

Social Welfare in East Asia: Low Public Spending but Low Income Inequality?



“Light” welfare states were perceived by some as one source of East Asian economic dynamism. Didier Jacobs has examined the strengths of several East Asian social welfare systems and the challenges they face after the financial crisis.



Japan has a fully-fledged social welfare system. Yet her public spending on welfare is low compared to the United Kingdom, especially in sectors such as unemployment and child benefits, housing and personal social services.



South Korea and Taiwan have passed important legislation in the last decade to strengthen their social welfare systems. Their public expenditures are therefore bound to rise as their populations age, their old age pension schemes mature and their various social security benefits are progressively extended to marginal occupational groups. Hong Kong and Singapore’s public expenditures on welfare are even lower, mainly because their social security is largely privately financed.



On an income inequality scale, Japan ranks between most continental European countries and the United Kingdom, together with Korea and Taiwan. Income in Singapore and Hong Kong is even more unequally distributed than in the United Kingdom.



Public transfers contribute little to income equality in East Asian countries. On the other hand, work is more evenly distributed across households. By retaining workers who are not necessarily profitable, enterprises are playing a major welfare role that contributes to low income inequality without high public spending. Three-generation households play a similar role by pooling income between workers and economically inactive people, with women providing personal care for children and the elderly.



These forms of enterprise and family welfare are currently being challenged, which may result in increased income inequality. As the state is called upon to fill the gap, public spending is also likely to grow, as is illustrated by recent measures for the unemployed in Korea and investment in personal social services in Japan to tackle her acute ageing problem.

Further Information

A more detailed account of sources and methods can be found in CASEpaper 10, *East Asian Social Welfare: A Comparative Analysis Including Private Welfare*, by Didier Jacobs. Copies are available free of charge from Jane Dickson, CASE, at the address below, or can be downloaded from our internet site: <http://sticerd.lse.ac.uk/Case>.

The Welfare States of Five East Asian Countries

Japan, Korea and Taiwan have insurance-based social security systems that are fragmented along occupational lines (i.e., civil servants, employees and the self-employed each have their own schemes). While Japan has achieved universal coverage in health care and pensions a long time ago, Korea and Taiwan have passed legislation to that end during the last decade (i.e., health care in both countries, pensions in Korea) or are about to do so (i.e., pensions in Taiwan). Social insurance schemes also cover the risks of invalidity, disability, occupational injuries and unemployment in all three countries.

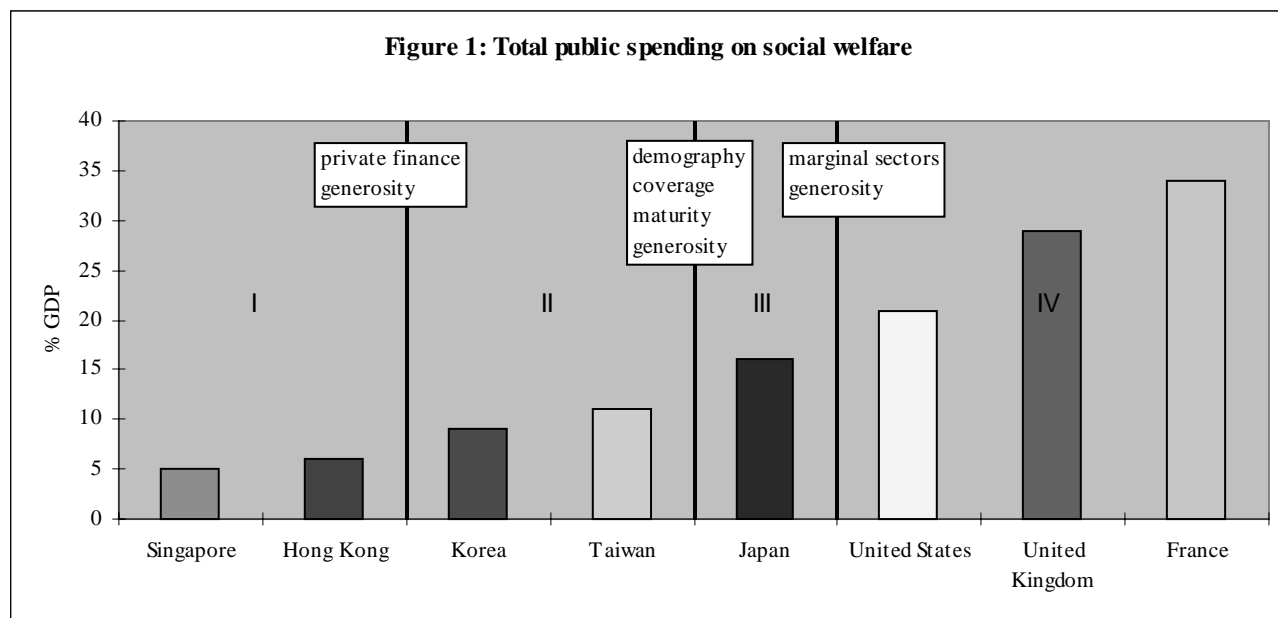
In Singapore, the pillar of social security is the Central Provident Fund (CPF). Employees must put money in individualised accounts, which they may withdraw upon retirement, disability or to pay for hospital bills or health insurance policies. In Hong Kong, a combination of mandatory severance pay, non-contributory and non-means-tested allowances and means-tested benefits cover the risks of old age and disability. In both countries, labour laws also enforce employers to pay minimum benefits in case of unemployment, sickness and occupational injuries.

