

### **3. Unemployment Insurance System**



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

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## **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	
<b>Total</b>	<b>1343.6</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>56.1</b>
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
<b>Urban</b>	<b>576.8</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>54.2</b>
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
<b>Rural</b>	<b>766.7</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>59.8</b>
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
<b>Whole country</b>	<b>2.88</b>	<b>4.29</b>	<b>2.30</b>	<b>3.90</b>	<b>4.73</b>
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
<b>Total</b>	<b>2.88</b>	<b>4.29</b>	<b>2.30</b>	<b>3.90</b>	<b>4.73</b>
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
<b>Total</b>	<b>2.88</b>	<b>4.29</b>	<b>2.30</b>	<b>3.90</b>	<b>4.73</b>
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

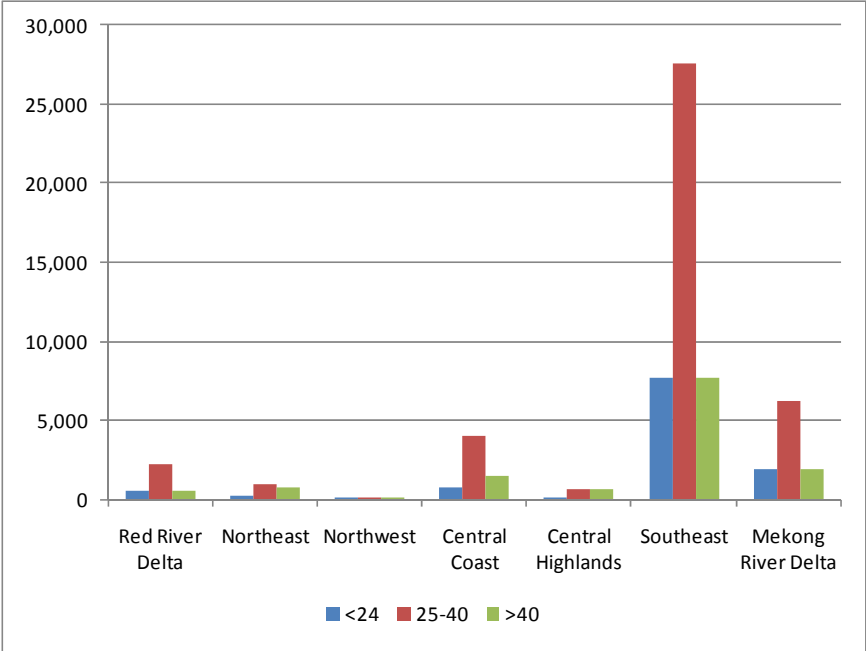
As mentioned above, the UI scheme in Vietnam has been in place since 1 January 2009. Up to December 2010, there were 7.1 million people joining the UI scheme, which accounted for merely 14% of the total labor force, and 75% of the total mandatory insured. In comparison with 2009, it was an increase by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

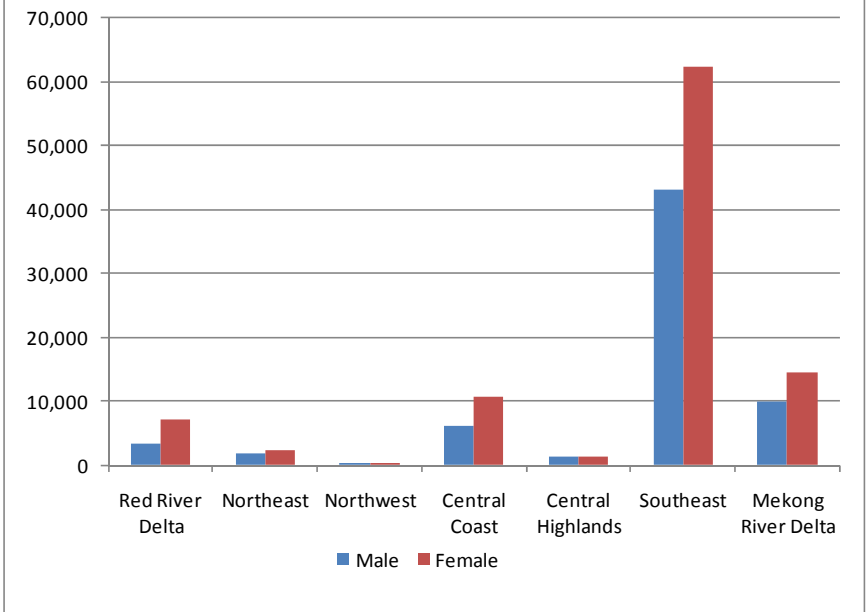
Figure 1: Number of beneficiaries by region and age, 2010



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.

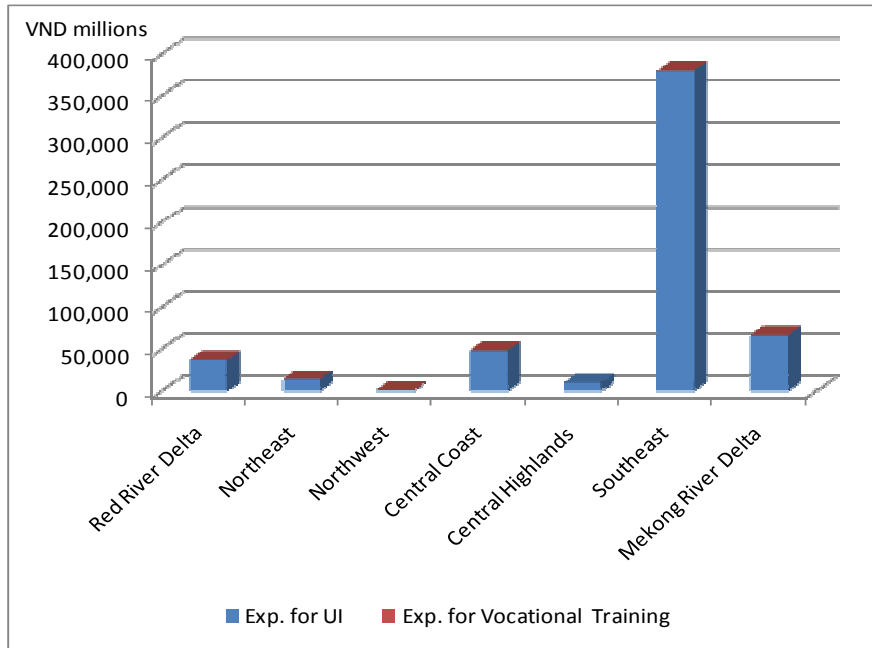
Figure 2: Number of beneficiaries by region and sex, 2010



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 16<sup>th</sup> 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
<b>Total</b>	<b>100.0</b>	<b>37.9</b>	<b>5.4</b>	<b>49.1</b>	<b>0.5</b>	<b>4.8</b>	<b>1.3</b>	<b>1.1</b>
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.

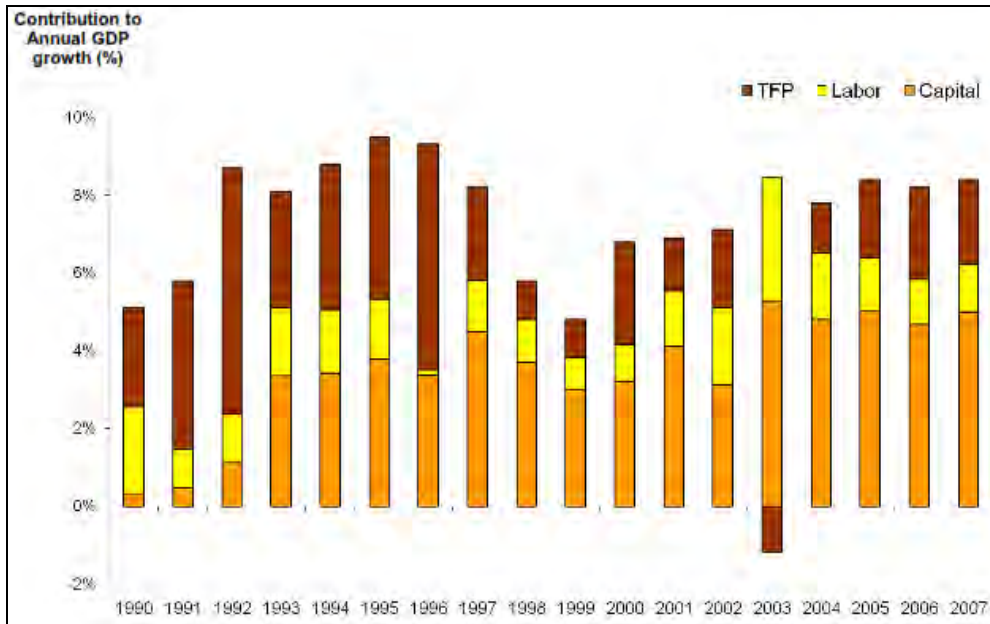
Table 6: Impacts of economic slowdown on employment, 2009

