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NIRA Report

The Market or Welfare? – Reconsidering the Alternatives

Socialization of Risk as the Way Forward for the Japanese Economy

【Executive Summary】

(General Overview)

The almost continuous stagnation of the Japanese economy for the past two decades has had a negative impact on Japanese households from at least three perspectives: A decline in the standard of living, an increase in risks and uncertainties in relation to livelihood, employment, old age, etc., and an increase in income inequality. The majority of economists and policymakers focus their attention on the increase in income inequality. The research discussed here, however, focused on the increase in risk and uncertainty among households and individuals. Based on this research, the authors propose a shift to a policy regime centering on the socialization of risk, involving the design of a system that will make possible a transition from a society in which individuals bear excessive risks to one in which risk is shared equitably by society as a whole.

The deficiency of Japan's policy regime

In terms of response to risk, the policy regimes of advanced nations can be divided into the following categories:

A) Policy regimes that emphasize income redistribution via market mechanisms - "Liberal" regimes (the U.S., etc.)

B) Policy regimes that emphasize income redistribution by the state

The latter can be further divided into

B-1) Policy regimes that emphasize income redistribution via the tax system - "Social democratic" regimes (Sweden, etc.)

B-2) Policy regimes that emphasize income redistribution by mutual assistance within collectivist entities - "Conservative" regimes (France, etc.)

In the sense that mechanisms for income redistribution by the government are underdeveloped, Japan's policy regime displays the characteristics of a liberal regime, and its emphasis on mutual assistance within collectivist entities such as families and companies also gives it the characteristics of a conservative regime.

The main defect of Japan's policy regime is its incompleteness as either of these regimes. Considered as a liberal policy regime, provisions for risk sharing via market mechanisms are poorly developed; considered as a conservative policy regime, there is insufficient redistribution of income.

As a result, those individuals who do not belong to a family, company, or other collectivist entity that functions as a risk shelter are exposed to severe risks.

A new orientation for Japan - Transition to a synthesis of social democratic and liberal policy regimes

▪ Japan should move away from a "conservative" policy regime - There is a limit to the effectiveness of risk sharing via collectivist entities

The fact that domestic companies are paying excessive labor costs due to the imposition of strong employment guarantees, even as international competition intensifies, represents such a limit. Such a policy change will expand opportunities for growth to be achieved by embracing economic globalization.

▪The lesson to be learned from social democratic policy regimes - An emphasis on fairness

It is important that we build a society in which excessive risk is borne not just by certain vulnerable individuals but in which risk is rather shared equitably by males and females, by permanent and temporary workers, and by the young, middle-aged, and elderly.

▪The lesson to be learned from liberal policy regimes - An emphasis on efficiency

Rather than expecting companies to play an excessive role as risk shelters, Japan should attempt to increase competitiveness by means of deregulation, thereby reducing risk through increased economic growth.

Based on the above, this report suggests the following three policy pillars:

One: The realization of equitable socialization of risk by the government

The reconsideration of present income redistribution policies, which are skewed towards the elderly population, and the transition to a system in which risk is shared equally between all generations. The provision of benefits to those genuinely in need, based on the concept of targeting, and the elimination of discretionary administration of the system.

Two: The formulation of policies with maximal focus on market mechanisms, and at the same time, the provision of infrastructure to support competition in the market.

The implementation of policies such as deregulation, which emphasize efficiency and utilize market mechanisms, leading to enhanced corporate competitiveness. In addition, the establishment of provisions for risk sharing via financial markets and generous bankruptcy laws to enable companies and individuals to take risks.

Three: The elimination of blanket protections via employment regulations and the introduction of a system enabling individuals to choose their own mode of work

The creation of a society in which individuals are able to make decisions on their own, choosing combinations of risk and return that are suitable for them, rather than being protected by regulations. At the same time, the creation of an equitable society without discrimination due to gender, employment status, or age.

(Discussion)

Chapter 1: The Income Risks faced by Households

Japanese households, even younger households, face unfair income risks

Trends in income risk in Japan

Empirical analysis of the income risks faced by Japanese households found that the income risks faced by households in their thirties tended to be greater than those for households in their forties. The analysis indicated that income shocks tend to continue for a longer period for households in their thirties and that households facing a persistent income shock tend to mitigate risk by means of the dependent spouse seeking work. At a time when intergenerational disparities between working generations and retired generations in terms of the pension system, etc., are coming to be viewed as problematic, this analysis suggests that income risks are not shared equitably even among working generations.

Income disparities and income risks overseas: Current conditions and long-term trends

Recent empirical research has shown that income disparities and income risks have increased significantly in the past 30 years, in particular in the Anglo-Saxon nations. Policies to redistribute income by means of taxation, income transfers, etc., not only reduce the level of disparities but also help dampen the long-term increase in disparities and the increase in disparities due to the business cycle.

Chapter 2: Responses to Employment Risk – A Survey of Empirical Research

Excessive protection of employment represents an impediment – What is required is support for individuals to find employment during periods when the hiring rate is low

We surveyed the existing empirical research concerning employment risk, the primary factor in income risk.

The literature indicated that, in Europe and the U.S., strong employment regulations had resulted in longer periods of unemployment and had increased the rate of unemployment among young people more than that of older workers. In Japan, strong employment regulations have reduced the hiring rate. In addition, previous research for Japan showed that

1) Increasing the minimum wage could have the effect of eliminating employment opportunities among certain segments of the working population, in particular low-paid workers
2) Excessive unemployment benefits impede reemployment
3) Self-education and on-the-job training allowances do not necessarily result in increased wages

In addition, the worsening employment conditions among new graduates are increasing the rate of temporary employment and joblessness among the younger generation, and causing a decline in yearly income. In other words, young individuals are being exposed to risks in response to which they can make no defensive maneuvers, other than continuing their schooling.

In order to correct this intergenerational inequity, it will be necessary to provide support to enable the generation seeking employment during the current recession to find employment under conditions similar to those enjoyed by previous generations.

Chapter 3: Policy Responses to Risk in Other Countries

The effectiveness of the functioning of mechanisms to compensate for deficiencies in a specific policy regime is one important measure of a nation's policy regime. A comparison of mechanisms to compensate for deficiencies and of systems for the redistribution of income reveals Japan's problems.

Mechanisms to compensate for deficiencies in the policy regime

In countries with liberal policy regimes, the level of income redistribution by the government is extremely low, and individuals are therefore prone to be exposed to risk. However, the use of financial products (loans, etc.) to share risk compensates for the deficiencies of the policy regime.

Countries with policy regimes that emphasize income redistribution policies experience the problem that a high level of benefits reduces the motivation to find work and lowers the labor supply. Sweden has adopted various measures to resolve these issues, including offering day care services in order to encourage the entry of women to the workforce.

The share of family allowances and unemployment benefits that tend to suppress employment is greater in France than Sweden, and it is possible that they actually suppress employment.

Japan's problem with regard to income redistribution policy

As indicated by measures including the Gini coefficient and the relative poverty rate, Japan can be considered deficient in terms of income redistribution by the government. However, Japan's income redistribution system is not in itself inferior to those of Sweden or France. Japan's problem is the high level of administrative discretion involved in the operation of its systems, as can be seen for example in the low take-up rate of the social assistance system.

Figure: Income redistribution by public expenditure for different generations (2005)