiscal subsidies for the insurance funds which can be allocated to further challenges in the health sector. In addition, fiscal expenditures can be reallocated between sectors, which will generate additional fiscal resources for the health sector. Improving tax administration is also an important means to increase fiscal revenues which can be allocated to health.

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A Brief Review on Health Care Expenditure in the Past, Present, and Future in Japan

Yoko Ibuka*

The Japanese national expenditure on health amounted to 8.5% of gross domestic product (GDP) in 2008¹. This is almost half of the corresponding value of the United States, and it ranked 20th among the Organisation for Economic Co-operation and Development (OECD) countries (OECD Health Statistics, 2011). The most recent statistics, however, show that the national health care expenditure increased by 3.4% between 2008 and 2009 (MHLW, 2011a), a significant jump compared to the 2.0% increase seen between 2007 and 2008. In this brief report, we will take a look at how health care expenditure evolved together with demographic changes in Japan. We will then briefly discuss issues associated with predictions for future health care expenditure.

Evolution of Health Expenditure

Figure 1 shows the trend of health expenditure as a percentage of GDP in Japan and other OECD countries since 1970. In 1970, Japan's health expenditure as a percentage of GDP was 4.5% and showed a growing trend over the next 38 years. In 2008, it reached 8.5%. The midterm trend commonly appears in almost all OECD countries. In 2008, there were eight countries where health expenditure exceeded 10% as a percentage of GDP² with the largest value of 16.4% being the case of the United States (US). Japan ranked 20th among the OECD countries, based on terms and definitions used by the OECD on health expenditure.

An increase in health expenditure as a percentage of GDP since 1970 is also largest in the US (9.3 percentage points [pp]), followed by Portugal (7.6 pp), Belgium (6.2 pp), France (5.7 pp), and Switzerland (5.3 pp)³. By contrast, expenditures in Sweden and Finland increased only by 2.4 pp and 2.8 pp, respectively, though they reported relatively high rates in 1970. In Japan, health expenditure per GDP has increased by 4.0 pp since 1970, which is ranked between Ireland (3.7 pp) and Norway (4.2 pp).

The total national health care expenditure has grown over time at a higher rate since the late 1960s (Figure 2a). Per capita national health care expenditure shows a similar pattern as the total expenditure in its trend, suggesting the increase in health expenditure is less likely to be attributed to an increase in the total population size. If we look at the age structure, the proportion of those

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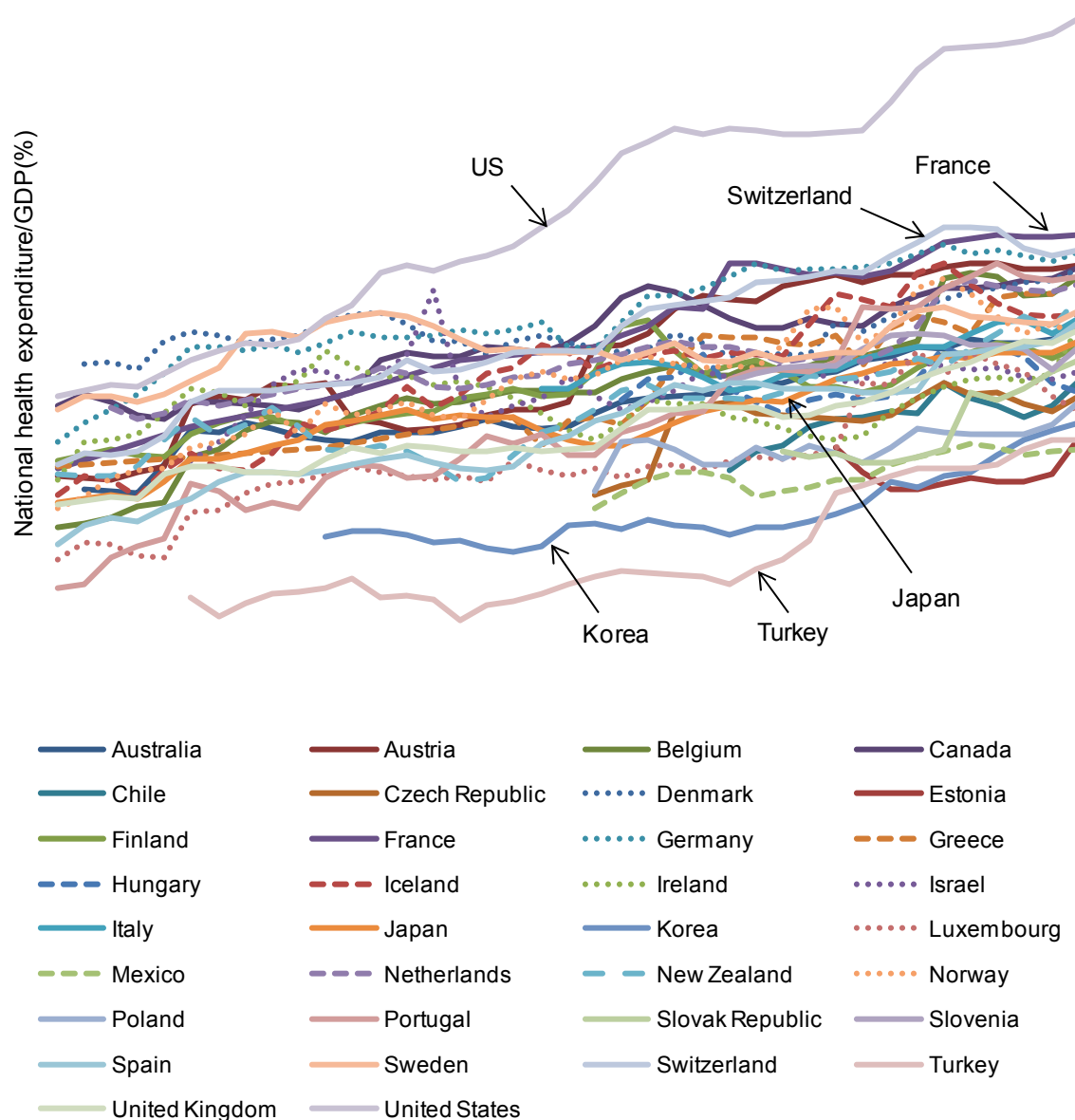
¹ The percentage is based on health expenditure by OECD. The National Health Care Expenditure, a commonly-used measure for national expenditure on health and medicine, shows 7.1% of GDP in 2008.

² They are the United States (16.4%), France (11.1%), Switzerland (10.7%), Austria (10.4%), Canada (10.3%), Denmark (10.3%), Belgium (10.1%), and Portugal (10.1%).

³ The ranking is evaluated based on 18 countries where the data is available since 1970.

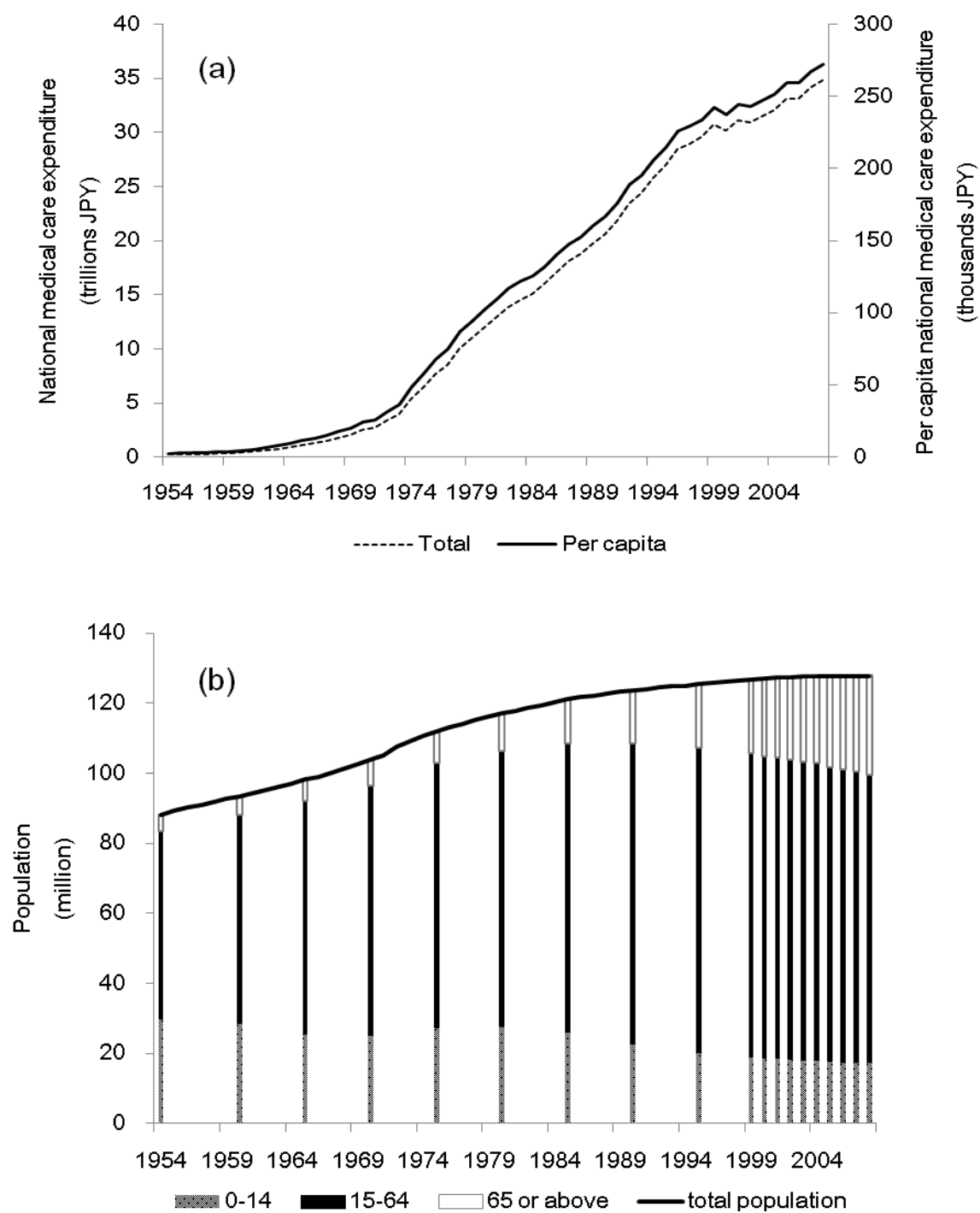
who are 65 years old or above has increased from 5.3% to 22.1% for the last 50 years, and by contrast the proportion of children and adolescents (0 to 14 years old) decreased from 33.4% to 13.5% (Figure 2b).

Figure 1: National health expenditure in OECD countries as a percentage of GDP, 1970-2008



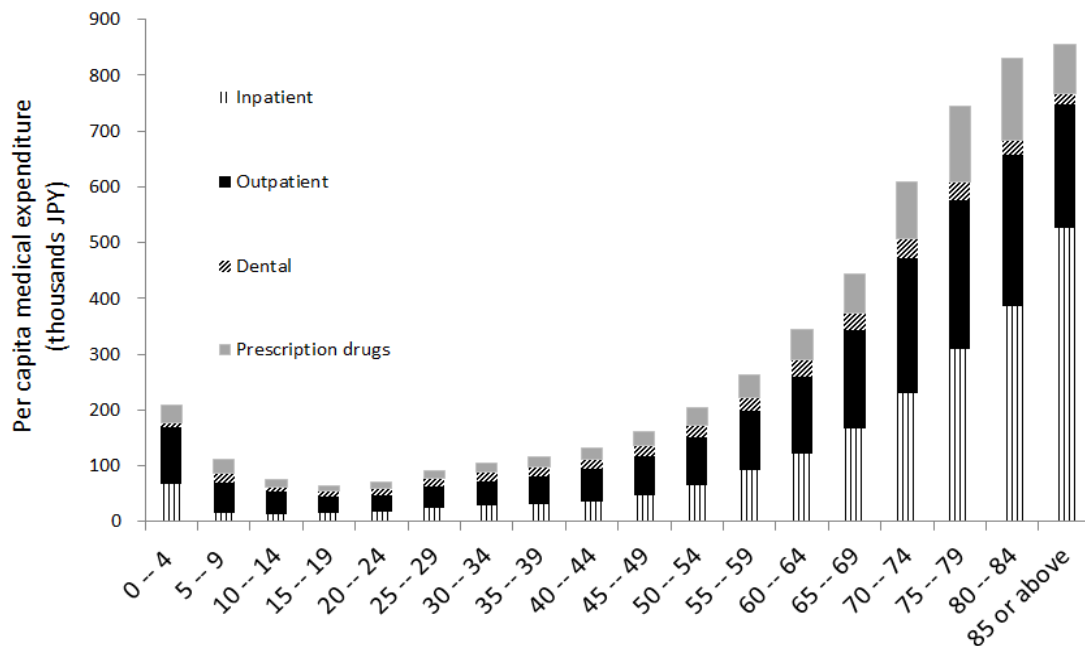
Source: OECD Health Statistics, 2011

Figure 2: Health care expenditure and population, 1954-2008, Japan



Source: (a) Ministry of Health, Labour and Welfare (2011b); (b) Ministry of Internal Affairs and Communications, Statistics Bureau (2011)

Figure 3: Health care expenditure per person, 2008



Source: Ministry of Health, Labour and Welfare (2011b)

Figure 3 plots how health care expenditure per person varies with age. The figure shows the health care expenditure per person by age group with age intervals of five years. Health care expenditure per person gradually increases with age, and the increase accelerates after 50 years of age. A person who is between 50 and 54 years old spends approximately 200,000 yen on average; however, the expenditure doubles for a person between 65 and 69 years old. The expenditure exceeds 800,000 yen for those who are 85 years old or above.

The value for each group presents an unconditional mean of health care expenditure and thus is associated with two factors: total number of individuals who are in need of care and how much each patient pays when s/he obtains medical treatment or care. Both are related to age. The proportion of individuals who need treatment for a disease rises with age. At the same time, health care costs per patient increase with the age of a person due to greater chance of morbidity and disability for her/him. It is well known that the highest medical costs are often incurred immediately before death (Scitovsky, 1984). Thus, the health care expenditure of the nation is correlated with the demographic structure of the society through the two channels.

Despite the accelerated aging of the population, as well as other factors that are known to be related to high medical costs⁴, the Japanese health care system has managed to control national health expenditure at a fairly low level, particularly compared to other OECD countries. Hashimoto et al. (2011) argued that there were two reasons for the contained costs. The first

⁴ Hashimoto et al. (2011) discussed that these factors include a private sector-dominated delivery system, payment by fee-for-service, and no gatekeeper function by family doctors.

reason is in the patient-side demand, that people in Japan use more outpatient services than inpatient care. The second reason is with the payment scheme in the Japanese health care system where fees for health services are centrally controlled in order to keep them uniform. Japan has approximately 3,500 insurers; however, a single payment system is applied to all the health insurance plans. Moreover, the revisions of the prices of drugs, devices, and services are made both globally and on an item-by-item basis. In particular, the global revision rate is determined by the government reflecting opinions by the group that represents providers so that the prices mirror the situation of the nation. The global revisions determine the basic health expenditure of the nation, and the revision rates are associated with the economy of the country. For example, the government decreased the global rate of the fee schedule four times consecutively starting in 2002 due to the deteriorating economic situation in the country (Hashimoto et al., 2011). In addition, item-by-item basis revisions are made reflecting the market prices of drugs and prices.

Challenge in Predictions on Future Health Care Expenditure

Projecting national health care expenditure is a quite challenging task. Projections are subject to a high degree of uncertainties, one of which is related to how morbidity and other epidemiological variables change in the future. For example, previous studies have addressed a few hypotheses between life expectancy and change in morbidity (European Commission, 2009). One hypothesis tells us that decline in mortality has occurred not because of suppression of disease prevalence or incidence but due to reduction in fatality rate for diseases, resulting in greater morbidity in the society (Olshansky et al., 1991). On the contrary, another hypothesis on the relationship between decreasing mortality and health is that people are expected to live longer in better health (Fries, 1980). The two hypotheses would determine the proportion of those who are in need of treatment in different ways. If the former hypothesis is right, the number of patients would increase as mortality decreases in the future. However, if the second hypothesis is right instead, the proportion of the patients would decrease. Assuming that mean costs per patient increase over time, each scenario would result in an increase in the total expenditure (according to the first hypothesis), or a decrease (according to the second hypothesis), keeping all other factors unchanged.

Thus, projections on health care expenditure at the macroeconomic level are often conducted in practice by applying past observed trends in socioeconomic variables in a model. There has been growing attention on the future of health and health care system in Japan, and estimating current national health care costs and simulating the evolution of future health care expenditure are of great concern for policy makers. Accordingly, a number of studies and government reports provided projections on health care expenditure⁵.

In those analyses, health care expenditure per person is often assumed to increase over time.

⁵ For an intensive summary of these studies, see Iwamoto (2007).

The source of the increase in health care expenditure can be decomposed into demography (population size and structure), income, and other factors explained by the residuals of the aforementioned two factors (such as advances in technology) (Horiuchi, 2011). The assumptions about the per-capita health expenditure are made either exogenously, or based on the relationship with income and other factors empirically observed in the past trend (European Commission, 2009; Iwamoto and Fukui, 2010).

We have seen the evolution of national health care expenditure in Japan, and have reviewed issues on the predictions of future expenditure. Further studies are needed for improved understanding of the mechanism of the connection between an aging population and health care expenditure.

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3. Unemployment Insurance System

Unemployment Insurance in Vietnam: Design, Implementation, and Policy Issues

Giang Thanh Long and Nguyen Thi Xuan Thuy*

I. Introduction

The concept of “unemployment” appeared in Vietnam about three decades ago when the economy began to transform from a centrally-planned to a market economy. Since then, it has become an important economic and social issue in Vietnam. Rural-urban migration and fiercer urban labor market are two, among others, crucial factors determining the shape of the labor market as well as unemployment patterns in Vietnam.

Unemployment insurance (UI), therefore, is also a new concept, which has been put in place since late 2006 along with the first-ever Social Insurance Law, and started since 1 January 2009. This period may not be long enough to see impacts of a policy, but some studies show that Vietnam’s UI scheme resembles those in both developed and developing countries in terms of coverage, qualifying conditions, contribution responsibility, and benefit duration and amount. In addition, the examination of Vietnam’s two-year experience with the UI scheme draws lessons not only for Vietnam but also for other developing countries which are considering the introduction of an UI program.

The main purposes of this paper are to describe the Vietnamese UI scheme with some important indicators, and to analyze some challenges of the scheme under economic changes in Vietnam. The paper will also propose policy suggestions in order to deal with financial sustainability and fairness of the UI scheme.

The paper is organized as follows. In the second section, we will provide some information about the UI scheme in Vietnam with important indicators such as coverage, qualifying conditions, and benefits. In the third section, we will analyze labor market and unemployment issues in Vietnam, as well as performances of the UI scheme over the past two years. The analysis on policy challenges will be discussed in the fourth section, while some concluding remarks are presented in the last section.

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II. The Vietnamese UI Scheme: Regulations and Performances

1. Coverage

The UI scheme in Vietnam was introduced as a part of the Social Insurance Law promulgated in 2006, but its implementation was from 1 January 2009 under the guidelines indicated in Decree No. 127/2008/NĐ-CP dated 12 December 2008. According to the Law and the Decree, only those with the following conditions are eligible for the UI scheme participation:

- Employees working under contracts of indefinite term or contracts of a term of three months and/or over;
- Cadres, public servants;
- Defense workers, police workers;
- Professional officers and soldiers of the Army; professional officers and non-commissioned officers, technical officers and non-commissioned officers of the police force; persons engaged in cipher work and enjoying salaries like army or police men;
- Non-commissioned officers and soldiers of the Army, non-commissioned officers and combatants of the police force on term services; and
- Persons working overseas for a definite term who previously paid compulsory social insurance premiums.

Employers participating in the UI scheme are those who employ ten or more employees at the following organizations:

- State bodies, state units, security services;
- Political organizations, social-political organizations, social-political-professional organizations, social-professional organizations, other social organizations;
- Foreign agencies and organizations, international organizations operating in Vietnamese territory; and
- Entrepreneurs, cooperatives, business individuals, cooperative groups, other organizations and individuals hiring, employing and paying wages to employees.

2. Qualifying Conditions

According to Article 81 of the Social Insurance Law and Article 127 of the Decree No. 127, only the unemployed who meet the following conditions are qualified for receiving UI benefits:

- The insured must have worked and contributed to the UI Fund for at least 12 months in the 24 months prior to his/her unemployment.
- The insured must be registered with the Employment Service Center at the Provincial Department of Labor, Invalids, and Social Affairs (DoLISA) when he/she loses his/her job, or when his/her labor/working contract is interrupted.
- The insured has not yet found a job within 15 working days after the date of making unemployment registration with the Employment Service Center of DoLISA.

3. Contributions

Contributions from employees, employers, and government are main sources forming the unemployment insurance fund. The total contribution is 3% of the employee's salary/wage, in which employees contribute 1% of their monthly salary/wage; employers contribute 1% of payroll; and the government contributes remaining 1%. Contributions of employees and employers are done monthly, while the government's contribution is done yearly.

4. Benefits

By participating in the UI scheme, the insured will receive the following benefits: (i) unemployment insurance benefit, (ii) health insurance, (iii) vocational training support, and (iv) free-of-charge job-seeking consultancy.

The monthly unemployment benefit provided to the insured is equivalent to 60% of the insured's average monthly salary/wage of the six consecutive months prior to unemployment.

The period of receiving the unemployment benefit is stipulated as follows:

- Three months, if his/her contribution to the UI scheme has been made for 12 months to less than 36 months;
- Six months, if his/her contribution to the UI scheme has been made for 36 months to less than 72 months;
- Nine months, if his/her contribution to the UI scheme has been made for 72 months to less than 144 months;
- Twelve months, if his/her contribution to the UI scheme has been made for 144 months and above.

The insured will also get vocational training support for a period of no more than six months from the date he/she receives monthly unemployment benefit. The support amount is equivalent to the level of expense for a short-term training course in accordance with the Law on Vocational Training.

To seek a job, the insured persons will get employment consultancy and recommendation free of charge in the duration of receiving unemployment benefits. Lastly, to protect the insured from health risks, health insurance benefits are also provided to him/her, in which the health insurance premium is paid by social insurance organizations.

5. Suspension and Termination

The insured will be suspended from receiving unemployment benefits if failing to report his/her job-seeking situation monthly to social insurance organizations or being remanded during the period of receiving unemployment benefits.

The insured shall be terminated from receiving unemployment benefits when the period of unemployment benefits ends, or if he/she:

- (i) finds a job,

- (ii) fulfills military service obligation,
- (iii) becomes an old-age pensioner,
- (iv) has twice refused jobs recommended by the social insurance organizations without plausible reasons,
- (v) fails to report his/her job seeking situation monthly to social insurance organization in three consecutive months,
- (vi) goes abroad for residence,
- (vii) serves administrative penalties at reformatories, training institutions, treatment institutions, or is under incarceration, or
- (viii) dies.

In the cases of (ii) and (iii) aforementioned, the insured will get a lump-sum benefit equivalent to the remaining amount of his/her unemployment benefit.

After the termination of receiving unemployment benefits, the previous duration of unemployment insurance contribution will not be counted for the subsequent receipt of the unemployment insurance allowance.

6. Current Unemployment Situation and Performances of the UI Scheme

6.1. Unemployment at a Glance

In 2010, out of 65.6 million persons aged 15 and over, 77.4% (or 50.8 million persons) participated in the labor force. The participation rates for males and females were different: 82% and 73%, respectively. Urban and rural labor forces respectively accounted for 28% and 72%, and urban and rural labor force participation rates were significantly different: 81% and 69.5%, respectively.

Of the labor force, 49.5 million persons were employed, while 1.3 million persons were unemployed. In Vietnam, an unemployed person is understood as a person aged 15 and over who fulfills all three conditions: (i) does not work, (ii) is willing to work, and (iii) has been actively seeking job during the 7 consecutive days (one week) prior to the current date. This group also includes persons, who are not currently working but are taking steps to start their own business or taking a new job after the reference period, or are temporarily absent from work due to staff reduction/dissolution/re-arrangement of the enterprise; or those, during the reference week, who are always available for work but are not looking for a job due to temporary illness, being busy in private matters (care of death, marriage, care of unwell baby), bad weather, or waiting for a seasonal crop.

The results of the 2010 Labor Force Survey (GSO, 2011) show that, among the unemployed, females accounted for 56.1% and urban persons accounted for 42.9%. Table 1 presents the unemployment situation by age groups and areas. Of 1.3 million unemployed persons, the youth (aged 15 to 29) constituted nearly two thirds of the share (66.5%), followed by the group 30-49 (23.8%) and the group 50 and over (only 9.7%). The situation was the same for both urban and

rural areas when the unemployed persons are disaggregated by age group. In particular, the youth unemployment in rural areas was severe.

Table 1: Distribution of the unemployed population by age group and area, 2010

Age group	Unemployed (thous. persons)	Percentage (%)			Female
		Total	Male	Female	
Total	1343.6	100.0	100.0	100.0	56.1
15 - 29	893.8	66.5	61.7	70.3	59.3
30 - 39	195.4	14.5	11.7	16.8	64.6
40 - 49	124.3	9.3	11.0	7.9	47.8
50+	130.0	9.7	15.6	5.1	29.4
Urban	576.8	100.0	100.0	100.0	54.2
15 - 29	353.4	61.3	54.8	67.5	56.4
30 - 39	93.8	16.3	14.6	17.9	56.3
40 - 49	63.4	11.0	12.9	9.2	42.7
50+	66.2	11.5	17.8	5.5	24.6
Rural	766.7	100.0	100.0	100.0	59.8
15 - 29	504.4	70.5	68.0	72.1	61.1
30 - 39	101.6	13.3	9.1	16.0	72.3
40 - 49	60.9	7.9	9.2	7.1	53.1
50+	63.8	8.3	13.6	4.8	34.4

Source: GSO (2011)

Table 2 shows the unemployment situation of different regions, disaggregated by area and sex. In general, with high concentration of labor, Red River Delta, Central Coast, and Southeast had the highest unemployment rates. In all regions, urban areas had higher unemployment rates than did rural areas, and females had higher rates of unemployment than did males. Especially in the aforementioned three regions, such situations are clear.

Table 2: Distribution of the unemployed population by region, 2010

Social economic region	Total	Residential area		By sex in urban	
		Urban	Rural	Male	Female
Whole country	2.88	4.29	2.30	3.90	4.73
Northern Midlands and Uplands	1.21	3.42	0.82	3.69	3.14
Red River Delta	2.61	3.73	2.18	3.53	3.95
North Central and South Central Coast	2.94	5.01	2.29	4.91	5.13
Central Highlands	2.15	3.37	1.66	2.71	4.12
Southeast	3.91	4.72	2.90	4.22	5.30
Mekong River Delta	3.59	4.08	3.45	3.21	5.23

Source: GSO (2011)

Table 3, showing the unemployed population by age groups, disaggregated by area and sex, obviously indicates that youth unemployment in Vietnam is a serious policy issue. The unemployment rates of young people (aged 15-24) in both urban and rural areas were higher than those of other age groups. Female youth had higher rates than did their male counterparts.

Table 3: Distribution of the unemployed population by age, 2010

Age group	Total	Residential area		By sex in urban	
		Urban	Rural	Male	Female
Total	2.88	4.29	2.30	3.90	4.73
15 - 19	7.62	15.11	6.23	15.22	14.97
20 - 24	6.68	10.91	5.23	9.45	12.31
25 - 29	3.44	4.93	2.75	3.57	6.28
30 - 34	1.81	2.69	1.41	2.06	3.35
35 - 39	1.22	1.98	0.88	1.85	2.13
40 - 44	1.01	1.81	0.66	1.83	1.79
45 - 49	1.18	1.91	0.86	2.15	1.64
50 - 54	1.66	2.85	1.14	3.29	2.34
55 - 59	3.34	6.23	2.22	6.23	-

Source: GSO (2011)

In terms of technical qualification, Table 4 provides interesting information to contrast urban and rural areas; males and females. In general, Table 4 implies that workers with qualifications of vocational training and university and above had the lowest rates of unemployment in terms of both area and sex. The unemployed with professional secondary or college qualification had the highest rates of unemployment. An interesting contrast between urban and rural areas is that the unemployment rate of non-technical workers was 4.63% in urban areas while only 2.19% in rural areas; but the unemployment rate for college qualification in urban areas was 2.87% and 3.09% in rural areas. This could be explained by the fact that the urban labor market needs more qualified workers than does the rural labor market.

Table 4: Distribution of the unemployed population by technical qualification, 2010

Technical qualification	Total	Residential area		By sex in urban	
		Urban	Rural	Male	Female
Total	2.88	4.29	2.30	3.90	4.73
Not any	2.76	4.63	2.19	4.37	4.92
Vocational training	3.16	3.13	3.18	2.66	4.66
Vocational high school	4.36	4.93	3.85	4.24	5.45
College	4.35	4.92	3.82	5.17	4.75
Undergraduate and above	2.92	2.87	3.09	2.38	3.49

Source: GSO (2011)

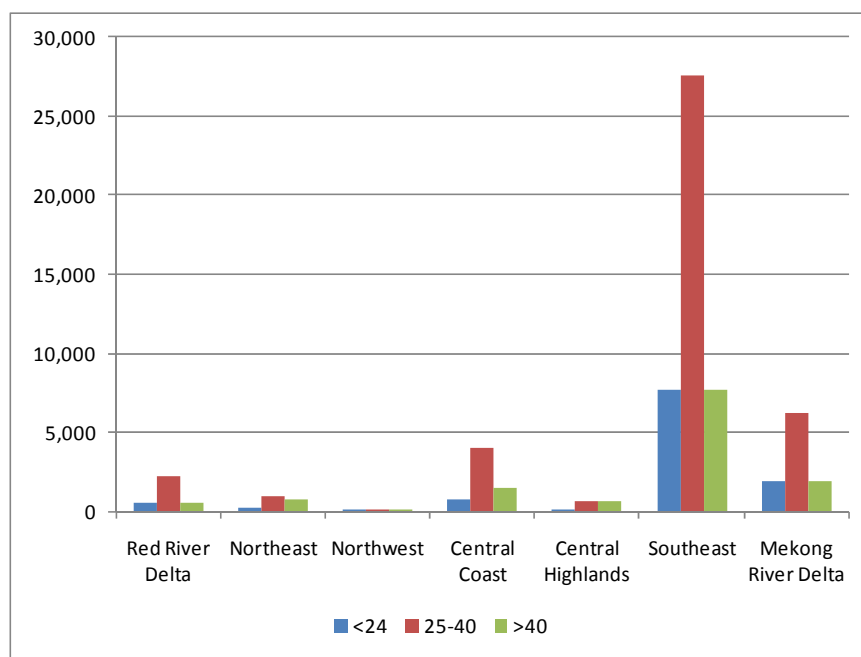
6.2. Performances of the UI Scheme

As mentioned above, the UI scheme in Vietnam has been in place since 1 January 2009. Up to December 2010, there were 7.1 million people joining the UI scheme, which accounted for merely 14% of the total labor force, and 75% of the total mandatory insured. In comparison with 2009, it was an increase by 1.06 million persons (or 17.7%).

