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## The Role of Private Actors in Social Security

German-Japanese Social Law Symposium

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## Preface

In Germany as well as in Japan, demographic development and worries about the competitiveness of national economies seem to compel the state to limit welfare-state interventions. Probably, such reform efforts are also supported by a social change of values and attitudes. Although the situation can be traced back to debates that have taken place since the introduction of Bismarck's social legislation, the background and the current level of development are now different.

In so far as the financial bases of social insurance cannot be strengthened by growth effects or budget shifts, there are two ways to limit state involvement, i.e. relieve the state from tasks and/or from respective responsibilities. The first consists in a (partial) retreat of the state from guaranteeing social security. Such a retreat, however, cannot be carried out completely, not even in cases where social security is transferred to private actors. Any form of state retreat is likely to be accompanied by a far-reaching change of regulatory instruments and by the introduction of private and autonomous arrangements. The second method is a direct and indirect withdrawal of public authorities from carrying out duties, i.e. a continuous increase in the allocation of duties to private actors and thus limiting the state's role to supervisory and subsidiary interventions.

The actually intended distribution of tasks cannot be formulated in an abstract and normative manner. Rather, a legal and economic analysis is necessary to describe the distribution of responsibilities and their functional prerequisites. This in turn must be done with due regard for the complexity of social security, i.e. functionally equivalent systems and regulatory and/or steering instruments in force.

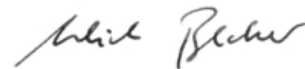
In this sense, the significance of private actors in guaranteeing social security and their integration in the performance of welfare-state duties was analyzed within the scope of the symposium.

The following compilation consists in revised and updated versions of the themes presented in association with the German-Japanese Social Law Symposium 2004, "*Die Rolle Privater für die Gewährleistung sozialer Sicherheit*" which took place on 18 and 19 November 2004 in Cologne, Germany.

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July 2005



Prof. Dr. Ulrich Becker

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# \*German Health and Long-Term Care Insurance – Legal Aspects –

*Ulrich BECKER*

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\* German original translated by Esther Ihle, MPI Sozial Law, Munich

## I. Introduction

The relationship between private and statutory – or more precisely – private and *social* insurance is a recurrent but unfailingly topical theme. In fact, it was already a topic of extensive deliberation in the days when German social insurance was first introduced, notably with a view to accident insurance.<sup>1</sup> A good 120 years later, these discussions have been resumed, now naturally in an altered setting – both in terms of the participating/existing institutions and the meanwhile gained experience. The pressure to reform is a result of the demographic trend<sup>2</sup> and social security systems' linkage to employment and, hence, to the labor market; indirectly, it is also the result of international competition. In the matter itself, a prime focus is on ways to relieve the state of its burden, especially in the field of old-age security.<sup>3</sup> And this demand is flanked by calls for strengthening the role of private insurance, thereby evoking the liberal conception of a societal order whereby social insurance is subject to the proviso of necessity.

Both aspects play an innate role in discussions about a fundamental restructuring of health insurance. Here especially, however, given the current mix of social and private insurance, they are enhanced by the question of who is to be included in what system, thus also asking among whom and in what way can, or must, a balancing of loads take place to ensure solidarity (so-called solidary equalization). That, at any rate, is one of the core issues of the currently discussed reform models,<sup>4</sup> which are being very roughly depicted and compared with each other in public under the headings of “citizens’ insurance” and “premium model”, without giving ample thought to the manifold differential options they embody. Both inevitably have to do with the roles that social and private health insurance are to be assigned in future. As for long-term care insurance, the situation is somewhat different insofar as, here, protection in the form of statutory insurance covering almost all persons was chosen from the outset, but was divided into social and private long-term care insurance.<sup>5</sup>

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1 For just one example, cf. *Vogel*, Bismarcks Arbeiterversicherung: ihre Entstehung im Kräftespiel der Zeit, 1951; with a particular regard to accident insurance, *Wickenhagen*, Geschichte der gewerblichen Unfallversicherung, 1980; *Köhler/Zacher* (Eds.), Ein Jahrhundert Sozialversicherung, 1981; *Ritter*, Der Sozialstaat, Entstehung und Entwicklung im internationalen Vergleich, 2nd ed. 1991; for a summary, *Peters*, Die Geschichte der sozialen Versicherung, 3rd ed. 1978, pp. 49 ff.; *Stolleis*, Geschichte des Sozialrechts in Deutschland, 2003, pp. 36 ff.; *Tennstedt*, Geschichte des Sozialrechts, in: v. *Maydell/Ruland* (Eds.), Sozialrechtshandbuch, 3rd ed. 2003, 2nd ed., in each case with substantiation.

2 For one recent example among many, *Becker*, Die alternde Gesellschaft – Recht im Wandel, JZ 2004, pp. 929 ff. with further substantiation.

3 Again, in the place of many, *Becker*, Private und betriebliche Altersvorsorge zwischen Sicherheit und Selbstverantwortung, JZ 2004, pp. 846 ff. with further substantiation.

4 Cf. Bericht der Kommission für die Nachhaltigkeit in der Finanzierung der Sozialen Sicherungssysteme (“Rürup-Kommission”) [Report of the Commission for the Sustainability of Social Security Funding], <http://www.soziale-sicherungssysteme.de/download/PDFs/Bericht.pdf>; report of the commission “Soziale Sicherheit” on the reform of social security systems, [http://www.cdu.de/tagesthema/30\\_09\\_03\\_soziale\\_sicherheit.pdf](http://www.cdu.de/tagesthema/30_09_03_soziale_sicherheit.pdf).

5 Pflegeversicherungsgesetz [Long-Term Care Insurance Act] of 26.5.1994 (BGBl. I, p. 1014).

Neither the past nor present relationship between social and private insurance has been free from ideological accentuation. That was already inherent in *Bismarck's* famous dictum warning about social security organized under private law: “anything but a private institution with dividends and bankruptcy”.<sup>6</sup> In the following, I have chosen to begin, not with an examination of legal policy issues, but with an overview of the respective roles of private schemes in health and long-term care insurance (II.). It is followed by a look at two aspects of particular significance to a comparison between both insurance forms: the insured's freedom of choice and the statutory provisions governing private insurance (III.). I conclude with a brief outlook (IV.).

## *II. Overview*

### *1. Health insurance*

#### *a) Underlying principle*

The present functional division between social and private health insurance requires only a few remarks. It is shaped by the selectionist approach taken in the statutory system of provision, which largely precludes self-employed persons from social security coverage against the risk of illness. As for such special groups as civil servants, judges and soldiers, precedence is still given to so-called internalized provision:<sup>7</sup> based on the construct of a special legal relationship, provisions for this category of persons are left to the state and its provident care duty. Up to this point, the layout of statutory health insurance conforms to the architectural principles of *Bismarckian* social insurance, a special feature being that not all persons in dependent employment are included in the mandatory scheme. This is because statutory health insurance sets an upper limit for compulsory coverage referred to as the gross annual earnings limit: persons whose salaries exceed this limit are exempt from the obligation to insure (§ 6 I No. 1, VI – VIII SGB V [Book V of the German Social Code]).

Hence, private health insurance does not only assume a supplementary function, namely in offering benefits not covered by the statutory insurance catalog. Rather, it also possesses a substitutive character, in that coverage for higher-income earners can be provided by private insurers. This idea is often expressed by the somewhat catchy phrase “bipolar insurance constitution”.<sup>8</sup> The gross annual earnings limit has also been labeled

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6 Marginal note by *Bismarck* in a pro memoria of the Bavarian Government of 31.12.1881, *Quellen-sammlung zur Geschichte der deutschen Sozialpolitik*, Abt. I, vol. 2, 1993, p. 482 note 14.

7 Regarding systematization, see *Zacher*, *Grundtypen des Sozialrechts*, in: *FS für Zeidler*, 1987, pp. 571 ff.

8 *Leisner*, *Sozialversicherung und Privatversicherung*, 1974, pp. 164 ff.

“peace limit”,<sup>9</sup> insinuating a kind of compromise in delineating the range of both insurance forms.

*b) Structural elements and figures*

aa) For many years, the gross annual earnings limit was equivalent to the income limit for the assessment of contributions. Since 1971, it had been geared to the income limit for the assessment of pension insurance contributions and amounted to 75%.<sup>10</sup> Its annual adjustment by way of statutory order was based on the trend in gross wages and salaries. In 2003, however, the base value was raised as a one-time measure<sup>11</sup> because an increasing number of persons were opting for private instead of statutory health insurance.<sup>12</sup>

**Balance of Migration to Private HI<sup>13</sup>**

1980	+	108,000
1985	+	145,000
1990	+	198,000
1995	+	85,000
2000	+	176,400
2001	+	213,200
2002	+	232,200
2003	+	208,000

Year	Income Limit for Contribution Assessment		Gross Annual Earnings Limit	
	Old Länder	New Länder	Old Länder	New Länder
1975	2,100.00 DM	—	2,100.00 DM	—
1980	3,150.00 DM	—	3,150.00 DM	—
1985	4,050.00 DM	—	4,050.00 DM	—
1990	4,725.00 DM	—	4,725.00 DM	—
1995	5,850.00 DM	4,800.00 DM	5,850.00 DM	4,800.00 DM
2000	6,450.00 DM	5,325.00 DM	6,450.00 DM	5,325.00 DM
2001	6,525.00 DM	6,525.00 DM	6,525.00 DM	6,525.00 DM
2002	3,375.00 €	3,375.00 €	3,375.00 €	3,375.00 €
2003	3,450.00 €	3,450.00 €	3,825.00 €	3,825.00 €

9 For example, cf. *Schnapp/Kaltenborn*, Verfassungsrechtliche Fragen der „Friedensgrenze“ zwischen privater und gesetzlicher Krankenversicherung, 2001.

10 Since the Zweite Krankenversicherungs-Änderungsgesetz [Second Health Insurance Amendment Act] of 21.12.1970 (BGBl. I, p. 170); regarding previous development, cf. *Peters*, Die Geschichte der sozialen Versicherung, 1978, pp. 164 f.