	$G_{1T}$ (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 (thousan d people)	Impact for 2010: L1 - L0 (thousan d people)
<b><i>Agriculture, Forestry, Fishery</i></b>			<b>23,440</b>	<b>23,262</b>	<b>23,592</b>	<b>23,550</b>	<b>152</b>	<b>288</b>
Agriculture, Forestry	0.86	-0.412	21677	21417	21873	21796	196	379
Fishery	3.71	0.551	1763	1845	1719	1754	-44	-91
<b><i>Industry and Construction</i></b>			<b>10,026</b>	<b>10,711</b>	<b>9,603</b>	<b>9,873</b>	<b>-423</b>	<b>-838</b>
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
<b><i>Services</i></b>			<b>12,680</b>	<b>13,398</b>	<b>12,432</b>	<b>12,983</b>	<b>-248</b>	<b>-415</b>
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)

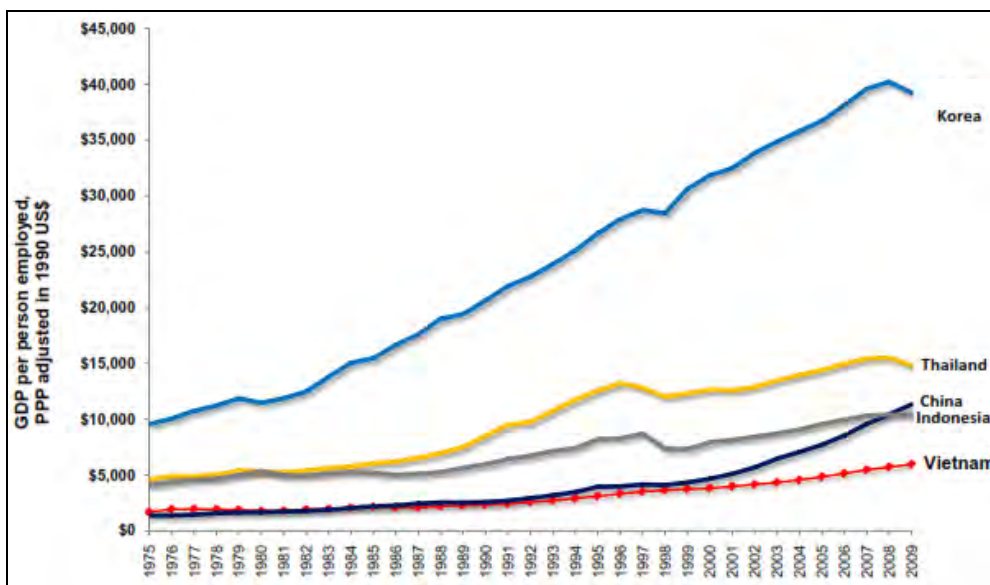
Fourth, for the long-term challenges of employment/unemployment in Vietnam, it is critical that both the contribution of total factor productivity (TFP) to economic growth (Figure 5) and improvement in labor productivity (Figure 6) have been low. In comparison with other regional countries, Vietnam has 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

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## 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.

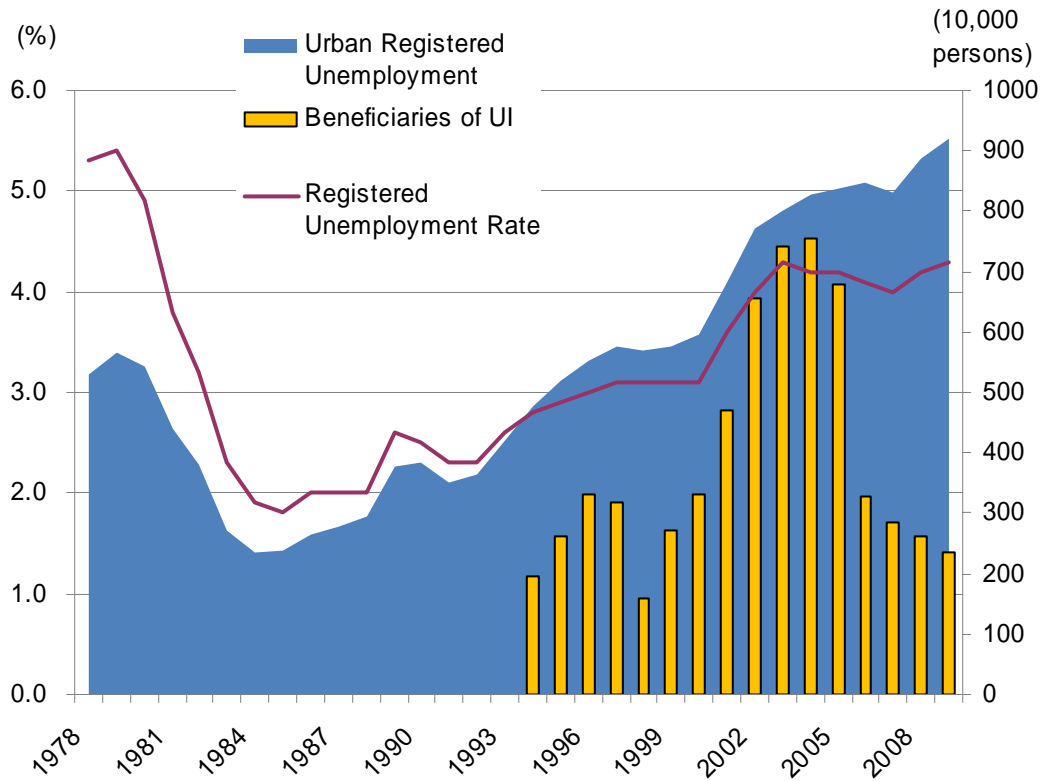
We must keep in mind that China's official unemployment rate only shows local urban workers registered as unemployed. It does not include two groups of job seekers in the labor market: One is rural workers who migrated to urban areas seeking jobs and the other is new graduates from high schools and colleges 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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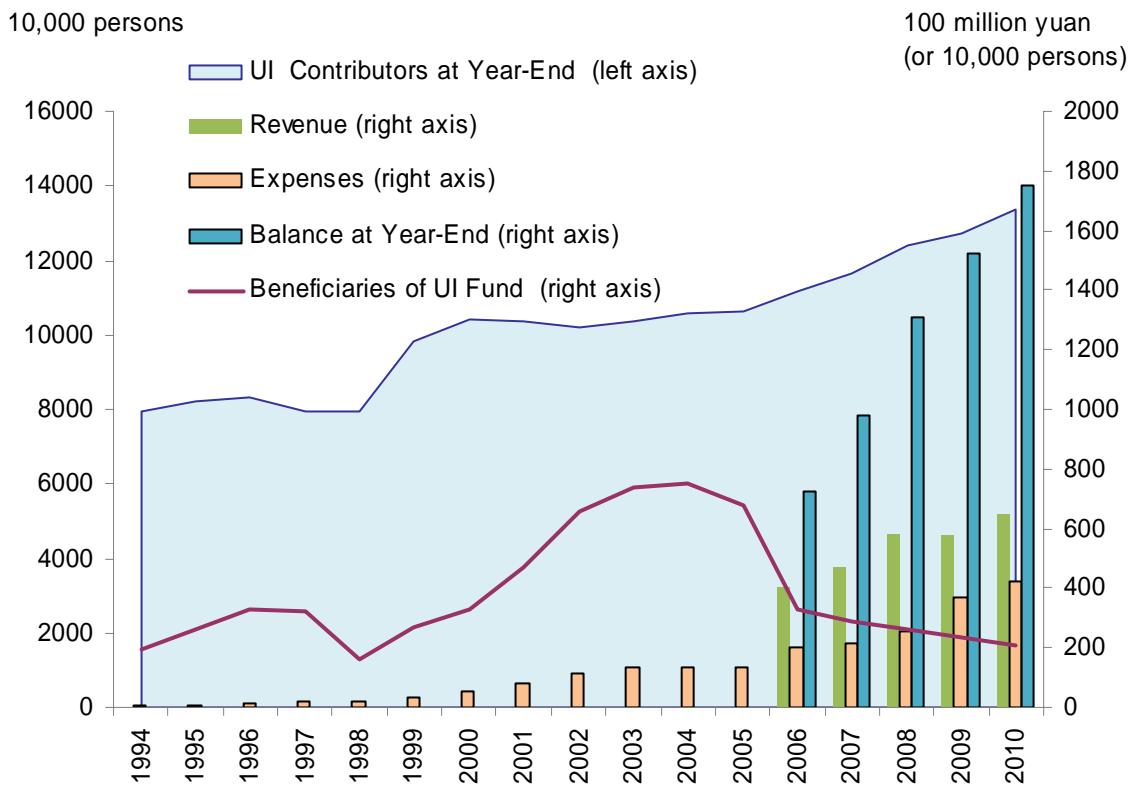
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Figure 1. Urban Registered Unemployment, Unemployment Rate and Beneficiaries at the Year End



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 &amp; 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 (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, Shandong 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 Shandong, 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 Japan<sup>1</sup>

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 2008-2009<sup>2</sup> 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%)<sup>3</sup>. 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

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<sup>1</sup> This paper was prepared for the PECC Social Resilience Project 2011.

