

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
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<http://www.jiia.or.jp/>

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ISBN978-4-8193-0211-1

Contents

Foreword	
Executive Summary	7
1. Pension System	
(1) The Role of the State in Managing the Cost of Aging in Asia-Pacific.....	19
<i>Prof. Mukul Asher</i>	
(2) Pension Issues in Japan: With a Special Focus on Coordination with Employment	27
<i>Prof. Noriyuki Takayama</i>	
2. Health Insurance System	
(1) Key Issues in Japanese Health Care	37
<i>Prof. Masako Ii</i>	
(2) Health System Reforms in the People's Republic of China: Progress and Further Challenges	49
<i>Dr. Hiroko Uchimura</i>	
(3) A Brief Review on Health Care Expenditure in the Past, Present, and Future in Japan	67
<i>Dr. Yoko Ibuka</i>	
3. Unemployment Insurance System	
(1) Unemployment Insurance in Vietnam: Design, Implementation, and Policy Issues	77
<i>Dr. Giang Thanh Long and Ms. Nguyen Thi Xuan Thuy</i>	
(2) What Makes Unemployment Insurance Funds Grow: China's Challenge to Stabilize Workers and the UI Fund	93
<i>Prof. Yukari Sawada</i>	
(3) Structural Changes in the Labor Market and Employment Insurance in Japan.....	111
<i>Prof. Naoki Mitani</i>	
(4) Varieties of Labor Market and Social Security in East Asia: Tackling the Barrier of Informal Employment	129
<i>Mr. Yasuhiro Kamimura</i>	
4. Macro Analysis	
(1) Exploding Welfare Claims in Japan: A New Look through Long-Term Time Series Data.....	153
<i>Prof. Wataru Suzuki and Dr. Yanfei Zhou</i>	
(2) Recent Trends in Consumption in Japan and the Other G7 Countries	171
<i>Prof. Charles Yuji Horioka</i>	

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 (JIIA). 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.