11 Under Art. 1 of the Beitragssatzsicherungsgesetz [Contribution Rate Stability Act] of 23.12.2002 (BGBl. I 2002, p. 4637).

12 For substantiation, BT-Drucks. 15/28, p. 11.

13 Source: PKV, Zahlenbericht [Private Health Insurance Facts & Figures] 2003/2004 (in the Internet under [www.pkv.de](http://www.pkv.de)), p. 14.



2004	3,487.50 €	3,487.50 €	3,825.00 €	3,825.00 €
2005	3,525.00 €	3,525.00 €	3,900.00 €	3,900.00 €

In February 2004, the Federal Constitutional Court rejected for decision-making a constitutional complaint filed by an insurance company against the raising of the compulsory insurance limit.<sup>14</sup> The Court based its grounds on the assumption that although the upward adjustment at the expense of private health insurers possibly constituted an intervention in their occupational freedom,<sup>15</sup> it was nonetheless justified because it had proved appropriate, necessary and reasonable for sustaining the financial stability of statutory health insurance. An additional criterion was that the business operations of these insurance companies were not unduly affected by the new regulation – at least not in the opinion of the Court.<sup>16</sup>

bb) In Germany, 9.83 percent of the population is fully covered under a private insurance scheme (= insurance of ambulatory and general hospital benefits). Included in this figure are civil servants, judges and soldiers. In 2003, the number of insured persons rose by 186.600 (net increase), corresponding to a rate of 2.35 percent.<sup>17</sup>

Apart from the good 8.11 million persons who are fully covered by private health insurance, nearly another 7.9 million have taken out some form of private supplementary protection<sup>18</sup> (approx. 9.6% of the population<sup>19</sup>). Even so, full coverage of the sickness contingency remains the chief type of private health insurance, its share of aggregate premium income amounting to 70.83 percent.<sup>20</sup>

### *c) New regulation on dental prostheses*

The Law on the modernization of statutory health insurance (GMG)<sup>21</sup> originally incorporated a new regulation on dental prostheses which was to enter into force on 1 January 2005. It provided that the relevant benefits were to be awarded in the form of fixed allowances (§ 55 SGB V) the amounts of which were to be uniformly stipulated in the statutes of the sickness insurance funds. Entitlement was based on a contribution to be borne solely by the fund members and defined collectively by the funds (§ 58 I SGB V).<sup>22</sup> The fund members, however, were to be free to conclude a contract with a private insurance

14 BVerfG (Chamber) of 4.2.2004, BvR 1103/03 (see Internet under [www.bverfg.de/entscheidungen](http://www.bverfg.de/entscheidungen)).

15 For an overview, see *Becker*, Staat und autonome Träger im Sozialleistungsrecht, 1996, pp. 153 f.

16 BVerfG, op. cit., marg. nos. 32 ff.

17 Cf. PKV, Zahlenbericht 2003/2004 (note 13), p. 11.

18 Figures from: PKV, Rechenschaftsbericht [Private Health Insurance Report] 2003 (in the Internet under [www.pkv.de](http://www.pkv.de)), pp. 10 and 12.

19 The population in 2003 was at 82,531,671; cf. [www.destatis.de/download/d/bevoe/31.12.03-werte.pdf](http://www.destatis.de/download/d/bevoe/31.12.03-werte.pdf).

20 PKV, Zahlenbericht 2003/2004 (note. 13), p. 26.

21 Gesetz zur Modernisierung der gesetzlichen Krankenversicherung (GKV-Modernisierungsgesetz – GMG) of 14.11.2003 (BGBl. I, p. 2190).

22 Just see *Kleinebrinker*, Neuordnung der Versorgung mit Zahnersatz ab 2005, KrV 2004, pp. 44 ff.; *Minn*, Zahnersatzversicherung wirft ihre Schatten voraus, ErsK 2004, pp. 185 ff.

company if they did not wish to participate in the scheme of their sickness fund (§ 58 II SGB V). In sum, obligatory standard coverage was maintained, but funded independently through a per-capita lump-sum contribution and combined with the right to opt out.

Yet by the end of 2004, the legislature had again abandoned the optional choice of a private insurance scheme under the Law on the adjustment of denture prosthesis funding<sup>23</sup> and, instead, upheld compulsory insurance, which, however, is now due to be funded by the members alone (through an additional contribution rate of 0.9%).<sup>24</sup> That is not the first time a proclaimed social law reform enactment has demonstrated such ephemerality by being repealed before even entering into force – with the legislature virtually overtaking itself. Remarkable also the reason given in the parliamentary debate for the reform of the reform: Not only must a less bureaucratic solution be found – this argument is cited in the draft bill itself<sup>25</sup> – but, according to the press releases of the Federal Health Minister, adherence to earnings-related contributions is also “socially more equitable”.<sup>26</sup> It takes not only a mischievous mind to surmise that the original solution has been abandoned to avoid the introduction of a premium model.<sup>27</sup>

## 2. Long-term care insurance

### a) Underlying principle

Private long-term care insurance likewise has a primarily substitutive function. The background here is that after lengthy consultations, the 1994 Law on long-term care insurance<sup>28</sup> sought to create a social insurance scheme that covers as many persons as possible. The decisive criterion was that the need for long-term care is not interpreted as an incidence of the sickness risk,<sup>29</sup> which was why statutory health insurance provided only a limited range of long-term care benefits, with a large part of the cost covered by tax-financed social assistance.<sup>30</sup> From the outset, statutory long-term care insurance was introduced in two forms, namely as social and as private insurance.

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23 Dated 15.12.2004 (BGBl. I, p. 3445).

24 § 241a SGB V (amended version).

25 Reference was made to “considerable practical difficulties” in regulating the above-cited GMG, see BT-Drucks. 15/3681, p. 4.

26 Cf. article in the *Süddeutsche Zeitung* dated 24.8.2004, p. 5.

27 Cf. also article in the *Frankfurter Allgemeine Zeitung* dated 17.8.2004, p. 11.

28 Cf. note 5.

29 Because no need for medical treatment is required. Consequently, it is necessary to distinguish between nursing care measures (responsibility of long-term care insurance) and measures of medical treatment care (in principle, a responsibility of health insurance); cf. also § 43 b SGB XI. For more details, see *Udsching*, Schnittstellen von gesetzlicher Kranken- und sozialer Pflegeversicherung, in: FS 50 Jahre BSG, 2004, pp. 691 ff.

30 Namely, within the scope of integration aid to persons with disabilities; now regulated in §§ 53 et seq. SGB XII.

To help achieve the goal of shifting the cost from social assistance to a social insurance scheme, the legislator thought it necessary to approximate private and social protection to as great an extent as possible. In so far, long-term care insurance exhibits two special features vis-à-vis the other established German social insurance branches: on the one hand, it is conceived as a universal scheme, but on the other, it is limited in terms of its benefit scope – that is, it does not fully compensate for burdens caused by the occurrence of the insured contingency. Entirely exempt are most persons lacking health insurance cover, but this does not apply if they are entitled to financial aid (§ 23 III SGB XI), meaning that civil servants are comprehensively included. The Federal Constitutional Court moreover held the exclusion of persons initially not covered by the statutory provisions to contravene the equality principle because a right to voluntary insurance did not exist.<sup>31</sup> That is why, for a transitional phase, the legislator provided the option of accessing either social or private long-term care insurance (§ 26a SGB XI).<sup>32</sup>

*b) Structural elements and figures*

In contrast to health insurance, the obligation to insure largely extends also to persons covered under private long-term care insurance. Book IX of the Social Code, in so far serving as a common legal basis, thus assigns the insured to one of the two insurance forms,<sup>33</sup> with optional rights existing on a certain scale (§§ 22, 26 a SGB XI). Notably persons voluntarily insured under the statutory health insurance scheme are able to opt for private instead of social long-term care insurance, with this aspect re-addressed further on.

At the end of 2003, just under 9 million persons were covered by private long-term care insurance.<sup>34</sup> According to private health insurers, the preponderant share was already privately health insured,<sup>35</sup> while only very few persons tend to opt voluntarily for a private scheme, or are allowed to do so in the first place. Conversely, nearly 70,485,000 persons were members of social long-term care insurance.<sup>36</sup>

Private insurance companies also offer supplementary coverage, namely in the form of daily-care-allowance and cost-of-care insurance. At the end of 2003, about 750,000 persons had taken out such supplementary policies.<sup>37</sup>

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31 BVerfGE 103, 225.

32 Under the law of 14.12.2001 (BGBl. I, p. 3728).

33 For social long-term care insurance, §§ 20, 21 SGB XI; for private long-term insurance, §§ 23, 24 SGB XI. Upon occurrence of the obligation to insure under social long-term care insurance, the private long-term care insurance contract can be cancelled, § 27 SGB XI.

34 PKV, Rechenschaftsbericht 2003 (note 18), p. 11.

35 PKV, Zahlenbericht 2003/2004 (note 13), pp. 20 ff. with a survey of the age structure of the insured.

36 According to figures published by the Federal Ministry of Health and Social Security (in the Internet under [www.bmgs.bund.de/downloads/ZahlenFakten05.pdf](http://www.bmgs.bund.de/downloads/ZahlenFakten05.pdf)).

37 PKV, Zahlenbericht 2003/2004 (note 13), p. 18.

### 3. *Incorporation into the process of European integration*

#### a) *Comparative reference*

First, a few remarks on how the relationship between the two insurance branches is structured in other European states.<sup>38</sup> Germany, with its mix of social and private insurance, obviously pursues a course of its own. Not only in the countries that have installed a national health service is population coverage through a state-run healthcare system regulated more comprehensively; other social insurance states such as Belgium, France and Austria likewise lack an upper earnings limit for compulsory insurance. At most, the Netherlands configuration of the insurance obligation is comparable to the German.<sup>39</sup>

That naturally does not mean private health insurance is insignificant in other countries. On a much larger scale, however, its function there is supplementary because it serves to cover benefits not provided by the state schemes. A quite different approach is taken in Switzerland, with the much-discussed example of a comprehensive, but in part privately operated health insurance system with fixed contributions. Here, also private actors are involved in the provision of obligatory insurance, this being perceived as their participation in the fulfillment of public duties. The insurers, it is said, are “cessionnaires of the public service”.<sup>40</sup> Along somewhat similar lines are current plans in the Netherlands to restructure statutory health insurance.<sup>41</sup> Due to be installed there is a uniform mode of coverage without differentiation between private and social health insurance, to be funded by premiums payable to the insurance provider but also by an additional earnings-related contribution to the administration. The insurance institutions are to be subject to the obligation to contract, and a scaling of premiums based on state of health is to remain excluded.