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<sup>2</sup> Mitani (2010).

<sup>3</sup> Duell et al. (2010).

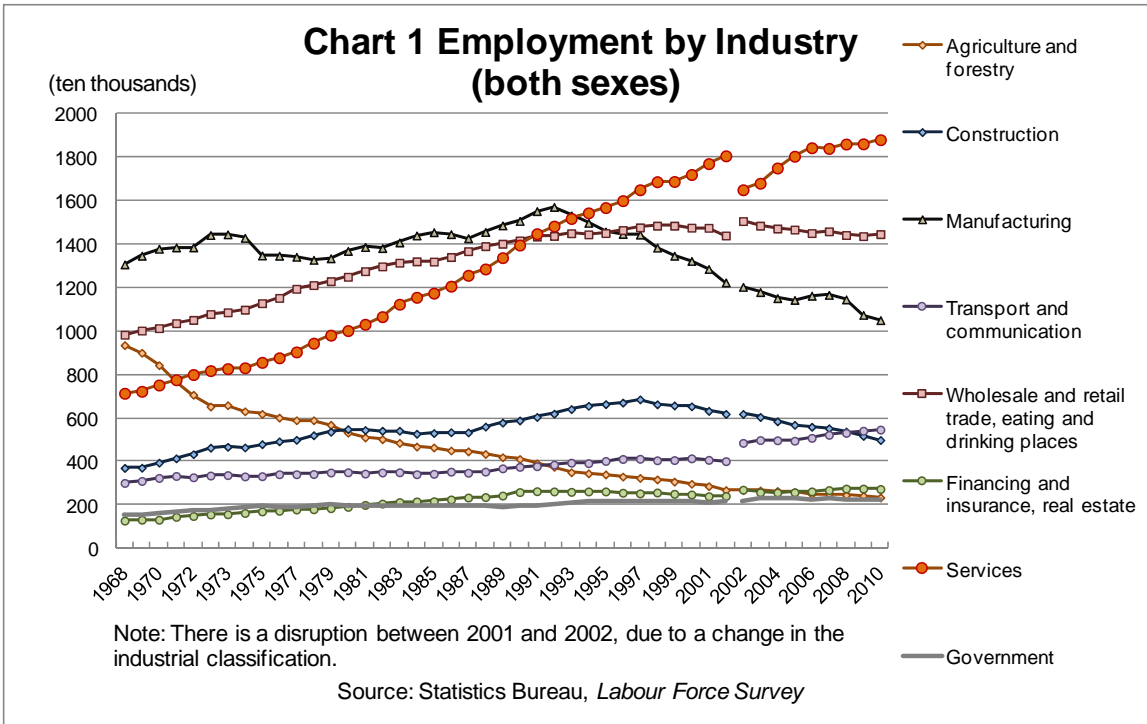
EI to the growing number of non-standard employees. Section 7 summarizes EI reforms recommended by researchers and officers. The final section is the conclusion.

**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.

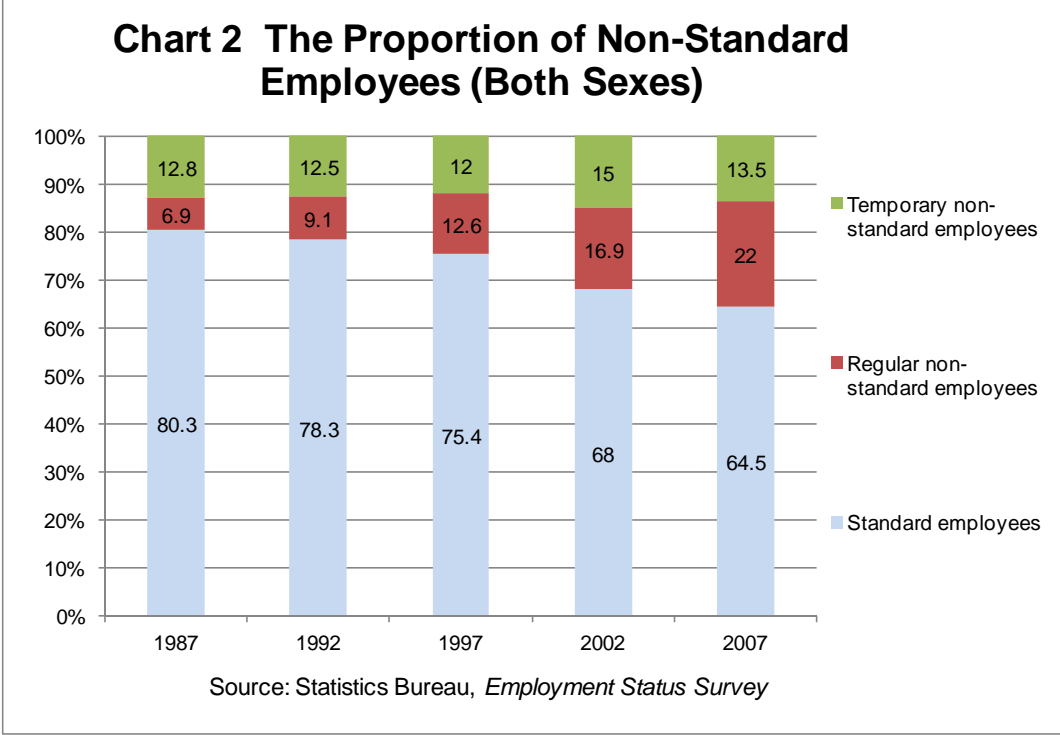
On the demand side of the labor market, the employment structure has greatly changed, largely due to the globalization of the economy and technological changes such as information and communication technologies (ICT).

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)<sup>4</sup>. 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.

<sup>4</sup> 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.

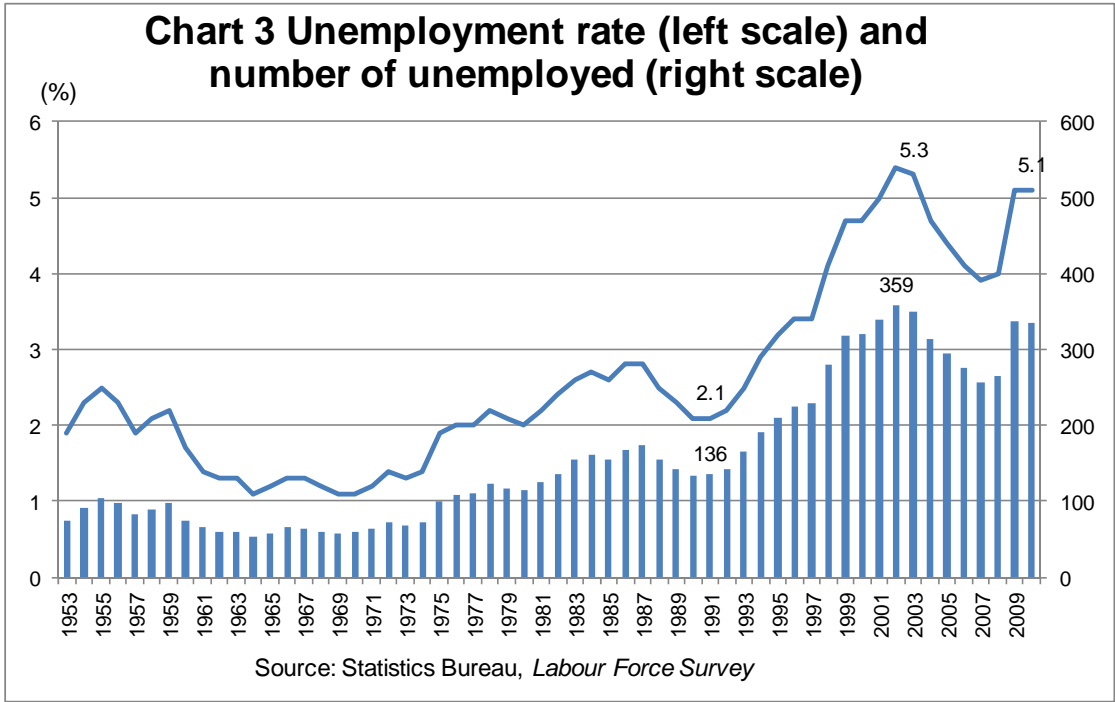
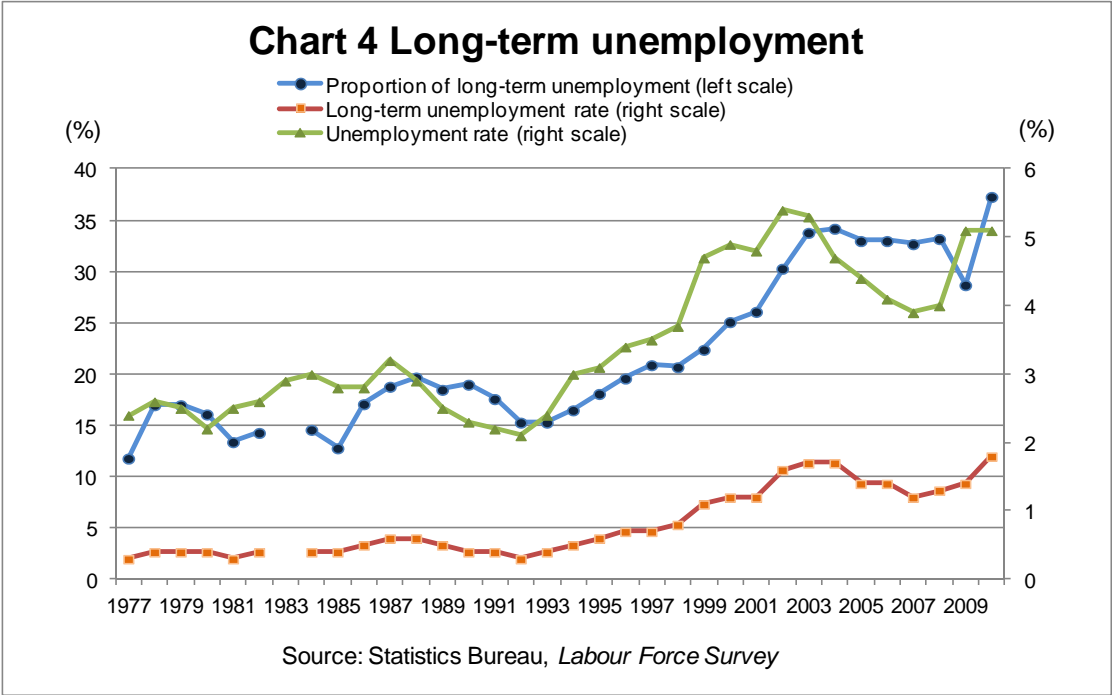