The total number of beneficiaries in 2010 was 156,765 persons. Figure 1 provides the number of beneficiaries by region and age. It is shown that, having high labor concentration, Red

River Delta, Central Coast, Southeast, and Mekong River Delta also had the highest number of unemployed. Moreover, persons aged 25-40 accounted for the highest proportion of unemployed in all regions. This shows a critical situation for such an important force of labor in Vietnam.

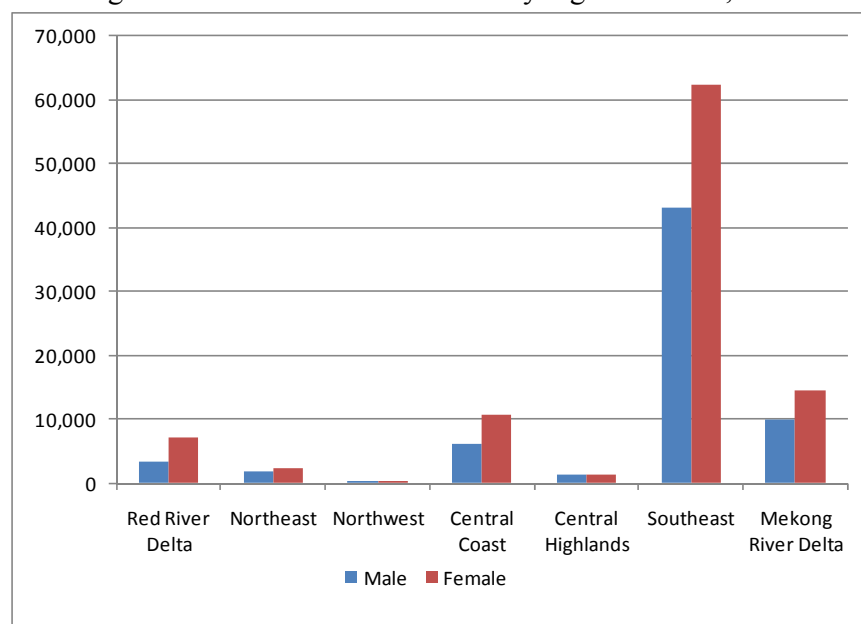
Figure 1: Number of beneficiaries by region and age, 2010



Source: VSS (2011)

The beneficiaries, disaggregated by region and sex, show that females had more claims for unemployment than did males in all regions (Figure 2). This is consistent with the fact that females generally have higher rates of unemployment than do males.

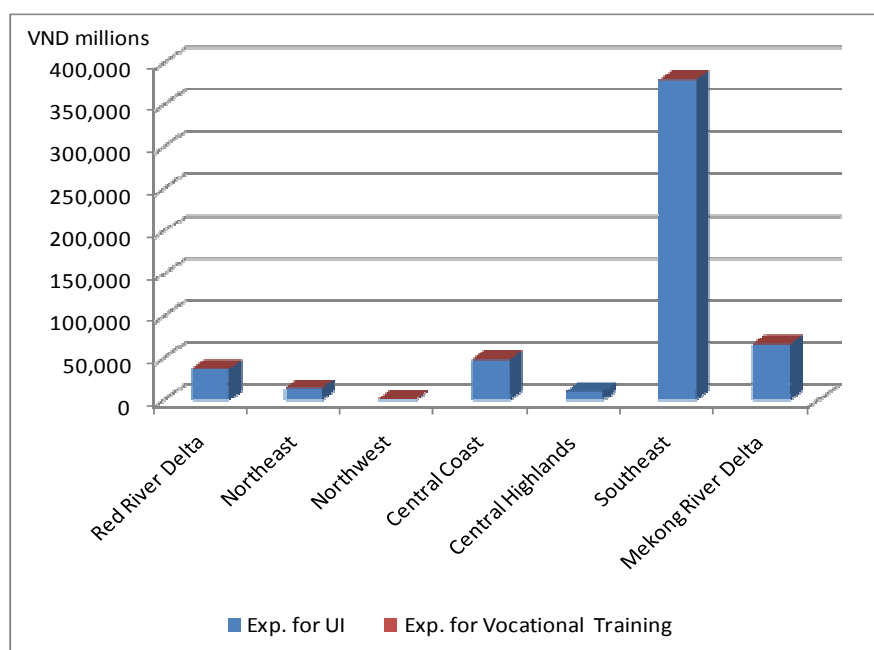
Figure 2: Number of beneficiaries by region and sex, 2010



Source: VSS (2011)

In terms of financing, Figure 3 shows different types of expenditure.

Figure 3: Expenditures of the UI scheme, 2010



Source: VSS (2011)

By December 2010, the UI fund collected VND4.8 trillion (about USD240 million), making the total accumulative revenue for both 2009 and 2010 reach VND8.3 trillion (about USD420 million). In 2010, about VND557.3 billion were spent for monthly UI benefits. The number of persons receiving lump-sum benefits, vocational support, and job-seeking consultancy were 3,007, 273 and 154,631, respectively. In the first four months of 2011, for a total of 106,358 workers registering for unemployment status, there were 65,191 receiving UI benefits, 157 supported for vocational training, and more than 78% of these registered workers receiving job-seeking consultancy. With these trends, Figure 3 shows that more than 97% of the total expenditure was for unemployment benefits, while that for vocational training was really small.

III. Policy Challenges and Recommendations

1. Policy Challenges

There are two main policy challenges for the UI scheme in Vietnam, in which the first challenge is from the design and implementation, while the second challenge is due to labor market and economic conditions.

1.1. Challenges due to design and implementation

First, the issuance of health insurance for the unemployed is usually slow, which in turn makes it difficult for the unemployed to get health care services.

According to Term 1, Article 19 of Decree No. 127/2008/NĐ-CP, the unemployed will benefit from health insurance during the time of unemployment, and he/she needs to submit

eligible documents within 15 days since his/her registration of unemployment. As such, the unemployed can get health insurance via provincial employment consultation centers from the 16th day since his/her unemployment registration. At the same time, however, Term 2, Article 38 of this Decree indicates that health insurance benefits will be provided only after 20 days since the time that documents are submitted. Therefore, the unemployed will not be able to get any health insurance benefits during the time of assessment for documents, and this in turn makes it difficult for them to get claims from social insurance organizations once they have health care services. According to the recent surveys by Vietnam Social Security (VSS), since some unemployed persons were not well aware about this regulation, they did not keep any receipts from health care stations in order to claim reimbursements from social insurance organizations.

Second, there are time constraints for registering unemployment status and getting UI benefits.

According to the current regulations, the unemployed must register their unemployment status within seven days, and submit eligible documents within 15 days in order to claim UI benefits. Missing such deadlines, the unemployed will not be able to claim any UI benefits. In fact, with the current administrative capacity, these time frames are too constrained for the unemployed, the employers and social insurance organizations to fulfill all relevant requirements. A recent report by VSS (2011) shows that there are a number of reasons for delayed claims, including low enforcement of UI regulation by enterprises, late provision of labor contract termination, delayed payments for UI contribution, and imprecise information of social insurance for the workers. Another common issue is that the unemployed are usually seeking jobs and miss the deadlines for unemployment registration, and therefore they are not eligible for unemployment benefits without certified documents.

Third, contributions and benefits are not closely linked, which can lead to unfairness among UI participants. This also creates “actively” unemployed groups.

According to the Social Insurance Law in 2009, and Term 3, Article 27 of the Decree 127/2008/NĐ-CP, the maximum wage used as the base for UI contribution is 20 times the minimum wage. As such, the amount of UI benefit that an unemployed person receives in three months is about 25 times the amount that he/she contributed in the 12 months prior to his/her unemployment. If the contributions include those from employers and the government and the payments exclude those for vocational training support and job-seeking consultancy, the gap is still five times (VSS, 2011).

Fourth, there have been “disguised” (or “fake”) unemployed persons.

Since the labor market in Vietnam is huge and changing over time, and given current administrative capacity, different employment or unemployment statuses are not controlled well. VSS (2011) shows that many people are receiving unemployment benefits at the same time as they are working for different enterprises without a labor contract. As discussed above, because the expected amount of UI benefits are much higher than UI contributions, some workers claim

UI benefits in a short time, and then return to work at the same place. This situation indicates a big “loophole” in the UI regulations.

Fifth, the number of unemployed persons getting vocational training is too low. This in turn makes it difficult for them to seek jobs and may become long-term unemployed, especially in an economic slowdown situation.

The regulations show that, during the time of unemployment, the unemployed with a demand for vocational training will be supported, and necessary training will be conducted by vocational training centers. The unemployed will not get any cash for self-training. The maximum monthly grant is VND300,000 per person, and the maximum time for training is six months. Given these provisions, in 2010 nationwide, only 273 out of 156,765 beneficiaries had vocational training. Some provinces did not even have any unemployed persons demanding vocational training. The main cause of such a situation is that demand for low-skilled workers is high, so that persons with vocational and other training qualifications sometimes find it difficult to get good jobs, and they are sometimes also paid the same as those without any skills. Another important reason is that the vocational training courses offered are poorly designed, and cannot meet the standards of skills required by employers.

1.2. Challenges due to labor market and economic conditions

Along with the abovementioned challenges from design and implementation of the UI scheme, a number of challenges also result from labor market and economic conditions.

First, labor market development is premature. This can be seen in the way the unemployed persons seek jobs (Table 5). For all unemployed persons with different levels of education/training qualifications, the main modes are “job application” and “via relatives/friends”. Such an organization will not help the unemployed reach necessary information about the labor market, which in turn helps them to find appropriate jobs.

Table 5: Mode of job search by qualification, 2010

Technical qualification	Total	Mode of job search						
		Applied for job	Via public employment service	Via friends/relatives	Via job search advertisement	Via recruitment advertisement	Setting up business/own account work	Others
Total	100.0	37.9	5.4	49.1	0.5	4.8	1.3	1.1
Not any	100.0	27.4	5.4	59.4	0.6	4.3	1.5	1.4
Vocational training	100.0	49.5	6.7	37.6	0.4	4.6	1.2	0.0
Vocational high school	100.0	68.9	4.3	22.7	0.2	3.5	0.4	0.1
College	100.0	62.0	5.1	24.1	0.2	8.3	0.2	0.2
Undergraduate and above	100.0	69.2	5.9	16.7	0.0	7.3	0.7	0.2

Source: GSO (2011)

Second, it is difficult to manage the UI scheme because there are a number of types for labor contracts. Informal approaches (such as no contract or verbal agreement) account for nearly

50% of the salaried and waged workers, who are expected to participate in the UI scheme. These approaches also tend to increase significantly over time (Figure 4).

Figure 4: Distribution of wage and salaried workers
by type of contract, 2007 & 2009



Source: MoLISA (2010)

Third, the labor market is really volatile with economic fluctuations. In particular, some labor-intensive industries, such as fishery and manufacturing, are sensitive to and negatively influenced by economic slowdown (Table 6). As these industries have contributed significantly in creating jobs for the economy, such impacts show that challenges for Vietnam in dealing with economic shocks (such as slowdown) are greatly difficult.

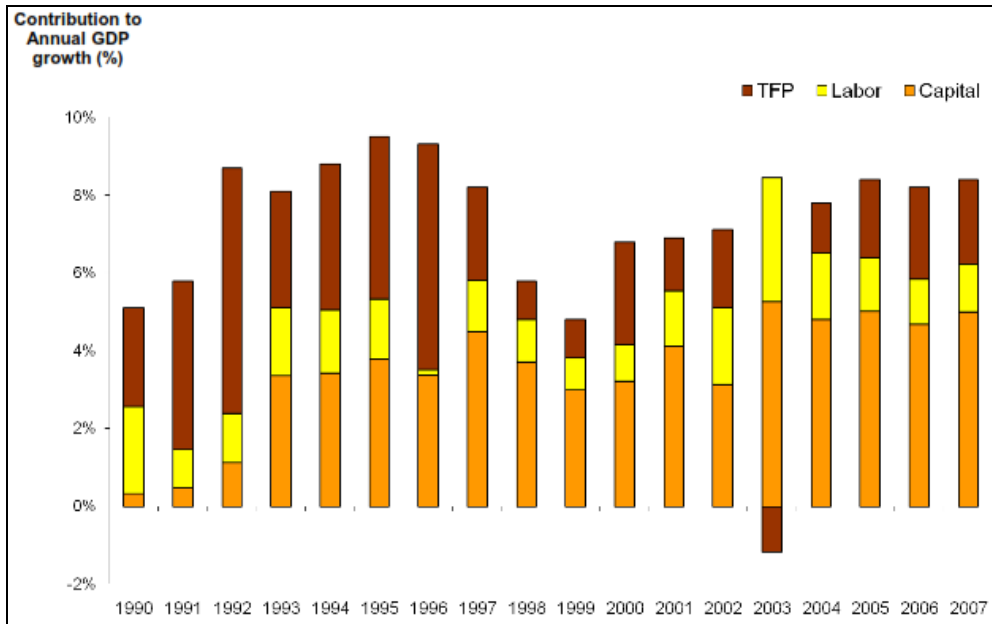
Table 6: Impacts of economic slowdown on employment, 2009

	G_{1r} (GDP growth rate in first half of 2009)	Elasticity	Jobs in 2009 without slowdown (L0 - 2009) (thousand people)	Jobs in 2010 without slowdown (L0 - 2010) (thousand people)	Jobs in 2009 with slowdown (L1 - 2009) (thousand people)	Jobs in 2010 with slowdown (L1 - 2010) (thousand people)	Impact for 2009: L1 - L0 (thousand people)	Impact for 2010: L1 - L0 (thousand people)
Agriculture, Forestry, Fishery			23,440	23,262	23,592	23,550	152	288
Agriculture, Forestry	0.86	-0.412	21677	21417	21873	21796	196	379
Fishery	3.71	0.551	1763	1845	1719	1754	-44	-91
Industry and Construction			10,026	10,711	9,603	9,873	-423	-838
Mining	7.30	2.854	463	497	521	630	58	132
Manufacturing	1.09	0.572	6741	7205	6346	6385	-395	-820
Electricity, gas & water supply	5.25	1.091	254	287	238	251	-17	-36
Construction	8.74	0.500	2568	2721	2499	2608	-69	-114
Services			12,680	13,398	12,432	12,983	-248	-415
Trade	6.53	0.372	5535	5703	5502	5636	-33	-67
Hotel & restaurant	-0.90	0.203	851	872	829	828	-22	-44
Transport, warehouse & communication	8.28	0.038	1227	1232	1226	1229	-1	-2
Finance, credit	6.37	1.793	254	293	245	273	-9	-20
Scientific & technical activities	6.28	0.256	27	28	27	28	0	0
Activities related to property business & consultancy service	2.86	5.896	297	350	294	344	-3	-7
Education & training	6.10	0.515	1462	1525	1445	1491	-16	-34
Health & social aid service	6.13	0.484	415	431	412	424	-3	-7
Culture & sport	6.17	0.140	136	138	136	137	0	-1
Other services	6.06	1.988	2476	2828	2315	2594	-161	-234

Source: Pham et al. (2009)

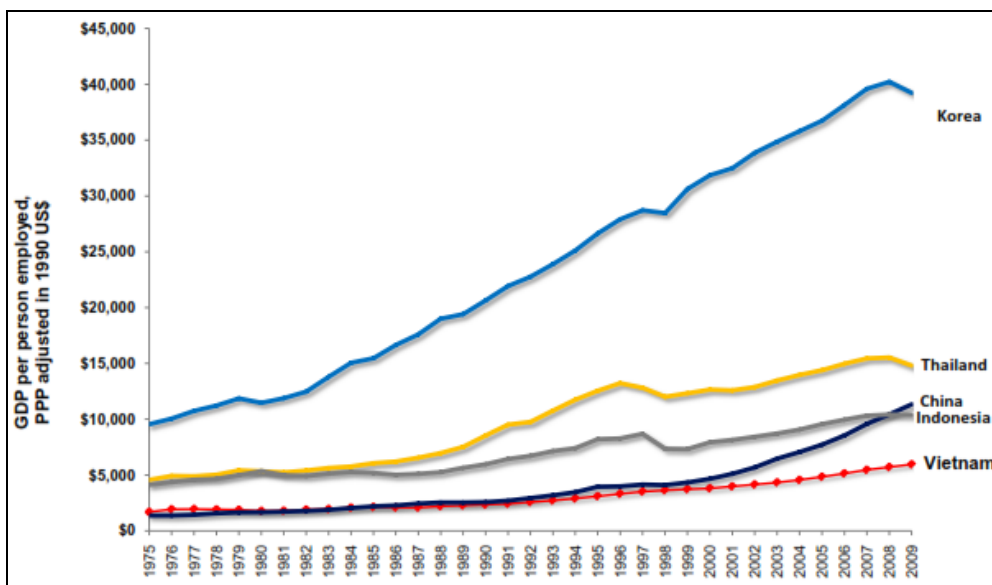
Fourth, for the long-term challenges of employment/unemployment in Vietnam, it is critical that both the contribution of total factor productivity (TFP) to economic growth (Figure 5) and improvement in labor productivity (Figure 6) have been low. In comparison with other regional countries, Vietnam has lagged behind in terms of labor productivity. Such a situation can be elucidated by the fact that in the labor market unskilled and low-skilled workers are abundant, while high-skilled and technical workers are rare. These issues in turn will significantly impact long-term economic growth and national competitiveness—two factors influencing job creation.

Figure 5: Sources of economic growth in Vietnam, 1990-2007



Source: Ohno (2008)

Figure 6: Labor productivity in Vietnam and other regional countries, 1975-2009



Source: CIEM and LKY School of Public Policy (2010)

2. Policy Recommendations

To deal with unemployment challenges for the UI scheme, we propose the following policy recommendations.

First, as employment and unemployment are “two sides of a coin”, we need to focus on creating employment rather than struggling with unemployment. To do so, with an increasing labor force, Vietnam needs to improve labor productivity and efficiency, since these factors have long-term impacts on economic growth and national competitiveness. As manufacturing industries will be acting as the key pillar for growth and job creation, vocational training for workers in

these industries is an important policy action. At the same time, diversification of rural employment via appropriate structural changes will also help create jobs for rural areas.

Second, a large number of workers are still outsiders of the UI scheme. Most of them are vulnerable persons, such as own account or family workers. Therefore, promoting voluntary unemployment insurance should be considered an important policy action in preparing unemployment risks for these groups.

Third, for the current UI scheme, some regulations should be revised or changed in order to adapt with situations. For instance, it is necessary to consider different points of time for unemployment registration, submission of unemployment benefit application, and benefit delivery. Along with these amendments, it is also necessary to improve the administrative capacity of provincial bureaus of labor and social insurance organizations to avoid “fake” unemployment. Policy actions include monitoring and evaluation of labor contracts, wage and income auditing, and maintaining a list of current workers for all types of enterprises.

Last, but not least, information dissemination about the UI rights and responsibilities for all employers and employees is equally important as other policy actions. Without transparent regulations, it is obviously hard to have an efficient and influential UI scheme to protect workers from various risks, including job loss.

IV. Concluding Remarks

Unemployment insurance is a risk-coping tool for the workers, and it is an important pillar in the social protection system as a whole. To reach financial sustainability and fairness, design and implementation are extremely crucial to cope with unemployment shocks.

The labor market in Vietnam is still premature and fragile to economic slowdown, especially labor-intensive industries. As such, special attention for the laborers of these industries should be in place. Demand-based vocational training and structural changes with particular investments in rural areas will be a key to dealing with unemployment. More importantly, improvement of labor productivity and efficiency must be a prioritized policy agenda and action, since these factors are critical to long-term economic growth and national competitiveness, which in turn shape labor market and unemployment patterns. This is also the best way to protect workers from unemployment risks.

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What Makes Unemployment Insurance Funds Grow: China's Challenge to Stabilize Workers and the UI Fund

Yukari Sawada*

Background

Many preceding studies on China's unemployment insurance (hereinafter UI) program have focused on how to sustain and stabilize the UI fund, and thus tend to be cautious toward raising the level of benefits. They were leaning toward putting much effort on preventing fraud cases and on investing the fund's surpluses in vocational training and business start-ups. Deregulation in the financial market was also preferred. Lately, however, more attention is paid to the reserves in the UI fund and its underlying problems.

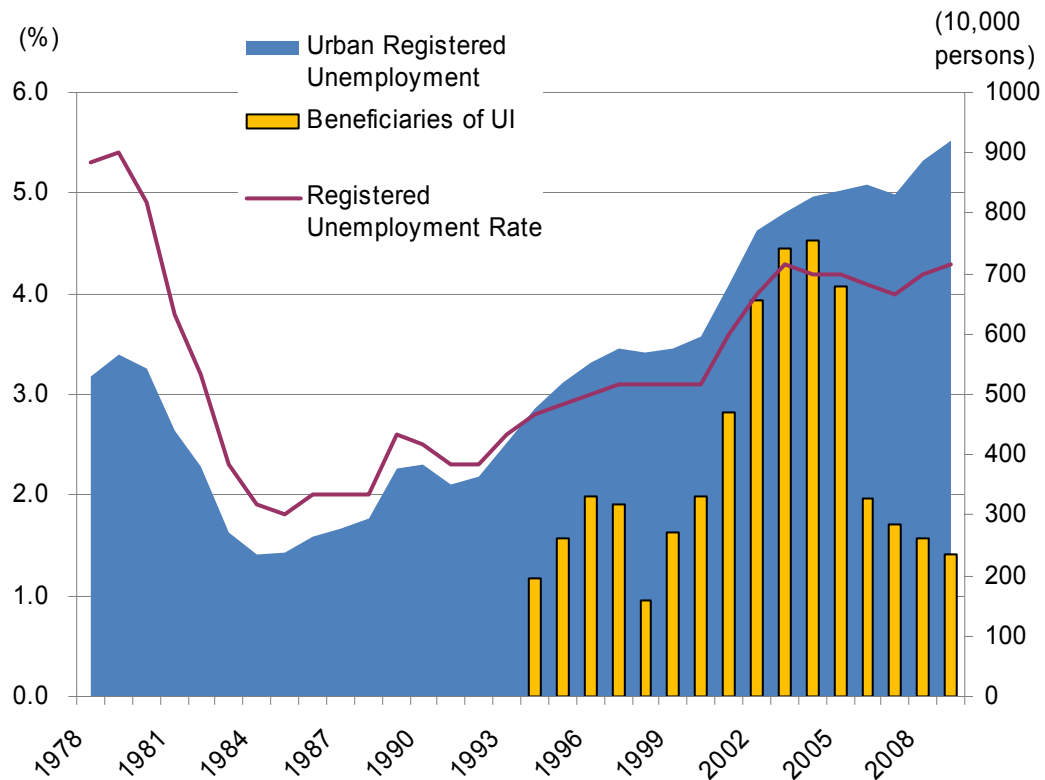
What is unique about China's case is that even under unprecedented economic growth that made it the second largest nation in terms of gross domestic product (GDP), the unemployment rate is steadily rising due to the pressure from a large supply of labor (Figure 1). At the same time, the UI fund's balance of payment is running a surplus, accumulating huge reserves (Figure 2). We can see from Figure 1 that the absolute numbers of beneficiaries are declining while the unemployment rate turned upward. Facing recent increases of labor disputes and social unrest, policymakers and academics started to consider making better use of UI reserves to solve workers' anxiety or lift the burden from employers.

We must keep in mind that China's official unemployment rate only shows local urban workers registered as unemployed. It does not include two groups of job seekers in the labor market: One is rural workers who migrated to urban areas seeking jobs and the other is new graduates from high schools and colleges who haven't found a job within six months after completing schooling. According to the press release by Dr. Li Wei of the Institute of Sociology in the Chinese Academy of Social Sciences, based on his survey conducted from May to September of 2008, the estimated urban unemployment rate was 9.4%, which was almost double the official number (ChinaNews.com). On March 22, 2010, Premier Wen Jiabao stated to the overseas delegates attending the 2010 annual meeting of the China Development Forum that China is facing the unemployment pressure of 200 million citizens (Ministry of Foreign Affairs, PRC). This means that the unemployment rate is already over 10%. Why is it possible for the UI fund to have more surpluses when the unemployed population is growing?

This paper first discusses elements that made huge reserves possible, then explores some side effects of UI reserves to the contributors, and finally suggests some ideas to cope with the side effects to promote social protection among the unemployed.

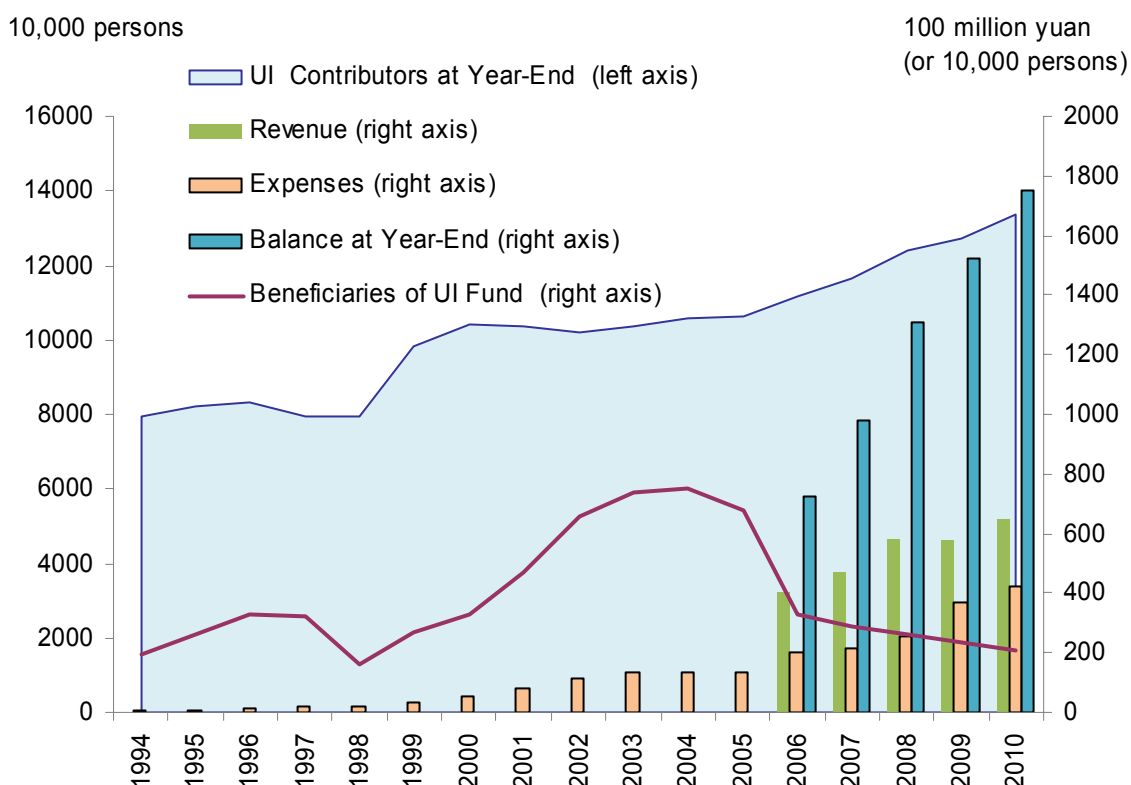
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Figure 1. Urban Registered Unemployment, Unemployment Rate and Beneficiaries at the Year End



Source: Guojia Tongji-ju Renkou he Jiuye Tongji-si & Laodong he Shehui Baozhang-bu Guihua Caiwu-si (Department of Population and Employment Statistics, National Bureau of Statistics & Department of Planning and Finance, Ministry of Labor and Social Security), ed. (2010)

Figure 2 Balance of Payment, Number of Contributors and Beneficiaries of UI Fund



Sources: For 1994-2009, Guojia Tongji-ju Renkou he Jiuye Tongji-si & Laodong he Shehui Baozhang-bu Guihua Caiwu-si (Department of Population and Employment Statistics, National Bureau of Statistics & Department of Planning and Finance, Ministry of Labor and Social Security), ed. (2010). For 2010, Renli Ziyuan he Shehui Baozhang-bu (Ministry of Human Resources and Social Security) (2011)

Elements behind UI Fund Surpluses

At the end of the year 2010, UI fund reserves reached 175 billion RMB, which was more than double the amount in 2006. This means that even during the global financial crisis of 2008 and 2009, China's UI fund was growing faster than its GDP. Recent increases in wages and the size of newly covered workers surpassing that of beneficiaries are the obvious explanations. A low replacement rate has also been effective in keeping the UI fund away from debt. The UI Ordinance of 1997 allowed provinces to determine the level of UI benefit within a range higher than the minimum living standard but lower than the minimum wage of the locality's urban area. Frequently it is set at around 60% to 70% of the local minimum wage standard. It is not linked to the unemployed individual's earnings, limiting UI's consumption smoothing effect, but it decreases income disparities via redistribution.

Aside from the above explanations, one element that caused the large surplus is rather ironical but typical of developing economies. Social insurance is usually mandatory so as to avoid adverse choice and lessen risks. However, in developing economies, the well-established formal

modern sector is likely to be a front runner in adopting newly introduced types of social insurance. As a result, the relatively stable and more well off than average employees are covered by UI before the rest. In other words, limited coverage works favorably in keeping the UI fund's balance of payments in the black.

In the case of China, a notable example is institutional organizations (IOs). IOs are organizations that engage in public services but are not part of the government. Typical examples are schools, hospitals, museums, publishers, and TV broadcasting stations. There are numerous institutions under this category, with a wide degree of variation, but they often receive subsidies from the government. Employees of IOs were integrated into the UI fund by the 1999 UI Ordinance. Given the extremely low frequency of dismissal, higher than average wages, and wide coverage due to strong influence from local government (more than 80% of employees had joined UI by 2008), IOs' presence contributed greatly to UI fund surpluses. Zhang (2010) estimated that out of the UI fund surplus accumulated at the end of 2009, 27.6% was provided by IOs, which is equivalent to 42.2 billion RMB.

However, Zhang's study indicates that if every IO contributed UI premiums in line with Article 6 of the 1999 UI Ordinance, which is 2% of total wages and 1% of an individual worker's wage, then the amount of contribution for 2009 should have been much higher than the actual one. The total sum of annual contribution made by IOs was 5.9 billion RMB, whereas the statutory contribution estimated was 21.8 billion RMB. Zhang (2010) concluded that incompliance was prevalent among IOs regarding UI contributions. IOs' reluctance to follow the ordinance is shared by enterprises that contributed for a long time without benefits. The issue was acknowledged by Mr. Wu Daohuai, the Head of the UI Division, Ministry of Labor and Social Welfare, in 2008, as he announced the launch of a new study project to amend the UI Ordinance (Xiang, 2008).

There is still another group that should be covered by UI but is more often excluded from the scheme than not. They are migrant workers from rural areas that are employed by urban enterprises or become self-employed in the cities. The number of migrant workers at the end of 2009 reached 145.3 million. Article 6 of the 1999 UI Ordinance exempted rural contract workers (another description for migrant workers) from paying their share of contribution, but employers are obliged to pay a premium. Also, article 21 states they may receive a lump-sum allowance from the local social insurance institution, provided that they were hired for more than a year, their contract was yet to expire, and their employers made contributions. They are eligible to receive a lump-sum allowance repeatedly if they find a job in an urban area after they return home to farming. The same article pronounces that provincial governments (which include four municipalities directly under the Central Government and autonomous regions) are responsible for setting methods and standards for the allowance.