#### b) *Provisions of Community law*

The configuration and maintenance of social insurance systems comes under the competence of the EC member states.<sup>42</sup> To be sure, the Treaty of Amsterdam<sup>43</sup> has entrusted the Community with certain powers to regulate social protection, but only on a small

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38 For a brief overview, cf., e.g., *Pieters*, The social security systems of the member states of the European Union, 2003.

39 According to the *Ziekensfondswet* (Arts. 3 and 3d), there are two insurance limits: for employees (currently 32,600 euros/p.a.) and for the self-employed (20,800 euros/p.a.); also cf. *Noordam*, *Sozialzekerheidsrecht*, 7th ed. 2004, p. 272.

40 *Poledna/Berger*, *Öffentliches Gesundheitsrecht*, 2002, p. 246.

41 Cf. legislative history of the new health insurance draft (*Zorgverzekeringswet*): *Kamerstukken II* 2004, 29 763 No. 3, pp. 20 ff.

42 Cf. judgments of the European Court of Justice: 1998-04-28, Case C-158/96 *Kohll* [1998] ECR I-1931, para. 17; 2001-07-12, Case C-157/99 *Smits and Peerbooms* [2001] ECR I-5473, para. 44; 2002-01-22, Case C-218/00 *INAIL* [2002] ECR I-691, para. 31.

43 OJ C 340, p. 1.

scale.<sup>44</sup> In practical terms, its role remains negligible. The prime responsibility of the European legislator continues to be the coordination of national social benefit schemes.<sup>45</sup> On a political level, however, increasing importance is being attached to their comparability.<sup>46</sup> In so far, even without the exercise of legal coercion, at least certain strategies for further developing the schemes could attain model character in the future.

Irrespective thereof, however, the member state systems are also affected by directly applicable legal norms laid down in the EC Treaty.<sup>47</sup> Meant here are the fundamental freedoms and competition law.<sup>48</sup> Without going into any further detail, their impact can be briefly outlined as follows: These rules place constraints on the member states to open their frontiers, but not their markets. Thus the member states themselves continue to define the degree of social redistribution. Yet if they admit private insurance companies, they may not without good reason prejudice or limit the freedoms of undertakings based in other member states.

#### *4. Reasons for the current division of functions*

What are the reasons for the public-private mix characterizing the German social security system? For the choice of its structural elements? In addressing these, it is necessary to make a clear distinction between health and long-term care insurance, and we will see that the differing reasons play a vital part in determining concrete structures.

##### *a) Health insurance*

The Health Insurance Act of 1883<sup>49</sup> already stipulated an upper earnings limit for compulsory insurance. Although it did not pertain to industrial workers, the limit did apply to the majority of white-collar workers and was set at 6 2/3 marks per day or 2,000 marks per

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44 Detailed in Arts. 136 et seq. EC.

45 On the basis of Art. 42 EC by way of Regulation 1408/71 (OJ L 149/1971, p. 2 with amendments). The meanwhile adopted amendment under Regulation 883/2004 (OJ 2004 L 166/1) has not entered into force.

46 Above all through the so-called open method of coordination; cf. Commission Communication: Strengthening the social dimension of the Lisbon strategy: streamlining open coordination in the field of social protection, COM(2003)261 final/2; further, Commission Communication: Modernising social protection for the development of high-quality, accessible and sustainable health care and long-term care: support for the national strategies using the open method of coordination, COM(2004)304 final.

47 For just one example, cf. *Becker*, Die soziale Dimension des Binnenmarkts, in: *Schwarze* (Ed.), Der Verfassungsentwurf des Europäischen Konvents, 2004, pp. 201 ff.; for a fundamental view, *Kingreen*, Das Sozialstaatsprinzip im europäischen Verfassungsverbund, 2003.

48 Above all the free movement of goods, worker mobility as well as the freedom of establishment and the freedom to provide services, Arts. 28, 39, 43 and 49 EC; regarding competition policy, see Arts. 81, 82, 86 and 87 EC.

49 Gesetz betreffend die Krankenversicherung der Arbeiter [Law on the health insurance of workers] (KVG), dated 15.6.1883, RGBl. 1883, p. 73.

annum.<sup>50</sup> With the codification of social insurance law through the Reich Insurance Code (RVO),<sup>51</sup> it was raised to 2,500 marks in 1911.<sup>52</sup>

The initial reason for this regulation was that only persons classified as in need of protection were granted health insurance coverage. Employees with earnings above this limit were considered in a position to bridge-over the sickness-induced non-productive time from their own reserves.<sup>53</sup> And later, with the creation of the RVO, physicians likewise rejected a raising of the compulsory insurance limit because that would have narrowed their earnings potential.<sup>54</sup>

Since the introduction of statutory health insurance, the category of insured persons has successively been extended<sup>55</sup> so that the principle of compulsory insurance only for the needy has been watered down to some extent; even so, a widely held view today is that the principle still ought to have a bearing.<sup>56</sup>

#### *b) Long-term care insurance*

The situation in long-term care insurance is quite another. As pointed out above, it is geared to universality, meaning it should cover as many persons as possible, even though the benefit scope remains restricted. In such a setting, private insurance companies had an interest in participating in the scheme – by offering a full insurance package.<sup>57</sup> Obviously, the market for supplementary insurance benefits was thought to be inadequate. In this way, the partitioning already existing in the health insurance market could be extended to long-term care insurance, thereby, however, forfeiting the voluntary nature of private protection.<sup>58</sup>

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50 § 2 b KVG.

51 Law of 19.7.1911 (RGBl. p. 509).

52 § 165 II RVO.

53 Also cf. *Wannagat*, Lehrbuch des Sozialversicherungsrechts, vol. I, 1965, p. 246; an extension under the statutes of the insurance institution was thus also out of the question, cf. *Stier-Somlo*, Deutsche Sozialgesetzgebung, 1906, pp. 153, 154. Regarding parallels to the Invalidity Insurance Act, cf. *Köhler/Biesenberger/Schäffer/Schall*, RVO, 1912, Zweites Buch, pp. 6 f.

54 Cf. *Hahn*, Handbuch der Krankenversicherung, Erster Band, 1915, pp. 212 f.

55 On that development, see *Stolleis*, Geschichte des Sozialrechts (note 1), pp. 101 ff. and 154 ff.

56 Above all, cf. *Hase*, Versicherungsprinzip und sozialer Ausgleich, 2000.

57 For details on the drafts, cf. *Jung*, Pflegeversicherung: Auf dem Weg zur fünften Säule der Sozialversicherung, ZfSH/SGB 1993, pp. 505 ff., 561 ff. and 618 ff.

58 For some critical remarks, see *Isensee*, Sozialversicherung über Privatversicherer – Rechtsprobleme der privaten Pflegeversicherung, in: FS für Gitter, 1995, pp. 401, 406 f.

### *III. Individual aspects of the functional division*

#### *1. Statutory provisions and implementation of private coverage*

##### *a) Health insurance*

aa) In principle, private health insurance functions in accordance with the general rules governing contractual obligations under civil law. The insurance relationship is established by concurrent declarations of intent made by the contracting parties. Its content, too, is subject to the parties' formation of that intent (private autonomy), their scope of action nevertheless restricted by regulations of insurance law.<sup>59</sup> Disputes between the insured and the insurers are brought before the civil courts under the purview of the Code of Civil Procedure (ZPO).

With this approach, two individual funding aspects are brought into line with each other:

- Men and women pay different premiums as a result of "risk-adjusted contribution assessment".
- The funding procedure itself is based on the principle of future benefit coverage.

bb) General safeguards in favor of the insured are set forth in the Law on the supervision of insurance companies (VAG)<sup>60</sup>, which was last amended in 2004,<sup>61</sup> not least to implement Community law provisions on the solvency, reconstruction and liquidation of insurance undertakings. Thus the very start of business operation requires a permit, the operation itself is subject to legal and financial supervision, and to rules on capital resources and investment.<sup>62</sup>

Some statutory provisions moreover deviate from the principle of private autonomy, reflecting the special function of private health insurance. For instance:

- The supervisory legislation includes a special provision on substitutive health insurance. Thus there are rules on premium calculation, the right of contractual notice of cancellation is restricted, and premium alterations are subject to the consent of an independent trustee.<sup>63</sup> Simultaneously, insurers are obliged to set aside old-age reserves on behalf of every insured person<sup>64</sup> – on the assumption that recourse to most benefits increases with age, so that provisions must be made for excessive premium burdens in later life.

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<sup>59</sup> Cf. bb) below.

<sup>60</sup> Versicherungsaufsichtsgesetz – VAG, dated 17.12.1992 (BGBl 1993 I, p. 2).

<sup>61</sup> Law of 21.12.2004 (BGBl 2004 I, p. 3610).

<sup>62</sup> §§ 5, 81 et seq., 53c et seq. VAG.

<sup>63</sup> §§ 12 and 12b VAG.

<sup>64</sup> § 12a VAG.

- The Law governing insurance contracts (VVG)<sup>65</sup> likewise contains a number of special provisions. Thus substitutive health insurance is, as a rule, of unlimited duration,<sup>66</sup> contractually agreed general qualifying periods may not exceed three months, an insured person's newborn child must be admitted without additional risk charges and qualifying periods, and the insured have the right to give contractual notice of cancellation as per the end of every year.<sup>67</sup> Under substitutive health insurance, contractual notice by the insurer is ruled out.<sup>68</sup>
- Worthy of note, moreover, is the social law provision that pertains to the employer's participation. In the case of the compulsorily insured, employers and employees share the cost of the contribution; for those voluntarily insured under the statutory scheme, the employer pays a supplement. To avoid the less favorable treatment of private schemes, privately insured employees are also eligible for an employer supplement (§ 257 SGB V).<sup>69</sup> Nevertheless, in such cases a standard tariff must be offered, notably to older insured persons (§ 257 IIa SGB V). This establishes a link to the benefit catalog of statutory health insurance and, within a certain scope, to its contribution burden, the aim being to avoid unaffordable insurance premiums in old age.<sup>70</sup>

#### *b) Long-term care insurance*

aa) To begin with, the above remarks on private health insurance likewise apply to private long-term care insurance. Provisions of insurance law serve the general protection of the insured, while the insurance relationship itself is established under civil law rules.