Chart 4 shows the incidence of long-term unemployment (one year or over). It was between 15% and 20% in the 1980s, but after the bubble burst, it rose rapidly to 33.8% in 2003 and continued to be high. After the financial crisis, it dropped temporarily but rose again to 37.3% in 2010. The long-term unemployment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



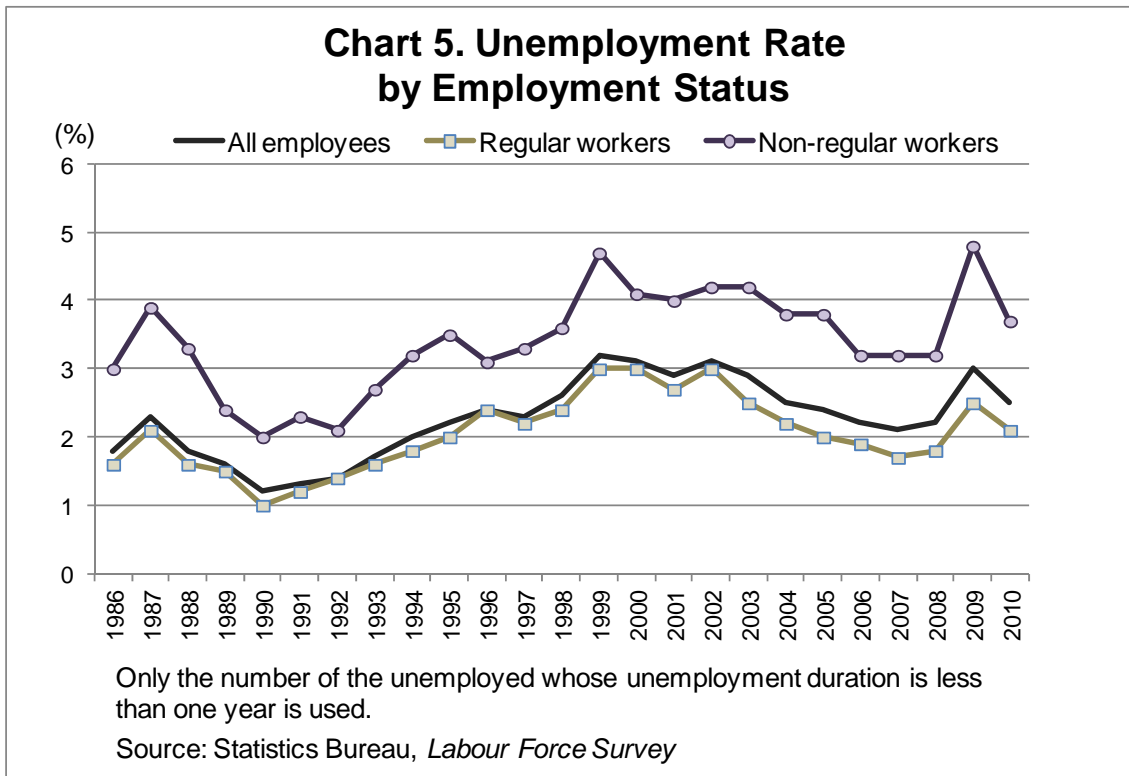
2004 is mainly accounted for by the increase in long-term unemployment among youths and high-school graduates. The incidence of long-term unemployment is higher among those who lost their jobs because of bankruptcy or dismissal.<sup>5</sup>



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).

<sup>5</sup> 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 follows<sup>6</sup>.

(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

<sup>6</sup> 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 OECD<sup>7</sup>, 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

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<sup>7</sup> 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 of months
					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)

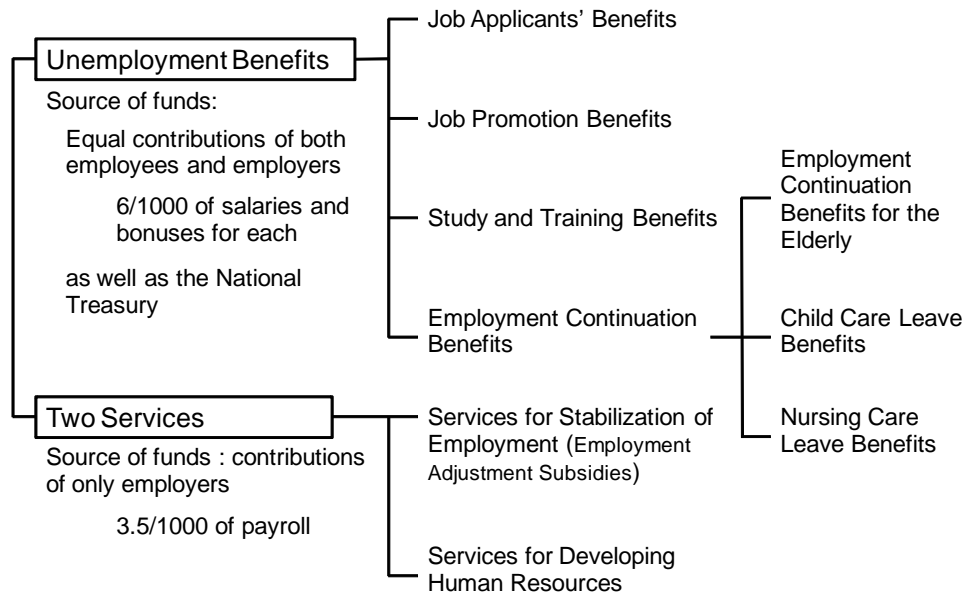
#### 4. Institutional Aspects of the Current Employment Insurance

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)

Insured period (years)	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> )	
Age (years old)	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)<sup>8</sup>:

- If  $2\,080 \leq \text{DAW} < 4\,100$ :  $\text{BR} = 0.8 \cdot \text{DAW}$ ;
- If  $4\,100 \leq \text{DAW} < 11\,870$ :  $\text{BR} = 0.8 - 0.3 \cdot (\text{DAW} - 4\,100) / (11\,870 - 4\,100)$ ;
- If  $11\,870 \leq \text{DAW} < \text{Maximum Amount}$ :  $\text{BR} = 0.5 \cdot \text{DAW}$ ; and
- If  $\text{DAW} < 2\,080$ , the daily amount is fixed at  $2\,080 \cdot 0.8$ , and if  $\text{DAW} \geq \text{Maximum Amount}$ , it is fixed at  $\text{Maximum Amount} \cdot 0.5$ . 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 ( $\text{BR} = 0.8 \cdot \text{DAW}$ ) 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  $15\,130 \cdot 0.45 = 6\,808.5$ , slightly below the maximum benefit amount for workers aged 45-59.

<sup>8</sup> 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 workers<sup>9</sup>.

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<sup>9</sup> 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.<sup>10</sup>

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.<sup>11</sup>

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

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<sup>10</sup> Duell et al. (2010).