Education and health care are provided by a mix of public and private facilities in all countries. Education is heavily subsidised by the state, although user fees are typically higher than in Western countries (which is matched by a higher willingness to pay for education, a Confucian heritage). Health care is almost free in public facilities in Hong Kong, but a large proportion of the population opts out to the private sector due to poor quality. The other countries partially subsidise health facilities but health care is mainly financed through insurance schemes or the CPF. A majority of people live in public housing in Hong Kong and Singapore, although user charges cover most of the costs. Japan, Korea and Taiwan intervene in the housing sector mainly through regulation, with limited subsidies and public housing.

The Sources of Low Public Spending on Welfare in East Asia

In Figure 1, East Asian and Western countries are divided into four groups according to their levels of public spending on welfare as a proportion of GDP (OECD definition). The differences in spending levels between each group can be explained by several factors:

- **Private finance:** Hong Kong and Singapore heavily rely upon privately financed social security instruments (i.e., provident fund and labour laws).
- **Generosity:** Some schemes have fairly low income replacement rates, such as Hong Kong and Taiwan's old age pensions. Korean and Taiwanese health insurance schemes also involve high user fees. Japanese benefits may be considered as less generous than those of some European countries.
- **Demography:** Young populations imply low needs in the retirement and health care sectors. While the proportion of the elderly is already as high in Japan as in many Western countries (and still growing faster), it is much lower in the other four countries.
- **Coverage:** Some occupational groups representing large numbers of people are not covered by any insurance for some social risks, especially in Korea but less so in Japan.
- **Maturity:** Spending on retirement pensions reflects past contributions, which are typically low for recently introduced schemes (e.g., Korea's National Pension Programme).
- **Marginal sectors:** 91% of Japan's total welfare spending is devoted to the three main sectors of education, health care and retirement pensions, compared to only 63% in the United Kingdom. In other words, spending on sectors such as unemployment and child benefits, housing and personal services are relatively low in Japan, as well as in the other East Asian countries.



Sources: OECD and national sources for non-OECD members (variations of up to 25% may exist between different sources).

Notes: Includes education, health care, social security, housing and personal social services. Various years (1990s)

The Sources of Income (In)equality in East Asia

There is some controversy about income distribution in Japan, due to the existence of two national surveys yielding quite different results. According to the least biased survey, Japan ranks between continental European countries and the United Kingdom, together with Taiwan and Korea (see Table 1). Hong Kong and Singapore are much more unequal societies.

Figure 2 highlights the main factors affecting the distribution of household disposable income and contrasts Japan, Korea and Taiwan with Western countries. On the one hand, the redistributive power of public transfers is weak in the East Asian countries. On the other hand, their distribution of household income before public transfers is relatively more equal. This is mainly due to the relatively even distribution of work across households. The ranking of Japan on a scale of individual earnings inequality is indeed almost the same as that of household disposable income presented in Table 1.