However, as shown in Table 1, even official statistics from the Ministry of Human Resources and Social Security indicate that the majority of migrant workers are yet to be covered by social insurance, among which UI is the lowest.

Table 1
Social Insurance Coverage (2009)

Types of Social Insurance	Urban Workers	Migrant Workers	
		Total*	New Generation
Old age pension	57.0	11.5	7.6
Industrial injury	47.9	24.3	21.8
Medical	52.7	18.9	12.9
Unemployment	40.9	7.2	4.1

Source: Renli Ziyuan he Shehui Baozhang-bu (Ministry of Human Resources and Social Security) (2010)

Furthermore, not all of those covered always received a lump sum upon their return to their home village. A sample survey among migrant workers in the Pearl River Delta conducted by Liu et al. (2011) in the midst of the global financial crisis shows that many did not take a lump sum as they left jobs, or simply did not have social insurance to withdraw to begin with (Table 2).

Table 2
Refunded Social Insurance upon Leaving Job

	2009		2008	
	Persons	Percent	Persons	Percent
Yes	59	6.9	80	8.8
No	367	42.7	371	40.8
Did not have social security	434	50.5	458	40.8
Total	860	100.0	909	100.0

Source: Liu Linping, et al. (2011: 79).

Notice that the survey refers not only to UI but to any form of social insurance. When the author conducted interviews personnel managers of foreign direct investments in the Pearl River Delta in 2000, many answered that they usually refund old age pensions to migrant workers annually before the Lunar New Year. The workers are nominally “dismissed” and allowed to take old age pension money kept in their individual pension accounts. The managers said this was welcomed by the workers, as they could spend the extra money to purchase New Year gifts for their families back home. However, UI was not included in the refund. Their explanation was that migrant workers left their job every year so they could not receive UI benefits; that is, they had not fulfilled the “more than one year” condition to be eligible. One manager added that the workers did not mind because they were exempted from contributing UI premiums, so they did not feel deprived of their rightful benefit.

Of course, one can see that migrant workers from rural areas have alternative means to

support their livelihood. They can always return to their farmland and start in agriculture again. In fact, land and family are the ultimate social insurance for workers from rural areas. For example, according to the Migrant Workers Statistics Observation by the National Bureau of Statistics, when the global financial crisis was triggered by the bankruptcy of Lehman Brothers in 2008, 70 million migrant workers out of 140.4 million returned to their home village by the end of the Lunar New Year.

However, these traditional safety nets are silently losing their effect. The one-child policy shrunk household size. Industrialization and urbanization in rural areas are spreading, so there is less and less cultivated land as time goes on. The Migrant Workers Statistics Observation found that after the New Year break, only 20% stayed in their home village while 80% went out to the cities again. Among those 80% (56 million workers), 45 million found jobs after the break, leaving 11 million seeking jobs in cities (Guojia, 2009).

Emergence of the New Generation of Migrant Workers

It should be noted that migrant workers are not the same group as those we witnessed in the 1980s and 1990s. The younger generation born after 1980 has gradually become the majority among the group. They are called “the new generation”. Based on the nationwide questionnaire survey on the new generation of migrant workers carried out by the National Bureau of Statistics in 2010, there are 84.9 million of them, which is 58.4% of total migrant workers. They are different from their parents in their strong tendency to leave their farmland and the village. Among 40-49-year-old villagers, 67.2% of the workforce stayed in agriculture, 24.1% engaged in non-agriculture business within the village, and only 11.7% became migrant workers. For the age group of 30-39 years, the majority still stayed in agriculture (51.3%), less joined the non-agriculture sector in the village (20.8%), and working outside of the village was the second most important employment opportunity (27.4%). The numbers also show that 70-85% of the total workforce stayed or returned home eventually.

However, for the age group in their 20s, working outside the village has become the number one choice. Only 37.6% remained farmers, 13.2% took a non-agricultural path but remained in the villages, and migrant workers have reached 49.3%. The ratio of migrant workers is even higher among the younger generation in their teens, surpassing half the workforce (50.2%) of the age group, so this tendency will likely continue in the near future (Cai, 2011:3-4).

Another difference from their parents is that the new generation of migrant workers have acquired a higher level of education: 9% finished vocational middle schools and 6.4% graduated from college or university. As a result, many of them lack the knowledge and skill necessary for farming. Sixty percent of the new generation migrant workers do not have elementary agricultural knowledge, and 24% have no experience of farming whatsoever. They spent almost 10 months of the year outside the village and 90% of the new generation did not spend a single day on agriculture (Cai, 2011:7). They are more aware of their rights and are ready to protest if those

rights are violated.

This also means that when they are unemployed they will have difficulty supporting their living through agriculture. Even when they return to their home village, the majority leave again to find jobs outside. According to the National Bureau of Statistics survey of 2010, the new generation presented a stronger preference to stay in cities (45.1%) than to return to their home villages (33.4%). Among young female workers, those wishing to stay in cities reached a majority (52.9%) and only 22.7% plan to go back (Table 3).

Table 3 Future Plan of Migrant Workers Born after 1980

Future Plan	Total	Married		Single	
		Male	Female	Male	Female
Never to return to villages	8.1	5.3	5.6	7.6	12.5
Stay in cities as long as possible, return to village if necessary	37.0	31.7	32.0	38.8	40.4
Return to home village after saving enough money	22.2	27.9	29.4	21.3	15.6
Definitely return to home village	11.2	15.1	13.7	11.3	7.1
Don't know	21.5	20.1	19.1	21.0	24.5

Source: Cai (2011: 15).

Based upon these findings, we can assume future migrant workers will be in need of unemployment protection more than their parents. Yet, only a handful have joined the UI program. The national survey mentioned above indicates that only 4.1% of the new generation of migrant workers is covered by UI (Table 1). This is considerably lower than that of migrant workers as a whole. The UI participation ratio for all migrant workers was 11.0% in 2008, the lowest among other statutory social insurances (Cai, 2011: 7, 213).

Local Governments Reducing the UI Contribution Rate

In the face of huge surpluses of the UI fund, some local governments started to consider reducing the contribution rate to extend coverage and to encourage the reluctant formal sectors to continue paying the premium. Article 6 of the 1999 UI Ordinance issued by the Central Government (State Council), however, clearly states that an employer must contribute a premium equivalent to 2% of the total wage, while an employee contributes 1% of his or her wage. Under the current system, migrant workers are not obliged to pay contributions for UI. The contributions are solely made by employers.

However, the 1999 UI Ordinance was more decentralized in principle compared to previous UI regulations. As mentioned earlier in this paper, Article 18 allowed local governments to determine the level of benefits if within a given range. It was a realistic way to handle vast income disparities between regions. By the same token, Article 9 affirmed that provincial governments may appropriately adjust the contribution rate of the locality based upon the magnitude of unemployed workers and the volume of its UI fund. It also obliged local governments to report the adjustment and obtain permission beforehand. In a way, because of a lack of detailed enforcement regulations, the UI Ordinance functioned as a guideline, and local governments had

strong influence over the actual details of execution.

For example, in Shenzhen, a city in Guangdong Province, the UI contribution rate has been merely 0.4% of total wage. Based on article 9 of the 1997 Shenzhen Special Economic Zone UI Ordinance, an employer is to pay a monthly contribution equivalent to 1% of the previous year's average wage in Shenzhen Municipality multiplied by the number of employees, then multiplied again by a fixed ratio. The fixed ratio is determined by taking into account the local employment structure, GDP, consumer price index, minimum wage, and the UI fund's balance of payments, and it is announced to the public annually. Thus, employers located in Shenzhen were able to save on production costs and are motivated to participate in the UI program.

Shenzhen had its own reason to adopt such an extreme adjustment. Thirty years ago, Shenzhen was just a small village. Located adjacent to Hong Kong China, it was considered geographically too vulnerable to foreign military attack during the Cold War. Consequently, state investments were scarce, leaving it free of workers made redundant by state-owned enterprises (SOEs). With a less negative legacy from the planned economy and its advantage of receiving overseas investment via Hong Kong China, Shenzhen became a major exporter and one of the major destinations for migrant workers. In fact, local residents, i.e. those who hold Shenzhen registration, are in the minority. The number of non-local residents is about six times the number of local residents. According to the 1999 UI Ordinance, they are also to be covered by the UI program as long as they are employed by local urban IOs and enterprises.

In reality, they are only half covered. Upon their dismissal, non-locals have no way to receive UI benefits because Shenzhen's 1997 UI Ordinance only allows locals to register as unemployed. Article 16 of the 1999 UI Ordinance issued by the State Council demands employees to register unemployment at local UI offices in order to receive UI benefits. On the other hand, their employers are told that UI contributions are mandatory. Since many of the non-local residents are migrants from rural areas, they themselves are exempted from paying the premium, but their employers must contribute their share. In short, urban enterprises that hire temporary residents are making contributions without receiving direct benefits.

The Shenzhen Municipal Social Insurance Bureau, in response to an open letter question by a journalist in December 2009, explained that when the 1997 UI Ordinance was enforced in Shenzhen, the Central Government's policy principle was to protect local residents in general. Considering the population structure of Shenzhen where the majority are non-locals, the municipal government decided to collect 40% of the standard premium from employers. This special bargain was meant to be a de facto way to exclude non-local residents from the UI coverage, thus making them ineligible as UI beneficiaries. At the time of the open letter response, there were approximately 2 million local residents and 8.7 million permanent residents, i.e. more than 12 million under the municipality's control, which meant that non-locals were included when paying UI premiums but were excluded from receiving benefits (*Yangcheng Wanbao*, Dec. 4, 2009).

Needless to say, in reality, the ratio of temporary residents among employees is quite different depending on the employer. The feeling of unrewarding UI contributions is making them reluctant to comply with the UI Ordinance. With the rapidly rising minimum wage standard recently, this sense of unfairness is increasing. In the case of Bao'an District in Shenzhen, it was reported in February of 2009 that 170,000 employees were covered by UI, but only 400 people received monthly UI benefits. Taking into account that the district's local registered population is 300,000 and that migrant workers residing there have already reached 5 million, coverage is very limited (*Yangcheng Wanbao*, Oct. 15, 2009).

Dongguan, another city in the Pearl River Delta that absorbed a large number of migrant workers, adjusted the employers' contribution rate in July 2007, cutting it from 1.5% to 0.5% (*Yangcheng Wanbao*, Jan. 24, 2007). As shown in Tables 4 and 5, Guangdong enjoyed a low unemployment rate and the largest UI fund surplus among the provinces in 2009. This was the period when the province was severely hit by the global financial crisis due to their high export dependency and dismissed a massive number of migrant workers. The effect of Guangdong's loose monitoring of eligibility and reduced contribution rates might be seen from comparing the numbers to Shanghai, where the legacy of large SOEs and stricter control over migrant workers, might appear. Liaoning, the well-known base for old SOEs, and export-oriented Jiangsu and Zhejiang are also highlighted for comparison.

Table 4

Urban Registered Unemployment & Unemployment Rate at the Year-End by Region

(10,000 persons, %)

Region	Unemployment					Unemployment Rate				
	2005	2006	2007	2008	2009	2005	2006	2007	2008	2009
Beijing	10.6	10.4	10.6	10.3	8.2	2.1	2.0	1.8	1.8	1.4
Tianjin	11.7	11.7	15.0	13.0	15.0	3.7	3.6	3.6	3.6	3.6
Hebei	27.8	28.7	29.3	32.2	34.5	3.9	3.8	3.8	4.0	3.9
Shanxi	14.3	15.6	16.1	17.5	21.6	3.0	3.2	3.2	3.3	3.9
Inner Mongolia	17.7	18.0	18.5	19.9	20.1	4.3	4.1	4.0	4.1	4.0
Liaoning	60.4	54.1	44.5	41.7	41.6	5.6	5.1	4.3	3.9	3.9
Jilin	27.6	26.3	23.9	24.3	23.4	4.2	4.2	3.9	4.0	4.0
Heilongjiang	31.3	31.2	31.5	32.1	31.4	4.4	4.4	4.3	4.2	4.3
Shanghai	27.5	27.8	26.7	26.6	27.9		4.4	4.2	4.2	4.3
Jiangsu	41.6	40.4	39.3	41.1	40.7	3.6	3.4	3.2	3.3	3.2
Zhejiang	29.0	29.1	28.6	30.7	30.7	3.7	3.5	3.3	3.5	3.3
Anhui	27.8	28.2	28.0	29.3	30.1	4.4	4.3	4.1	3.9	3.9
Fujian	14.9	15.1	14.9	15.0	15.2	4.0	3.9	3.9	3.9	3.9
Jiangxi	22.8	25.3	24.3	26.0	27.3	3.5	3.6	3.4	3.4	3.4
Shandong	42.9	43.7	43.5	60.7	45.1	3.3	3.3	3.2	3.7	3.4
Henan	33.0	35.4	33.1	36.5	38.5	3.5	3.5	3.4	3.4	3.5
Hubei	52.6	52.6	54.1	55.1	55.3	4.3	4.2	4.2	4.2	4.2
Hunan	41.9	43.3	44.4	47.0	47.8	4.3	4.3	4.3	4.2	4.1
Guangdong	34.5	36.2	36.2	38.1	39.5	2.6	2.6	2.5	2.6	2.6
Guangxi	18.5	20.0	18.5	18.8	19.1	4.2	4.2	3.8	3.8	3.7
Hainan	5.1	5.2	5.4	5.6	5.3	3.6	3.6	3.5	3.7	3.5
Chongqing	16.9	15.4	14.1	13.0	13.4	4.1	4.0	4.0	4.0	4.0
Sichuan	34.3	36.1	34.8	37.9	36.3	4.6	4.5	4.2	4.6	4.3
Guizhou	12.1	12.1	12.1	12.5	12.3	4.2	4.1	4.0	4.0	3.8
Yunnan	13.0	13.8	14.0	14.8	15.4	4.2	4.3	4.2	4.2	4.3
Tibet					2.0					3.8
Shaanxi	21.5	21.5	21.0	20.8	21.5	4.2	4.0	4.0	3.9	3.9
Gansu	9.3	9.7	9.5	9.4	10.3	3.3	3.6	3.3	3.2	3.3
Qinghai	3.6	3.7	3.7	3.9	4.1	3.9	3.9	3.8	3.8	3.8
Ningxia	4.4	4.2	4.4	4.8	4.8	4.5	4.3	4.3	4.4	4.4
Xinjiang	11.1	11.6	11.7	11.8	11.9	3.9	3.9	3.9	3.7	3.8

Source: Guojia Tongji-ju Renkou he Jiuye Tongji-si & Laodong he Shehui Baozhang-bu Guihua Caiwu-si (Department of Population and Employment Statistics, National Bureau of Statistics & Department of Planning and Finance, Ministry of Labor and Social Security), ed. (2010)

Table 5

Statistics of Unemployment Insurance by Region (2009)					
Region	UI Contributors at Year-End (10,000 persons)	Beneficiaries of UI Fund (10,000 persons)	Revenue & Expenses (100 million yuan)		
			Revenue	Expenses	Balance at Year-End
Beijing	675.7	1.8	27.9	17.8	81.7
Tianjin	239.2	3.1	18.9	15.6	41.5
Hebei	484.4	10.4	24.9	24.2	50.6
Shanxi	293.3	6.1	11.9	6.2	38.1
Inner Mongolia	229.7	2.5	9.7	5.2	21.8
Liaoning	625.3	13.4	35.5	21.6	39.0
Jilin	241.4	14.3	12.0	8.4	27.1
Heilongjiang	471.3	9.3	14.5	8.2	57.0
Shanghai	523.5	14.6	61.8	54.7	76.4
Jiangsu	1079.1	19.7	58.5	36.3	141.2
Zhejiang	784.5	5.5	43.8	17.6	127.8
Anhui	377.8	10.5	14.4	11.5	21.4
Fujian	348.1	3.6	11.3	4.3	46.2
Jiangxi	275.5	3.4	7.0	2.8	22.4
Shandong	899.5	23.0	41.5	22.2	131.5
Henan	690.2	16.7	17.8	12.3	39.0
Hubei	440.3	7.0	14.6	8.9	39.4
Hunan	392.0	8.3	13.7	7.3	30.4
Guangdong	1470.7	12.8	31.0	18.1	186.2
Guangxi	237.0	7.6	10.5	5.3	38.9
Hainan	97.5	2.8	3.8	2.0	12.3
Chongqing	215.9	4.7	10.7	4.8	23.4
Sichuan	463.5	10.0	25.4	13.7	47.5
Guizhou	144.6	1.1	6.6	5.8	30.5
Yunnan	198.7	3.5	8.0	5.4	34.7
Tibet	8.8		1.1	0.5	4.1
Shaanxi	331.0	9.3	15.2	7.4	37.9
Gansu	164.1	3.7	8.4	6.1	15.4
Qinghai	36.0	1.0	2.5	1.5	7.7
Ningxia	44.9	1.1	2.4	1.2	7.1
Xinjiang	231.8	4.9	15.0	10.1	45.4

Source: Guojia Tongji-ju Renkou he Jiuye Tongji-si & Laodong he Shehui Baozhang-bu Guihua Caiwu-si (Department of Population and Employment Statistics, National Bureau of Statistics & Department of Planning and Finance, Ministry of Labor and Social Security), ed. (2010)

In the wake of the global financial crisis following the Lehman Brothers bankruptcy in 2008, other local governments temporarily began to reduce the UI contribution rate to lighten the burden for employers. In Qingdao, the municipal government reduced the contribution rate of employers from 2% to 1% (*Bandao Dushi Bao*, May 16, 2009), whereas in Changsha it was reduced only by 0.5%, leaving the contribution rate at a level of 1.5% for employers in July 2010 (Changsha Laodong he Shehui Baozhangju, Jan. 10, 2010). In Rizhao, Shangdong Province, both employers' and employees' contributions were cut by half in October 2011, reducing the whole contribution

rate from 3% by 1.5% (Rizhao-shi Renli Ziyuan he Shehui Baozhang-ju, Oct. 10, 2011).

In the Pearl River Delta, Foshan Municipality's Shunde District, the ratio was reduced to 0.5% for both employers and employees (Foshan-shi Shunde-qu Shehui Baoxian Jijin Guanliju, Aug. 30, 2010), and Zhongshan Municipality's UI contribution rate of 1% was reduced to 0.8% in July 2009 (*Zhongshan Ribao*, Jul. 21, 2009). But the boldest move was made by Guangzhou Municipality, where the UI contribution rate of 3% was lowered to only one-tenth the original, i.e. 0.3% from January 1, 2009. It was planned to expire at year-end, but in March, it was extended until the end of 2010 (*Guangzhou Ribao*, Mar. 10, 2010).

On the contrary, in Shaanxi Province where SOEs used to be concentrated and which has a lower UI fund surplus compared to coastal provinces like Shangdong, Guangdong, Zhejiang, or Jiangsu, as Table 5 indicates, the contribution rate was higher by 0.5% compared to prior to the financial crisis. After the crisis, the Shaanxi Provincial Human Resources and Social Welfare Bureau announced the reduction of the employers' contribution rate to 2% but kept the employees' rate the same at 1%, so the total UI control result is 3%, or 10 times that of Guangzhou (*Shaanxi Ribao*, May 24, 2009).

Recent Developments

The Social Insurance Law was passed in October 2010 and was enforced from July 2011. It stated that all workers whose employer and who themselves contributed UI premiums for one year or more are eligible for UI payments provided that they are dismissed involuntarily and are already registered as unemployed while maintaining the will to take jobs. In order to receive UI benefits, the unemployed person must present a document issued by the former employer as proof of his/her dismissal to the public employment service institutions to complete unemployment registration (Article 50). If one refuses to take jobs or vocational training offered by departments or institutions that are appointed by the local government without proper reason, he/she will become ineligible to receive UI benefits (Article 51).

In accordance with the above law's passage, provinces and municipalities started to adjust their UI payment scheme for migrant workers. A frequently seen scheme is to pay properly the lump-sum UI benefits to dismissed peasant migrant workers. In the case of Anhui Province, an additional 10% of the lump-sum amount is offered to the applicants, but at the same time, they will be disqualified from receiving any further UI in any form. In Shenzhen, the municipality's People's Congress started to deliberate on a draft amendment of its UI Ordinance on December 22, 2011. It is finally to cover all non-Shenzhen registered citizens and provide lump-sum UI benefits to non-locals if they so desire.

Contribution deductions depending on the employer's lay-off frequency was also suggested in the newly revealed Shenzhen Special Economic Zone UI Ordinance revised draft. Taking reference from Article 8 of the Industrial Insurance Ordinance, the "Floating Contribution System" was designed to determine a contribution adjustment for employers based on the

previous year's achievements such as the amount of benefits the employees received, rate of dismissal, lay-offs, and job placements. An employer may enjoy a maximum 40% deduction of contributions depending on the stability one offered to the workers. This is also expected to encourage IOs to participate and continue to pay premiums.

On the other hand, if an employer failed to pay statutory premiums, arrears interest of 0.05% is added daily after the deadline. When the local labor and social welfare office find an employer not participating, it will give a certain moratorium period, but if the employer still refuses to join, a fine of two to four times the missing amount of premium will be levied upon the employer (*Guangzhou Ribao*, Dec. 23, 2011).

Shenzhen also suggested a new adjustment to keep the UI premium level low. Since Shenzhen's wage level is one of the highest in the nation, by paying premiums for every migrant worker, contributions from enterprises are estimated to increase 7.5 times if the current national and provincial standard of 2% based on total wage is applied. In order to reduce the employers' burden, the Shenzhen UI Ordinance revised draft of December 22, 2011, proposes the minimum wage standard as a base for contribution instead of the previous year's average wage.

Conclusion

When a developing economy introduces a UI program, it often struggles with constraints that are different from the ones seen in developed economies. According to Milan Vodopivec's study published in 2009, typical difficulties developing economies face are: (1) a large informal sector, (2) weak administrative capacity, (3) large political risk, and (4) an environment prone to corruption. In order to minimize employment disincentives, as well as assuring affordability and maintaining the balance of payments to sustain the UI program, Vodopivec (2009) suggest, along with other recommendations, (1) simplified monitoring of eligibility requirements, since it is both ineffective and likely to lead to corruption, (2) modest benefits in terms of both the replacement rate as well as potential duration of benefits (Vodopivec, 2009:2, 40), and, in case of China, (3) reducing UI contribution rates to extend coverage to all formal workers (Vodopivec and Tong, 2008:26).

All the listed difficulties fit China except for weak administrative capacity. Guidelines provided by the Central Government had strong influence over local governments although the local governments were able to adjust them. As a result, most of Vodopivec and Tong's suggestions have been adopted, not always intentionally, but nonetheless persistently. As can be seen from Shenzhen's case, simplified monitoring of eligibility requirements, modest benefits, and reduction of UI contribution rates have been put into practice today. But whether the new Social Insurance Law will be effectively adjusted is another matter. One of the important elements in the course of adjustment was the public's voice. Shenzhen's huge UI surplus was heavily criticized by both employers and employees through the mass media. People asked "Why let our money sleep when many suffer from the economic downturn?" This might bring new pressure to

increase benefits in future, but so far the local government's priority seems to be set on extending coverage.

It is still too early to say that strong administrative capacity may compensate other shortfalls. On the contrary, what is more important is to balance the demand for more benefits with the level of contribution. If the benefits are kept too meager to maintain a low level of premium, it might not be effective to support workers livelihood and to solve their anxiety over job loss, but too generous a benefit may bankrupt the fund. One recommendation is to utilize migrant worker non-governmental organizations (NGOs). They consult workers to protect their labor rights and provide services to secure their livelihood. In Beijing, the municipality and district governments started to purchase their service to reach the grassroots.

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Structural Changes in the Labor Market and Employment Insurance in Japan¹

Naoki Mitani*

1. Introduction

Japanese employment insurance (EI) has played important roles to maintain the resilience of the society during the downturn of the economy after the financial crisis in 2008-2009² as partly documented in the 2010 Report and after the Great East Japan Earthquake in 2011. Aside from the short-run fluctuations, structural changes have been taking place in the Japanese labor market over decades. The labor force is rapidly aging and decreasing gradually, with an increasing share of female workers. Employment is growing in the service sector, while it is declining in manufacturing and construction. The unemployment rate has become persistently high since the 1990s. The most significant changes in recent years are (1) increase in non-standard employment and (2) increase in long-term unemployment.

The ratio of recipients of unemployment insurance and social assistance to the working age population is fairly low (1.2%) in Japan, compared with the Organisation for Economic Cooperation and Development (OECD) average (nearly 7%)³. It may reflect the low coverage of EI and the low ratio of unemployment benefit (UB) recipients to unemployment (International Labour Organization [ILO] definition) as well as the fact that there is no unemployment assistance system. Thus, it is a challenge for EI to adapt to the structural changes in the labor market, especially the growing non-standard employment.

Efforts have been made to adapt EI to these issues. Recently, the coverage of EI has been extended to cover more non-standard workers. Jobseeker assistance has just been introduced to assist non-insured workers with training, training allowance and employment support.

How has EI adapted to the structural changes in the labor market? And what are the future issues for EI?

The structure of the paper is as follows. The next section reviews major structural changes in the labor market. Section 3 shows the characteristics of the Japanese EI, compared with other OECD countries. Section 4 describes the institutional aspects of the current EI. Section 5 shows the proportion of UB beneficiaries among the unemployed and the coverage of non-standard employment in EI. Section 6 gives an overview of the historical developments in the adaptation of

¹ This paper was prepared for the PECC Social Resilience Project 2011.

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² Mitani (2010).

³ Duell et al. (2010).

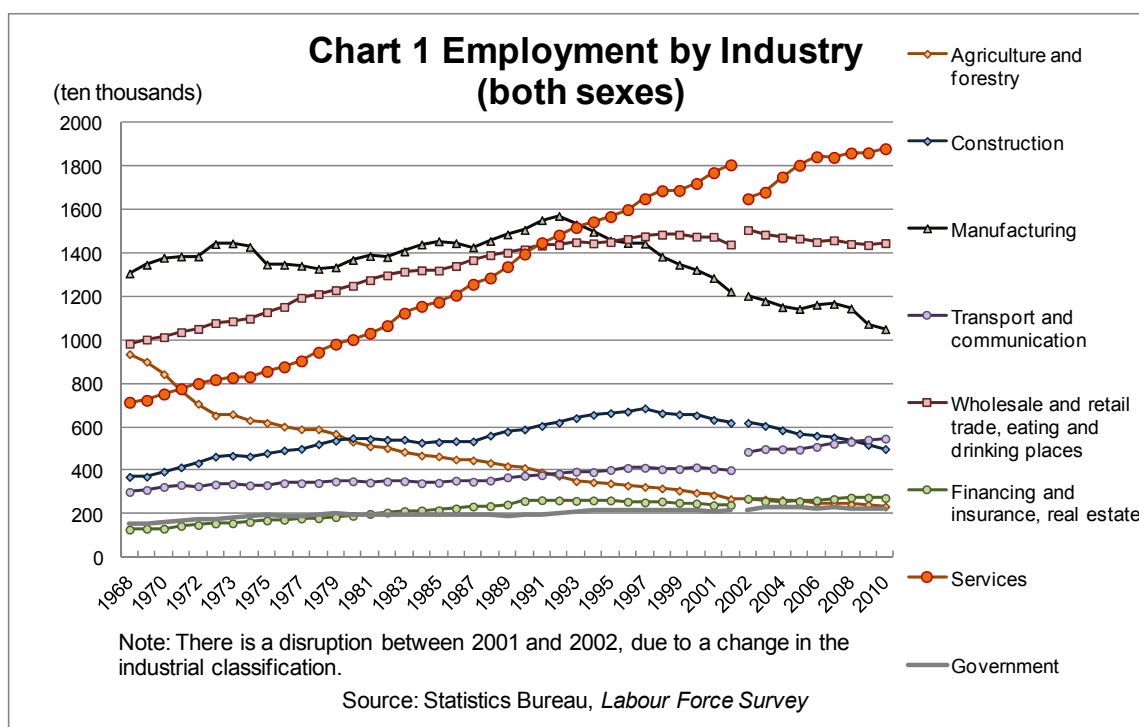
EI to the growing number of non-standard employees. Section 7 summarizes EI reforms recommended by researchers and officers. The final section is the conclusion.

2. Structural Changes in the Labor Market

Japan has been experiencing structural changes in the labor market over decades, especially after the burst of the bubble economy in 1991. There are long-term structural changes in the supply side of the labor market. First, the labor force population is rapidly aging and it has begun to decrease since 1998, mainly due to the demographic changes stemming from the falling fertility rate and increase of longevity. Second, the share of the female workers in the labor force has increased. The labor force participation rate of female workers has been rising rapidly since the mid-1970s.

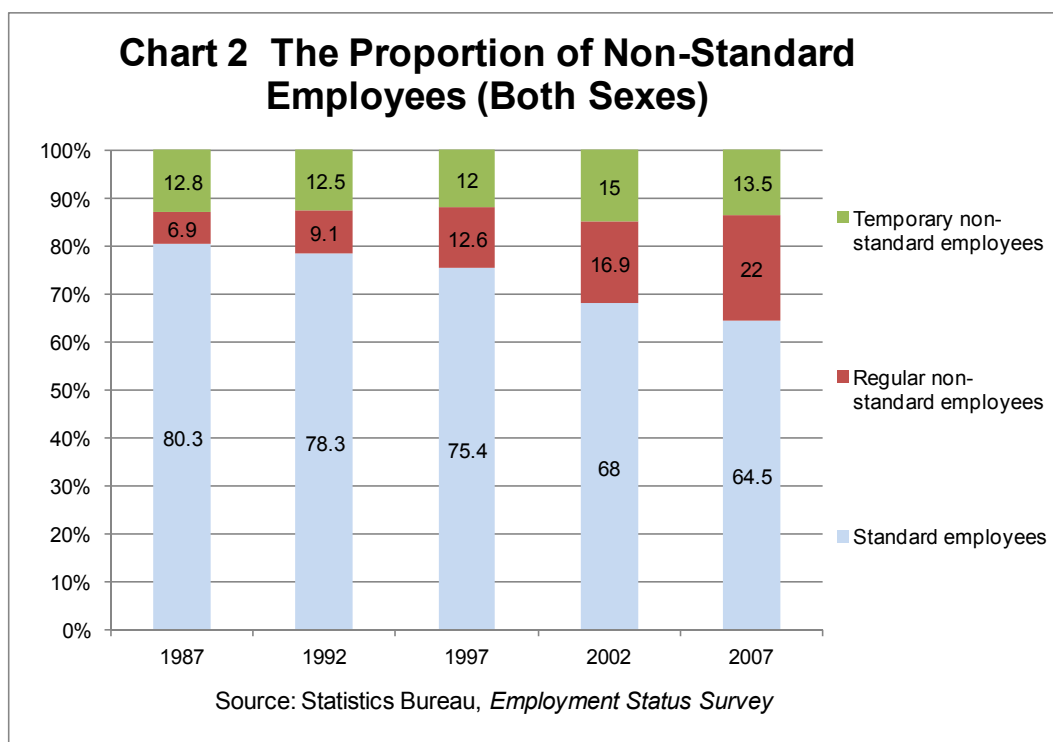
On the demand side of the labor market, the employment structure has greatly changed, largely due to the globalization of the economy and technological changes such as information and communication technologies (ICT).