<sup>11</sup> 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
<b>Median</b>	<b>52</b>	<b>40</b>	<b>25</b>	<b>13</b>	<b>9</b>	<b>28</b>

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.<sup>12</sup>

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

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<sup>12</sup> 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 Employment<sup>1</sup>

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

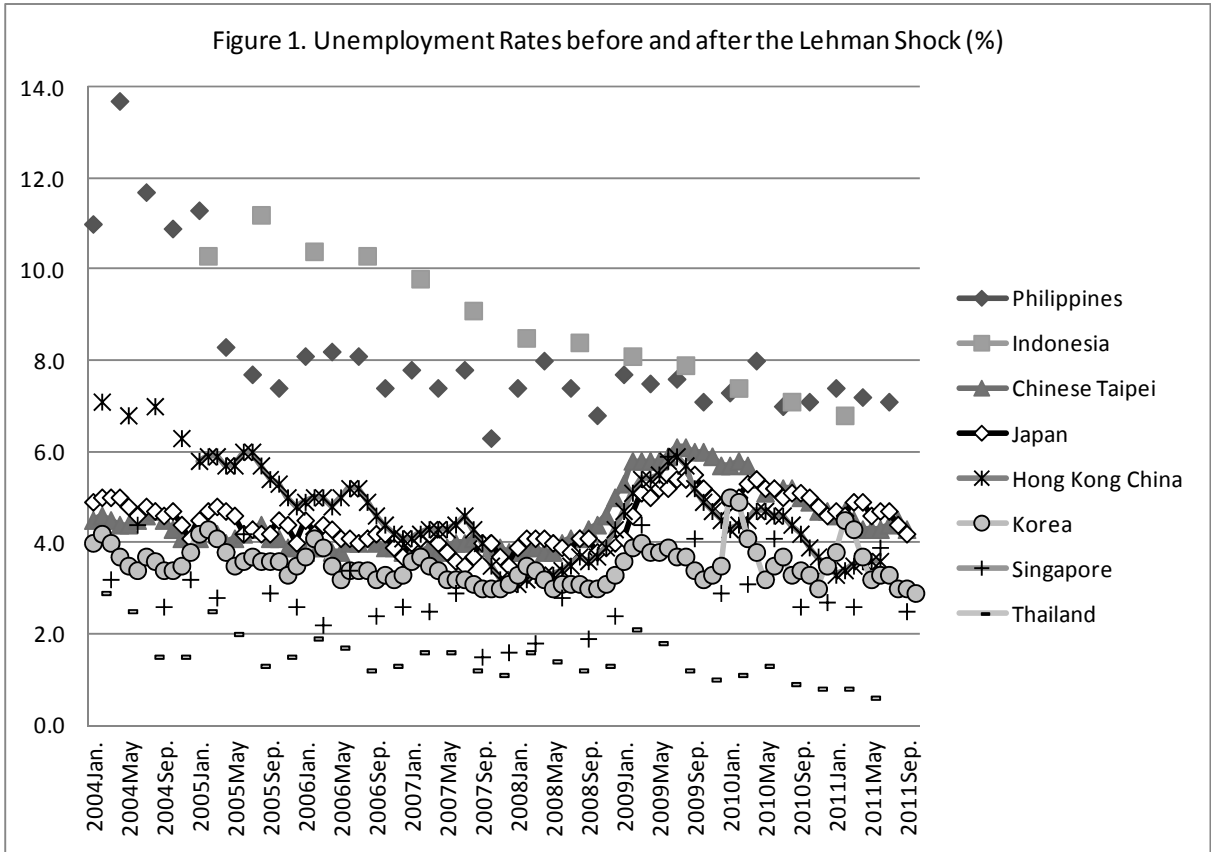
The various impacts caused by the Lehman shock that took place in September 2008 do not

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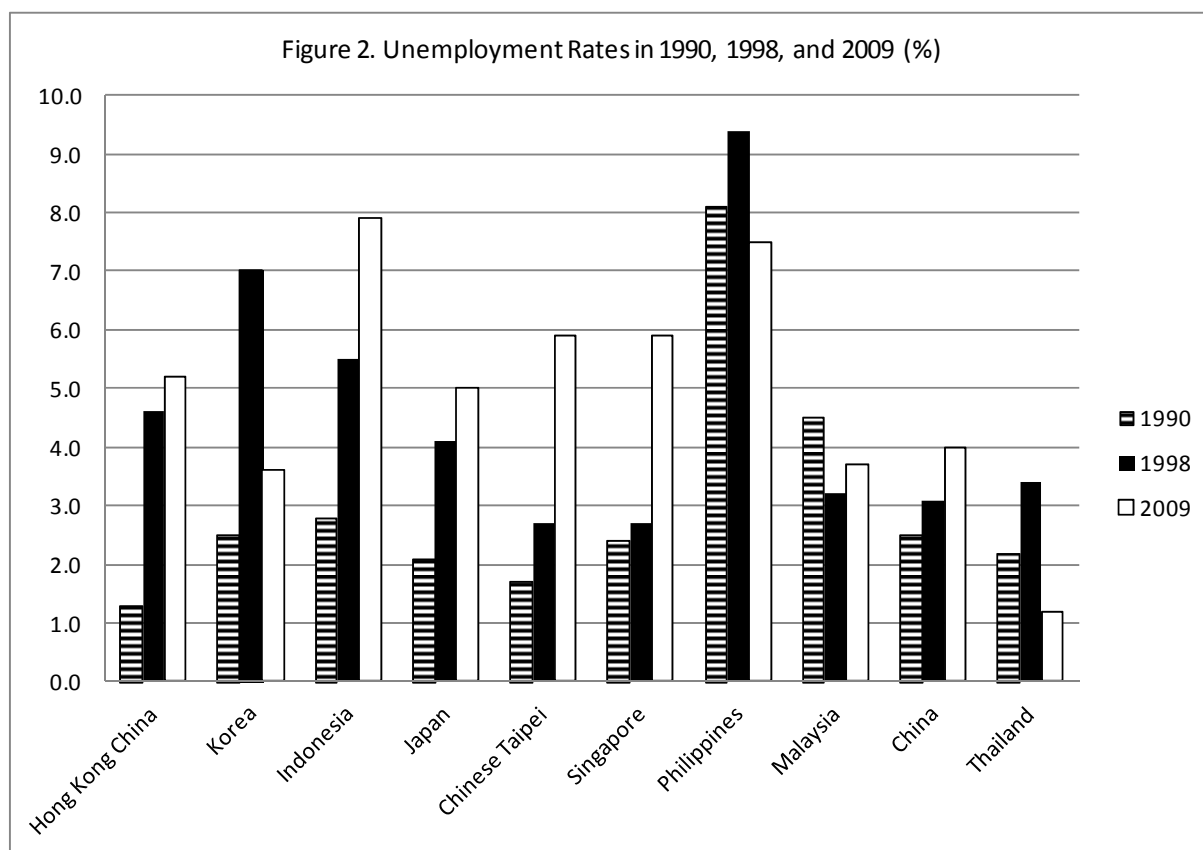
appear uniformly. Figure 1 charts the monthly unemployment rates for several East Asian economies before and after the shock.



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

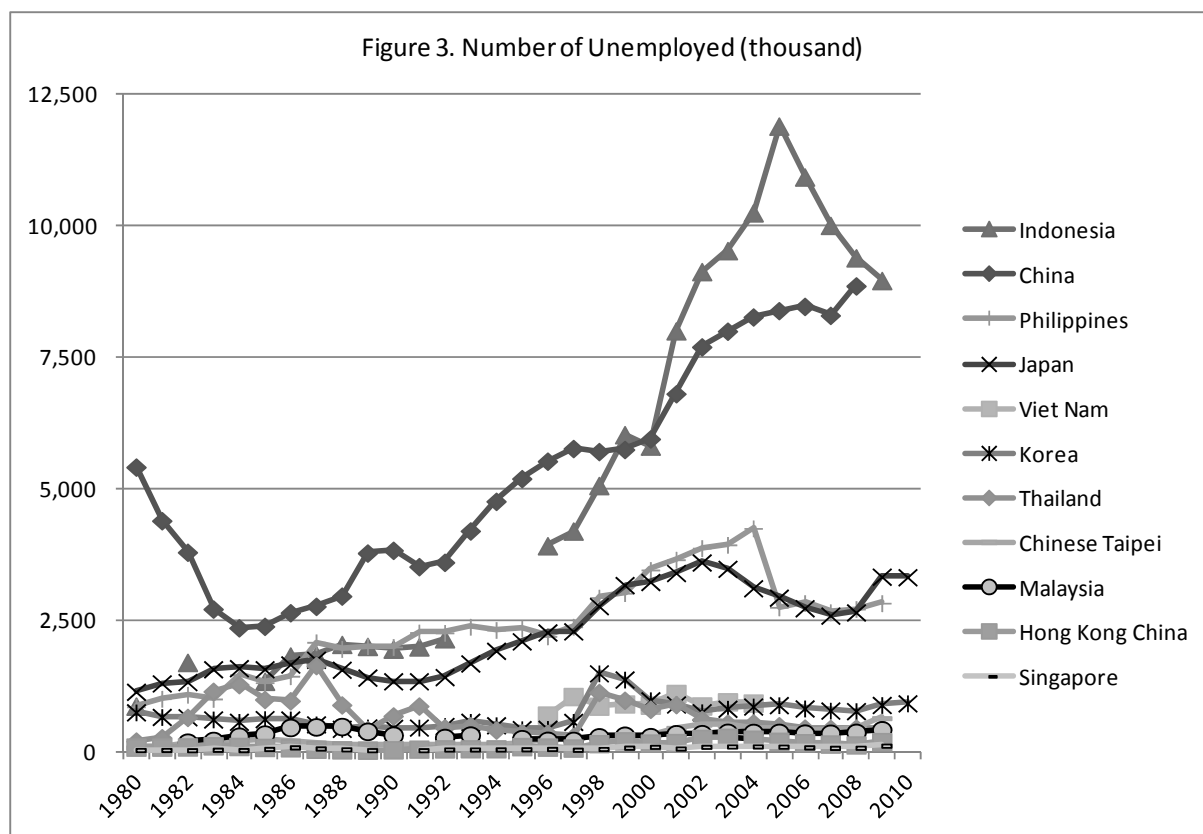
There was an apparent increase in unemployment after the Lehman shock only in Japan, Chinese Taipei, Hong Kong China, and Singapore—all of which have wage employment-centered labor markets. As for Indonesia, Thailand, and the Philippines, where self-employment is dominant, there were no short-term impacts.