Over and above this, however, SGB XI intervenes heavily in the free form of contract (§ 110 SGB XI). Thus it stipulates:

- insurance companies' obligation to contract;
- the limitation of premiums to the maximum contribution paid under social long-term care insurance;
- premium-free co-insurance of children;
- no exceptions for previous illness and no extra risk charges upon introduction of long-term care insurance;
- exclusion of withdrawal and cancellation rights;
- financial equalization between insurance companies in respect of receipts and expenditure, without the cost of administration (§ 111 SGB XI).

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65 Versicherungsvertragsgesetz – VVG, dated 30.5.1908 (RGBl. p. 263 with amendment); regarding current reform efforts, cf. Abschlußbericht der Experten-Kommission zur Reform des Versicherungsvertragsrechts [Final Report of the Expert Commission on the Reform of Insurance Contract Law], dated 19.4.2004 (<http://www.bmj.bund.de/media/archive/667.pdf>).

66 § 178a IV VVG.

67 §§ 178c, 178d and 178h VVG; the regulations apply to all health insurance contracts; regarding the right of extraordinary cancellation upon occurrence of the insurance obligation under statutory health insurance, cf. § 178h II VVG.

68 § 178i VVG.

69 Since 1971, cf. *Peters*, Geschichte (note 10), pp. 163.

70 Amendment of § 257 SGB V under the law of 21.12.1992 (BGBl. I, p. 2266).



Furthermore, the type and scope of benefits must conform to those of social long-term care insurance (§ 23 I 2 SGB XI).<sup>71</sup> Here, not the civil but the social courts are called upon to decide on disputes.<sup>72</sup> Against that backdrop, it might be interesting to take a closer look at whether, in specific cases, the application of civil law provisions leads to different results from those obtained under administrative procedure law. Interesting case examples can be found in a number of court rulings, some dealing with corrective adjustments to decisions on the certified degree of care assigned to an insured person. In one instance, the insurer had obviously proceeded from incorrect facts, in spite of a medical opinion, and had therefore inadvertently awarded too high benefits, as was confirmed by a subsequent medical examination. In private long-term care insurance, a pertinent settlement is not possible under the differentiated provisions governing the annulment of administrative acts (§§ 45 et seq. SGB X), but can be attained only through the application of civil law provisions. Since a rescission is largely out of the question, the only alternative remaining – under certain conditions, namely on the basis of a medical opinion certifying a change in the need of care – is to plead frustration of contract.<sup>73</sup>

bb) This approximation of private insurance to social insurance not only raised objections in respect of regulatory policy, but also prompted a number of legal questions.

Is private long-term care insurance in essence not a form of social insurance? And further, would that even be permissible on the envisaged scale?

- (1) Is the far-reaching “imposition of duties on private actors” compatible with the basic rights of insurance companies? The question must be posed regardless of the fact that the Private Health Insurance Association took part in the legislative procedure and had approved the solution that led to the participation of insurance companies.<sup>74</sup>
- (2) May insured persons be forced to conclude contracts with private insurance companies, or would it not be more beneficial for them, given the mandatory element, to be covered by a social insurance scheme?

The Federal Constitutional Court, in its fundamental judgments of April 2001 on constitutional issues relating to long-term care insurance, dealt with all three questions and –

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71 Regarding implementation, cf. the Allgemeinen Versicherungsbedingungen [General Terms and Condition of Insurance] (MB/PPV).

72 Cf. § 51 II 3 SGG.

73 Regarding the quality of the benefit commitment as a declaratory acknowledgement of a debt and the extensive lack of judicial control of the “second opinion” on the basis of § 64 VVG, cf. reports of the Federal Social Court: BSGE 88, 262 = SozR 3-3300 § 23 No. 5; 88, 268 = SozR 3-3300 § 23 No. 6; for some critical remarks on the latter point, see *Bastian*, Die Rechtsnatur der Leistungszusage und die Bedeutung ärztlicher Feststellungen in der Privaten Pflegeversicherung, NZS 2004, pp. 76, 80 ff.; conversely, see a recent judgment of the Federal Social Court: BSG dated 22.7.2004, B 3 P 6/03 R; regarding changes that prompt a new medical opinion, also cf. BSG, dated 23.7.2002, B 3 P 9/01 R. A benefit commitment undertaken by a private insurer has no binding effect on a long-term care fund in the event of a later changeover to social long-term care insurance, cf. BSG dated 13.5.2004, B 3 P 3/03 R (all decisions cited without a source can be accessed in the Internet under [www.bsg.de](http://www.bsg.de)).

74 Therefore the critical stance by *Rolfs*, Das Versicherungsprinzip im Sozialversicherungsrecht, 2000, pp. 488 ff.

citing grounds that were very brief in parts – held the statutory provisions to be constitutional.<sup>75</sup>

## *2. Freedom of choice for the insured*

### *a) Accessing and moving between the systems*

Employed persons whose earnings exceed the compulsory insurance limit can opt for membership of statutory health insurance when first entering into employment. If they fail to do so, they have, in principle, forfeited their right to access the system at a later date.<sup>76</sup> The underlying intent is to prevent persons from initially selecting the less costly form of private insurance and then profiting in old age, when benefit needs increase, from social equalization under the statutory system.

In long-term care insurance, owing to the extensive insurance obligation, the sole option consists in the choice between social and private insurance. Yet the law grants this option only to those who are voluntarily insured under the statutory system – who thus have the possibility of switching from a sickness fund to a private insurer.<sup>77</sup>

### *b) Within the systems*

Fundamentally speaking, both statutory and private health insurance present options within the respective system, namely in the choice of insurance providers. An interesting phenomenon here is that the social insurance system in fact offers more freedom of choice than private insurance. While most statutorily insured persons can choose from among a host of sickness funds after a relatively short term of membership (18 months),<sup>78</sup> switching from one insurance company to another fails in practice because the insured's old-age reserves cannot be "taken along", that is, cannot be transferred to the new insurance relationship. As a result, concluding a new insurance policy with another company becomes expensive and, hence, economically unattractive.<sup>79</sup>

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75 BVerfGE 103, 197, 217 et seq. (on the admissibility of private long-term care insurance based on Art.74 I No. 11 GG [Basic Law], and also on the admissibility of a "Volksversicherung" [universal coverage]); 103, 271, 287 et seq. (on the lacking freedom of choice of those covered by private health insurance).

76 Cf. § 9 I 1 No. 3 SGB V.

77 § 22 SGB XI; the choice options under § 26 a SGB XI are limited in time and of no comparative consequence.

78 Namely, since 1996; cf. §§ 173 et seq. SGB V.

79 On the discussion about changes, cf. *Scholz and Meyer*, Zu den Wechseloptionen der PKV, PKV-Dokumentation 25, 2001; on the more restricted problem of "aging tariffs" (i.e. being bound to certain tariffs within an insurance company), cf. *Meyer*, Tarifwechsel nach § 178f VVG – Probleme und Perspektiven, in: *Basedow/Meyer/Rückle/Schwintzowski* (Eds.), Beiträge zur 12. Wissenschaftstagung des Bundes der Versicherten, 2004, pp. 67 ff.

#### *IV. Outlook*

1. In summary, it can be noted that in the motherland of social insurance, private insurance plays a significant role in the branches of health and long-term care insurance – precisely because of its substitutive function. But in long-term care insurance, this key function has been bought at the price of considerable deviance from the fundamental principles that characterize civil law structures. Now one could ask how far the interchangeability of the two insurance forms can and is allowed to go, although other European countries, too, tend to display an obliteration of ingrained system-related principles.

2. The role of private insurance also influences discussions about the reform of statutory health insurance. On the one hand, it spurs reform ideas because the existing system of giving higher-income earners a free choice of insurance is felt to be unjust – a circumstance which, however, does not seem to compel action unless the elimination of the ostensible injustice simultaneously promises to strengthen the financial base.

Both so-called citizens' insurance and the so-called premium model could impact the status of private health insurance – the former, by strongly reducing the possibilities of offering substitutive health insurance, and the latter, by intensifying competition because premiums would likely be subsidized by tax funds. All that triggers a series of constitutional questions that cannot be detailed here.<sup>80</sup> Whether it is meaningful and whether it is factually and legally possible not only to readjust the established institutional mix between social and private insurance in the face of the demographic trend, but, beyond that, to subject it to a radical change is indeed an open question.

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<sup>80</sup> Cf., e.g., *Bieback*, Verfassungsrechtliche Aspekte einer Bürgerversicherung, *SozSich* 2003, pp. 416 ff.; *Isensee*, „Bürgerversicherung“ im Koordinatensystem der Verfassung, *NZS* 2004, pp. 393 ff.; *F. Kirchhof*, Verfassungsrechtliche Probleme einer umfassenden Kranken- und Renten-„Bürgerversicherung“, *NZS* 2004, pp. 1 ff.; *Schmidt-Aßmann*, Verfassungsfragen der Gesundheitsreform, *NJW* 2004, pp. 1689 ff.; *Muckel*, Verfassungsrechtliche Grenzen der Reformvorschläge zur Krankenversicherung, *SGb* 2004, pp. 583 ff and 670 ff.



# \*German Health and Long-Term Care Insurance – Economic Aspects –

*Jürgen WASEM*

## I. Introduction

## II. Private provision of health insurance cover

1. On the logic of private health insurance markets
2. German private health and long-term care insurance from an economic perspective
3. Should supplementary insurance be regulated as well?