First, employment has been decreasing in the manufacturing sector and construction sector since the 1990s, while employment in services is increasing rapidly (Chart 1).



Second, employment by occupation has also changed. The proportions of professional and technical workers, clerical and related workers and service workers have increased, while that of agricultural, forestry and fishery workers has sharply fallen. The proportion of production workers and laborers increased to about 30% in 1970 and remained unchanged thereafter. But it began to decrease gradually in the early 1990s.

Third, the proportion of non-standard workers has increased (Chart 2)⁴. Typically, one out of three employees is non-standard. This is one of the most salient features in recent structural changes in the Japanese labor market. Non-standard workers consist of part-time workers, dispatched workers and contract workers, etc. Most of them are female workers and temporary workers.



The following factors are in the background of the growing share of non-standard workers.

First, the share of service sectors, where daily busy times are concentrated, is growing. It is economically rational to employ part-time workers only for those busy times.

Second, international competition has become severe because of the globalization of the economy. Faced with severe competition, employers tend to reduce labor costs by hiring non-standard workers whose wages are relatively cheap.

Third, the polarization of the labor market is progressing because of ICT. The developments in ICT increase the demand for highly skilled workers who have creativity and high management abilities, while reducing that for middle-skilled jobs which are substituted by ICT. On the other hand, they tend to increase the demand for workers who are low-skilled but in charge of the tasks which a machine cannot conduct, such as tasks that involve human interaction and automobiles safely, etc. Most of the workers of the latter category are non-standard workers.

⁴ In Chart 2, “regular” means the length of employment contract is more than one year, while “temporary” means it is less than one year.

Fourth, the labor supply for non-standard jobs is also increasing. In particular, married female workers tend to work in part-time jobs to supplement the household budget in the face of the husband's diminishing earnings due to the long-term stagnation of the economy.

Chart 3 shows the long-term trend in unemployment rate in Japan from the beginning of the 1950s onwards. The unemployment rate decreased from over 2% in the early 1950s to a level of 1% in the 1960s and rose again to over 2% in a gentle U-shape. The number of the unemployed remained below 1 million in the 1960s and until the mid-1970s. After the First Oil Price Shock in 1974, it began to increase gradually and in the 1980s moved around 1.5 million. In this period, the unemployment rate was not so sensitive to business cycles and remained below 3% even during the recessions. Thus, the Japanese labor market in this period is characterized by a “low and stable unemployment rate”. Nonetheless, after the bubble burst in the early 1990s the unemployment rate rose sharply from 2.1% in 1991 to 5.3% in 2002. The number of the unemployed increased from 1.36 million in 1991 to 3.59 million in 2002. The unemployment rate began to fall in 2003 but only to 3.9% in 2007 and jumped up again to 5.1% in 2009 after the Lehman Shock in 2008. Thus, in this period, the Japanese labor market is characterized by a “persistently high unemployment rate”. Since the unemployment rate has not declined so much during the upturns of the business cycles, it is argued that the persistence of the high unemployment rate may be due to some structural factors in the labor market.

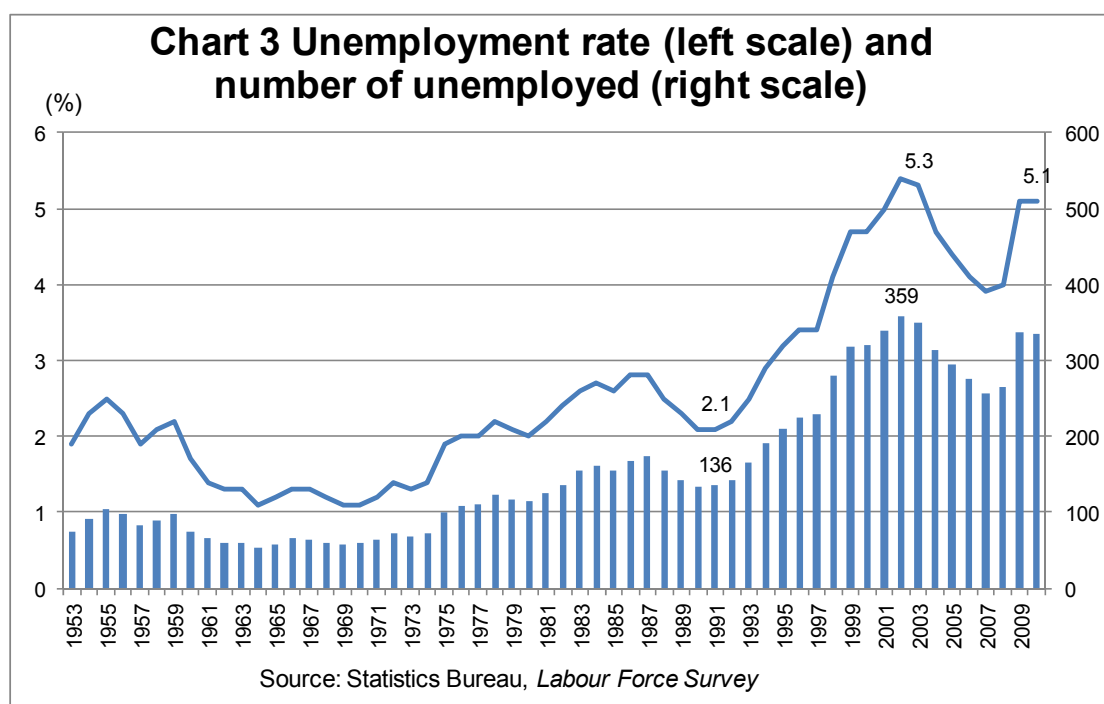
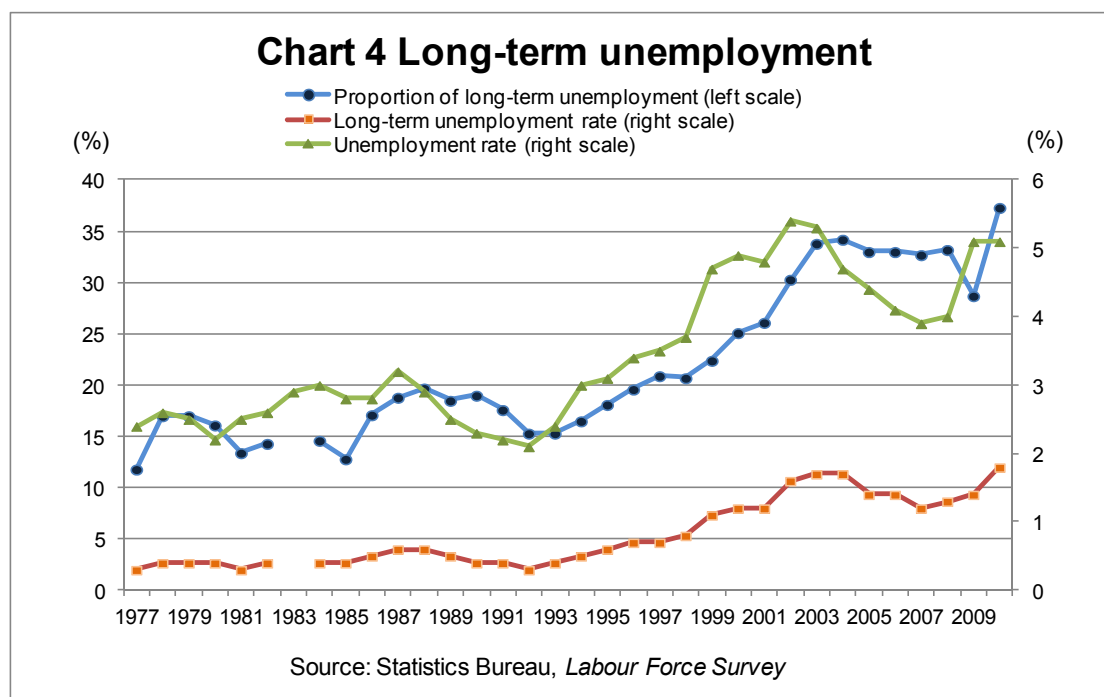


Chart 4 shows the incidence of long-term unemployment (one year or over). It was between 15% and 20% in the 1980s, but after the bubble burst, it rose rapidly to 33.8% in 2003 and continued to be high. After the financial crisis, it dropped temporarily but rose again to 37.3% in 2010. The long-term unemployment rate increased sharply, especially among low-educated workers and older workers. The increase in the long-term unemployment rate between 1994 and

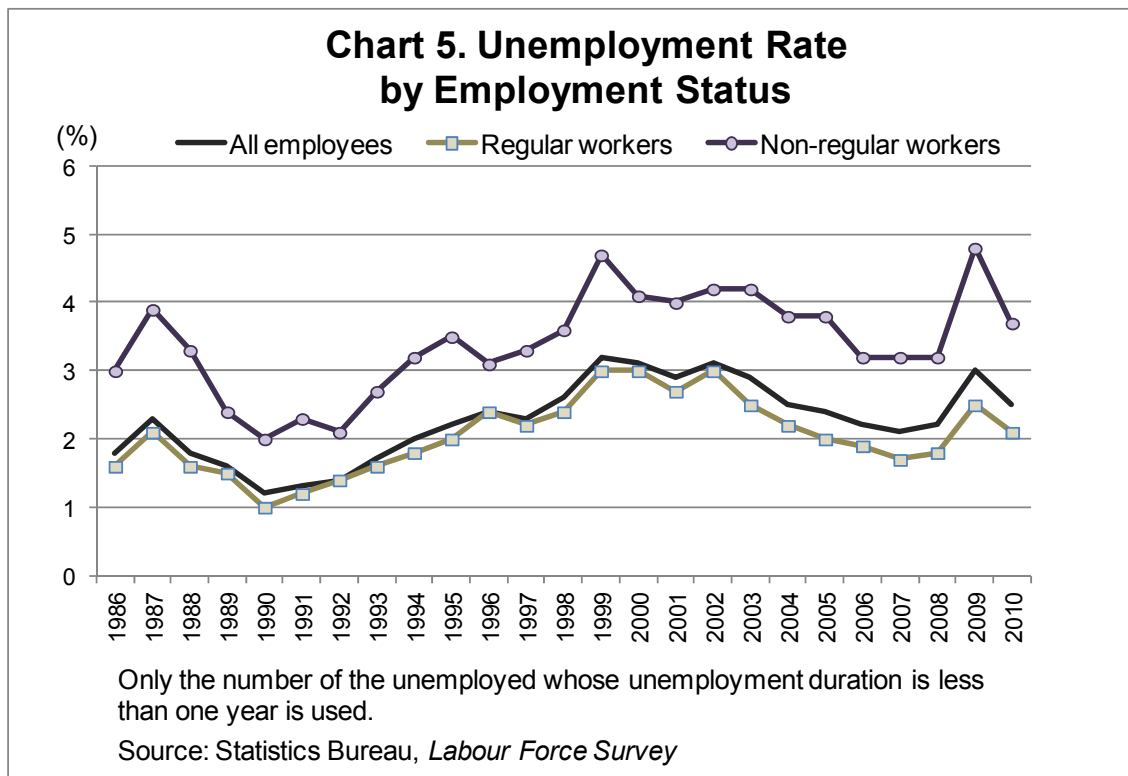
2004 is mainly accounted for by the increase in long-term unemployment among youths and high-school graduates. The incidence of long-term unemployment is higher among those who lost their jobs because of bankruptcy or dismissal.⁵



The persistent rise of the unemployment rate during the 1990s has provoked concern about the quantitative and qualitative evaluation of structural factors behind this trend. Mitani (2011) investigated, mainly by reviewing the literature, the factors behind the transition from the low and stable unemployment rate in Japan in and before the 1980s to the persistently high unemployment rate in and after the 1990s. The role of a specific mismatch or structural factor is limited, as shown by various mismatch indicators. Rather, the response of the unemployment rate to business cycles has become larger and long-lasting. The possible factors behind this change include (1) deflation and rigidity of nominal wages, (2) decline in the discouraged worker effect, (3) increase in non-regular employment and (4) long-term scars of youth unemployment.

Especially, the effect of the above “(3) increase in non-regular employment” on the overall unemployment rate is apparent (Chart 5).

⁵ Shinozaki (2004).



3. Characteristics of Employment Insurance in Japan

The ratio of the recipients of unemployment insurance and social assistance to the working age population is about 1.2% in Japan. This is far lower than in other OECD countries, where this ratio is around 7%. This is partly accounted for by the relatively low unemployment rate in Japan, compared with other OECD countries. However, the proportion of unemployment insurance (UI) benefit recipients to unemployment as indicated by the Labour Force Survey (LFS) is also relatively low and tends to decline gradually in the long run. These phenomena may reflect the fact that the EI system is not adapted to the recent structural changes in the labor market.

Compared with other OECD countries, the features of the institutional aspects of the Japanese EI scheme are as follows⁶.

(1) The qualification conditions to be insured include the lower limit of the expected duration of employment in addition to scheduled weekly hours worked and age, etc. In any economy, not all employees are necessarily insured, but only those satisfying certain conditions are qualified to be insured. The qualification conditions are different across countries. In Japan and Germany, weekly hours worked are used. In Japan, the scheduled weekly hours worked must be 20 hours or over to be insured, while in Germany it must be 15 hours or over. In the United States, the criterion is the number of annual weeks worked. In addition, the amount of the total wage bill is also added to the

⁶ This part is based on Higuchi (2010), who made an international comparison of six OECD countries: Japan, the United States, the United Kingdom, Germany, France and Sweden.

criterion for the eligibility of the contributions by the employers. In Japan, the qualification conditions to be insured also include the lower limit of the expected duration of employment. It is 31 days after April, 2010. As regards the age, the upper age limit for being insured is 65 years old in Japan, the United Kingdom (male workers), Germany and Sweden. The lower age limit is also set in the United Kingdom and Sweden.

(2) Regarding the qualification conditions in Japan to receive UB, the payment is stopped when the beneficiary is re-employed, even if the hours worked are short and the wages are low. In other countries, payment is made for the partially unemployed. For example, in Germany, although the benefit is reduced if net earnings exceed EUR165 per month, the beneficiaries do not lose total benefits unless they work more than 15 hours per week. According to a recent report of the OECD⁷, among the 16 OECD countries, there are only two countries (Japan and Italy) where there are no benefits for those partially unemployed.

(3) An employment promotion allowance is paid as an incentive for early re-employment when the beneficiary is employed before the expiration of the duration of UB in Japan.

(4) The replacement ratio is lower for beneficiaries whose former wages were higher in Japan, while elsewhere it is the same regardless of former wages. In Japan, the replacement ratio is constant for the whole period of payment, while in some countries it decreases as the duration of UB becomes longer.

(5) The replacement ratio in Japan is not so low, as the gross wages before tax reduction are used to calculate daily wages and UB is exempted from tax.

(6) There is no unemployment assistance scheme, which assures income for the unemployed after the expiration of the UB duration or those unemployed not qualified for UB, such as certain non-standard employees, even though the payment is lower.

(7) The proportion of UB beneficiaries among the unemployed (in the ILO definition) is lower in Japan compared with other countries. According to the ILO (2009), Germany (87%), France (82%), the United Kingdom (60%) and the United States (43%) have much higher proportions than Japan (23%). It should be also noted that the proportion is decreasing gradually (Table 1).

Among these features, (1), (2) and (6) might be related to the low proportion of UB beneficiaries among the unemployed and the low ratio of the recipients of unemployment insurance and social assistance to the working age population. Thus, it is needed to adapt EI

⁷ OECD (2007).

scheme to the structural changes in the labor market as it has been adapted so far since the introduction of UI/EI scheme. Before discussing the recent developments of the adaptation of EI to structural changes, we would like to show the current institutional aspects of EI briefly.

Table 1 Proportion of EI recipients to LFS unemployment and population

Fiscal year	Ratio of EI persons insured to total employees in the economy	Net UB beneficiaries	Labour Force Survey (LFS) unemployment	Population 15-64	Ratio of UB recipients to		Average duration of completed benefit spells
					LFS unemployment	Population 15-64	
	%	Thousands, annual average			%		
1980	62.9	683	1100	78740	62.1	0.9	5.8
1985	63.7	647	520	82350	42.6	0.8	5.5
1990	64.9	496	1310	86080	37.9	0.6	5.7
1995	63.7	857	2030	86980	42.2	1.0	6.1
2000	62.6	1069	3110	86570	34.4	1.2	6.1
2001	62.6	1129	3280	86250	34.4	1.3	5.7
2002	63.1	1064	3500	85770	30.4	1.2	5.5
2003	63.6	853	3360	85380	25.4	1.0	5.1
2004	64.6	697	3020	85140	23.1	0.8	4.7
2005	65.4	643	2840	84610	22.6	0.8	4.4
2006	66.0	598	2630	83960	22.7	0.7	4.4
2007	67.2	582	2480	83130	23.5	0.7	4.3
2008	68.5	622	2530	82440	24.6	0.8	4.2
2009	69.0	870	3180	81640	27.4	1.1	5.5

Source: Duell (2010)

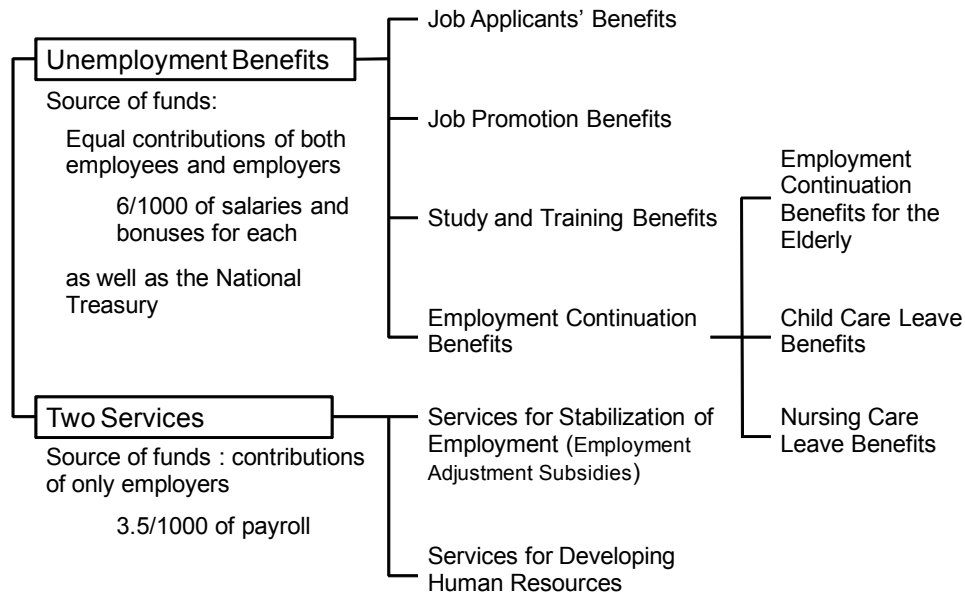
4. Institutional Aspects of the Current Employment Insurance

The current EI scheme consists of granting benefits for unemployment and two services—services for stabilization of employment and services for developing human resources (Chart 6). Services for stabilization of employment are mainly those granting employment adjustment subsidies. Services for developing human resources consist of subsidies for training by employers and management of public training facilities, etc.

The qualifying conditions to be insured are as follows:

- The number of hours scheduled per week must be 20 hours or more.
- The duration of employment must be more than 31 days.
- The employee must be younger than age 65.
- Voluntary coverage applies for employees in agricultural, forestry, and fishery establishments with less than five standard employees.
- Exclusion: Seasonal workers whose duration of employment is 4 months or less.
- Special systems apply for daily workers, seamen and civil servants.

Chart 6 Outline of the Employment Insurance Scheme



Source: The budget of the fiscal year 2010

The job applicant benefits consist of the following:

- (i) Basic allowance;
- (ii) Skill acquisition allowance;
- (iii) Lodging allowance; and
- (iv) Injury and disease allowance.

The qualifying conditions for the unemployment benefit (basic allowance) are as follows:

- Must have at least 12 months of insurance during the last 24 months before unemployment (at least 6 months of insurance during the last 12 months for specific qualified recipients and the qualified recipients who are separated for specific reasons, see the next paragraph for the definitions).
- Must be registered with the Public Employment Security Office and be capable of, and willing to, work.
- Unemployment must not be due to voluntary leaving, serious misconduct, refusal of a suitable job offer, or non-attendance at vocational training (otherwise, the benefit may be limited to 1 to 3 months).

The duration of benefits varies with age, tenure and reasons of separation, etc. (Table 2). The specific qualified recipients are those who are obliged to be separated through bankruptcy or dismissal (excluding dismissal due to significant cause imputable to the employee), etc. Qualified recipients who are separated for specific reasons are those who are separated because their fixed term labor contracts are not renewed or because of other compelling grounds. The latter category of conditions to receive benefits for a longer duration was added in the law amended in 2009.

Table 2 Duration of benefits (basic allowances) (days)

	Duration of benefits for							
	(1) separated workers having specified recipient qualification or specific reason (<i>unemployment due to bankruptcy, dismissal etc.</i>)					(2) separated workers not falling under category (1) (<i>ordinary unemployment</i>)	(3) separated workers having difficulty finding a job (<i>difficult to re-employ</i>)	
Insured period (years)	Age (years old)					All ages	Age (years old)	
	Under 30	30-34	35-44	45-59	60-64		Under 45	45-64
Less than 1	90	90	90	90	90	-	150	150
1-4	90	90	90	180	150	90	300	360
5-9	120	180	180	240	180	90	300	360
10-19	180	210	240	270	210	120	300	360
20 or over	—	240	270	330	240	150	300	360

The introduction of a separate benefit entitlement schedule for cases of “ordinary unemployment” in 2001 particularly affected benefit entitlements for older workers with long contribution records. Following the principle that longer benefit durations are payable only to people “without a time margin to prepare for unemployment”, neither termination of employment at the end of a temporary contract nor termination upon retirement counted as “dismissal” before 2009. However, since 2009 the former has come to count as “dismissal” to ease the hardships of those unemployed who were non-standard workers, as mentioned above.

The daily amount of the basic allowance is an amount obtained by multiplying the daily amount of wages (DAW) by a rate ranging from about 50% to 80% (the rate is higher, the lower the wages). The DAW is obtained by dividing by 180 the total amount of monthly wages (excluding bonus, etc.) paid during the last six months before the separation from employment.

For those aged under 60, the ratio of benefit to earnings (BR) is calculated using the following formula (in 2007)⁸:

- If $2\,080 \leq \text{DAW} < 4\,100$: $\text{BR} = 0.8 \times \text{DAW}$;
- If $4\,100 \leq \text{DAW} < 11\,870$: $\text{BR} = 0.8 - 0.3 \times (\text{DAW} - 4\,100) / (11\,870 - 4\,100)$;
- If $11\,870 \leq \text{DAW} < \text{Maximum Amount}$: $\text{BR} = 0.5 \times \text{DAW}$; and
- If $\text{DAW} < 2\,080$, the daily amount is fixed at $2\,080 \times 0.8$, and if $\text{DAW} \geq \text{Maximum Amount}$, it is fixed at $\text{Maximum Amount} \times 0.5$. The Maximum Amount is JPY 12 790 for those aged less than 30, JPY 14 200 for ages 30-44 and JPY 15 620 for ages 45-59. In the last case, the maximum benefit amount is JPY 7 810 per day, paid seven days per week.

For recipients aged 60 or over but under 65, the same formula ($\text{BR} = 0.8 \times \text{DAW}$) applies for DAW up to JPY 4 100, but for higher earnings:

- BR declines more steeply, reaching 0.45 when the DAW is 10 640 (rather than 0.5 when the DAW is 11 870); and
- The Maximum Amount is 15 130, so that the maximum benefit ceiling is $15\,130 \times 0.45 = 6\,808.5$, slightly below the maximum benefit amount for workers aged 45-59.

⁸ Duell et al. (2010).

The maximum benefit for 45-59-year-old workers corresponds to about 61% of the average wage and is paid to people who have a DAW level of 121% of the average wage or more.

5. Proportion of UB Beneficiaries among the Unemployed and Coverage of Non-Standard Employment in EI

As mentioned above, the proportion of UB beneficiaries among the unemployed (as defined by ILO) is lower in Japan than in other OECD countries such as Germany, France, the United States, etc. In addition, it has decreased in the long run from 62.1% in 1980 to 27.4% in 2009, though it has risen somewhat from the bottom of 22.6% in 2005 (Table 1).

The reasons behind the relative low proportion of UB beneficiaries among the unemployed in Japan may be largely accounted for by the following two factors. First, the coverage of EI is relatively low, as some non-standard workers are not covered. Second, with no unemployment assistance, the long-term unemployed may have exhausted their UB entitlements.

The coverage of non-standard employees is much lower than standard employees. In 2007, according to MHLW, the General Survey on the Diversification of Employment Status, the proportion of the non-standard employees insured in EI was 60%, while that of standard employees was 99.2%. Male non-standard workers were less covered (56.0%) than female non-standard workers (62.4%).

6. Historical Developments in the Adaptation of EI to the Growing Number of Non-Standard Employees

Historically, EI has been successively amended to cover the growing number of non-standard workers (Table 3). Special schemes have been prepared for seasonal workers and daily workers in EI from the start of EI in 1975 to avoid possible moral hazards due to short-term employment. The Employment Insurance Law of 1974 (Art. 6, and 38) set out specific benefit entitlement rules for day laborers and “Specially Insured Persons in Short-term Employment”, but did not allow exemption from contributions on grounds only of the short-term nature of the employment. The law stated that “undertakings in which a worker or workers are employed shall be covered undertakings” but it did not apply to “persons who are employed in a seasonal undertaking scheduled for a period not exceeding four months”. However, the contribution coverage of short-term employment under the system for “Specially Insured Persons in Short-term Employment” is low. After 6 months of contributions, whereas regularly insured persons were entitled to 90 days of benefit paid monthly, “Specially Insured Persons in Short-term Employment” were entitled to 50 days of benefit paid as a lump sum (see Art. 13, 22, 40, etc. of the EI Law of 1974); in the 2000s, the lump sum amount was reduced to 30 days of benefit and later increased to 40 days. Many contributors to this system are seasonal construction workers⁹.

⁹ Duell et al. (2010).

In 1989, EI was amended to cover part-time workers whose scheduled working hours per week were half of the statutory maximum working hours (22 hours, which was reduced to 20 hours in 1994) or over. Conditions for the UB for part-time workers were different from those for full-time workers because of the relatively high turnover rates of the former at the start. In 2003, these conditions for UB were equalized for full-time workers and part-time workers.

Table 3 Historical developments in Employment Insurance

1975	Employment Insurance replaces Unemployment Insurance. Benefit duration is made dependent on age instead of contribution record.
1984	Benefit duration is made dependent on both age and contribution record.
1995	Benefit duration for people in their sixties is extended by 30-60 days.
1989	The coverage of EI was extended to par-time workers, whose working hours were 22 hours or over. The threshold of working hours was reduced to 20 hours or over in 1994.
2001	The minimum income threshold for enrolment as a part-time insured worker is removed. The previous age by contribution record schedule determining benefit duration is replaced by separate schedules for “ordinary unemployed” and for “unemployed as a result of bankruptcy, dismissal, etc.”. In the case of “ordinary” unemployment, benefit duration is reduced, particularly for older long-term insured workers. In the case of unemployment “as a result of bankruptcy/dismissal”, benefit duration is increased for persons aged 45-59, but reduced (below the duration for ages 45-59) for persons aged 60-64. The earnings ceiling (maximum earnings eligible for the benefit replacement rate of 0.6) becomes age-dependent, ranging from JPY 14 590 per day for workers aged less than 30, to JPY 19 450 for workers aged 60-64.
2003	For workers with 5 or more years of contributions, the maximum benefit duration is reduced by 30 days in cases of “ordinary unemployed” and increased by 30 days in cases of “bankruptcy, dismissal, etc.”. The earnings ceiling for ages 60-64 is reduced below the ceiling for ages 45-59. The gross replacement rate now declines from 0.8 to 0.5 as earnings increase (previously it declined from 0.8 to 0.6) for workers aged less than 60 (from 0.8 to 0.45 for workers aged 60 or more). As a result, the maximum benefit amount is reduced by about 25%. UB was fully equalized between full-time and par-time workers.
2009	Fixed-term employees whose employers are “expected to hire them for six months or more” are allowed to contribute to the system (previously restricted to those “expected to remain employed for one year or more”).
2010	The applicable scope of employment insurance contributions is extended to include people who are expected to be employed for 31 days or more.
2011	Job-Seekers Support Program started in October.

Source: Duell (2010) and Hamaguchi(2010)

Prior to the 2001 reform, the conditions for being obliged to contribute to the regular employment insurance system were:

- 1) Annual income of JPY 900,000 or more;
- 2) Work 20 or more hours per week regularly; and
- 3) Expect employment to continue one year or more.

In 2001, the first condition (the income minimum) was abolished. By June 2001 the number of part-timers enrolled in the insurance system was one third higher than a year earlier—although aggregate statistics (Table 1) suggest this change had only a minor longer-term impact. The third condition was modified in 2009 to cover employment expected to last for 6 months or more, and

in 2010 to cover employment expected to last for 31 days or more.

The “Second Safety Net”

Certain measures announced in response to the recent financial crisis are grouped together under the heading of a “second safety net”. These are:

- Emergency loans and housing allowances, announced in April 2009, for those who have lost jobs and homes. These provide assistance in finding a home, housing allowances for up to six months and loans to cover daily living expenses (not more than JPY0.2 million per month) for up to one year. However, this measure responded to dramatic press stories that many laid-off workers were also being evicted from company housing.
- Training and daily life allowances, i.e. subsistence allowances (in the form of a non-repayable loan) payable to participants in labor market training who lack entitlement to EI.

In October 2010, the Job Seekers’ Support Program started, perpetuating the above Emergency Training Assistance Service introduced in 2009. This program aims to assist those unemployed who are not eligible for UB (such as those who are not insured, those who cannot receive UB because the insured period is not long enough to meet the criterion, those who exhausted their entitlement of UB, new graduates who have no employment experience, and those self-employed whose business closed down) by providing the following services:

- (1) Free professional training (Job-Seekers Support Training)
- (2) Professional Training Participation Allowance (10,000 yen per month), if certain conditions including means test are met
- (3) Strong employment support by the Public Employment Service (PES).

The program accompanies rigorous monitoring by PES to avoid moral hazard or fraud. This program is a new attempt to fill the gap between EI and public assistance due to the absence of unemployment assistance in Japan.

7. Recommendations

As mentioned above, the coverage of EI has been consecutively extended to cover more non-standard employees. Prior to 2001, annual income of the worker had to be over a certain amount to be insured in EI. This condition was abolished in 2001. To be insured, the scheduled working hours had to be over three fourths of the working hours of ordinary workers or over and 22 hours or over until 1988. This threshold was shortened to “22 hours or over” in 1989 and to “20 hours or over” in 1994. Moreover, to be insured, the expected length of employment had to be more than one year prior to 2009. The threshold was shortened to “half a year or more” in 2009,

and then “31 days or more” in 2010. Further reforms such as shortening of the threshold of scheduled working hours to be insured are recommended.¹⁰

Although it is expected that these reforms of EI contributed to cover more non-standard employees, the extended coverage might accompany the risk of frequent repeated unemployment or moral hazard, which may induce the necessity to raise premiums. Thus, several policy recommendations are proposed.