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.

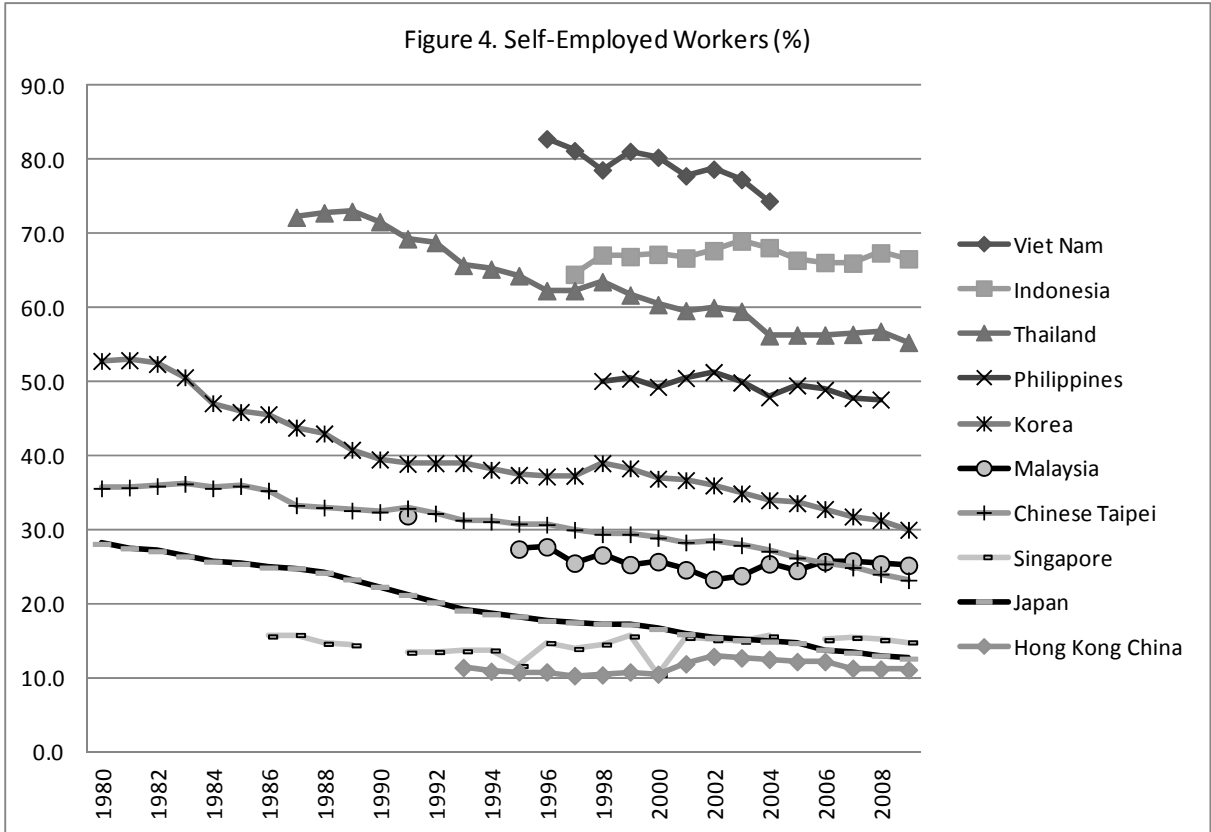
The third point implies the fact that the existence of unemployment insurance itself enables the status of unemployment, allowing the maintenance of the improvement of the skills of the unemployed. In an economy without unemployment insurance, a low unemployment rate does not automatically equate to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

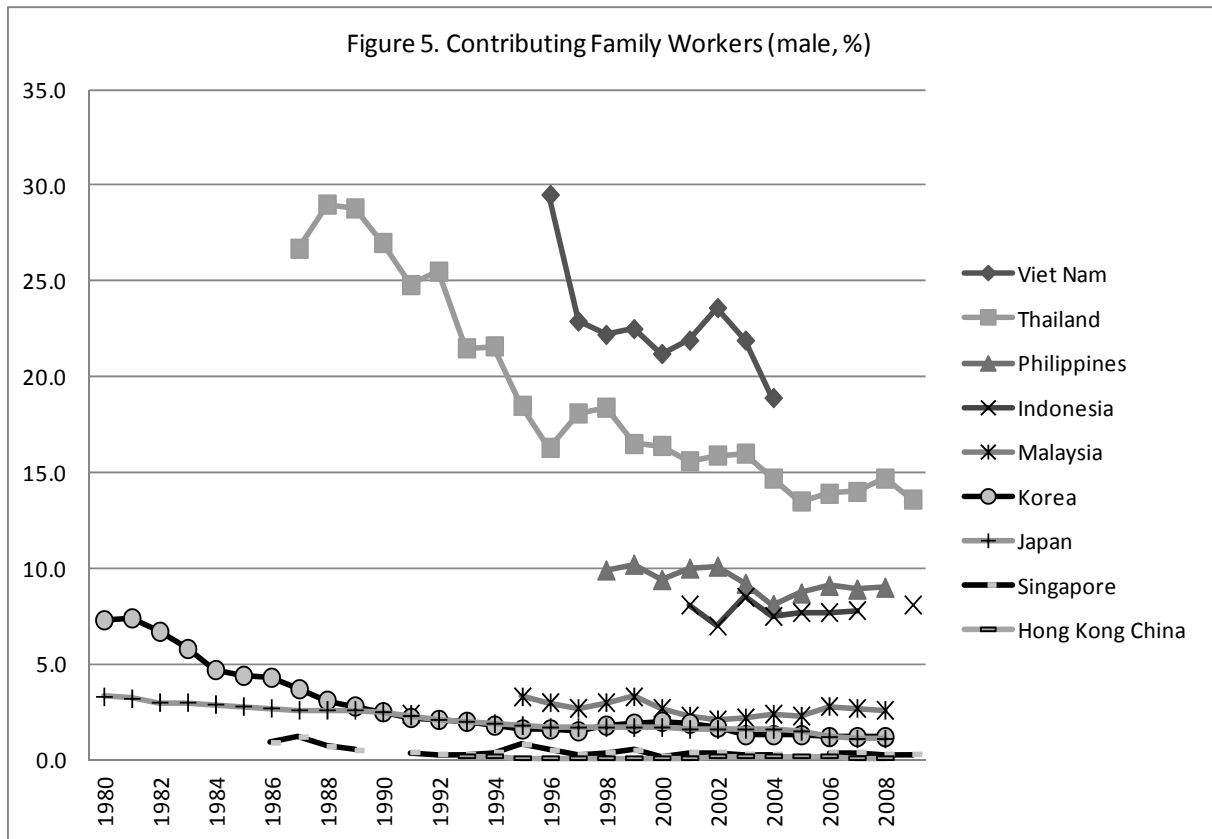
Although, as it will be explained later, self-employment is not equal to informal employment, the two categories do have a connection with each other. In a self-employment-centered labor market, the ratio of informal employment is high. The decline of