## III. What is decisive – the legal form/institution or the regulatory frame and its incentive structures?

## IV. Literature

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## *I. Introduction*

The rendering of social services in the field of health and long-term care insurance is based on a triangular relationship between insurance institutions, benefit providers and the insured or patients, with the state regulating these relations “at the center of the triangle”. As a result, the role of private actors takes on two dimensions: the private provision of health and/or long-term care insurance and the private provision of benefits. This paper deals only with the first aspect of private insurance (in section II. below) and concludes (with section III.) by querying the elements that are decisive to the guarantee of social security: the legal form/institution or the regulatory frame in conjunction with incentive structures?

## *II. Private provision of health insurance cover*

This section first deals with the logic of private insurance markets (1.) and is followed by a look at the dual system of health and long-term care insurance in Germany from an economic perspective (2.). It ends by discussing the regulation of supplementary insurance schemes (3.).

### *1. On the logic of private health insurance markets*

According to the underlying economic theory, the “individual actuarial equivalence principle” will prevail in competitively organized private health insurance markets (Zweifel and Hauser 1987). Thus insurers subject to competition must seek to avoid a systematic cover shortage in individual insurance contracts – that is, they must ensure that individual premium receipts do not fall short of the corresponding individual benefit expenditures. Otherwise, they are faced with the threat of so-called systematic adverse selection. For instance, were an insurer to forbear from assessing potential customers’ health risk, while the remaining insurers conducted such risk assessments and subjected individuals with prior medical conditions to higher premium payments or excluded them from certain benefits, the one insurer would particularly attract persons with prior conditions. This insurer would therefore tend to be less competitive because of the disproportionately high premiums charged to healthy customers who would pay less elsewhere. Moreover, to cite another example, insurers who fail to scale premiums on a gender risk basis would be preferred by female customers who incur higher health insurance expenses, at least in the mid-phase of life.

This insurance theory which postulates that the individual actuarial equivalence principle would prevail in competitively organized private health insurance markets is also underscored by empirical observations. In the Netherlands, for instance, such a development

won through in the 1970s, after societal restrictions on individual property rights had existed there before (*Okma* 1995). Other examples are the private health insurance markets in the United States or in Chile. In such markets, insured persons who incur very high costs lack health insurance protection or pay exceedingly high premiums or must accept gaps in their cover.

The equivalence principle can heighten allocative efficiency in the sense that health coverage is produced on a minimal-cost basis. Nevertheless, this has been known to result in a so-called separating equilibrium in which a sub-market offering relatively low health cover and lower premiums flanks another with extensive cover and disproportionately high premiums, without this necessarily reflecting preferences, say, for good risks (*Rothschild and Stiglitz* 1976).

A health insurance market organized along the lines of an efficiency theory based on the principle of actuarial risk equivalence leads to tensions with such ethical concepts that reject the imposition of heavier financial burdens, via insurance contributions and health-care costs, on persons with adverse health conditions – this notion holding true above all for egalitarian ethics (*Rawls* 1975). Authors who acknowledge these tensions but nonetheless seek to uphold risk-equivalent premiums propose that, in such cases, the state should subsidize the health insurance premiums of sick persons down to a socio-politically acceptable level through (tax-financed) transfers (*Zweifel and Breuer* 2002).<sup>1</sup> Such an approach, however, is then faced with the challenge of generating sufficient efficiency of its own accord. For if every health insurance premium chosen by sick persons were generally subsidized down to a specified level of maximum burden in proportion to household income, there would be no incentive for the insured to select the most efficient solution possible (*Rothgang et al.* 2005).

An alternative could be to annul the actuarial equivalence principle through regulations (*Beck* 2004). Thus the state could lay down the obligation to contract (at least for the level of a basic benefit catalog) – that is, prohibit insurers from rejecting anyone. Or it could ban risk markups or stipulate additional provisions governing premium calculation (e.g. to prevent a rating of premiums according to gender or place of residence). Such specifications bearing a social policy/ethical intent will nevertheless heighten insurers' interest in circumventing them and engaging in so-called risk selection. This is illustrated by the following example: If health insurance companies are forced to offer an identical tariff with identical premiums to all insured, each of the individual companies will have strong incentives to insure only young healthy men, if possible – because then they can keep premiums low and secure a competitive edge. Should that effect be undesired, the insured's premium payments must be decoupled from the insurers' proceeds by introducing mechanisms of risk structure equalization under which insurers covering below-average risks likewise generate only below-average earnings, while those insuring above-average risks correspondingly achieve above-average earnings (*van de Ven and Ellis* 2000). Such an equi-

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1 Among the actors in the German healthcare sector, the Association of Research-Based Pharmaceutical Companies has adopted this position (Verband Forschender Arzneimittelhersteller e.V. 2003). In the German political arena, a model pointing in this direction has been proposed by the Free Democratic Party (FDP 2004).

brating mechanism could be state-imposed, but could also take the form of self-regulation by the insurance branch (under state supervision).

## 2. *German private health and long-term care insurance from an economic perspective*

Private health and long-term care insurance in Germany exhibits a peculiar mix between the activation of market forces and regulation. Which comes as no surprise – given the above tensions between the effects of developing market forces and their impact on efficiency, on the one hand, and the effects of social policy/ethics, on the other. To understand the specific regulative frame governing German private health insurance, it must first be pointed out that the large majority of the population is insured in the statutory health insurance system, which provides the option of voluntary insurance once the compulsory obligation to insure ceases. This constellation is of such central importance because it enables private health insurers to demand medical examinations for new members and, hence, to reject bad risks, or to charge risk markups that are so high as to deter newcomers from accessing private insurance, causing them to remain in the statutory system.

Obviously, the actuarial equivalence principle has been put into effect here. However, its consequences – now a topic of extensive debate in the dispute over the introduction of so-called citizens' insurance (WaseM 2004) – are reflected in the tendency that the “good” risks among the voluntarily insured are drifting away from the statutory system, whereas the “bad” risks are staying. A noteworthy aspect is that the regulation restricts the rating of health risks to the time-point of private scheme access. In other words, during the insurance relationship, private insurers are not allowed to raise premiums or cancel the policy on account of a worsening state of health. Nevertheless, when the insured switches to another insurance company, the new insurer can again demand a medical examination. Here, the non-portability of aging reserves largely prevents an ongoing adverse selection process in the form of good risks seeking new insurers and unfavorable risks remaining where they are. That is because the non-portability of reserves in the event of a change of insurers incurs considerable financial losses also among the good risks if they have accumulated lengthy insurance periods with a previous insurer (Unabhängige Expertenkommission zur Untersuchung der Problematik steigender Beiträge der privat Krankenversicherten im Alter [Independent Expert Commission on the Problems of Rising Private Health Insurance Premiums in Old Age] 1997; Züchner 1995). Even so, there are models that propose the portability of aging reserves without the effect of separating good and bad risks (Meyer 1992).

Compared to private *health* insurance, private *long-term care* insurance is more heavily regulated. Persons with full private health coverage are also obliged to obtain their long-term care cover from a private insurer. Hence, insurance companies operating in this market are subject to the obligation to contract. The most extensive regulations are those motivated by social policy concerns to protect persons who were already privately health insured when long-term care insurance was first introduced. These persons may not be charged risk markups, even in the event of existing long-term care needs or a heightened



probability of occurrence. But numerous regulations also exist for those who have newly taken out full private health and attendant long-term care coverage since the introduction of long-term care insurance. This has led to a distinct restriction of competition on the supply side. In particular, financial equalization measures have been introduced here to compensate for deviations from the actuarial equivalence principle (Wasem 1995; Wasem 2000).

As pointed out above, an essential feature of the German health insurance system is embodied in the concept of “institutional competition” (*Systemwettbewerb*) between statutory and private insurance. The term institutional competition has been chosen for this specific form of co-existence to characterize a situation in which two legal institutions (or subsystems) subject to utterly different rules compete with each other for the group of voluntarily insured persons. This unique form of competition has recently come under heavy criticism (Jacobs and Schulze 2004). In particular, its contributions to an efficient provision of health insurance cover and healthcare services are denied. Instead, it is held to enable individuals who are allowed to opt between statutory and private health insurance to maximize their partial utility to the detriment of the collective whole. This is fundamentally true. For an overall assessment, however, it must be noted that today the privately insured substantially cross-subsidize the statutorily insured via higher prices when claiming healthcare benefits. Nor should it be overlooked that the coexistence of both subsystems has been able to cushion the impact of the cost containment policy of rationing by offering benefit providers an income-securing “loophole”. Yet it is no doubt also true that, given the basic parameters of institutional competition (as opposed to competition *within* one system), data on the relative performance of both subsystems does not say anything about the suitability or efficiency of the chosen arrangements or participating actors.

### 3. Should supplementary insurance be regulated as well?

As opposed to the situation in the 1990s, European Union directives are now fundamentally geared to extensive deregulation in the insurance sector in striving to achieve the internal market. For health insurance, however, an exception is made in the area of full coverage: Based on Article 54 of the Third Council Directive on the coordination of non-life insurance, member states can adopt rules to harmonize competition with social criteria, say, by defining calculation methods or setting standard tariffs in conjunction with the obligation to contract – rules of which Germany and the Netherlands have availed themselves, being the only EU member states offering full private coverage of sickness costs (Grefß and Wasem 2003; Wasem et al. 2004).

These options are not, however, open to private supplementary insurance schemes, which thus remain subject to the “normal” EU market legislation (Mossialos and Thomson 2002). In recent years, there has been increasing controversy over the need to adopt additional regulations here. Notably the French side has presented a proposal to enable low-income earners and persons with prior medical conditions to access supplementary insurance schemes (Rocard 2000). Such considerations put national health policymakers in a

dilemma: In order to contain the cost of their social health insurance systems, they are continually striving to exclude benefits or raise co-payments. At the same time, efforts are made to ensure that the excluded benefits nonetheless remain accessible to all. It seems the national legislator is called upon to consistently weigh up the benefits that are “necessary” (but would then have to remain in the benefit catalog of statutory health insurance) with those that are “unnecessary” (but would then dismiss the need to regulate supplementary insurance).