First, consideration must be given to applying a higher premium for fixed-term employees or introducing an experience-rated premium as practiced in the United States. Because benefit entitlements do not usually increase in proportion to years of contributions, temporary workers with employment spells that are just long enough to qualify for a benefit tend to be the greatest net beneficiaries from an unemployment insurance system, while high-tenure workers are net contributors. Since the reform in 2009, three months of benefit are paid after six months of contributions, which is a fairly generous ratio of benefit duration to contribution duration in comparative terms. EI needs to cover situations of repeat involuntary unemployment, and yet minimize the subsidization of rotation between short-term jobs and benefit claims by people who could have taken a more permanent job. A higher premium for the employers of non-regular workers may also contribute to mitigate the dualism of the Japanese labor market by moderating the growing number of non-standard employees.

Second, to avoid any moral hazard, efforts should be made to frequently monitor job search activities of UB beneficiaries or to make participation in training programs a condition for the payment of UB.

Third, it is recommended to require, as many other OECD countries do, the payment of EI contributions on earnings from part-time work. EI covers only contracts with 20 or more standard hours per week, which, given that real hours can vary independently of standard hours, can lead to selective enrolment.¹¹

The condition of the entitlement to basic allowance is now to have six months of contribution during the one year before the separation. The duration of benefits is determined by the reason of separation, age and length of contribution, as shown in Table 2, with consideration given to the difficulties of re-employment and in order to avoid easy job-hopping. With regard to the entitlement to basic allowance and the duration of benefits, some recommendations are proposed.

First, regarding the conditions of benefit entitlement, it is proposed to extend the duration of penalty from one month to two months in the case of refusal of job offers by PES to prevent moral hazard.

Second, some contend that the duration of benefits should be lengthened with the introduction of a gradually decreasing benefit system. Because there is no unemployment

¹⁰ Duell et al. (2010).

¹¹ Duell et al. (2010).

assistance in Japan, the benefit is suddenly suspended after the expiration of the duration of benefit (Table 4). Nonetheless, it must be taken into consideration that, on the other hand, the extension of the length of benefit may increase the number of the long-term unemployed.

Third, in Japan, UB is suspended as soon as the recipient is employed, even if hours worked and earnings are very small. In other OECD countries, benefits continue to be paid to the recipient who is employed or partially unemployed, if earnings or hours worked are within certain thresholds. This might prevent decline in disposable income through part-time work and contribute to promoting early re-employment.

Table 4 Generosity of unemployment benefits
Net replacement rates at different points during an unemployment spell, percentage, 2007

	Year 1	Year 2	Year 3	Year 4	Year 5	Five-year average
Norway	72	72	72	72	72	72
Belgium	65	63	63	63	63	63
Austria	61	58	58	58	58	59
Denmark	68	68	68	68	9	56
Ireland	50	50	50	50	50	50
Portugal	79	79	56	24	3	48
Germany	64	48	42	36	36	45
France	67	64	31	31	31	45
Finland	60	58	33	33	33	43
Australia	42	42	42	42	42	42
Spain	69	65	25	25	13	39
New Zealand	38	38	38	38	38	38
Sweden	66	63	41	8	8	37
Iceland	57	54	54	8	8	36
United Kingdom	28	28	28	28	28	28
Netherlands	71	59	3	3	3	28
Switzerland	80	40	0	0	0	24
Luxembourg	87	8	8	8	8	24
Canada	52	14	14	14	14	22
Hungary	48	13	13	13	13	20
Poland	42	16	8	8	8	16
Czech Republic	33	11	11	11	11	15
Japan	45	3	3	3	3	11
Turkey	46	0	0	0	0	9
Slovak Republic	32	3	3	3	3	9
Greece	33	5	1	1	1	8
Italy	37	0	0	0	0	7
Korea	31	0	0	0	0	6
United States	28	0	0	0	0	6
Median	52	40	25	13	9	28

Source: OECD Employment Outlook 2009

Fourth, there is still a “chasm” between the EI system and the public assistance system, so the majority of unemployed people are not current recipients of either benefit. But it should be

borne in mind, when considering possible increases in EI benefit duration, that the experience in European countries suggests that long-term wage-related UI benefit tend to be more expensive in terms of both direct costs and the active programs needed to limit benefit dependency, than benefit coverage of the unemployed through assistance benefits, although it does not provide the same level of income protection.¹²

The amount of benefit is calculated by multiplying the daily salary before the separation by a fixed rate in order to maintain the living standard as before the separation and to maintain the labor force. The replacement rate is lower for higher daily salary workers.

However, there are many workers in Japan, especially among middle-aged and older workers, whose re-employment wages are much lower than those before separation. If the replacement rate is high, the benefit tends to be relatively high, compared with the re-employment wages. It would hamper the re-employment of these unemployed. Thus, it is proposed that the level of benefit should be determined by taking into consideration the level of re-employment wages. It should also be pointed out that in terms of disposable income, the current replacement rate is not so low, because the unemployment benefit is tax-exempt, while the daily wages are calculated on the basis of gross salary before separation.

The Job Seekers' Support Program is a new program to cope with the increasing non-beneficiaries among the unemployed and is expected to fill the gap between EI and the national assistance system with training programs and employment support services. However, as beneficiaries do not need to contribute to EI, moral hazard problems such as frequent unemployment or non-intensive job search activities might come up. Rigorous monitoring and intensive employment support are needed to avoid such moral hazard or any fraud. Moreover, statistical research is also needed to evaluate the program.

8. Concluding Remarks

This paper provided an overview of the historical adaptation process of EI to the structural changes in the labor market and the recommended future reform of EI.

Long-term structural changes have been taking place in the Japanese labor market. The labor force population is aging and decreasing gradually, reflecting the demographic changes, accompanied by an increase in the female participation rate. Employment is decreasing in the manufacturing and construction industries, while that in the service sector is increasing. The unemployment rate has become persistently high since the burst of the bubble. Among others, the most salient structural changes are (1) increase in non-standard employment and (2) increase in long-term unemployment.

In Japan, the ratio of recipients of unemployment insurance and social assistance to the working age population is fairly low, compared with the OECD average. It may reflect the low

¹² Duell et al. (2010)

coverage of EI and the low ratio of UB recipients to unemployment (ILO definition) as well as the fact that there is no unemployment assistance system. Thus, it is a challenge to adapt EI to the structural changes in the labor market, especially the growing non-standard employment.

EI has been reformed consecutively to adapt to the growing non-standard employment since its start in 1975. The coverage of EI has been extended to cover more non-standard employees, by relaxing the conditions to be insured on the minimum earnings (abolished), the scheduled working hours before separation (shortened to 20 hours per week) and the condition of the expected length of employment (shortened from one year to 31 days). In addition, the Job Seekers' Support Program started in 2011. It is a new program to assist those unemployed who are not eligible for UB by providing training and employment support as well as a Professional Training Participation Allowance. Efforts have been made to prevent any moral hazard by shortening the duration of benefit for ordinary unemployment as well as introducing a Re-employment Allocation to promote early re-employment. Further reforms of EI are recommended to adapt to the extended coverage of EI covering much of short-term employment as well as to fill the chasm between EI and national assistance.

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Varieties of Labor Market and Social Security in East Asia: Tackling the Barrier of Informal Employment¹

Yasuhiro Kamimura*

Wide variations exist in the characteristics of the labor market in East Asian economies. In order to upgrade and expand the existing social security system, it is necessary to base the institutional design of such system on an in-depth understanding of the characteristics of the labor market of each economy—in which the issue of informal employment is pivotal. In this study, I argue that in order to expand social security coverage for informal workers, it is necessary first to clarify and operationalize the concept of informal employment. This paper first provides a schema that explains how various forms of informal employment emerge from the interaction between state regulations and the labor market. Next, I examine strategies aimed at expanding social security coverage.

In the first section, after presenting an overview of unemployment in East Asia, I maintain the necessity of focusing on various types of informal employment, such as the self-employed, migrant workers who shuttle between wage employment and self-employment, and workers who are not covered by unemployment insurance.

In the second section, the literature on informal employment and related discussions within the International Labour Organization (ILO) are reviewed. Then, I explain the perspective that informal employment develops out of the interaction between the regulatory capacity of the government and the characteristics of the labor market.

In the last section, based on a review of the preceding sections, I propose a novel schema to capture the phenomenon and attempt to measure the scale of informal employment. Finally, I argue for the need for governments to enhance their capacity to formalize each type of informal employment.

1. A New Age of East Asian Unemployment

East Asia is witnessing a new age of unemployment. In addition to the increase in the unemployment rate, we need to look at the structural changes taking place in the labor market that are behind this increase. We also need to focus on the issue of informal employment, which does not appear in unemployment statistics.

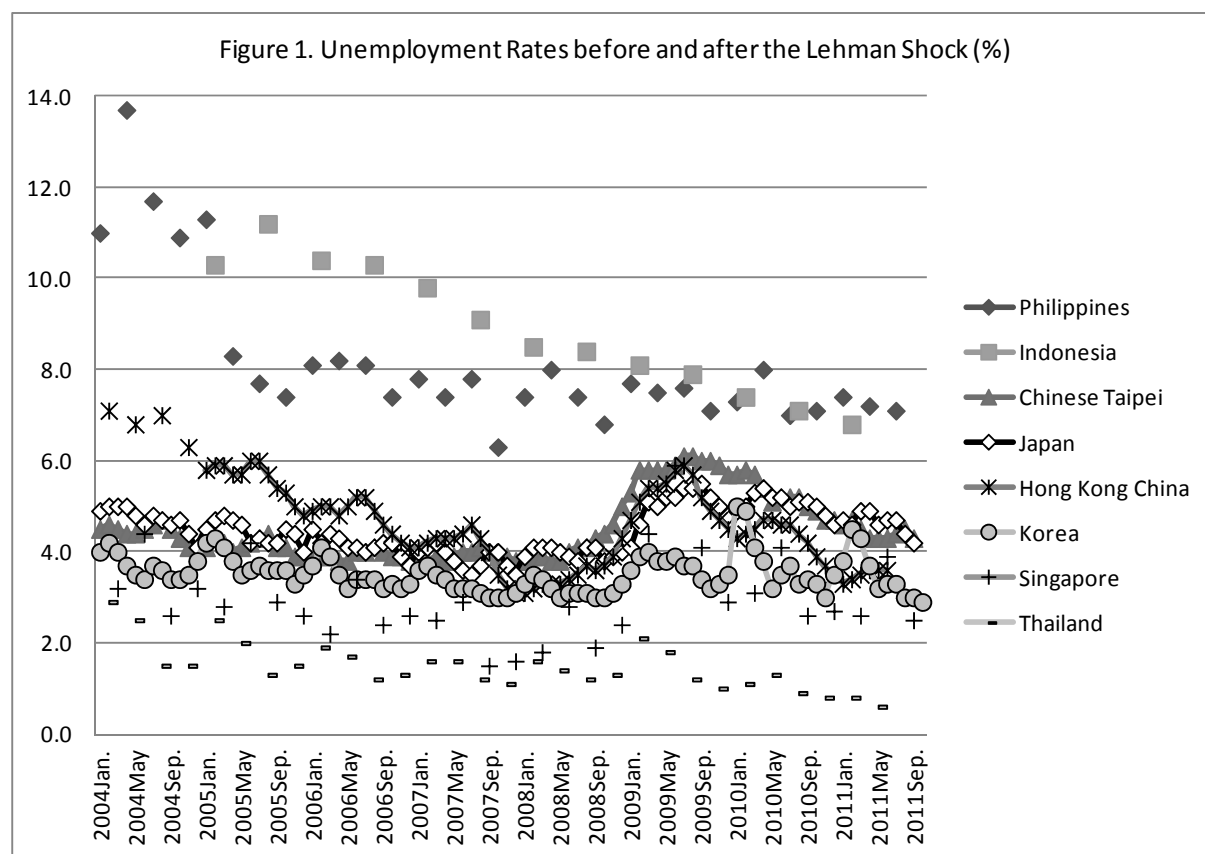
Trends in Unemployment

The various impacts caused by the Lehman shock that took place in September 2008 do not

¹ This paper is based on the original Japanese version, which will be printed in the *Journal of Social Science* (Institute of Social Science, The University of Tokyo), Vol. 63, No. 5-6, 2012.

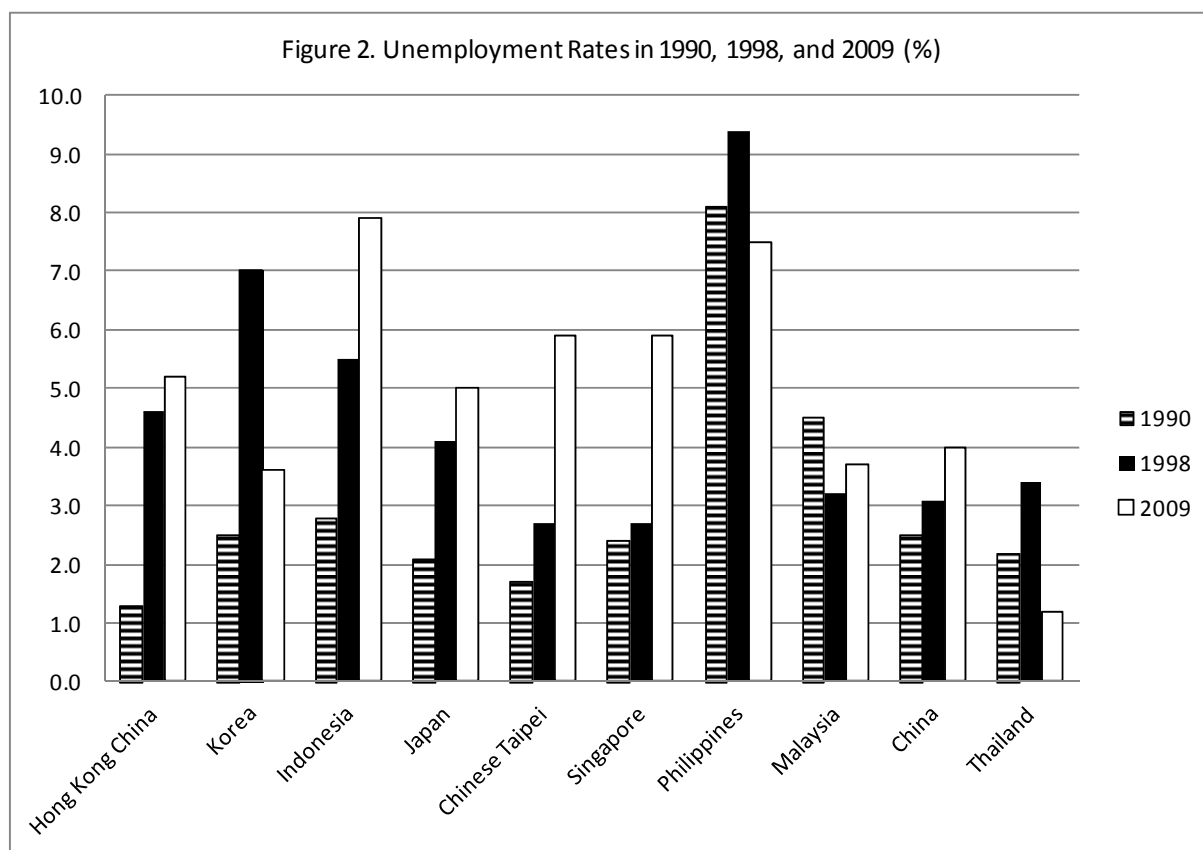
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appear uniformly. Figure 1 charts the monthly unemployment rates for several East Asian economies before and after the shock.



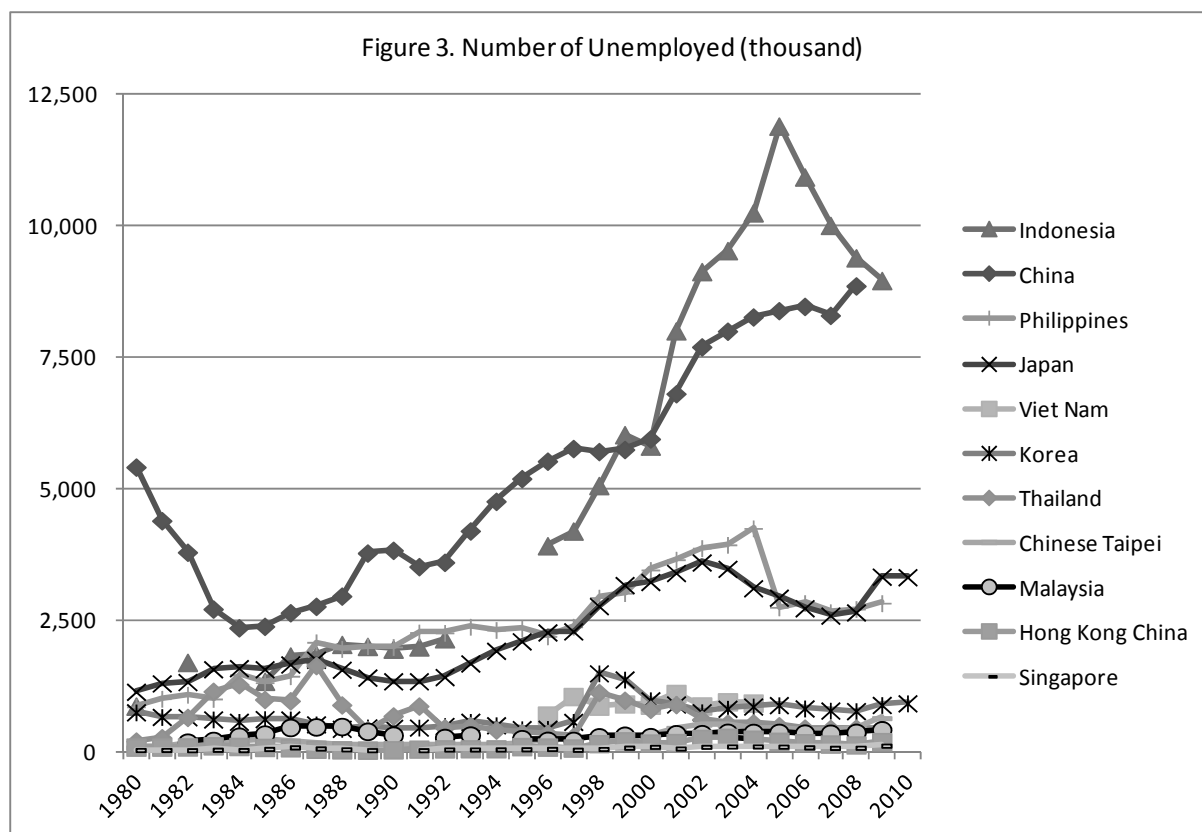
Data Source: ILO Department of Statistics, *Short Term Indicators of the Labour Market*, 2011.
(<http://laborsta.ilo.org/sti>)

There was an apparent increase in unemployment after the Lehman shock only in Japan, Chinese Taipei, Hong Kong China, and Singapore—all of which have wage employment-centered labor markets. As for Indonesia, Thailand, and the Philippines, where self-employment is dominant, there were no short-term impacts.



Data Source: ILO, *Key Indicators of the Labour Market*.

Figure 2 compares the unemployment rates in various East Asian economies in 1990, 1998 (after the Asian economic crisis), and in 2009 (after the Lehman shock)—which shows a more dramatic change. Hong Kong China, Korea, Indonesia, and Japan experienced a sharp rise in unemployment around 1998, while Chinese Taipei and Singapore experienced one around 2009. On the other hand, there was no such clear change in the Philippines, Malaysia, China, and Thailand. Here we should be careful with the different definitions of “unemployment” as used in each economy. In China, jobless rural residents are not counted as being “unemployed,” while the unemployment rate in Thailand excludes the “seasonally inactive labor force;” and the unemployment rate in Indonesia after 2000 includes discouraged workers (Kamimura 2010).



Data Source: ILO, *Key Indicators of the Labour Market*.

Figure 3 shows the trends in the numbers (not rates) of the unemployed, which shed light on the problem from a different angle. The fact that two highly populated economies, China and Indonesia, are experiencing a sharp increase in unemployment holds great significance for the region as a whole.

Between Unemployment and Informal Employment

The problem is not limited to unemployment, nor is an adequate solution to establish unemployment insurance schemes that cover the currently unemployed. According to Pellissery and Walker (2007), unless constructed on the basis of an understanding of the characteristics of a labor market, social security is, in fact, likely to impede social integration. In most developing economies, “The fluidity of jobs and employers makes registration and compliance difficult to ensure, while low wages and productivity undermine actuarial viability and inhibit provision and uptake. Consequently, social security often serves as a discriminating feature of the formal employment sector, rather than as a mechanism for social cohesion” (Pellissery and Walker 2007: 403). In short, Western-style social insurance, which presupposes a wage employment-centered labor market, is not adequate as a measure for social security for developing economies.

A theory of unemployment proposed by Okochi (1952) 60 years ago may provide a suggestion for considering this issue. In those days, Japan had a large agricultural sector, and the

industrial sector was also supported by many migrant workers from rural areas—which are characteristics common to the current situation in developing economies. In this context, Okochi argued:

First, unemployment denotes that a worker who does not have his own means of production has lost his workplace. If he has his own workshop, land, or store, he cannot be unemployed. In such a case, if that worker cannot earn enough money to live, he is called “poor” or “underemployed,” but he is not “unemployed” in a precise sense (Okochi 1952: 9).

Second, the idea of unemployment presumes that the unemployed worker retains his willingness to work. It implies that he shares a characteristic of modern wage workers that Weber calls “the spirit of capitalism.” Such a worker should not be idle and should make every effort to earn his own bread (Okochi 1952: 12).

Third, if a worker cannot find a job that suits his skill or ability set, it can be said that he is “unemployed.” In countries where unemployment insurance is inadequate, dismissed workers may be ready to accept whatever job is possible. If they get a new job that is not appropriate to their skills, however, it is a kind of unemployment, in the sense that they are misallocated from the viewpoint of the efficiency of the whole of industrial society (Okochi 1952: 16).

The first point suggests that the concept of unemployment is aimed only at wage workers, and cannot be applied to poor self-employed workers or the problem of underemployment. The issue of self-employed workers, however, cannot be ignored in the context of considering an extension of social security in East Asia.

The second point reminds us of migrant workers who shuttle between wage employment and self-employment. In developing economies, dismissed workers may go back to their home villages and join the family business as unpaid workers. Although they may not appear to be unemployed, there certainly is a problem here.

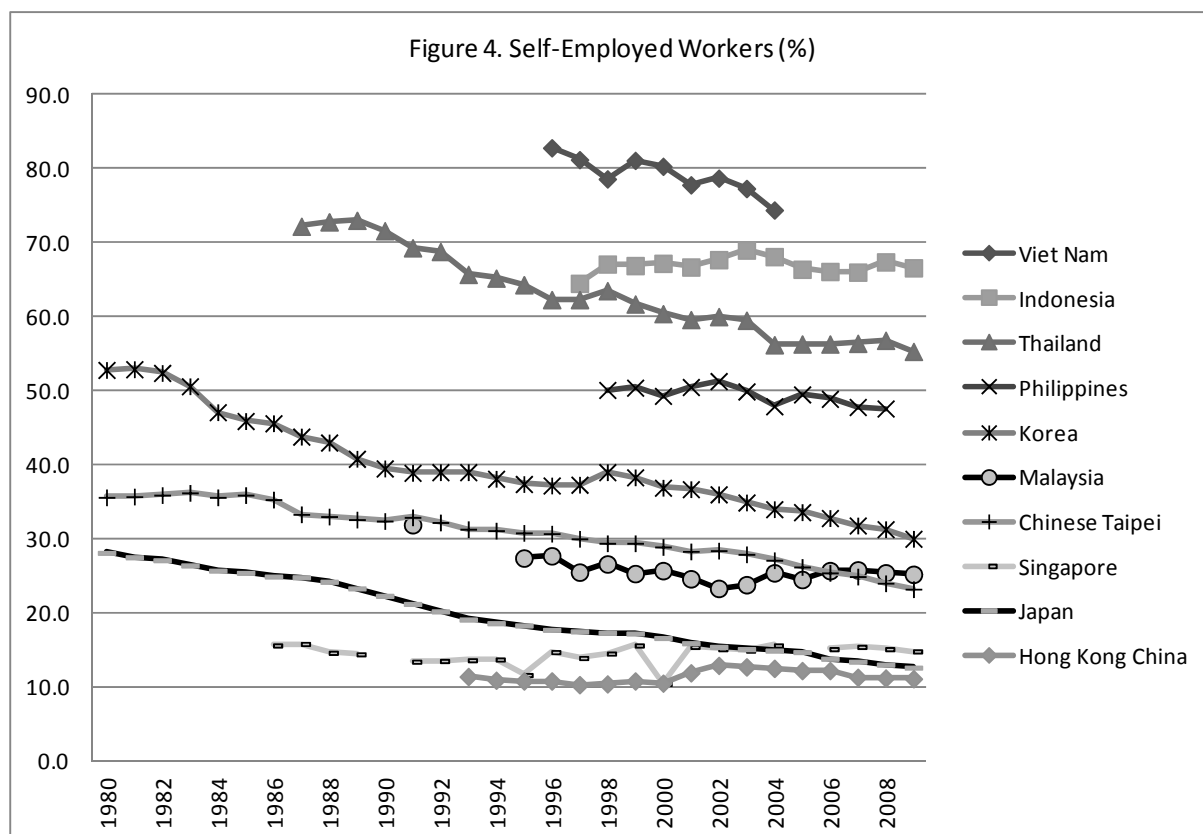
The third point implies the fact that the existence of unemployment insurance itself enables the status of unemployment, allowing the maintenance of the improvement of the skills of the unemployed. In an economy without unemployment insurance, a low unemployment rate does not automatically equate to an efficient industrial society as a whole.

Based on Okochi’s argument, it is not enough to pay attention to unemployment only. Instead, we need to focus on the problems of various types of informal employment, such as the self-employed, migrant workers who shuttle between wage employment and self-employment, and workers who are not covered by unemployment insurance. Before defining informal employment in the next two sections, here I present some data on the situation regarding self-employment, which has a deep connection with informal employment.

Self-Employment: Shrinking But Remaining

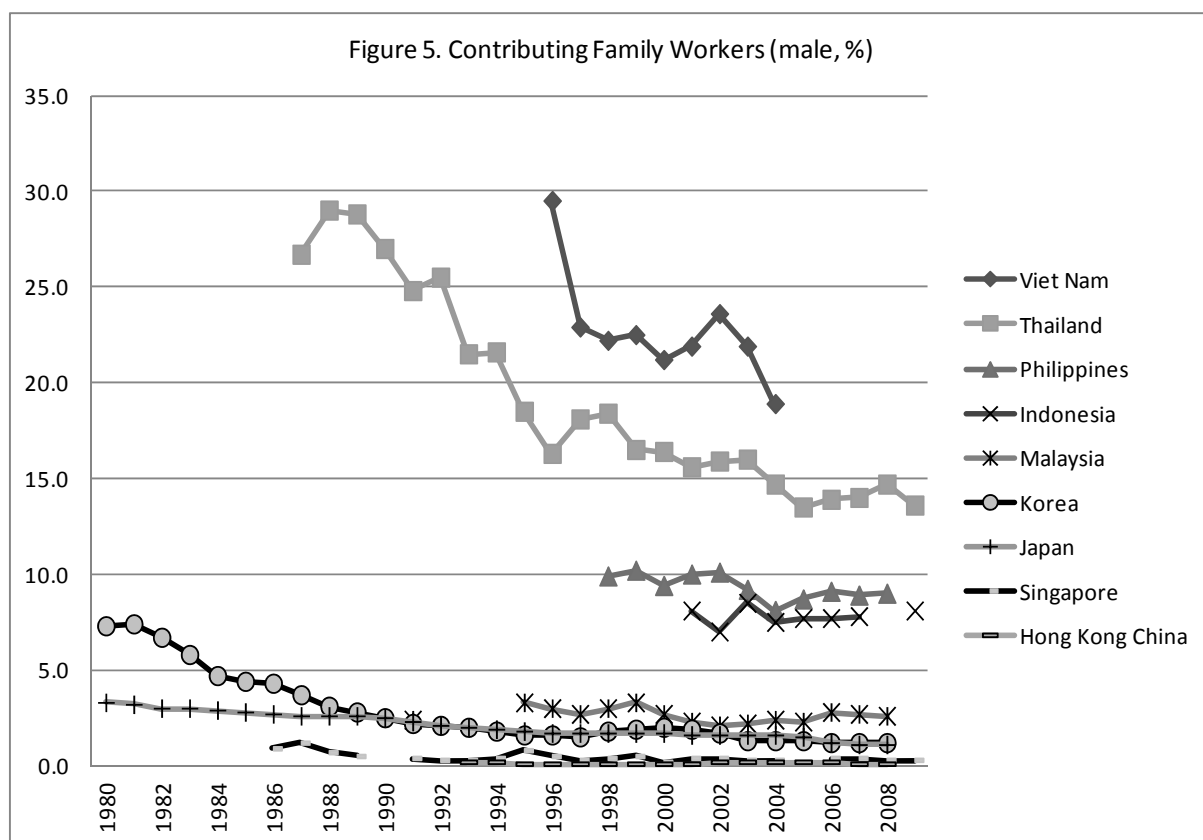
Although, as it will be explained later, self-employment is not equal to informal employment, the two categories do have a connection with each other. In a self-employment-centered labor market, the ratio of informal employment is high. The decline of

self-employment may lead to a reduction of informal employment.



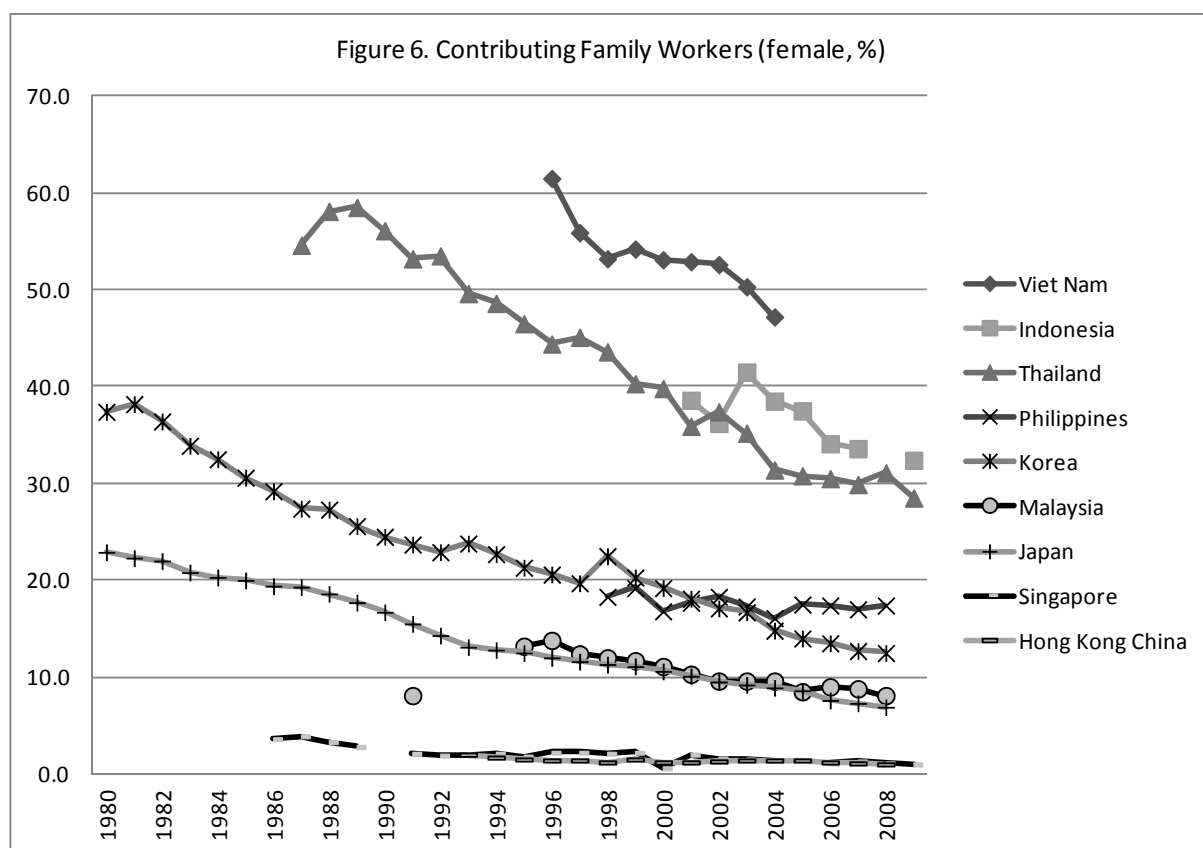
Data Source: ILO, *Key Indicators of the Labour Market*.