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



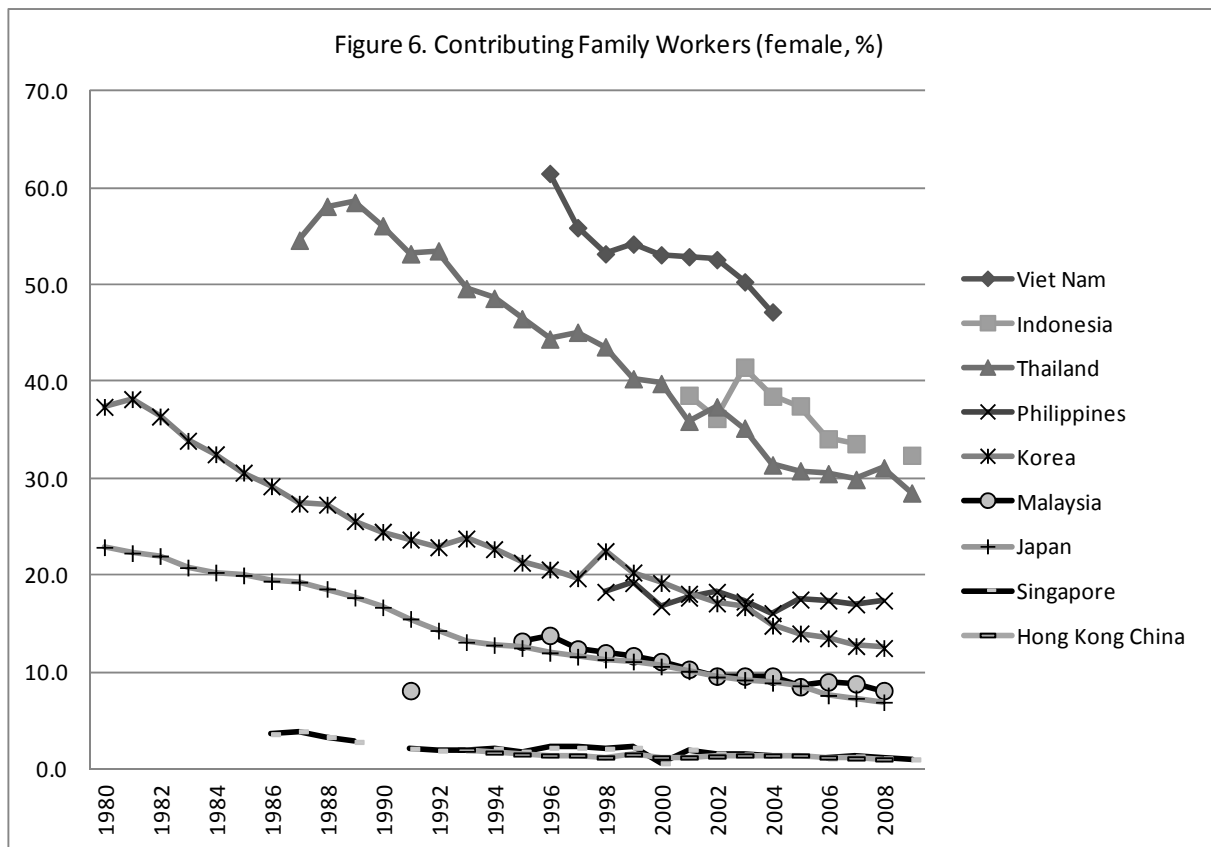
Data Source: ILO, *Key Indicators of the Labour Market*.

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.



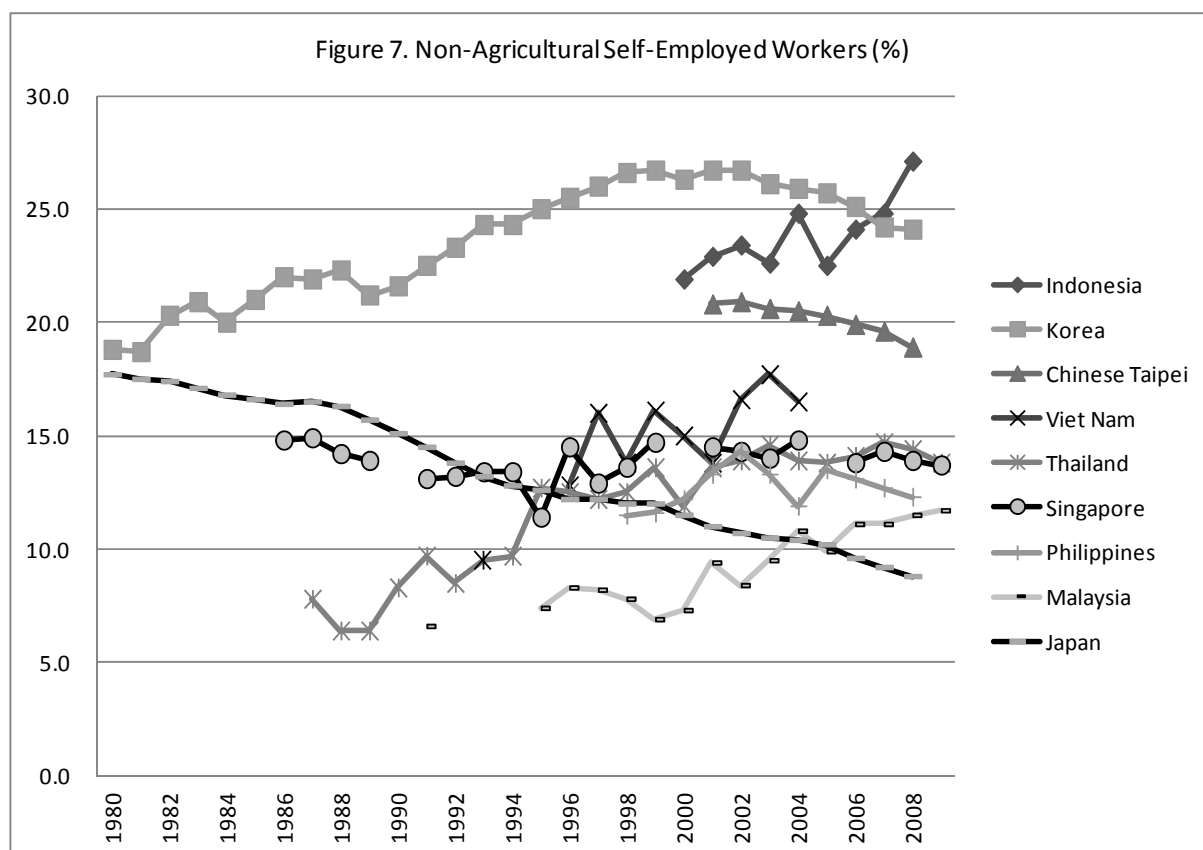
Data Source: ILO, *Key Indicators of the Labour Market*.

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.

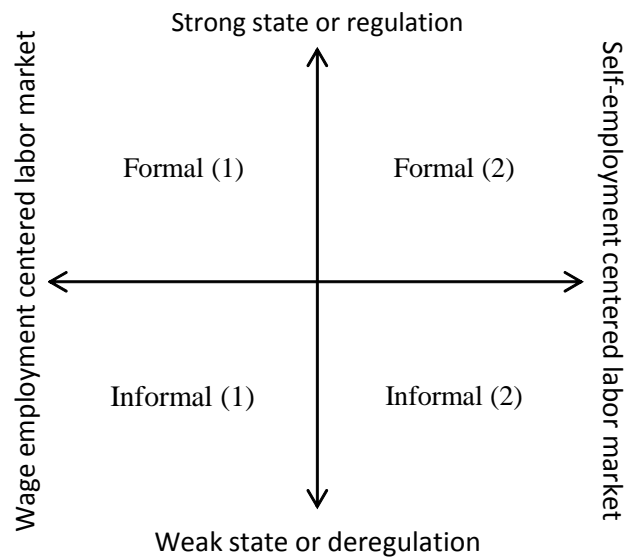
### **3. Social Security and Informal Employment**

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.