### *III. What is decisive – the legal form/institution or the regulatory frame and its incentive structures?*

The preceding section has shown that private insurers operating in health insurance markets seek to implement the individual actuarial equivalence principle, which bears undesired consequences from the social policy point of view. Hence, if social protection is to ensue via private health insurers, these adverse effects must be neutralized or eliminated through appropriate Social State regulations. Even older investigations on German insurance economics had already come to the surprising conclusion that, in this regard, profit-oriented private insurance corporations and non-profit mutual insurance companies scarcely differ from one another in de facto terms of business policy. Obviously, the pressure exerted by the insurance market leads to a strong assimilation of conduct modes (*Brenzel 1975*).

Most recent debate on the regulatory aspects of healthcare economics increasingly shows that very similar effects are achieved if public law health insurance institutions, for example “statutory sickness funds”, are sent into the competitive arena (*Sheiman and Wase 2002*). Although these public insurers are typically subject to a wider range of state-imposed requirements and instructions than private insurers, the central motivating argument likewise applies to them: Under competitive conditions, they are entitled to the same economic incentives as private insurers. Consequently, if they are subject to a ban on the calculation of risk-adjusted premiums, this will generate incentives for risk selection, which in turn must be offset by mechanisms of risk structure equalization. Decisive from this perspective is not so much whether “private” or “public” actors are entrusted with insurance functions; rather the principal question is: What incentives are they offered and how is the regulatory framework structured? If market-related and competitive steering instruments are employed to achieve more efficiency, regulatory measures must compensate for the “social consequences” – largely independent of whether the relevant functions are exercised by public or private actors.

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# \*Japanese Health and Long-Term Care Insurance – Legal Aspects –

*Katsuaki MATSUMOTO*

## I. Health insurance

1. The role of private health insurance
2. The situation of private health insurance
3. Comparison

## II. Long-term care insurance

1. The role of private long-term care insurance
2. The situation of private long-term care insurance
3. Comparison

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\* German original translated by Esther Ihle, MPI Sozial Law, Munich

## *I. Health insurance*

### *1. The role of private health insurance*

In Japan, the entire population – not only employees, but also the self-employed, farmers and civil servants – is subject to mandatory coverage under the statutory health insurance system. Different from the German system, there is no exemption from statutory insurance, also not for persons whose income exceeds a certain limit. As a result, private schemes play no role in providing full health coverage. Many people, however, have concluded private supplementary insurance contracts to cover costs that are not borne by the statutory system.

Included in these costs are the co-payments required under statutory health insurance. In Japan, insured persons under the age of 70 must contribute 30 % to the payment of medical expenses, while those over 70 pay 10 %. If co-payment exceeds a certain upper limit, the added cost is assumed by the insurance institution to avoid undue hardship for the insured. In addition, insured persons undergoing hospital treatment must contribute 780 yen (approx. 6 €) per day to cover board costs.

Other medical costs not covered by the statutory system include the cost of more comfortable hospital rooms and state-of-the-art medical treatment. Thus the insured bear the extra cost of comfort accommodation. And they must pay in full if they wish to profit from the latest developments in diagnostic or therapeutic treatment, which as a rule is offered only by such highly specialized hospitals as university clinics and is not yet included in the benefit catalog of statutory health insurance.

Over and above this, the insured must defray certain outlays that arise in the course of a hospital stay, including the cost of daily needs and the commuting expenses of family members.

According to the results of a survey, persons hospitalized in 2001 paid a daily average amount of 12,900 yen (approx. 100 €) from their own pockets.

### *2. The situation of private health insurance*

As a rule, persons insured under a private health insurance scheme receive cost refunds for both hospital treatment and operations – in other words, they are entitled to monetary benefits. In the case of hospital treatment, insurance providers pay a daily lump-sum benefit. As for operations, depending on the type, the refund here is 10, 20 or even 40 times as high as that of the daily benefit for hospital treatment. Some private health insurers also refund co-payment to statutory health insurance as well as other kinds of actually incurred outlay. In principle, the insurance premium depends on the content and scope of benefits and on the insured's age and sex.

According to a recent survey, some 70 % of the respondents state that they have taken out a life insurance policy under which they also receive hospital benefits.

### *3. Comparison*

In Japan, too, an aging population and rapid medical progress threaten to generate a disproportional rise in health insurance expenditure. To avoid excessive increases in insurance contributions, precipitous expenditure growth must be dampened by reforms. Yet the implementation of any reform is liable to have a strong impact on the development of private health insurance.

For over twenty years, one of the chief reform measures in Japan has been to raise co-payment under statutory health insurance, thus increasing insured persons' share of the cost burden. And this in turn has led to a heightened readiness to take out private health insurance policies.

It is not likely, however, that any benefits required for the treatment of illness will be deleted from the benefit catalog of the statutory system in the near future. Nor would it be acceptable to exempt certain categories of persons from the obligation to insure. The rejection of such measures is embedded in fears that changes of this kind could pose a threat to the equal treatment of the insured and thus weaken solidarity within the population. At present, it therefore appears improbable that a statutory reform will broaden the scope of action of private health insurers.

Even so, the latest provisions governing statutory health insurance benefits are remarkable with a view to the role of private health insurers. Thus panel doctors and hospitals admitted under the statutory system are not allowed to administer any treatment that is exempt from the statutory benefit catalog. If insured persons receive hospital treatment involving a medical novelty that has not yet been recognized as a benefit by the statutory health insurance institution, they must not only pay for the novel therapy itself but for all other services as well (e.g. accommodation, normal examinations).

There is, however, one exception: it concerns a set of advanced medical benefits stipulated by the Minister of Health which may be offered by hospitals with a so-called special permit. If an insured person receives treatment comprising such a state-of-the-art benefit, all related services can be awarded as statutory health insurance benefits.

The Deregulation Council has recently deliberated on this problematic matter and come up with a new proposition. According to it, the insured could obtain the normal benefits in conjunction with an advanced medical therapy without the restriction imposed by statutory health insurance. That could ease the financial burden of patients undergoing such treatment and simultaneously provide incentives to obtain private coverage for state-of-the-art benefits. Yet this proposal has met with a fair amount of resistance. A prime reason is that patients themselves, as a rule, are unable to judge whether the sophisticated medical treatment recommended by an attending physician is truly necessary. It follows that therapies of this kind must, by way of exception, be subject to stricter government controls.

## *II. Long-term care insurance*

### *1. The role of private long-term care insurance*

Japanese statutory long-term care insurance is compulsory for all inhabitants from the age of 40. Hence, full insurance coverage under a private scheme is out of the question for this age group. Private long-term care insurance schemes are therefore targeted to outlays not covered by the statutory system.

Statutorily insured persons become eligible for benefits if their condition has been certified as requiring long-term care. Insured persons between the age of 40 and 65 are entitled only if their need for long-term care was caused by certain age-related illnesses (e.g. brain stroke). They must bear 10 % of the benefit cost as a form of co-payment.

Not all services in effect required by the beneficiary are covered by the statutory insurance system, given that every degree of care specifies an upper limit for ambulatory benefits. If care expenses exceed this limit, the differential amount must be paid by the beneficiary. The insured themselves must also carry the cost of any services not included in the statutory benefit catalog (e.g. “meals on wheels”).

Conversely, there is no cap on in-patient benefits; however, persons in need of in-patient care must pay 780 yen (approx. 6 €) per day for board, in addition to the 10 % co-payment. If they are accommodated in rooms designed for one or two persons, they must also defray the surplus expense. Additional charges include, for example, the cost of articles of daily use and diapers.

According to figures provided by the Ministry of Health for the year 2001, elderly persons requiring long-term care in a nursing home paid a monthly average of 34,000 yen (approx. 260 €) from their own pockets.

### *2. The situation of private long-term care insurance*

Under private long-term care insurance schemes, the insured as a rule receive care allowance and/or care annuities if their condition necessitating nursing care has lasted for more than a specified number of days (e.g. 180 days). The care allowance is paid out as a lump sum or in instalments. The amount of both the allowance and the annuities is independent of the diagnosed degree of required care and the actual cost of that care. Some private insurance companies refund the co-payment to statutory long-term care insurance as well as other costs that have actually arisen. The premium amount is fundamentally geared to the content and scope of the awarded benefits and the age and sex of the insured person.

According to survey findings, the proportion of respondents who have taken out long-term care coverage with a life insurance or indemnity insurance company, respectively, was 4 % in either case.



### *3. Comparison*

Thus we see that the main role of private long-term care insurance in Japan is to supplement the statutory scheme. And it is not to be expected that private coverage will replace statutory coverage in this branch of insurance.

In contrast to Germany, Japan has no mandatory private long-term care insurance; private coverage is always supplementary and, hence, voluntary. Currently, the percentage of contracts effected for private long-term care insurance is much lower than for private health insurance, one reason being that the long-term care risk is considered less urgent than that of illness. Another reason could be that the insured's cost share is much smaller for in-patient nursing care than for hospital treatment.

The introduction of statutory long-term care insurance has had a positive effect on private insurance companies operating in this branch. On the one hand, it has heightened people's awareness of the risk of needing long-term care; on the other, it has led to an improvement of nursing care services, especially those rendered in the ambulatory sector. The expansion of long-term care has made it possible for private long-term care insurance to secure the needs of their insured through the provision of monetary benefits.

Plans to extend risk coverage and the category of persons insured are leading issues in the upcoming reform of statutory long-term care insurance. These proposals would not, however, narrow down the scope of private long-term care insurance. Quite on the contrary, if an additional group of persons were entitled to statutory long-term care benefits, this would augment the role of private operators providing supplementary insurance.

As pointed out above, the objectives of private and statutory health and long-term care insurance in Japan are not competitive but complementary.



# \*Japanese Health and Long-Term Care Insurance – Economic Aspects –

*Kazuaki TEZUKA*

## I. Background and Objectives of the Symposium

## II. Japan's Position in the Face of Spiraling Medical Care Costs

1. Introduction
2. Public and private burdens in the field of medical and long-term care
3. Public and private health insurance
4. Private Health Insurance in Japan

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\* German original translated by Esther Ihle, MPI Sozial Law, Munich

## *I. Background and Objectives of the Symposium*

In both Germany and Japan, fewer and fewer children are being born, and the aging of society is thus progressing a rapid pace. As a result, both countries are losing their ability to compete; the state's social function is on the decline and approaching its limits.