Figure 4 indicates the ratio of self-employed workers (including contributing family workers). While the ratio is apparently declining in Japan, Chinese Taipei, Korea, Thailand, and Vietnam, there is no such change in Indonesia, the Philippines, and Malaysia. In Vietnam, Indonesia, Thailand, and the Philippines, self-employed workers are in the majority.



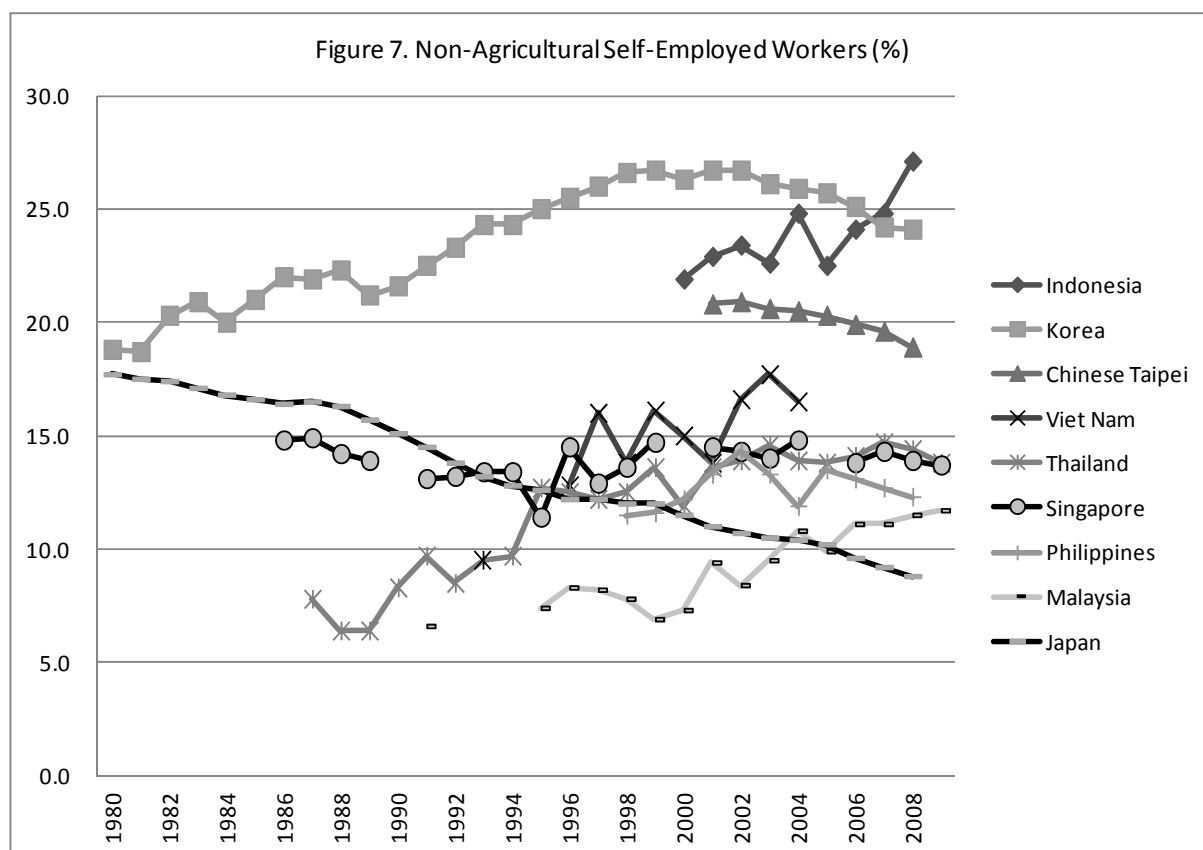
Data Source: ILO, *Key Indicators of the Labour Market*.

Figures 5 and 6 show the ratio of unpaid contributing family workers, who are the most vulnerable within the ranks of the self-employed, and who are most easily excluded from the application of social security. Figure 5 shows the data for males. The ratio is relatively high in Vietnam, Thailand, the Philippines, and Indonesia. Although they are declining, the ratios in Vietnam and Thailand account for more than 15%.



Data Source: ILO, *Key Indicators of the Labour Market*.

Figure 6 shows the data for females. The ratio is relatively high in Vietnam, Indonesia, and Thailand. Although they are also declining, the ratios account for more than 30%. In most East Asian economies, the ratio of female unpaid contributing family workers is twice that of males. Female workers are inclined to engage in informal employment, and are therefore easily excluded from the application of social security.



Data Source: ILO, *Key Indicators of the Labour Market*.

Figure 7 shows the ratio of non-agricultural self-employed workers (calculated by extracting the agricultural population from the number of the self-employed) in various East Asian economies. The ratios show different tendencies from those of self-employed workers as a whole. The ratios are relatively high in Indonesia, Korea, and Chinese Taipei, while they are relatively low in Japan, Malaysia, and the Philippines. There is an increasing tendency in Indonesia, Vietnam, and Malaysia. This indicates that a reduction in the agricultural population does not always result in a decline in self-employed workers.

2. What Is Informal Employment?

For extending social security in East Asia, I have argued that it is necessary to focus on informal employment in addition to unemployment. What then is informal employment? The existing definitions are somewhat inadequate. Here I examine the literature on informal employment and related discussions within the International Labour Organization (ILO).

Various Definitions

The concept of informal employment (or the informal sector) was first coined by Hart (1973), the economic anthropologist, when he explored the urban sub-proletariat in Ghana. According to him, “The distinction between formal and informal income opportunities is based

essentially on that between wage-earning and self-employment” (Hart 1973: 68). In other words, his concept of informal employment is equivalent to self-employment.

On the other hand, according to Feige (1990; quoted by Portes and Haller 2005: 404), the informal economy is one of the four types of “underground economy” (the other three types being: illegal, unreported, and unrecorded economy). “The informal economy comprises economic actions that bypass the costs of, and are excluded from the protection of, laws and administrative rules covering ‘property relationships, commercial licensing, labor contracts, torts, financial credit, and social security systems’” (Feige 1990; quoted by Portes and Haller 2005: 405).

Castells and Portes (1989; quoted in Portes and Haller 2005: 405) classified things differently. They classified economic activities into three categories: formal economy (process of production: licit, final product: licit); informal economy (process of production: illicit, final product: licit); and criminal economy (process of production: illicit, final product: illicit).

While Hart limits the scope of informal employment and then explores its characteristics, Feige as well as Castells and Portes first define the concept of informal economy. Feige defines “informality” as economic activities that “bypass costs and are excluded from protection,” whereas Castells and Portes define it as economic activity in which “the final product is licit, but the process of production is illicit.”

Here we should pay attention to the fact that the extent of self-employment is not always congruent with that of the informal economy. Although they are correspondent with each other in Ghana—where Hart conducted his research—in advanced economies, most of the self-employed neither bypass the costs of taxes and social security, nor are they excluded by labor laws and other legislation. In this case, it is not appropriate to count the economic activities of the self-employed as being “informal.” On the other hand, without the distinction of advanced and developing economies, there are some employees at large companies who are legally exempt from the application of social insurance or labor regulations. Of course there may also be some employees who bypass the application illegally. Although not being self-employed, they are all informal workers in the sense of the definitions of Feige as well as Castells and Portes.

The 2002 Consensus of the ILO

Recently, the issue of informal employment has once again been receiving increased attention in relation to the concept of “decent work,” which has been promoted by the ILO since 1999. This is because, in order to achieve decent work for all, the existence of informal employment cannot be ignored. The most important document in this respect is ILO (2002), which is known as the “2002 consensus” (ILO 2007: 2).

According to the consensus, intensified global competition has made the labor market more flexible, boosting informal employment both in advanced and developing economies. Therefore, “increasingly, ‘informal sector’ has been found to be an inadequate, if not misleading, term to reflect these dynamic, heterogeneous and complex aspects of a phenomenon which is not, in fact,

a ‘sector’ in the sense of a specific industry group or economic activity. The term ‘informal economy’ has come to be widely used instead to encompass the expanding and increasingly diverse group of workers and enterprises in both rural and urban areas operating informally” (ILO 2002: 2).

In summary, this is a proposal to define informality by its characteristics, rather than by the scope of “sector.” Here “informal economy” indicates “all economic activities that are, in law or practice, not covered or insufficiently covered by formal arrangements” (ILO 2007: 3). This is close to the definition by Feige given above (“economic activities that bypass costs and are excluded from protection”).

Although this definition can decide the scope of people who are included within an informal economy, the outline is not as clear as Hart’s classic description. “The informal economy includes wage workers and own-account workers, contributing family members and those moving from one situation to another; it also includes some of those who are engaged in new flexible work arrangements and who find themselves at the periphery of the core enterprise or at the lowest end of the production chain” (ILO 2007: 3). This is nothing more than saying that one is an informal worker if one is not a formal worker—no matter for which sector one works.

The classification by Chen (2008) gives concrete expression to the concept of informal employment in the 2002 consensus. According to it, informal employment consists of “informal self-employment” and “informal wage employment.”

Informal self-employment (Chen 2008: 19):

- 1) employers: owner operators who hire others,
- 2) own account workers: owner operators of single-person units or family businesses/farms who do not hire others in informal enterprises,
- 3) unpaid contributing family workers: family members who work in family businesses or farms without pay,
- 4) members of informal producers’ cooperatives (where these exist).

Informal wage employment (Chen 2008: 20):

- 5) informal employees: unprotected employees with a known employer (either an informal enterprise, a formal enterprise, or a household),
- 6) casual or day labourers: wage workers with no fixed employer who sell their labour on a daily or seasonal basis,
- 7) industrial outworkers: subcontracted workers who produce for a piece-rate from small workshops or their homes (also called homeworkers).

Among these, informal self-employment is equal to the scope of informal employment, which Hart initially supposed. Employers and own account workers, however, is not informal, if

they are covered by formal arrangements. On the other hand, informal wage employment includes not only employees of informal enterprise, casual or day laborers, industrial outworkers, but also employees of formal enterprises if they are not covered by formal arrangements.

As shown in the first section, in most East Asian economies, the ratio of self-employed workers is declining in association with the reduction of the agricultural sector. As for non-agricultural self-employed workers, however, there are some economies in which the ratio is being maintained or is even increasing. It is reasonable to suppose that informal self-employment at various ratios exists in these economies. Then how can we measure the ratio? Is it also possible to measure the increase in informal wage employment? Before considering these problems in the next section, here I examine the factors that increase informal employment.

Why Has Informal Employment Increased?

Although there are several explanations for the recent increase in informal employment, here I follow the summary by Huitfeldt and Jütting (2009). According to them:

Firstly, informality could to a large extent be seen as a result of the type of development that fails to generate sufficient good jobs for all. This has been accentuated by low capacity in the private and public sectors to accommodate rapid population and labour force growth and has been worsened by labour market discrimination and segregation between men and women, social groups and different occupations.

Secondly, an increase in subcontracting driven by globalisation and economic liberalisation has led to greater diversity in the forms of informal employment. This in turn has led to a greater heterogeneity among informal workers, and an increase in the number of those with higher skills and productive capacity.

Thirdly, formal regulations have mostly been designed for larger enterprises and are therefore often inadequate for the needs and conditions of the growing sector of micro-enterprises. Changes in labour regulations and/or in implementation of labour regulations may also have had an impact on the share of informality in the economy.

Fourthly, there has been informalisation by employers of once-formal jobs as a strategy to lower labour costs and deal with competition.

(Huitfeldt and Jütting 2009: 100)

The first point attributes the cause to the weak capacity of the actual market economy for job creation. The second point refers to the increased flexibility of employment caused by globalization. The third point discusses the limit of the regulatory capacity of the government. The fourth point, which is related to the second one, mentions the informalization caused by the

competitive strategies of companies.

It may go beyond the scope of this paper to determine the cause for the increase in informal employment by data analysis, but based on the summary by Huitfeldt and Jütting, it can be said that the quality and quantity of informal employment are dictated both by the regulatory capacity of the government and the characteristics of the labor market. Moreover, the regulatory capacity of the government and the characteristics of the labor market are not independent of each other. Here the following explanation by Portes and Haller provides a clue. “Variations in the scope of official regulations and states’ differential capacity to police them interact with the characteristics of the population subject to these rules. It stands to reason that societies vary in their receptivity or resistance to official regulation and in their ability to organize underground forms of enterprise” (Portes and Haller 2005: 411). It can be supposed that the interaction between state and society (here the government and labor market) may create various types of informal employment.

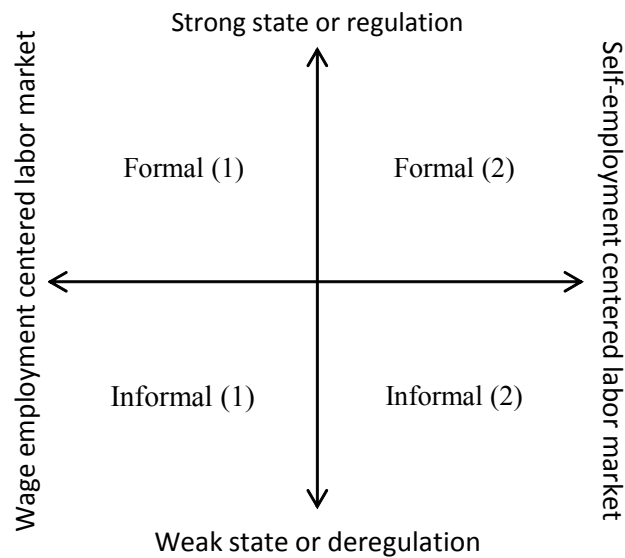
3. Social Security and Informal Employment

In order to expand social security coverage to informal workers, it is necessary first to clarify and operationalize the concept of informal employment. In this section, I propose a novel schema to capture the phenomenon, attempt to measure the scale of informal employment, and finally discuss policy implications.

Interaction between State and Market

Based on a review of the preceding sections, a coordinate plane such as that shown in Figure 8 can be considered for capturing the interaction between the regulatory capacity of the government and the characteristics of the labor market. Although “formal employment” means employment that is covered by regulations and protection such as tax systems, labor laws, and social security, the following argument mainly focuses on the application of social security.

Figure 8. Interaction between State and Market



Formal (1), upper left, is a combination of a state with a strong regulatory capacity (or a tightening of regulations) and a wage employment-centered labor market. Western welfare states that were established in the mid-20th century fit into this type. The conditions for a workable social insurance, which is contributed to by employers and employees, are the state's capacity to run the scheme and a type of labor market wherein most employers can afford to pay the contribution premiums for their employees. In such a system, informal employment can hardly proliferate. There is, however, a possibility of a move to Informal (1) as a result of deregulatory reform.

Formal (2), upper right, is a combination of a state with a strong regulatory capacity (or a tightening of regulations) and a self-employment-centered labor market. In a self-employment-centered labor market, it is not easy to collect premiums from workers regularly and constantly, let alone from their employers. Accordingly, states with a strong regulatory capacity devise efficient methods to collect premiums from self-employed workers, or devise schemes based on a government budget. For example, it could be a personal saving accounts scheme or non-contributory social allowances. The idea of basic income may be worth considering.

Informal (1), lower left, is a combination of a state with a weak regulatory capacity (or deregulation) and a wage employment-centered labor market. This type of system can emerge from two different paths. One is as a result of neoliberal deregulatory reform in advanced economies where a Formal (1) type combination was once established. The other is where self-employment-centered Informal (2) type economies, as a result of economic development, move to a wage employment-centered labor market without establishing comparable social

security schemes. Here informal wage employment is dominant. We should strengthen the capacity of the government to place the responsibility for social security on employers.

Informal (2), lower right, is a combination of a state with a weak regulatory capacity (or deregulation) and a self-employment-centered labor market. Most developing economies have this type of feature. This type of system can also emerge for two different reasons. One is where formal schemes exist, but their coverage cannot be extended to most workers as a result of either the weak regulatory capacity of the government or the self-employment-centered labor market. The other is where a specific scheme has not existed from the outset. Here informal self-employment is dominant. We should strengthen the capacity of the government to devise suitable methods to a self-employment-centered labor market.

I would like to add two comments on these models. First, where a specific scheme does not exist in Informal (1) or (2): In the case, for example, of economies that have not introduced an unemployment insurance scheme yet, it may be possible to say that workers who are not covered by unemployment insurance are not informal workers, for all workers are out of coverage. If so, the problem of informal employment can be resolved by eliminating all state regulations and protection. This is illogical. Therefore, it may be pointless to classify formal/informal employment by domestic criteria. We need a certain kind of international standard. All employment in an economy in which a certain scheme does not exist should be judged as being informal in terms of the specific area.

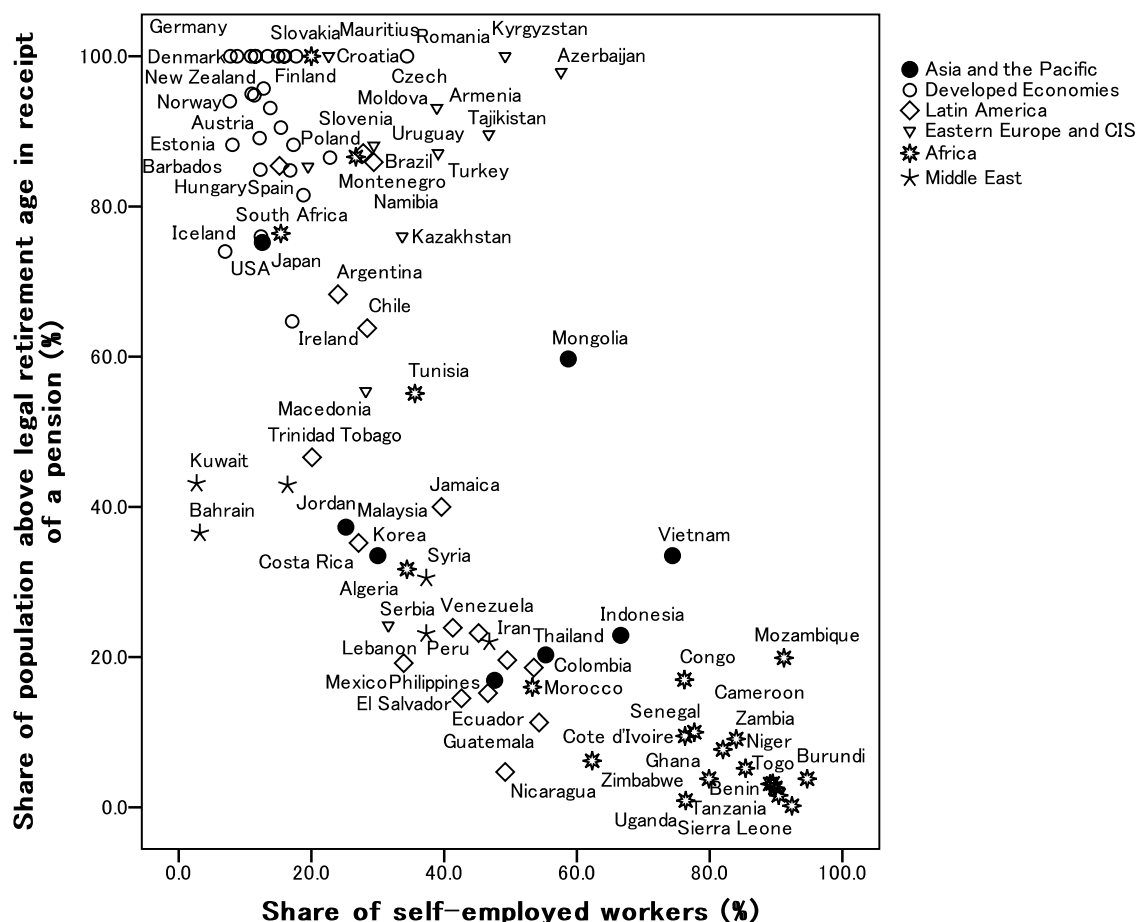
Second, as mentioned later, in reality, there are only a few cases that fit into the Formal (2) type. Most developing economies are located in Informal (2). On the other hand, in a case where a shift toward Informal (1) occurs due to economic development, it is recommendable to introduce a Western-style social security system, i.e. Formal (1). As for cases, however, of economies that remain in Informal (2) or of remaining informal self-employment in an economy of Informal (1), it should also be considered to construct a developing economy-style scheme, i.e. Formal (2). Here we should refer to the Japanese experience of implementing the National Health Insurance, which covered farmers and the self-employed before the Second World War (Hiroi 2003, Kitayama 2011).

Measuring Informal Employment

As mentioned in the second section, it is not easy to measure the proportion of informal employment (including informal self-employment and informal wage employment). This does not always result from the inadequacy of statistics. When we say “not covered by formal arrangements” or “bypass costs and are excluded from protection,” there are always gray areas—such as cases that are covered by some schemes but are excluded by others, or cases that are excluded from protection even when taxes are being paid. Accordingly, I propose to measure the proportion of informal employment in each specific scheme separately. Here I concentrate on analyzing data on pensions and unemployment insurances. It is not surprising that there are cases that are covered by a pension scheme, but are not covered by unemployment insurance. There is

no way to proceed other than to synthesize the measurements of each specific area.

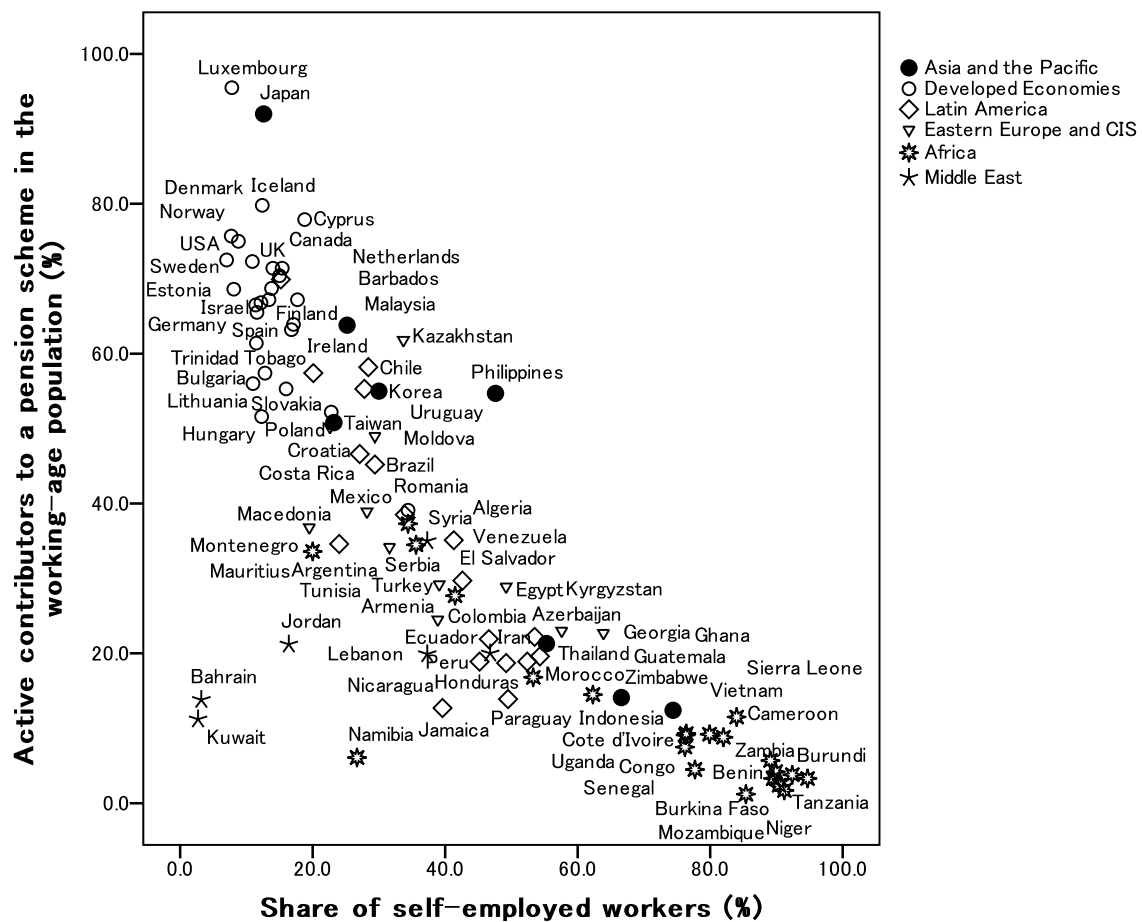
Figure 9. Effective Coverage of Pensions



Data Source: ILO, *World Social Security Report 2010-2011*, Table 21, p. 240 (For Japan: National Institute of Population and Social Security Research, *Statistical Yearbook of Social Security*). For the ratio of self-employed: ILO, *Key Indicators of the Labour Market*.

Figure 9 shows the effective coverage of pensions (i.e. share of the population above legal retirement age in receipt of a pension). The horizontal axis shows the share of self-employed workers in each economy. Most advanced economies, including Japan, are concentrated in the upper left. This corresponds to the Formal (1) type. The Philippines, Thailand, Indonesia, and Vietnam are located in the lower right, which corresponds to the Informal (2) type. Malaysia and Korea are located in the lower left, which means that the process of formalization does not keep up with the increase in wage employment (i.e. Informal (1)). On the other hand, in some CIS economies—Kyrgyzstan, Azerbaijan, and Tajikistan—the share of informal employment is small for their relatively high ratio of self-employment (i.e. Formal (2)). Although somewhat distant, Mongolia has a similar tendency.

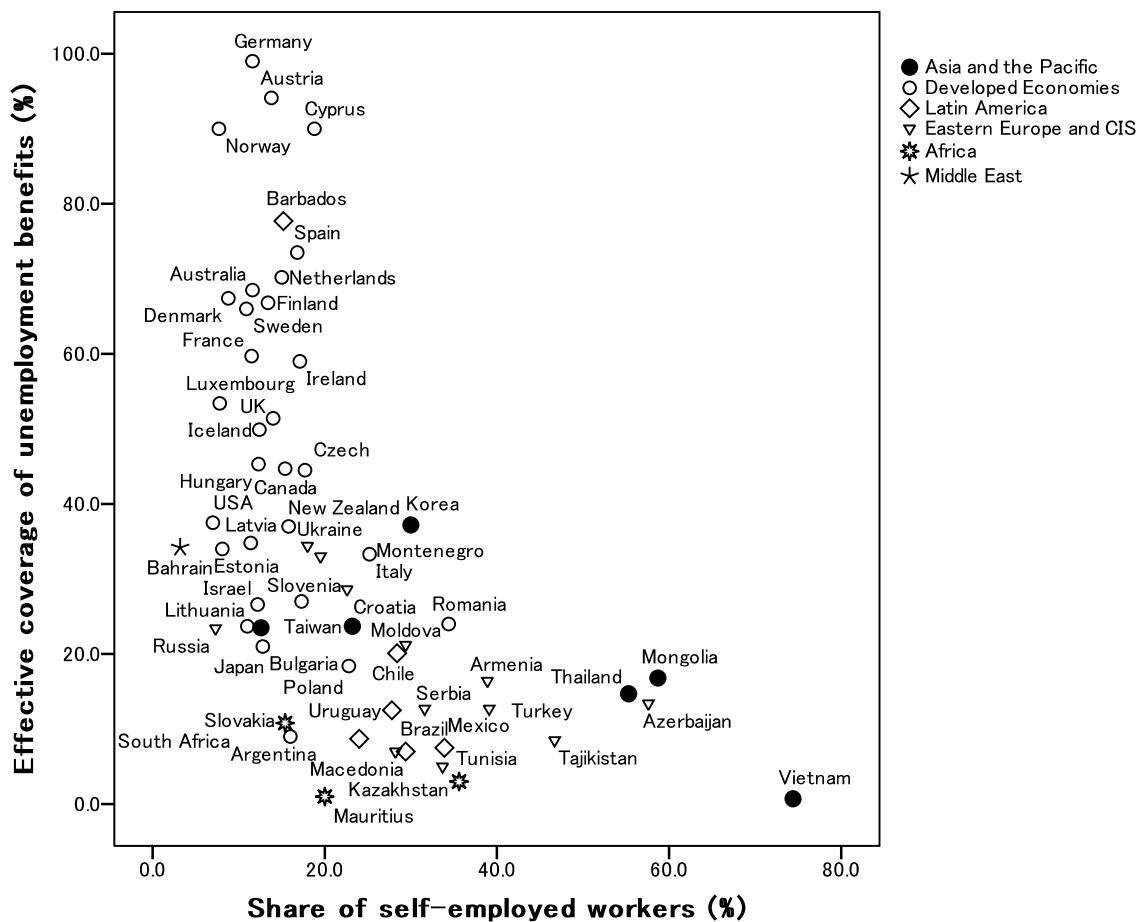
Figure 10. Legal Coverage of Pensions



Data Source: ILO, *World Social Security Report 2010-2011*, Table 21, p. 240 (For Japan: National Institute of Population and Social Security Research, *Statistical Yearbook of Social Security*). For the ratio of self-employed: ILO, *Key Indicators of the Labour Market*.

Figure 10 shows the legal coverage of pensions (i.e. share of active contributors to a pension scheme in the working-age population). The horizontal axis shows the share of self-employed workers in each economy. The overall picture shifts downward from Figure 9. This means that the ratio of Figure 9 includes not only social insurance-type pensions, but also pension financed by the government budget. On the other hand, in Malaysia, Korea, the Philippines, and Chinese Taipei, the legal coverage surpasses the effective coverage. Presumably because the pension schemes of these economies have recently been extended, the participation rate (i.e. the legal coverage) of the working generation is higher than the ratio of beneficiaries (i.e. the effective coverage). This implies the process of formalization is currently proceeding.

Figure 11. Effective Coverage of Unemployment Benefits



Data Source: ILO, *World Social Security Report 2010-2011*, Table 22a, p. 245 (For Chinese Taipei: Council of Labor Affairs, *Yearbook of Labor Statistics*). For the ratio of self-employed: ILO, *Key Indicators of the Labour Market*.