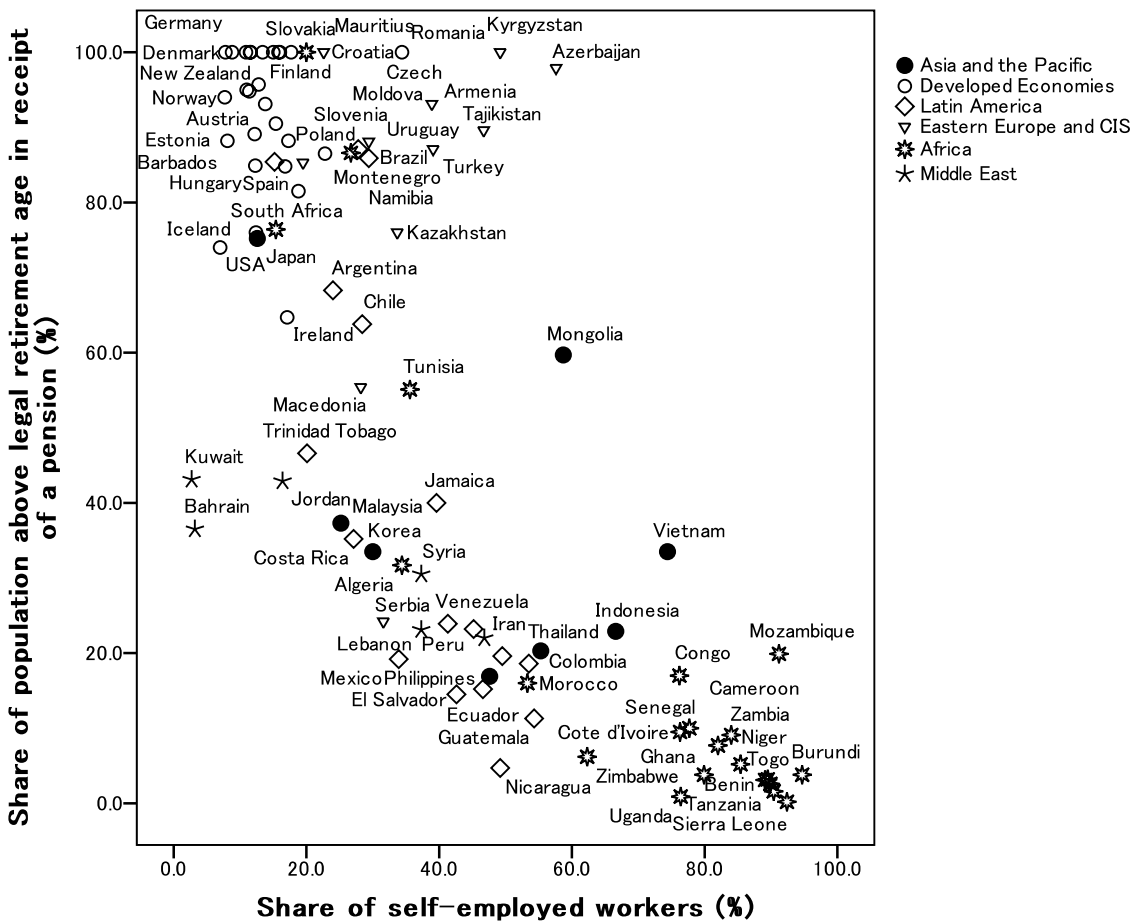
Second, as mentioned later, in reality, there are only a few cases that fit into the Formal (2) type. Most developing economies are located in Informal (2). On the other hand, in a case where a shift toward Informal (1) occurs due to economic development, it is recommendable to introduce a Western-style 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.

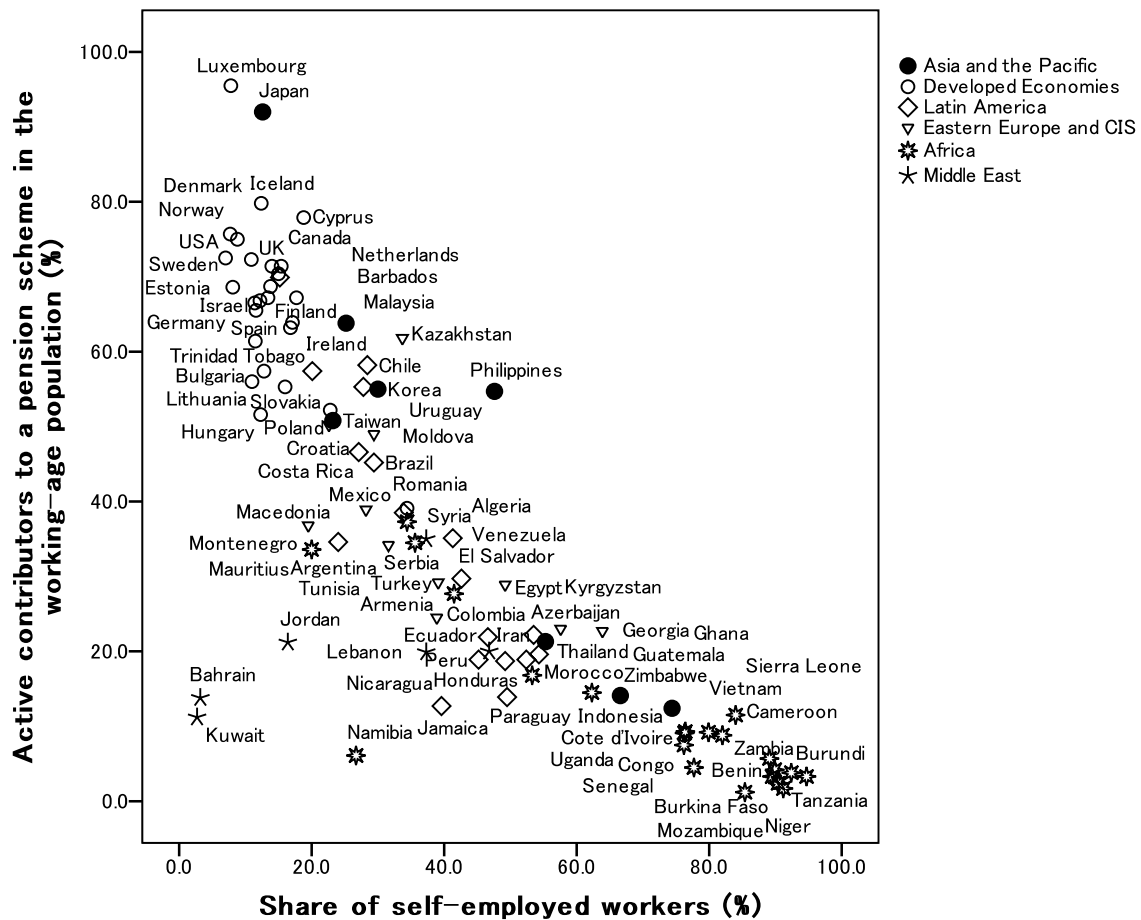
Figure 9. Effective Coverage of Pensions



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.

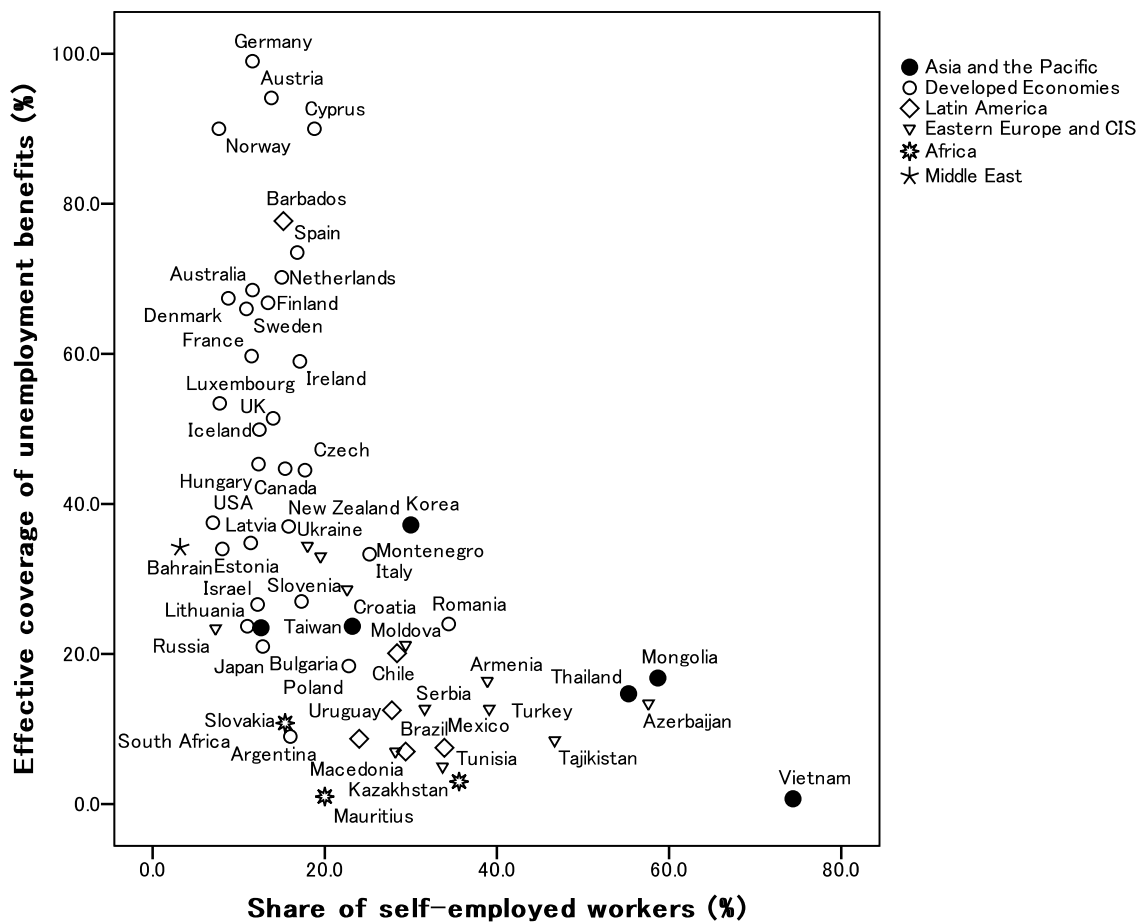
Figure 10. Legal Coverage of Pensions



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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