Under these circumstances, hitherto debated elements of Bismarckian social legislation are inevitably retreating into the background. At any rate, economic growth and concomitant state funding in support of social security have been weakened. Two ways out of this dilemma are seen in the curtailment of social security benefits on the one hand and the reduction of government social spending on the other.

The first solution involves a decrease in public social insurance, which cannot be fully replaced by transferring coverage to private insurers. To accompany this process, regulatory methods need to be amended further, thereby extending the scope of action for private autonomous operations.

To achieve the second solution, both direct and indirect state authority must forfeit some of its responsibilities and pass these over to the private sector, with the state's role ultimately confined to custodial and supplementary functions.

Abstract legal norms are not feasible, even if one has concrete ideas and seeks to rearrange current tasks accordingly. Legal and economic analyses are required to ascertain and depict functional prerequisites, and to show what parties are to accept responsibility for the current state of affairs and in what way.

That must be the presupposition for dealing with the complex factors of social security and, simultaneously, for implementing the control system which interconnects all schemes along functional lines and is applicable in practical terms.

In the light of these objectives, the two-day symposium hoped to bring forth some fruitful discussions on the significance of private actors in the provision of social security and the practicability of their alignment with state functions.

## *II. Japan's Position in the Face of Spiraling Medical Care Costs*

### *1. Introduction*

It is a well-known fact that Japan has the highest proportion of very old inhabitants in the world. The upward trend in population aging is expected to continue at a fast pace until 2030. This trend and the extremely rapid progress in medical technology are generating a steep rise in the cost of medical treatment and therapy, which is reflected in spiraling national expenditure in this sector.

According to most recent figures (Ministry of Health, Labor and Welfare), total social insurance benefits amounted to ¥ 83.5666 trillion in 2002 – of which pensions accounted for ¥ 44.3781 trillion (53.1%), medical treatment ¥ 26.2399 trillion (31.4%), long-term

care costs ¥ 4.6995 trillion (5.6%), and other social costs ¥ 8.2145 trillion (9.95%). The Japanese government estimates that social insurance benefits will increase to about ¥ 152 trillion by the year 2025. Accordingly, pensions, which are expected to be kept in check, would comprise ¥ 69.6 trillion, medical costs ¥ 59.3 trillion, long-term care costs ¥ 19 trillion, and others ¥ 11.4 trillion.

If this trend persists, expenditures on pensions and medical treatment are likely to switch positions by the year 2030, with pensions then making up ¥ 95.7 trillion and medical costs rising to ¥ 110.2 trillion. Long-term care costs would surge to ¥ 35.5 trillion, and others would come to ¥ 13.4 trillion.

Based on these long-term projections, an increased strain on public budgets is anticipated on account of the sharp rise in medical care costs. The discussion therefore now focuses on means to sustain the present social insurance system.

To do so, it is necessary to scrutinize the relationship between public and private medical cost burdens in Japan, to assess how the situation has changed as a result of the upsurge in these costs and, subsequently, to deliberate viable future measures from a legal perspective.

## *2. Public and private burdens in the field of medical and long-term care*

Since 2002, co-payments to medical care costs have risen from 10 to 30% (with older persons continuing to pay 10%). As a result, social insurance expenditure on medical treatment was at minus 1.4% in 2004. Nevertheless, these favorable effects of cost containment are expected to be of only short duration. Discussions therefore now focus on how to cut medical care costs.

A fundamental proposition is to adjust the level of public medical and long-term care benefits to the pace of economic growth. To this end, the scope of public insurance benefits is to be reviewed and brought into line with appropriate efforts to extend private initiative.

In the process, duplicate benefits in the areas of medical and long-term care services are to be avoided. Moreover, medical services at the administrative district level are to be made more effective by creating and implementing a “Program for Medical Cost Adjustment”.

The big controversial issue here centers on the introduction of “mixed medical care”.

According to this model, patients themselves must bear the entire cost of advanced therapies, for example drugs against cancer, if these are not covered by public health insurance. Even in cases where treatment covered by public insurance is administered together with a non-covered treatment, the patient must likewise assume the full cost. The governmental Council on the Promotion of Regulatory Reform and Private Finance Initiative (abbr.: Deregulation Council) recommends that this aspect of the regulation be repealed. Accordingly, all therapies “above a certain level” offered by certain clinics should be made fully accessible in accordance with the patients’ choice and the clinic’s diagnosis. Hence, a patient who has received such a clinical therapy not covered by public health

insurance would only have to pay for the amount in excess of the insured benefit. The Council urges the prompt implementation of such a scheme.

The Ministry of Health, Labor and Welfare is against the recognition of unrestricted mixed medical care, but intends to admit certain forms of previously non-covered medical services to the category of publicly insured benefits as soon as possible.

The Deregulation Council has thus proposed a liberalization of mixed medical care to include “preventive measures within the scope of certain medical treatments as well as checkups whose frequency is laid down by the insurance authorities”, “services in conjunction with these medical treatments” and “sterilization treatment”. The government’s economic policy advisory council also favors the earliest possible implementation of these measures.

Concrete discussions on these proposals have not yet commenced because the Japan Medical Association and the medical supply side still oppose them. They argue that the current public health insurance system should be sustained, based on the principle of real compensation for all therapeutic expenses.

The second aspect concerns the introduction of so-called private self-help. The aim is to raise co-payments to the “hotel costs” for medical treatment/long-term care. At present, co-payment to long-term care insurance services is set at 10%, but there are demands to increase the contribution to meal costs. As for nursing home expenses, the envisaged reform of contributions to long-term care insurance recommends raising co-payments.

The contributions to long-term care insurance are rising very rapidly. At the moment, they are fixed at ¥ 3,293, but could almost double to roughly ¥ 6,000 by the year 2012 – if the current trend persists. One fundamental measure under consideration is to oblige all persons over the age of 20 to contribute to long-term care insurance.

### *3. Public and private health insurance*

My personal opinion on this development is that despite existing co-payments, the current public health insurance system is unable to cover all costs. That is why the need for collaboration with private insurance schemes is being stressed on an increasing scale.

Private insurance in Japan merely plays a supplementary role. In Germany, by contrast, private coverage is accessible to higher income earners and assumes a substitutive function, taking the place of public insurance and in fact forming a part of it.

In Japan, private health insurance packages are offered by life insurance companies, whose products frequently lack transparency. It is not always clear for which therapies insurance benefits are in effect paid, say, in the case of cancer, heart or brain diseases. Court action is sometimes necessary to clarify these issues.

A typical example is the refusal of payments to cancer patients who undergo chemotherapy in clinics but are not operated there. These patients receive no compensation for surgery or accommodation, although the insurance companies advertise that policyholders can expect benefits for “cancer treatment” which the public sickness funds are not in a position to cover.

We see that Japanese insurance companies focus either on therapies not covered by public health insurance or on the replacement of co-payments. Moreover, private supplementary insurance products are sometimes characterized by a lack of certainty, transparency and equity. In this way, Japanese private coverage differs from the operational and competitive ability of German private insurance, which substitutes for a part of the public scheme.

As I see it, the intent in Germany is to integrate all forms of advanced medical treatment into the public insurance schemes. Nevertheless, we in Japan must opt for the expansion of private insurance in the face of mounting public expenditure on medical care, which makes it ever more necessary for patients to act on their own initiative through participation in private insurance schemes.

I conclude with the following overview of private insurance products:

## 4. Private Health Insurance in Japan

PRODUCTS	ACCESS AGE	BENEFIT (IN PATIENT)	OP BENEFITS	DEATH BENEFITS, ETC.	SPECIAL TARIFS
A (US group)	0 - 69 years	¥ 5,000, ¥ 8,000, ¥ 10,000	Per OP: ¥ 50,000, ¥ 100,000, ¥ 200,000	Special conditions	Death benefit: ¥ 1Mio.; female disorders, special conditions
B (US group)	16 - 80 years; special conditions for children	Cancer insurance (¥ 10,000)	Diagnosis: ¥ 1Mio.; OP: ¥ 200,000; Highly advanced care: ¥ 60,000 - ¥ 1.4Mio.	¥ 100,000	Diseases, injuries, certain female disorders, children, special tariffs for families
C (Swiss health insurance)	18 - 65 years	¥ 5,000 - ¥ 12,000	Daily hospital allowance: 10-/20-/40-fold	Combined with special tariff (fixed insurance)	In-patient/OP/out-patient in case of specified diseases
D (Swiss cancer insurance)	18 - 65 years	Plans for ¥ 5,000 - ¥ 30,000	Diagnosis, OP, follow-up care, out-patient care, depending on plan	Combined with special tariff (fixed insurance)	
E (Japan)	18 - 70 years	Frame for ¥ 5,000, ¥ 7,000, ¥ 10,000	10-/20-/40-fold amount of benefits for in-patient care		Special child tariff
F (Japan)	18 - 65 years	Plans for ¥ 5,000, ¥ 10,000	¥ 100,000, ¥ 200,000, ¥ 400,000	For spouses and families	
G (Japan) Secom cancer insurance	16 - 79 years	¥ 500,000 for preparatory cancer treatment and real in-patient cost + ¥ 10,000	Total in-patient cost		Free and public care included
H (Japan) Arico insurance for the elderly	55 - 80 years	Frame for ¥ 3,000, ¥ 5,000, ¥ 8,000	40-fold amount of in-patient benefits, ¥ 30,000 - ¥ 320,000		No prior examination required
I (Japan) Tokyo marine insurance	20 - 70 years	4 types: ¥ 10,000, ¥ 15,000, ¥ 20,000, ¥ 30,000	Depending on type: ¥ 100,000 - ¥ 1.2Mio.	Benefits for diagnosis, long-term in-patient as well as out-patient care	Renewable up to max. age of 90



# \*German Employment Promotion – Legal Aspects –

*Angelika NUßBERGER*

- I. Introduction
- II. Historical review
- III. Current reforms
- IV. Actors in the labor market
- V. The monopolization of employment placement by the state – a retrospection
- VI. Reallocation of tasks between the state and private actors – the new approach taken in current reform efforts
  - 1. Allocation of counseling tasks between the state and private actors
  - 2. Allocation of placement tasks between the state and private actors
- VII. Obligating the employer
- VIII. Strengthening the personal responsibility of those concerned: from “joblessness” to “job seeking”

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\* German original translated by Esther Ihle, MPI Sozial Law, Munich

## *I. Introduction*

If we ask about the division of tasks and responsibility between the state and private actors in safeguarding against the unpredictable risks of life, we might be reminded of the philosopher Kant who felt that all-out risk provisioning was a form of despotism that led to the citizen's infantilism, so that it was doubtless better if everyone were the architect of their own fortune. But, on the other hand, history has taught us that also a laissez-faire attitude on the part of the state proves to be destructive. Between these two poles, of course, there are a wide range of configurative options and boundaries in respect of which tasks are to be allocated to the individual and which to the state.