Figure 11 shows the effective coverage of unemployment benefits (i.e. percentage of the unemployed receiving unemployment benefits). The horizontal axis shows the share of self-employed workers in each economy. Differing from pensions, the effective coverage of unemployment benefits varies even among advanced economies where the ratio of self-employment is similarly low. Economies such as Japan have experienced informalization in terms of unemployment insurance. It is worth noting that the effective coverage in Japan was over 80% in the 1960s (Statistics Bureau, *Longitudinal Statistics Series of Japan*). This was partly because the unemployment rate at that time was quite low. Still, one of the main reasons of the decline seems to be neoliberal regulatory reforms. Although the coverage in other East Asian economies is similarly low, we should also pay attention to the fact that there are many economies that have not introduced unemployment insurance yet (Kamimura 2010).

Strategies for Extending Social Security

Bearing these conditions in mind, how can we formalize both informal self-employment and informal wage employment? Setting the problem of the informalization of employment in advanced economies aside, here I concentrate on the issue of extending social security (here, mainly unemployment insurance) in developing economies.

There are difficulties peculiar to the implementation of unemployment insurance in developing economies. The causes are attributed to both government and market. A World Bank labor economist, Vodopivec (2009), maintains:

The most important circumstances which dictate deviations from a standard UI [unemployment insurance] program are the low stage of development of the labor market and weak administrative capacity. In developed countries, UI has emerged in response to the developments of the labor market, specifically, the emergence of the unemployment as a “discrete event.” In important ways, labor market conditions in developing countries—particularly the prevalence of large informal sector—make unemployment more a “continuous” variable, with important consequences for the design of unemployment insurance. Moreover, the administrative capacity of developing countries (even in upper-middle income group) lags behind the capacity of developed countries, which is likely to worsen the efficiency properties of UI program.

(Vodopivec 2009: 10)

Vodopivec recommends Unemployment Insurance Savings Accounts that have no risk-pooling functions and place stress on individual responsibility, considering that it is not realistic to introduce a Western-style unemployment insurance scheme into developing economies. On the other hand, the ILO Office for Indonesia emphasizes the importance of introducing unemployment insurance even in economies such as Indonesia.

The [Indonesian] government’s strong policy response [for the economic crisis] has included infrastructure development, which is critical for providing jobs, in particular for the unskilled. The government has also put in place various social assistance programmes for the poor, which have been strengthened as a result of the crisis. What is missing, however, is protection for the semi-skilled, in particular for women and the near-poor. They do not qualify for the social assistance programmes for the poor and, given their relatively higher skill levels, the lower skilled jobs in infrastructure often do not represent appealing alternatives. Furthermore, as infrastructure works typically attract mainly male workers, they cannot sufficiently absorb the large number of women who have been laid off in export-oriented industries. For these groups, unemployment insurance can function as an automatic stabilizer that may cushion the impact of the economic shock and help maintain aggregate demand. Unemployment insurance could also slow down the transmission of the crisis from urban to rural areas,

especially in countries where large numbers of rural migrants have lost jobs in export-oriented industries.

(ILO Office for Indonesia 2009: 22)

In short, even in economies such as Indonesia, there are types of workers that should be covered by unemployment insurance, rather than by social assistance or public-works programs.

Of course there is no need to narrow formalization strategies down to a single way. Wage earners, who are increasing, should be covered by Western-style social insurance schemes. Although it is not easy to cover casual or day laborers, the experience of Day Laborers' Unemployment Insurance in postwar Japan (Ujihara 1989: 45) may serve as a useful reference to find solutions, setting the Unemployment Insurance Savings Accounts aside. On the other hand, it may not be realistic to cover the remaining self-employed workers by unemployment insurance. It is better to give priority to establishing a community-based insurance in the area of health and pensions.

Nevertheless, we should not forgive the survival of informal employment on the grounds of "weak regulatory capacity of the government" or "self-employment-centered labor market." Instead, we should consider strategies for formalizing each type of informal employment, and make governments enhance their capacity to realize such strategies.

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4. Macro Analysis

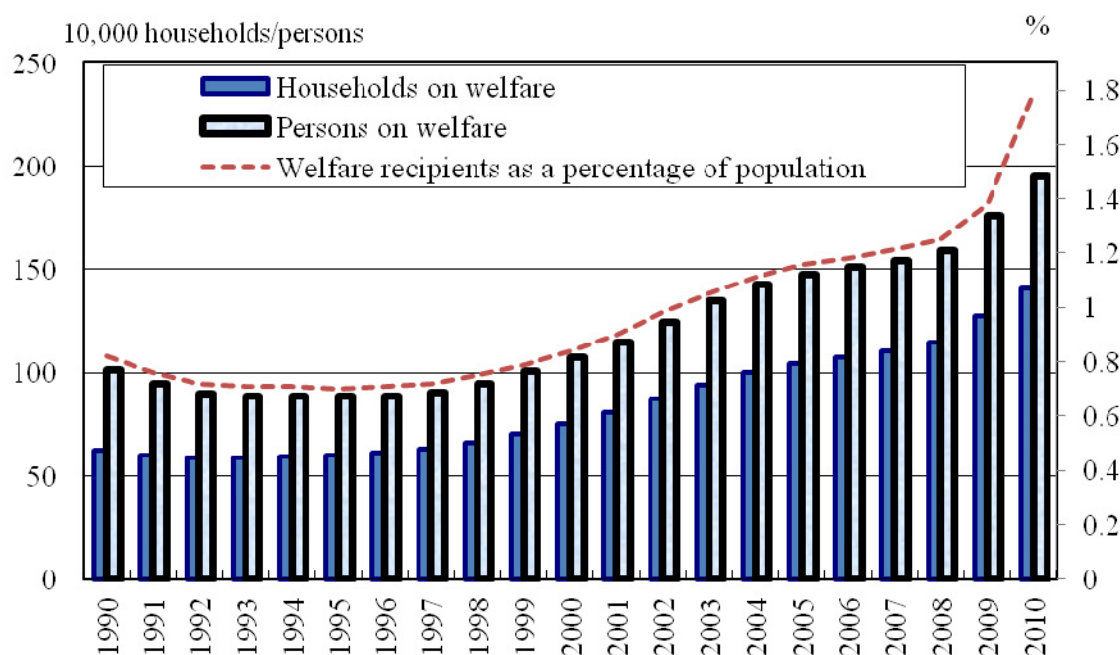
Exploding Welfare Claims in Japan: A New Look through Long-Term Time Series Data

Wataru Suzuki, Yanfei Zhou*

I. Introduction

The number “2,022,333” is definitely a shocking one for most Japanese, and for the whole world as well. The monthly average number of welfare recipients, for the first time in March 2011, has exceeded 2 million since 1952. The turning point came in the late 1990s. The percentage of welfare recipients against the total population had been steadily declining until 1995 when the trend changed direction and the number has continued to rise drastically thereafter. Along with Japan’s unprecedented speed of aging, the number of welfare claims has been growing exponentially: its size has doubled in just one decade (Figure 1).

Figure 1 Number of households/persons on welfare (1990-2010)



Data source: “Welfare Administration Report” by Ministry of Health, Labour and Welfare.

Notes: (1) Monthly averaged values. (2) Forecasted values for 2010.

Although elderly households continue to be the predominant claimants of welfare, since the

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turn of the century, the number of working-age households requesting welfare has been growing at an unprecedented pace. Between 2008 and 2009 alone, these households increased from 121,570 to 171,978 (41.5% rise). We embarked on the study with suspicion that this rapid increase of working-age households on welfare has been triggered not only by the economic downturn but also by the generous government stance on welfare approvals.

This paper investigates to what extent “temporary/business cycle shock” or “permanent/structural shock” (aging and government stance) could explain the recent rapid rises in welfare figures. If the temporary shock dominates, we can expect a moderate rise or even decline of welfare claims when the economy recovers. On the contrary, if the permanent shock plays a central role, rises in welfare claims are very likely caused by persistent transitions in population structure and welfare programs, and are hard to alleviate or reverse in a short run.

There have been very few empirical studies on this topic in Japan with the sole exception of Suzuki and Zhou (2007). Using a bivariate vector autoregression method, which was originally implemented by Blanchard and Quah (1989) in real business cycle analysis, Suzuki and Zhou (2007) try to separate out the effects of temporary shocks and permanent shocks on the rises of welfare claims. Their study, for the first time, confirms the relative importance of permanent shock on the rises of welfare claims since 1992, but their analysis only traces until October 2006. This paper, however, adds the most recent period (November 2006 to March 2011) into the analysis target, and aims to disclose whether permanent shock is still the major driving force for the rises of welfare claims in recent years, particularly for the years after the Lehman crisis.

Our empirical findings indicate that permanent shock, as a whole, played a central role in driving up the welfare requests during the last two decades. While Suzuki and Zhou (2007) find that temporary shock explains more than half of the public assistance rate variance at 0 to 60 months, this paper reveals that the permanent shock dominates even at the very initial time horizon. A further look on the gap of forecasted and real values of the public assistance rate indicates that permanent shock plays a particularly important role in explaining the rapid rises of welfare claims since 2008. Permanent shock accounts for only 52.0% of the gap between forecast and actual values (“forecast-real gap”) at the beginning of the Lehman shock, but its share reaches as high as 82.3% now.

The expansion of the permanent shock was unsteady and was obviously interrupted between 2003 and 2007, during which period there were strong public opinions expressed in Japan criticizing the overuse of welfare. As a result, stricter supervision on welfare approvals was instructed by the government. In other words, the influence of permanent shock seems to be strengthened (or weakened) in parallel with the generosity (or toughness) of the government stance toward welfare approvals.

In addition to the above, we found that the impact from temporary shock can last for a long time. It takes 64 months for the impulse of temporary shock to converge to zero. Put differently, even if the public assistance rate rises due to temporary shock such as a recession or an

earthquake, it takes nearly 5 years to regain the normal level.

II. Background

A. Sluggish Economy

Welfare recipients will definitely increase in a bad economy. Japan's economy has been suffering a near zero gross domestic product growth and persistent deflation for the entire period of the 1990s and 2000s, which are termed the "lost decades". The pain of the "lost decades", however, went disproportionately to young and unskilled workers.

To fend off heavy competition from rival companies based overseas, most Japanese companies began to replace their permanent workforce with temporary workers who had no job security and fewer benefits, and these non-regular employees now make up over a third of Japan's labor force. Although the unemployment rate is not yet at crisis-level high (a peak of 5.8% in March 2003), nowadays young generations and unskilled workers stand much slimmer chance of getting secure and well-paid work. As a consequence, income inequality has risen quickly and populations below the poverty line have surged as well.

As we can observe from Figure 1, the number of welfare claims moved simultaneously with the economy's sluggishness to some extent. For example, welfare claims shifted to an upward trend in 1995, just a couple of years after the collapse of the bubble economy. When the economy deteriorates, as with the most recent example of Lehman Brothers' collapse in 2008, the number of welfare caseloads skyrocketed thereafter. Meanwhile, when the economy recovered slightly during the period from 2002 to 2007, welfare claims increased moderately.

If a sluggish economy is the major factor responsible for the climbing welfare claims, this rapid upward trend could be moderated or even reversed when the economic condition is improved. Put differently, as long as the lost decades persist, the welfare dependency rate is likely to keep rising.

B. Rapid Aging and Dysfunctional Public Pension System

Rapid aging, however, is another critical factor for welfare claims. Japan outweighs all other nations with the highest proportion of elderly citizens, 23.1% over the age of 65 in 2010 (Source: Statistics Bureau, Japan). Households headed by the elderly make up the biggest group of welfare collectors in Japan. As Table 1 indicates, more than 40% of the households on welfare are elderly households.

Why are there so many elderly citizens collecting welfare despite the fact that Japan has a universal public pension system? The coverage of basic pension is universal, but a significant number of the self-employed, farmers and non-employed, for whom subtracting pension premiums from pay checks is near impossible, are defaulting on premium payments, either because they are too present-orientated, in money shortage, or have no confidence in the public

pension system (Suzuki and Zhou, 2001). Since the eligibility for pension benefits requires a minimum of 25 years of premium payments, some of the defaulters are going to lose their entitlement to pension benefits. While premium defaulting was rare in the 1970s and 1980s¹, the most recent default rate is as high as 40% (2009). Put differently, we will see more and more non-pensioners in the future. The welfare program is going to face an even bigger challenge when these present premium defaulters enter retirement.

Table1 Household Types on Welfare (2005-2010)

	2005	2006	2007	2008	2009	2010
Total number of households on welfare	1,041,508	1,075,820	1,105,275	1,148,766	1,274,231	1,409,067
		(3.3)	(2.7)	(3.9)	(10.9)	(10.6)
Elderly households	43.4%	44.0%	45.0%	45.6%	44.2%	42.8%
		(4.8)	(5.0)	(5.3)	(7.5)	(7.1)
Households whose head is disabled or in illness	37.4%	36.9%	36.3%	35.4%	34.2%	33.0%
		(1.9)	(0.9)	(1.5)	(7.1)	(6.7)
Single-mother households	8.7%	8.6%	8.4%	8.1%	7.8%	7.7%
		(2.3)	(0.3)	(0.5)	(6.6)	(9.2)
Other types of households	10.3%	10.2%	10.1%	10.6%	13.5%	16.1%
		(2.4)	(1.3)	(9.2)	(41.5)	(32.2)

Sources: “Welfare Administration Report” by Ministry of Health, Labour and Welfare.

Notes: (1) Number in the parentheses is the percent changes from previous year. (2) Monthly averaged values. (3) Forecasted values for 2010. Data of the nuclear disaster-affected Fukushima Prefecture (regions other than Koriyama City) is excluded from the statistics of 2011:02.

C. Government Stances on Welfare Approval

The stance of the government is another important but always neglected factor in determining welfare claims. Criteria for approving or rejecting welfare applications are at least partly under the cloud of subjective judgment. For example, the likelihood of a healthy, working-age poor man getting access to welfare could vary notably by his residence (wealthier municipalities are basically more generous), application skills and know-how, and luck. The general stance of the government on welfare approval is not time-invariant, however.

Welfare administration is monitored by the Ministry of Health, Labour and Welfare (MHLW), mainly through detailed notices and orders. When outlining the major notices concerning welfare administration in the last two decades (Table 2), one can easily find swaying government stances on welfare approval. The years between 1998 and 2003 and between September 2008 and the present could be classified as “Eras of Generous Stance”, periods in which welfare applications of healthy working-age applicants were relatively easily approved.

¹ The default rate on national pension premiums was less than 5% in the 1970s. Data source: Homepage of Pension Finance by Pension Bureau, Japan.

The years between 2003 and 2008, however, could be classified as “Era of Tough Stance”, a period in which welfare approvals were relatively strict.

What has led to such big changes in the government’s stance? Public criticism, regime change and anti-poverty social movements are very likely factors driving these changes.

(Era of Generous Stance: 1998-2003) There have been an increasing number of homeless people in urban Japan since the late 1990s, and the problem of their subsistence rights has been rising as a new social concern. Although Japan’s welfare program traditionally turns down any applicants that have no settled residences, it was from then on that MHLW has instructed flexible treatment of homeless welfare applicants. For example, some districts such as Tokyo and Osaka began to help the homeless people secure a residence, a prerequisite for welfare approval, either by subsidizing rental deposits or by directly providing free or cheap lodging houses. As a result, the number of free or cheap lodging houses rose sharply in the Kanto area (Tokyo), and it became much easier for the homeless people to get access to welfare compared to before.

(Era of Tough Stance: 2003-2008) Along with too rapid rises of welfare expenditures and the prevalence of bogus welfare claims, public criticism surged and the government turned to a new direction of curbing the welfare claims. MHLW set up a welfare council named, “Experts Committee on the New Welfare Programs” in 2003 to discuss the revision of welfare law. In December 2005, MHLW and local governments concluded an agreement on *proper* management of the welfare system. Detailed stricter welfare approval criteria were directed to welfare agencies in March 2006, through a formal notice named “Handbook for proper management of the welfare system”. In response to this change in stance, welfare agencies began strictly confining welfare applicants and some of the potential users were refused even at the consulting stage, a situation mocked by lawyers and welfare workers as the “Waterfront Strategy” (Mizugiwa Sakusen)².

(Era of Generous Stance: September 2008-present) The government stance on welfare approvals returned to a generous one along with the Lehman crisis in September 2008. At the end of 2008, to protest the massive dismissal of dispatched workers, anti-poverty activists set a New-Year Tent village for laid-off workers in Hibiya Park, a place right under the eyes of Japan’s political inner circle. As the activities had intended, this action attracted intensive media and political attentions. Under huge political pressure, welfare agencies approved many tent villagers to use welfare in the short term, many of which lacked careful screening. This generous stance was accelerated by the regime transition from the conservative Liberal Democratic Party (LDP) to the Democratic Party of Japan (DPJ) in September 2009. After the regime transition, MHLW issued the notices “Improving welfare administration on poor persons under the urgent

² Under the Waterfront Strategy, some sorrowful incidents happened. In July 2007, for example, a former welfare recipient of Kitakyushu City was found dead from hunger, leaving a message that “I want to eat rice ball” in their diary. Two other similar deaths were found in Kitakyushu City in January 2005 and May 2006.

employment measures” (10/2009) and “Special attention on support for the jobless poor” (12/2009) to formally confirm this generous government stance.

A direct outcome of the government stance of generous approval could be the steep rises of working-age welfare recipients, and this worry has already turned partly into reality. Table 1 discloses an unusually high two-digit increase of “other types of households” in two consecutive years (41.5% rises in 2009 and 32.2% rises in 2010). Since the elderly, those with disabilities or illness and single-mother households have already been excluded from the definition of “other types of households”, we can safely declare that welfare claims among healthy working-age men has been increasing at an incredibly high pace in recent years.

In sum, the sluggish economy, population aging as well as government stances are all telling and only telling part of the story about exploding welfare claims in Japan. In this paper, we assume the sluggish economy to be a “temporary or business-cycle factor”, because the economic condition will inevitably improve at some point, no matter how many years it takes. On the other hand, both the population aging and government stances are assumed to be “permanent or structural factors” because their effects are long-lasting and are hard to reverse in the short run.

Table 2. Major Policy Events concerning Welfare Administration (1998-present)

	Background	Policy Shifts (Major Notices)
1998-2003	Increasing number of homeless people and rising social concerns. Easier welfare approval to the homeless.	Expanding policy support to the homeless to secure a residence, which is a prerequisite for getting welfare approval.
2003-2008	Criticism of exploding welfare caseloads. Strict eyes on bogus claims of welfare and tighter welfare approval.	MHLW notice "Handbook for proper management of welfare system" (03/2006) MHLW notice "Actions against misuses of welfare by Yakuza" (03/2006)
09/2008	Lehman Shock - Massive dismissal of dispatched workers	
2008-2009	New-Year Tent village for laid-off workers in Hibiya Park, run by anti-poverty activists, attracted intensive media attention (12/2008-01/2009) Surging social and political pressures on more generous welfare approval	MHLW notice "Positive actions against the declining job market" (12/2008) MHLW notice "Intensive support for laid-off and homeless persons" (03/2009)
09/2009	Change of regime from the LDP to the DPJ	
2009-present	Further generosity on welfare approval under Democratic Party administration	MHLW notice “Improving Welfare administration on poor persons under the Urgent Employment Measures” (10/2009) MHLW notice “Special attention on support for the jobless poor” (12/2009)

III. Decomposing the Shifts of Welfare Claims

While both the “temporary factor” and “permanent factor” are affecting welfare claims to some extent, it is important to understand which factor imposes a relatively larger shock on the

climbing welfare dependency for the reasons we mentioned earlier. In order to verify the relative importance of each factor, we tried to decompose the shifts of welfare claims into two parts: (1) changes due to permanent shock and (2) changes due to temporary shock. Here, the number of welfare claims per 1,000 persons, which we call “public assistance rate”, is our analysis target.

A. Method of Blanchard–Quah Decomposition³

Using a bivariate VAR (BVAR), Blanchard and Quah (1989) propose a smart way to decompose real GNP into its temporary and permanent components. To take our study as an example, suppose we are interested in decomposing the sequence of the public assistance rate, say $\{y_t\}$, into its temporary and permanent components. In a univariate framework, there is no unique way to perform the decomposition. Blanchard and Quah(1989), however, suggest to introduce a second variable, say unemployment rate $\{z_t\}$ in our case, that is affected by the same two shocks. If we ignore the intercept terms, the bivariate vector moving average (BVMA) of the $\{y_t\}$ and $\{z_t\}$ sequences will have the following form:

$$y_t = \sum_{k=0}^{\infty} c_{11}(k)\varepsilon_{1t-k} + \sum_{k=0}^{\infty} c_{12}(k)\varepsilon_{2t-k} \quad (1)$$

$$z_t = \sum_{k=0}^{\infty} c_{21}(k)\varepsilon_{1t-k} + \sum_{k=0}^{\infty} c_{22}(k)\varepsilon_{2t-k} \quad (2)$$

where ε_{1t} and ε_{2t} are independent white-noise disturbances, each having a constant variance of 1. $c_{ij}(k)$ are the individual coefficients of the polynomials where k denotes lag operator.

The key to decomposing the $\{y_t\}$ sequence into its trend and irregular components is to assume that one of the shocks ε_{1t} has only a temporary effect on the $\{y_t\}$ sequence. In the long run, if the public assistance rate is to be unaffected by the ε_{1t} shock, the accumulated effect of an ε_{1t} shock on the $\{y_t\}$ sequence must be equal to zero. Hence, the coefficients $c_{11}(k)$ in equation (1) must be such that

$$\sum_{k=0}^{\infty} c_{11}(k)\varepsilon_{1t-k} = 0 \quad (3)$$

Although the permanent and temporary shocks are not observed, the problem could be cleared up by using a BVAR estimation. Given both the $\{y_t\}$ and $\{z_t\}$ sequences as stationary, there exists a VAR representation for equations (1) and (2) as follows.

³ Description of the Blanchard–Quah decomposition method is from Suzuki and Zhou (2007).

$$y_t = \sum_{l=0}^p a_{11}(l)y_{t-l} + \sum_{l=0}^p a_{12}(l)z_{t-l} + e_{1t} \quad (4)$$

$$z_t = \sum_{l=0}^p a_{21}(l)y_{t-l} + \sum_{l=0}^p a_{22}(l)z_{t-l} + e_{2t} \quad (5)$$

where $a_{ij}(l)$ are the individual coefficients and l denotes lag operator. Blanchard and Quah (1989) find that the VAR residual of e_{1t} and e_{2t} are composites of the pure innovations ε_{1t} and ε_{2t} . That is,

$$e_{1t} = c_{11}(0)\varepsilon_{1t} + c_{12}(0)\varepsilon_{2t} \quad (6)$$

$$e_{2t} = c_{21}(0)\varepsilon_{1t} + c_{22}(0)\varepsilon_{2t} \quad (7)$$

Since the values of e_{1t} and e_{2t} can be easily obtained by BVAR estimations, it would be possible to recover the values of ε_{1t} and ε_{2t} if only we know the values of $c_{11}(0)$, $c_{12}(0)$, $c_{21}(0)$, $c_{22}(0)$. Blanchard and Quah show that the BVMA model plus equations (3), (6), and (7) provide exactly four restrictions that can be used to identify these four coefficients. Hence, by substituting the estimates into the following two equations, we can obtain the values of temporary and permanent shocks to the public assistance rate shift.

$$\text{(Temporary shock)} \quad y_t = \sum_{k=0}^{\infty} c_{11}(k)\varepsilon_{1t-k} \quad (8)$$

$$\text{(Permanent shock)} \quad y_t = \sum_{k=0}^{\infty} c_{12}(k)\varepsilon_{2t-k} \quad (9)$$

Finally, by using the estimation results of equations (1) and (2), we will then be able to estimate the impulse response function, decompose the forecast error variance of public assistance rate, and perform historical decomposition on the public assistance rate.

B. Make a Check of the Data

Before turning to the decomposition results, we make a comparison between the two sequences of our concern—public assistance rate and unemployment rate. The monthly nationwide data over the period April 1960 to March 2010 (N=600) are used. Possibly because these two sequences have diverse trends⁴, the original sequence of the public assistance rate seems to have an inverse movement with that of unemployment rate (Figure 2).

⁴ Due to the economic growth and the accumulation of national wealth, the public assistance rate has a downward trend in the long run. The unemployment rate, on the other hand, has an upward trend in the long run because mismatch unemployment has increased substantially along with radical technology innovation and industry structure transitions.

The graph displays two data series over a 50-year period. The unemployment rate, represented by a solid line, shows significant volatility, with major peaks in the mid-1970s and around 2010. The public assistance rate, represented by a dotted line, also shows volatility, with peaks in the mid-1960s and around 2010. Both rates show a general downward trend from the mid-1960s to the mid-1990s, followed by a sharp increase in the early 2000s.

Year	Unemployment rate (Left Scale, %)	Public assistance rate (Right Scale, %)
Apr-60	1.5	17.5
Apr-62	1.8	17.5
Apr-64	1.2	18.5
Apr-66	1.5	17.5
Apr-68	1.2	16.5
Apr-70	1.0	15.5
Apr-72	1.5	14.5
Apr-74	1.2	13.5
Apr-76	2.5	12.5
Apr-78	2.2	12.5
Apr-80	2.0	12.5
Apr-82	2.5	12.5
Apr-84	3.0	12.5
Apr-86	2.5	11.5
Apr-88	2.2	10.5
Apr-90	2.0	9.5
Apr-92	2.2	8.5
Apr-94	3.0	8.5
Apr-96	3.5	8.5
Apr-98	4.5	9.5
Apr-00	5.0	10.5
Apr-02	5.5	11.5
Apr-04	4.5	12.5
Apr-06	4.0	13.5
Apr-08	5.0	14.5
Apr-10	4.5	15.5

The graph displays two data series over a 50-year period. The unemployment rate (solid line) shows significant volatility, with a notable peak around 1962 and a sharp decline around 1975. The public assistance rate (dotted line) shows a general upward trend, starting around 15% in 1960 and reaching nearly 20% by 2010. Both series show a similar pattern of a sharp increase in the late 1990s and early 2000s, followed by a decline around 2008.

Year	Unemployment rate (Left Scale, %)	Public assistance rate (Right Scale, %)
Apr-60	1.4	15
Apr-62	1.4	15
Apr-64	0.5	15
Apr-66	0.5	15
Apr-68	0.5	15
Apr-70	0.5	15
Apr-72	0.5	15
Apr-74	-0.5	15
Apr-76	0.5	15
Apr-78	0.5	15
Apr-80	0.5	15
Apr-82	0.5	15
Apr-84	0.5	15
Apr-86	0.5	15
Apr-88	0.5	15
Apr-90	-0.5	15
Apr-92	-0.5	15
Apr-94	-0.5	15
Apr-96	-0.5	15
Apr-98	1.5	15
Apr-00	1.5	15
Apr-02	1.5	15
Apr-04	1.5	15
Apr-06	1.5	15
Apr-08	1.5	15
Apr-10	1.5	15

⁵ Public assistance rate=12.12865-0.0043507*trend+3.533062*Oil shock dummy
(38.43) (-5.66) (11.55) Adj R-squared= 0.5149
Unemployment=0.3017669+0.0074976*trend+0.340172* Oil shock dummy
(3.60) (36.79) (4.19) Adj R-squared= 0.8192

movement between the sequences of the public assistance rate and unemployment rate (Figure 3). Hence, the unemployment rate should be regarded as an appropriate variable for Blanchard and Quah decomposition. In estimations of the BVAR, stationary sequences after controls of time trend and oil shock break are used, as shown by the plots of Figure 3.

C. Forecast Error Variance Decomposition and Impulse Response Estimates

Using monthly data over the period April 1960 through March 2011, we estimate the BVAR model with 12-month lags⁶ (Table 3). To be noted, we treat the month dummies as exogenous deterministic regressors when performing the BVAR estimation because the original sequences are seasonal.

The forecast error variances of the public assistance rate obtained from the above BVAR estimation are decomposed into two parts: those due to permanent and those due to temporary shocks (Table 4). We find that permanent shocks play a central role not only in the long run but also in the short run, which is a major difference from this paper and Suzuki and Zhou (2007).

Using an older and shorter time series sequence (1960:4-2006:10), Suzuki and Zhou (2007) find that temporary shock accounts for a dominant percentage of the public assistance rate variance in the short-run (e.g., 85.4% at 12 months) and gradually fades in the long-run horizon. This paper, however, indicates that permanent shock dominates even at the very initial horizon. For example, permanent shock is responsible for 82.5% of the variance of the public assistance rate at the 1-month horizon and its weight reaches 94.6% at 120 months (Table 4). The increasing role of permanent shock indicates that there could be some structural changes that arose during the newly added five years (2006:11-2011:03).

Notes: (1) t-values are in parentheses. (2) Oil shock dummy equals 1 if before December 1973; 0 otherwise.

⁶ Estimation result by using 24-month lags is basically the same with the case of using 12-month lags.

Table 3 Estimation Result of the BVAR Model

Dependent variables (Y):	(1) Public Assistance Rate			(2) Unemployment Rate		
	Coeff.	S.E.	p value	Coeff.	S.E.	p value
Public Assistance Rate {1}	1.012	23.636	0.000	0.077	0.037	0.039
Public Assistance Rate {2}	0.016	0.261	0.794	-0.106	0.053	0.045
Public Assistance Rate {3}	0.037	0.612	0.541	0.009	0.053	0.865
Public Assistance Rate {4}	-0.032	-0.525	0.599	0.013	0.052	0.809
Public Assistance Rate {5}	-0.001	-0.020	0.984	0.028	0.052	0.597
Public Assistance Rate {6}	-0.003	-0.056	0.956	-0.061	0.052	0.245
Public Assistance Rate {7}	-0.016	-0.267	0.790	0.092	0.052	0.080
Public Assistance Rate {8}	0.014	0.239	0.811	-0.079	0.052	0.131
Public Assistance Rate {9}	0.090	1.489	0.137	0.099	0.053	0.060
Public Assistance Rate {10}	-0.078	-1.278	0.202	-0.073	0.053	0.165
Public Assistance Rate {11}	0.000	0.007	0.995	0.084	0.053	0.111
Public Assistance Rate {12}	-0.042	-0.977	0.329	-0.089	0.037	0.018
Unemployment Rate {1}	0.039	0.787	0.432	0.835	0.043	0.000
Unemployment Rate {2}	-0.009	-0.139	0.890	-0.012	0.055	0.833
Unemployment Rate {3}	-0.041	-0.637	0.525	0.085	0.055	0.126
Unemployment Rate {4}	0.050	0.777	0.438	0.021	0.055	0.698
Unemployment Rate {5}	-0.074	-1.162	0.246	-0.007	0.055	0.903
Unemployment Rate {6}	0.015	0.232	0.816	0.098	0.055	0.074
Unemployment Rate {7}	0.071	1.115	0.265	-0.075	0.055	0.171
Unemployment Rate {8}	-0.022	-0.343	0.732	-0.027	0.055	0.630
Unemployment Rate {9}	-0.005	-0.074	0.941	-0.022	0.055	0.695
Unemployment Rate {10}	-0.082	-1.286	0.199	-0.005	0.055	0.925
Unemployment Rate {11}	0.044	0.691	0.490	0.042	0.055	0.444
Unemployment Rate {12}	0.028	0.562	0.574	0.042	0.043	0.321
Constant	0.120	2.484	0.013	0.345	0.042	0.000
February dummy	-0.102	-2.449	0.015	-0.211	0.036	0.000
March Dummy	-0.065	-1.523	0.128	-0.042	0.037	0.259
April Dummy	-0.238	-5.458	0.000	-0.446	0.038	0.000
May Dummy	-0.139	-3.214	0.001	-0.374	0.037	0.000
June Dummy	-0.086	-2.143	0.033	-0.379	0.035	0.000
July Dummy	-0.080	-1.935	0.054	-0.359	0.036	0.000
August Dummy	-0.101	-2.355	0.019	-0.246	0.037	0.000
September Dummy	-0.134	-2.923	0.004	-0.285	0.040	0.000
October Dummy	-0.106	-2.246	0.025	-0.291	0.041	0.000
November Dummy	-0.083	-2.028	0.043	-0.288	0.035	0.000
December Dummy	-0.046	-1.142	0.254	-0.326	0.035	0.000
N	600			600		
Std Error of Y	2.151			0.561		

Note: Sequences after controls for time trend and oil shock break are used.