	Definition 1	Definition 2
Sweden	0.23	0.28
Germany	0.26	0.32
France	0.29	0.35
Taiwan	0.30	0.31
Japan	0.32	0.28
Korea	..	0.33
UK	0.34	0.39
USA	0.34	0.36
Hong Kong	..	0.39
Singapore	..	0.42

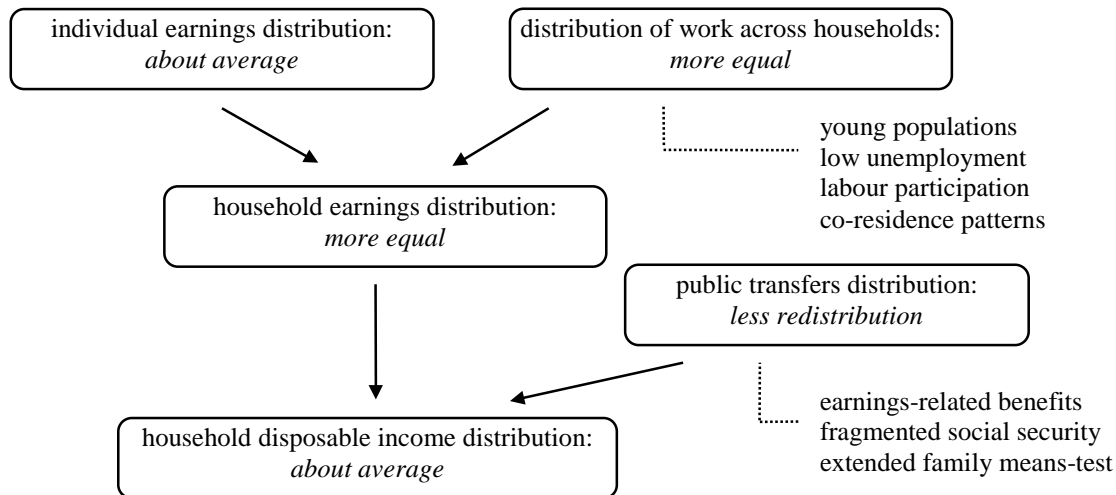
Sources: Luxembourg Income Study (definition 1) and national sources (definition 2). Japan: 2 different national sources.

Notes: In definition 1, income is equalised for household size, not in definition 2. Various years (1980s and 1990s).

Figure 2 also shows the major causes of those differences. Most social security schemes in Japan, Korea and Taiwan offer earnings-related benefits that involve very little redistribution between rich and poor. The fragmentation of social security between occupational groups also limits redistribution from high-earnings groups (e.g., employees of large enterprises) to low-earnings groups (e.g., farmers), despite the existence of limited transfers between schemes. The application of tests of means to extended families rather than households further limits the redistributive role of

the state. As to the distribution of work across households, it is more equal in East Asian countries because of the relatively low proportion of elderly people (except in Japan), the low unemployment rates, the high labour force participation rates of the elderly and the high proportion of elderly and youths living with their children and parents respectively.

Figure 2: Structure of household disposable income distribution in Japan, Korea and Taiwan compared to Western countries



The Importance of Enterprise and Family Welfare in East Asia and the Challenges they Face

It is not true that welfare benefits voluntarily paid by enterprises compensate for the relatively low public spending in Japan, because voluntary non-wage labour costs are about as high in many Western countries. However, Japanese (and to a lesser extent, Korean) enterprises do play a major welfare role by retaining workers who are not necessarily profitable, thanks to a wide variety of pro-active and reactive redeployment measures. Workers accept this flexibility in exchange for employment security. As shown in Figure 2, low unemployment contributes to low inequality without high public spending.

Three-generation families play a similar role in all East Asian countries by pooling income between workers and economically inactive people. Moreover, the relatively low financial commitment of the state in personal social services rests upon the assumption that women remain the major providers of personal care for children and the elderly at home.

However, these forms of enterprise and family welfare are currently being challenged. Japan is still in the midst of her longest recession since World War II and many observers believe that enterprises will not be able to avoid massive layoffs any longer. In Korea, the recent financial crisis has already boosted the unemployment rate to European levels. As to personal care, Japan is confronted by the vicious circle of three intertwined trends: family nuclearisation, rising female employment and falling fertility. The former two imply a decreased readiness of women to care for their parents or children, the latter accelerates the ageing of the population and increases the need for care. Those crises of family and enterprise welfare are likely to lead to increased public spending and income inequality.