Table 4 Forecast Error Variance Decomposition of Public Assistance Rate

Horizon (Months)	Standard Err.	Percentage of variance due to permanent shock	Percentage of variance due to Temporary shock
1	0.15	82.5	17.5
6	0.41	85.1	14.9
12	0.65	85.4	14.6
24	1.08	86.5	13.5
36	1.43	88.1	11.9
48	1.71	89.7	10.4
60	1.94	91.0	9.0
84	2.31	92.9	7.1
120	2.67	94.6	5.4

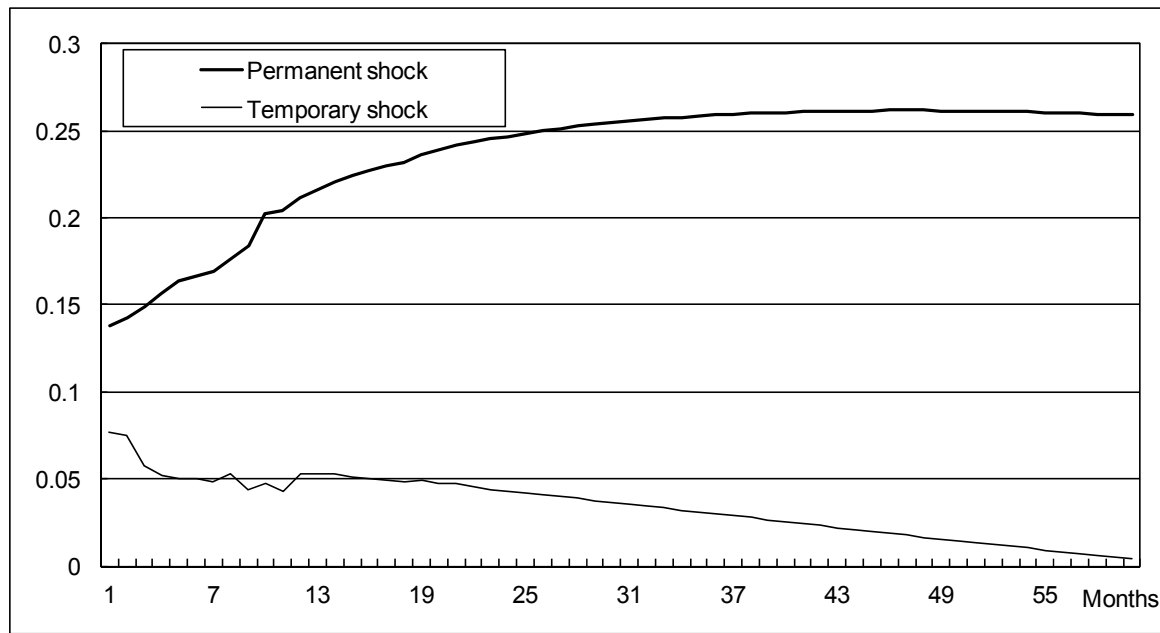
Turning to estimations of the impulse response function on public assistance rate, Figure 4 indicates that the impulse of temporary shock fades gradually with time. The impulse of permanent shocks, on the other hand, steadily rises up as the forecasting horizon grows. Still, it takes 64 months for the impulse of temporary shock to converge to zero. Put differently, even if the public assistance rate rises due to temporary shocks, e.g. a recession or an earthquake, it takes nearly 5 years to regain the normal level⁷.

Why does the temporary shock keep its influence for such a long time? Like many other advanced nations, Japan's welfare program takes the form of guaranteed monthly income, under which the welfare agency determines the income needed for an eligible person based on family size and area living costs. If there are any earnings obtained, a large part of it will be subtracted from this needed level⁸. Welfare recipients are then inclined to stay in the welfare program rather than work outside even after the initial temporary shock has ended for a long time, a situation which we call "poverty trap". Since Japan has no US-style lifetime cap on welfare, the work disincentive of the welfare program could be huge.

⁷ Suzuki and Zhou (2007) estimate that a much longer period (105 months) is needed for temporary shock to converge to zero. Since our approaches are the same, the gap is likely be formed by the difference in sequence length.

⁸ Japan's welfare program permits very little "earned income retained". According to the estimates of Hashimoto (2006), on average 83-93% of the earned income is balanced out. Put differently, if a welfare receiver earns 100 yen, only 7 to 17 yen will be his or her net income on hand. See Abe (2008) for a detailed discussion about the work disincentive problem of Japan's welfare program.

Figure 4 Impulse Response Function Estimates on Public Assistance Rate



Note: The impulse being imposed is one standard error shock.

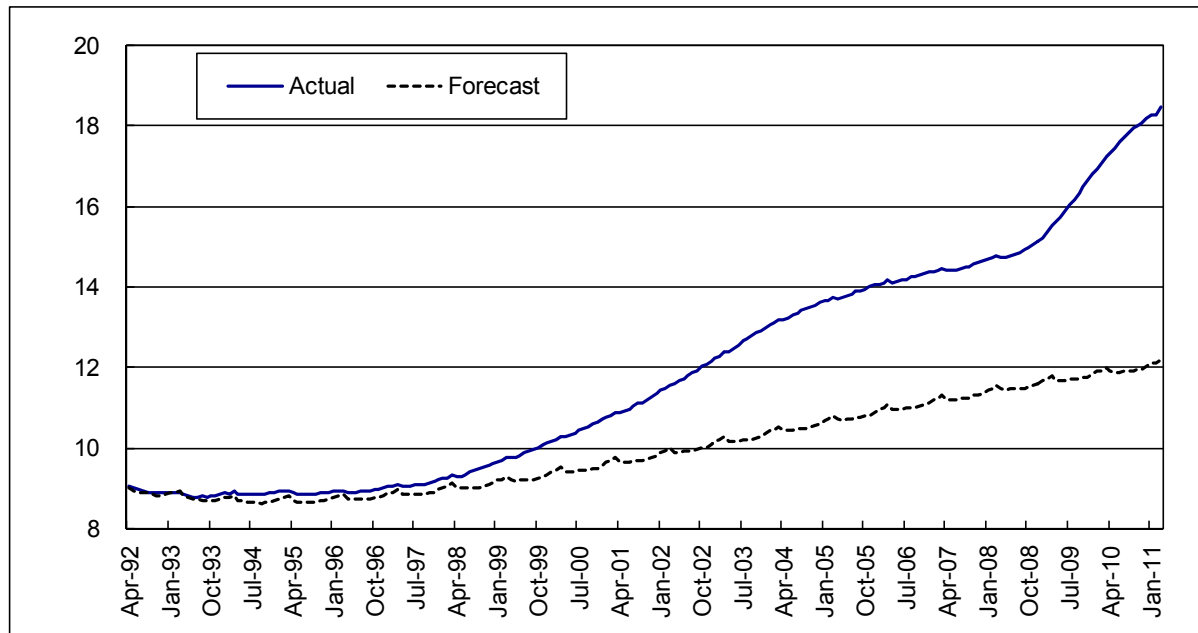
D. Historical Decomposition on Recent Rapid Rises of Public Assistance Rate

After decomposing the forecast error variance into temporary and permanent shocks throughout the whole estimation period, we then turn to another important issue: How should the rapid rises of welfare claims in recently years be understood?

“Historical decomposition” serves the goals of verifying the relative importance of permanent and temporary shocks within a limited period. Since April 1992 is the most recent bottom point of the welfare assistance rate (Figure 1), we choose the recent 228-month sequence (1992:04-2011:03) as the target of historical decomposition.

The approach is simple. First, we estimate a BVAR model by using the previous sequence (1960:04-1992:03). Second, using the BVAR estimates, we forecast the values of the public assistance rate of our concerned sequence (1992:04-2011:03) through dynamic simulations. Third, we compute the gap between the real and forecasted values of the public assistance rate in regard to our concerned sequence (Figure 5). This gap is the part of changes that could not be explained by previous information and is likely born solely from the exogenous shocks that emerged since April 1992. Finally, we decompose this gap into permanent and temporary components (Figure 6).

Figure 5 Gap between Real Values and Baseline Forecasts of Public Assistance Rate
(April 1992-March 2011)

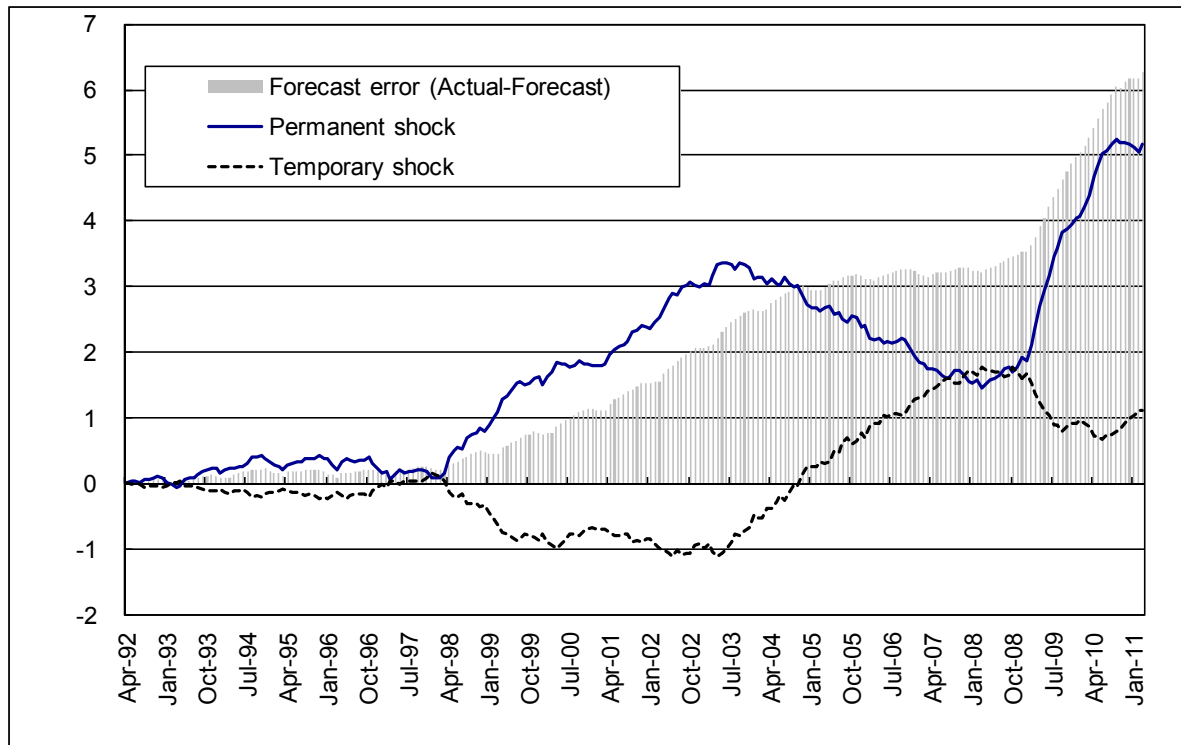


Note: Sequences after controls for time trend and oil shock break are used.

Figure 5 demonstrates the gap between baseline forecasts and real values of the public assistance rate during the period from April 1992 to March 2011. The real values of the public assistance rate after removing the time trend and oil shock break rose drastically, from 9.1‰ to 18.5‰ (9.4‰ points up). The baseline forecasts of the public assistance rate, however, rise only 3.1‰ points. There is left a forecast-real gap of as large as 6.3‰ points. Worth mentioning is that nearly half (45.2%) of the gap was created after the Lehman crisis. Thus, the unexpected rapid rises of the public assistance rate within the past 19 years are mainly due to exogenous and unexpected shocks that emerged after 2008.

Looking deeper into the components of the gap, the result of the historical decomposition (Figure 6) indicates that permanent shock plays a particularly important role in enlarging the forecast-real gap after 2008. Permanent shock accounts for only 52.0% of the forecast-real gap at the beginning of the Lehman shock (September 2008), but its share reaches as high as 82.3% in April 2011. Dating back to the pre-Lehman period, we find that the power of permanent shock has once experienced rapid expansion between 1998 and 2002. The expansion was temporarily interrupted by the mildly recovering economy, a good time (2003-2007) termed “Izanagi Keiki”. And then, it came back, with even stronger power. However, as a whole, permanent shock imposes a continuously positive impact on the public assistance rate and should be regarded as the main driving factor of the upward shift of the public assistance rate.

Figure 6 Historical Decomposition on the Forecast-Real Gap of Public Assistance Rate
(April 1992-March 2011)



Note: Sequences after controls for time trend and oil shock break are used.

Although the temporary shock is not responsible for the quantitative upward shift of the public assistance rate, it did work as a driving force for the rises of welfare claims in recent years (2005-present). Figure 6 also indicates that there exists a time lag between business cycle and public assistance rate. For example, the Japanese economy has been turning toward recovery since 2003, but the temporary shock keeps imposing a positive impact on the public assistance rate. This lag arose because even with the economy recovering, the present public assistance recipients may need some time to search for new jobs before they stop using welfare. On the other hand, even if the economy is entering a recession and the unemployment rate is rising, the new jobless may not immediately turn to welfare use because they possibly have savings or unemployment insurance benefits.

IV. Discussions: How to Interpret Permanent Shock

How can we interpret this strengthened role of permanent shock? Shall we interpret it as the result of population aging? Or, shall we regard it as an outcome of changing government stance upon welfare approvals? Possibly both, but we suspect that the government stance factor could represent a larger source of the permanent shock in recent years.

It should be remembered that aging only moves forward and steadily, while government stance swings forward and backward, as we mentioned earlier. If aging presents the permanent

shock, the influence of the permanent shock should be accumulated steadily upon the whole span. In fact, however, the expansion of the permanent shock is far from being steady and was obviously interrupted between 2003 and 2007 (see Figure 6). Instead, we find a linked movement with government stance and the strength of permanent shock (See Table 5).

Table 5 Linked Movements between Government Stance and Permanent Shock

	Influence of Permanent Shock	Aging	Economy	Government Stance
1998-2002	Strengthened	Proceed Steadily	Recession	Generous
2003-2007	Weakened	Proceed Steadily	Mild Boom	Tough
2008-present	Strengthened	Proceed Steadily	Recession	Generous

It was around 2003 that many public opinions in Japan were criticizing the overuse of welfare, and it was from then that MHLW began to instruct the welfare agencies to exercise stricter oversight on welfare approvals. The return to greater welfare use in 2008 is accompanied by a surge of political pressure from anti-poverty movements, and this was further enhanced by the transition of regime from the conservative LDP to liberal DPJ. It is not so hard to find that the influence of permanent shock strengthened (or weakened) in parallel with the generous (or tough) government stance toward welfare approvals.

Although we suspect government stance represents a larger source of the permanent shock for the above reason, our conclusion is tentative. As the above table shows, THE impact of permanent shock also varies simultaneously with economic condition: being strengthened in recession and being weakened in boom. Hence, a more likely flow could be as represented in the following chart.

Bad economy → Antipoverty movement, political pressures → Generous government stance
 Larger impact of permanent shock ← Rapid increases of welfare claims[↓]

No matter whether it is the bad economy that triggered a generous government stance or not, as long as the government stance on welfare approvals stays as it is now, the public assistance rate is going to keep rising at a high pace in the coming future.

However, to what extent can Japanese nationals afford the heavy burden of welfare programs? The total expenditure on the welfare program has already exceeded 3 trillion yen in 2010, which is nearly double the size compared to one decade ago. If this trend prevails in the coming two decades, the annual expenditures on welfare programs is likely to reach 10 trillion yen, a figure big enough to spur a bankruptcy of the government. In order to maintain a fiscally stable and sound welfare system in the future, MHLW may need to develop a stricter stance on approvals even in a bad economy.

V. Concluding Remarks

Separating the shocks on welfare claims into permanent and temporary parts is challenging because of the complicated technique. Interpreting the permanent shock, however, is an even more difficult task. As such, very few studies provide a definite separation on these two shocks. Nonetheless, this paper has confirmed the increasing power of permanent shock through estimates, and for the first time, points out that the government's generous stances upon welfare approvals could play an important role in driving up welfare claims in recent years.

Anti-poverty is definitely an important policy target for any government. Allowing many healthy, working-age poor to live on welfare, however, cannot be justified. According to the projection of National Institute of Population and Social Security Research, Japan's old-age dependency ratio is going to increase from the current 26% to the 50% range in 2030. Japan obviously cannot afford letting more and more precious workable citizens turn from the "supporting groups" to the "supported groups". The proper way to help the working-age poor is not to provide easy welfare, but to encourage them to search for new jobs either through tax credits or by providing job search assistance and free vocational training.

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Recent Trends in Consumption in Japan and the Other G7 Countries¹

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Introduction

The Japanese economy has been in a prolonged recession for most of the past two decades (Japan's so called "Lost Decades"), and private consumption has been stagnant for most of this period along with the other components of gross domestic product (GDP), although, as Horioka (2006) shows, the stagnation of public and private investment has been even more pronounced than the stagnation of private consumption.

Even during the relatively prosperous period between the Asian financial crisis of 1997-98 and the global financial crisis of 2008-09, the Japanese economy has been relatively stagnant, with private consumption being no exception. In this paper, we present data on recent trends in private consumption growth in Japan and the other Group of Seven (G7) countries (Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States) during the 2002-09 period and explore the reasons for why private consumption was stagnant in Japan compared to the other G7 countries. We compare Japan to the other G7 countries because of their importance in the world economy and because we wanted to compare Japan to countries at a similar stage of economic development and with similar market systems.

This paper is organized as follows: In section 2, we present data on recent trends in private consumption in the G7 countries, and in section 3, we present data on recent trends in possible determinants of private consumption (such as GDP, household incomes, household saving rates, and household wealth) in the G7 countries in order to shed light on the reasons for differences among the G7 countries in recent trends in private consumption. Section 4 is a brief concluding section that summarizes and makes policy prescriptions.

1. Trends in Private Consumption Growth

Table 1 shows, among other things, data on the average annual growth rate of private consumption in the G7 countries during the 2002-07 and 2007-09 periods, and as can be seen from this table, there were substantial differences among the G7 countries in private consumption

¹ This research was conducted as part of the Social Resilience Project 2011 of the Pacific Economic Cooperation Council (PECC) and the Japan Institute of International Affairs (JIIA), and the author is grateful to Dr. Yoko Niimi, Ambassador Yoshiji Nogami, and the other participants of PECC International Workshop on Social Resilience Project 2011, held on July 12, 2011, at Plaza Hall, Kasumigaseki Building, Tokyo, Japan, and those of the Twentieth General Meeting of PECC: State of the Region, held on September 29, 2011, at the Madison Hotel, Washington, D.C., U.S.A., for their helpful comments.

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growth rates in both periods. During the 2002-07 period, private consumption increased fastest in Canada (3.74%) and the United States (2.98%), relatively fast in the United Kingdom (2.44%) and France (2.09%), and slowest in Japan (1.30%), Italy (1.05%), and Germany (0.33%).

Table 1: Growth Rate of GDP and Consumption					
	2002–2007			2007–2009	
	GDP	Net Household Disposable Income	Consumption	GDP	Consumption
Canada	2.61	3.52	3.74	–0.98	1.67
France	2.00	1.94	2.09	–1.41	0.21
Germany	1.55	0.40	0.33	–1.91	0.27
Italy	1.14	0.51	1.05	–3.29	–1.30
Japan	2.10	1.00	1.30	–3.76	–1.33
U.K.	2.68	1.14	2.44	–2.50	–1.38
U.S.	2.75	2.61	2.98	–1.35	–0.73

During the 2007-09 period, the average annual private consumption growth rate was lower than during the 2002-07 period in all of the G7 countries due to the advent of the global financial crisis, with four of the G7 countries (Italy, Japan, the United Kingdom, and the United States) showing negative private consumption growth rates and only three of the G7 countries (Canada, France, and Italy) showing positive private consumption growth rates. However, the rank ordering of the G7 countries with respect to private consumption growth remained largely unchanged, with Canada still showing the highest average annual private consumption growth rate, France still ranking relative high, and Italy and Japan still ranking relatively low. Germany rises in the rankings, while the United Kingdom and the United States fall in the rankings.

Thus, private consumption growth rates varied considerably among the G7 countries during both time periods, and moreover, the differences among the G7 countries were relatively stable.

2. Determinants of Private Consumption Growth

In the previous section, we found that there are substantial and stable differences among the G7 countries in private consumption growth rates. In this section, we attempt to shed light on the reasons for these substantial differences. However, we confine our analysis to the 2002-07 period for two reasons—first, because sectoral data (in particular, data on the household sector) are still not yet available for the most recent period, and second, because the 2002-2007 period was a relatively prosperous period between the Asian financial crisis and the global financial crisis and it is important to understand why private consumption growth was relatively stagnant in Japan even during this period of global prosperity.

(1) GDP Growth

Arguably, the most important determinant of consumption growth rates is GDP growth rates. Table 1 shows data on GDP growth rates alongside data on private consumption growth rates in

the G7 countries during the 2002-07 and 2007-09 periods. As can be seen from this table, there is, in fact, a high correlation between private consumption growth rates and GDP growth rates. Moreover, private consumption growth rates roughly equal GDP growth rates in many countries, including France (2.09% vs. 2.00%), Italy (1.05% vs. 1.14%), the United Kingdom (2.44% vs. 2.68%), and the United States (2.98% vs. 2.75%). However, private consumption growth rates exceed GDP growth rates by a considerable margin in some countries such as Canada (3.74% vs. 2.61%) and fall short of GDP growth rates by a considerable margin in some countries such as Germany (0.33% vs. 1.55%) and Japan (1.30% vs. 2.10%). Thus, GDP growth rates are apparently not the only determinant of private consumption growth rates.

(2) Household Income Growth

Another possible determinant of consumption growth rates is the growth rates of net household disposable income, and it is quite possible that it is a more important determinant of consumption growth rates than GDP growth rates because households finance their consumption primarily from net household disposable income. Table 1 shows data on the average annual growth rate of net household disposable income in the G7 countries during the 2002-07 period in addition to showing data on the average annual growth rates of consumption and GDP during the same time period, and as can be seen from this table, there is a high correlation between GDP growth rates and household income growth rates, with the two being roughly equal in many countries including France (2.00% vs. 1.94%) and the United States (2.75% vs. 2.61%).

However, there are some notable exceptions: the average annual household income growth rate was considerably higher than the average annual GDP growth rate (3.52% vs. 2.61%) in Canada during the 2002-07 period, and the fact that the average annual private consumption growth rate was higher than the average annual GDP growth rate in Canada (3.74% vs. 2.61%) during the 2002-07 period can be explained by the fact that the average household income growth rate was higher than the average GDP growth rate in that country during this period.

Conversely, the average annual household income growth rate was considerably lower than the average annual GDP growth rate in Germany (0.40% vs. 1.55%) and Japan (1.00% vs. 2.10%) during the 2002-07 period, and the fact that the average annual private consumption growth rate was lower than the average annual GDP growth rate in Germany (0.33% vs. 1.56%) and Japan (1.30% vs. 2.10%) during the 2002-07 period can be explained by the fact that the average annual household income growth rate was lower than the average annual GDP growth rate in these countries during this period. Thus, not surprisingly, household income growth rates appear to be much better at explaining private consumption growth rates than GDP growth rates.

(3) Household Saving Rates

Another possible determinant of consumption growth rates is the household saving rate. Consumption growth rates will exceed household income growth rates if the household saving

rate declines over time and vice versa. In order to shed light on the importance of trends over time in the household saving rate as a determinant of consumption growth rates, we present data on trends over time in the household saving rate and on the net change in household saving rate in the G7 countries during the 2002-07 period in Table 2.

Table 2: Household Saving Rate							
	2002	2003	2004	2005	2006	2007	Change, 2002-07
Canada	3.53	2.70	3.24	2.18	3.63	2.57	-0.96
France	13.66	12.46	12.36	11.37	11.44	11.87	-1.79
Germany	10.06	10.41	10.55	10.63	10.71	10.92	0.87
Italy	11.36	10.34	10.30	9.96	9.19	8.22	-3.14
Japan	5.09	3.88	3.63	3.85	3.65	3.78	-1.31
U.K.	-0.05	0.43	-1.70	-1.26	-2.95	-4.27	-4.21
U.S.	3.65	3.76	3.37	1.48	2.47	1.73	-1.93
Mean	6.76	6.28	5.96	5.46	5.45	4.97	-1.78

As can be seen from this table, the level of the household saving rate varies greatly among the G7 countries, being relatively high in France, Germany, and Italy (8.22% to 13.66%), relatively low in Japan, Canada, and the United States (1.48% to 5.09%), and negative (-0.05% to -4.27%) in the United Kingdom in all years but one (2003, when it was 0.43%). More importantly, the G7 countries also show substantial variation in the net change in the household saving rate during the 2002-07 period, with only Germany showing an increase (0.87 percentage points), Canada, Japan, France, and the United States showing relatively moderate declines (-0.96, -1.31, and -1.93 percentage points, respectively), and Italy and the United States showing relatively sharp declines (-3.14 and -4.21 percentage points, respectively).

The relatively sharp declines in the household saving rates of Italy and the United Kingdom can explain why private consumption growth rates exceeded household income growth rates in Italy and the United Kingdom (1.05% vs. 0.51% in Italy and 2.44% vs. 1.14% in the United Kingdom). Thus, trends in household saving rates can explain the divergence between private consumption growth rates and household income growth rates in some cases.

This factor was not so important in Japan because the decline in its household saving rate was not so sharp (-1.31 percentage points), as a result of which its private consumption growth rate was only slightly (0.30 percentage points) higher than its household income growth rate during the 2002-07 period. To put it another way, one reason for the stagnation of consumption in Japan during the 2002-07 period is the fact that household saving rates declined only moderately during this period, due perhaps to increased pessimism about the future.

(4) Household Wealth

Private consumption growth will also be influenced by changes in household wealth, with increases (decreases) in household wealth due to capital gains (losses) on equities, land, and other assets causing private consumption to increase (decrease) by more than would be expected by GDP growth, household income growth, and trends in household saving rates.

Thus, Table 3 shows data on the ratio of net household wealth to net household disposable

income in 2002 and 2007 and the net change in net household wealth during the 2002-07 period as a ratio of net household disposable income in the G7 countries, and, as can be seen from this table, household wealth increased sharply in France (by 235.0% of household income) and the United Kingdom (by 185.2% of household income), moderately in Italy (by 109.5% of household income), the United States (by 101.4% of household income), and Germany (by 94.0% of household income), and least sharply in Canada (35.8% of household income) and Japan (by 15.9% of household income).

Table 3: Ratio of Net Household Wealth to Household Income			
	2002	2007	Change, 2002-07
Canada	5.127	5.485	0.358
France	5.713	8.063	2.350
Germany	5.336	6.276	0.940
Italy	7.475	8.570	1.095
Japan	7.194	7.353	0.159
U.K.	7.156	9.008	1.852
U.S.	5.143	6.157	1.014
Mean	6.163	7.273	1.110

Thus, the sharp increase in household wealth in the United Kingdom (by 185.2% of net household disposable income) during the 2002-07 period can explain the strong private consumption growth in the United Kingdom (2.44%), and in particular, why the average annual private consumption growth rate during the 2002-07 period was much higher than the average annual household income growth rate during the same period (2.44 vs. 1.14%).

By contrast, the stagnation of household wealth in Japan (it increased by only 15.9% of household disposable income during the 2002-07 period) can explain why private consumption growth was relatively weak during this same period (1.30%).

(5) Conclusion concerning the Determinants of Private Consumption Growth

In this section, we showed that private consumption growth is determined by trends in GDP growth, household income growth, household saving rates, and household wealth but that the relative importance of these factors differs greatly from country to country.

For example, in the case of Japan, we found that the stagnation of consumption during the 2002-07 period was due primarily to the stagnation of household income (which was much more stagnant than GDP) and due partly to the relative stability of household saving rates, which was presumably due in large part to increased pessimism about the future, and the sharp decline in household wealth.

Similarly, private consumption was the most stagnant in Germany due primarily to the stagnation of household income (which was much more stagnant than GDP) and due partly to a moderate increase in its household saving rate.

France showed an intermediate growth rate of private consumption because its household income growth rate was also intermediate, but its private consumption growth rate was somewhat

higher than its household income growth rate, presumably because France showed by far the largest increase in household wealth.

By contrast, the strong growth of private consumption in Canada and the United States was due primarily to the strong growth of household income (far in excess of GDP growth in the case of Canada) and due partly to moderate declines in their household saving rates.

The most interesting cases are those of Italy and the United Kingdom, which showed considerably higher growth rates of private consumption than of household incomes due in large part to the sharp decline in their household saving rates and (especially in the case of the United Kingdom) sharp increases in household wealth.

3. Summary and Policy Implications

In this paper, we found that there has been significant variability among the G7 countries not only in their private consumption growth rates but also in the determinants of private consumption growth during the 2002-07 period, with the relative importance of GDP growth, household income growth, household saving rates, and household wealth varying from country to country.

With respect to Japan, we found that private consumption has been relatively stagnant during the 2002-07 period and that the stagnation of private consumption has been due primarily to the stagnation of household income and due partly to the relatively stability of its household saving rate and the sharp decline in household wealth.

This suggests that the best way of stimulating private consumption and of bringing about a recovery of the Japanese economy as a whole would be to boost household incomes. Possible ways of doing this would be to increase wages, create more job opportunities (especially for young workers, whose unemployment rates are still very high), provide more opportunities for vocational training, increase the share of regular workers (whose share has been declining), and improve the wages and other benefits and working conditions of part-time and temporary workers (whose share has been increasing).

Finally, since we found that the stability of household saving rates is a contributing factor to the stagnation of private consumption in Japan, improving social safety nets and improving access to consumer credit would also boost private consumption by reducing precautionary saving (see Horioka and Yin (2010) for cross-country evidence on the impact of social safety nets and consumer credit on household saving and consumption).

The author hopes that these policy measures will be adopted as soon as possible so that private consumption as well as the Japanese economy as a whole can receive a boost, enabling it to extricate itself from two “lost decades” of stagnant growth and high unemployment.

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Data Sources

(For data on consumption, GDP, and net household disposable income, Table 1)

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