## *II. Historical review*

As regards the risks of illness, old age and invalidity, Bismarckian social insurance had achieved an initial compromise on which part of the burden was to be imposed on the individual and which borne by the polity. That was different in the field of unemployment, which I will address in the following. In contrast to other social risks, unemployment up until the early industrial age was perceived as unwillingness to work. The response was to erect poorhouses in which the jobless were supposed to be re-accustomed to regular work through hard labor. The state thus held the occurrence of the risk of unemployment to be the sole responsibility of the affected individual and sought to counteract it by means of coercion.<sup>1</sup> The late 19th century witnessed the first commercial placement services, which were nevertheless subject to increasing restrictions on account of fears they could take advantage of and exploit the unemployed. Only gradually did it become accepted that unemployment was a problem of society as a whole, necessitating a response – as well as an assumption of responsibility – by the state. In the 1920s, employment promotion was severed from poor relief and financed by employee contributions; job placement was defined as a sovereign task of the Reich Agency for Employment Placement and Unemployment Insurance. Commercial job placement services were prohibited in 1931.<sup>2</sup>

## *III. Current reforms*

Over the years, regulations governing employment promotion were frequently an object of sweeping reforms, but, today, notably in the face of a persisting high level of unem-

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1 Cf. *Geremek*, *Geschichte der Armut* 1988, pp. 288 ff.

2 On the history of the risk of unemployment, cf. *Benöhr* (Ed.), *Arbeitsvermittlung und Arbeitslosenversicherung in der neueren deutschen Rechtsgeschichte* 1991, Führer, *Arbeitslosigkeit und die Entstehung der Arbeitslosenversicherung in Deutschland 1902-1927*.

ployment in Germany, they have become an experimental ground for social policy measures – with an explosive impact. Bearing in mind that labor promotion legislation was first incorporated into Book III of the German Social Code (SGB III) in 1997, the so-called Job-AQTIV Act of 2001 constituted a further major reform. The acronym AQTIV stands for the German terms activation, qualification, training, investment and placement. These concepts inherently indicate the proposed course of action: the point is to provide helpful support rather than help. Another catchphrase is “modern services at the workplace”, due to be implemented under an additional reform package consisting of various statutes. Of notable importance here are the First and Second Acts on Modern Services at the Workplace dating from 2002, as well as the respective follow-up Third and Fourth Acts now being extensively debated. Also of relevance to our subject is the “Act on Facilitating the Election of Employee Representatives to Supervisory Boards”, dated 23-03-2002. Other than its name suggests, the Act seeks to further privatize job placement.<sup>3</sup>

#### *IV. Actors in the labor market*

If we now look at the legal field of labor promotion with a view to the division of tasks and responsibilities, we must first query among whom these tasks and responsibilities can be distributed.

That the *unemployed* themselves must actively seek new employment goes without saying. Over and above this, however, a host of additional obligations can be imposed upon them. These may also apply to potentially unemployed persons, i.e. who still have work, as well as to those who have just found work.

As a rule, the *state* as an actor appears in two roles: first, in offering assistance to those who seek work, namely through placement services, and second, in providing for the payment of support benefits in the event of unemployment. Only the first aspect need interest us in the following. To speak of the “state” in this context is not quite precise, however. In Germany, the Federal Employment Agency belongs to the domain of so-called indirect state administration. In terms of administrative organization law, the Agency is an institution governed by public law and operated on the basis of self-administration. Its self-administrative bodies are composed of the representatives of employees, employers and public corporations, thus reflecting a tripartite structure.

Finally, *third parties* may be integrated in the system – as involved and non-involved parties. The first group could include employers who contribute to the avoidance of unemployment. Conversely, non-involved parties may render support or assistance from the sidelines, usually in their own economic interest.

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<sup>3</sup> Cf. *Rixen*, Das neue Sozialrecht der Arbeitsvermittlung nach der Reform der Bundesanstalt für Arbeit, NZS 2002, pp. 466 ff.

## V. *The monopolization of employment placement by the state – a retrospection*

While, as outlined above, the entire burden of finding new employment was imposed on the unemployed themselves until well into the 1920s, supported at best by commercially run placement services, this approach was reversed in 1927 under the Employment Placement and Unemployment Insurance Act. With the creation of a state-controlled employment placement monopoly, labor exchange was defined as an exclusive duty of the state. Private recruitment agencies were prohibited and any violation thereof prosecuted.

What are the grounds justifying such an extreme approach?

The employment placement monopoly of the state was justified by the need for a “large-scale and long-range” labor market policy requiring multiple aspects of labor market observation and a variety of measures geared also to the future. Only a state institution, thus it was held, could keep track of the entire labor market and seek to influence it along regulatory lines. Private agencies, by contrast, especially if profit-oriented, were considered “incapable of solving the entirety of tasks” – thus the direct quote of the German Federal Constitutional Court.<sup>4</sup> Private recruitment agencies were thought to “form a foreign element within the system of standardized employment placement, and to obstruct and interfere with its successful activities”.<sup>5</sup>

This appraisal was submitted by the Federal Constitutional Court in 1967, that is, in a phase of relative full employment, and upheld until the early 1990s. A new standpoint on this issue was taken by the European Court of Justice in its judicial evaluation of the German employment placement monopoly as an infringement of Art. 86 EEC Treaty – albeit only in respect of the recruitment of executive staff in the private sector.<sup>6</sup> In its judgment the Court considered it proved that the publicly operated employment agency was not in a position to successfully place *all* employees since there were groups such as private-sector executives for whom it was unable to procure employment.<sup>7</sup>

## VI. *Reallocation of tasks between the state and private actors – the new approach taken in current reform efforts*

This detailed historical retrospection serves to illustrate the reversal in employment promotion policy as it is perceived today on the basis of the new legislation. Thus the state has not abandoned its responsibility, but continues to perform functions involving consultation on the one hand and placement on the other. Nevertheless, a new approach to the

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4 Cf. BVerfGE 21, 245 et seq.

5 Cf. BVerfGE 21, 245 et seq.

6 Cf. EuGH, decision 23.4.1991, NJW 1991, 2891 et seq.

7 Cf. The comment on the Constitutional Court Decision: *Eichenhofer*, Das Arbeitsvermittlungsmonopol der Bundesanstalt für Arbeit und das EG-Recht, NJW 1991, pp. 2857 ff.

division of tasks is being sought, given that monopolized employment promotion seems to have failed, an appraisal which cannot be interpreted otherwise in view of longstanding unemployment rates of way beyond the four million mark.

### *1. Allocation of counseling tasks between the state and private actors*

The Employment Agency is obliged to render counseling services free of charge (§ 43 SGB III). This corresponds to legal claims on the part of employees (vocational counseling, § 29 SGB III) as well as on the part of employers (labor market counseling, § 34 SGB III). The performance of a solely advisory, non-mediating function by third parties is not expressly provided for under the law, nor, however, is it ruled out. Nevertheless, and this again is a reform of the reform, Section 288 a SGB III enables the Employment Agency to prohibit a third party from rendering vocational counseling “insofar as this is necessary to protect the person seeking advice.” But, apart from that, counselors are subject to less extensive obligations than placement agents since the former act on the basis of freely negotiable contracts for work or services.

### *2. Allocation of placement tasks between the state and private actors*

Pursuant to Section 35 SGB III, the state Employment Agency is obliged to offer jobseekers and employers its placement services. These encompass all activities aimed at bringing together jobseekers and employers for the purpose of establishing an employment relationship. To this end, a so-called *integration agreement* is concluded, setting forth the Employment Agency’s placement efforts as well as the jobseeker’s own efforts. But, contrary to the past, a prospective failure of these efforts by the state agency has now been taken into account by the legislature itself. Thus the lawmaker has supplemented state placement efforts by a new employment promotion instrument – the commissioning of third parties with placement. Now private actors, whose role in the labor market used to be regarded as “interfering and obstructive”, may be called upon to help out as the *deus ex machina*. It is thereby at the Employment Agency’s discretion to commission third parties to render their support in providing full or partial placement services (§ 37 (1) SGB III), especially if occupational (re)integration can thus be facilitated. Moreover, it is now explicitly provided for that: “A remuneration can be agreed for the placement activities of third parties.” An even further-going regulation stipulates that the unemployed can *demand* from the Employment Agency that it commission a third party with their placement if they are still without a job after six months from commencement of unemployment.

The inclusion of private recruitment agencies was additionally supported by the allotment of so-called placement coupons. By submitting these coupons, albeit limited in time until the end of 2004, unemployed persons could claim cost refunds up to a specified amount for the services of an agency they themselves had engaged (§ 421 g SGB III).

Finally, a special form of placement service is the reference of jobless persons to a Personnel Service Agency, an agency that employs jobseekers and hires them out to other enterprises. Personnel Service Agencies are primarily run by private undertakings on the basis of a permit; in addition to the remuneration they receive from the hirer, they are also paid a fee by the Employment Agency (§ 37 SGB III). This aspect, too, illuminates the paramount role now assigned to private actors.

This new regulatory concept does not absolve the state from its basic function, nor does it release it from its responsibility. But the presumption that, in case of doubt, the state will be more successful in its actions than third parties has ceased to apply. Rather, it has been recognized that the state's failure in the job placement sector is inherent to the system and in need of rectification. The aim is to achieve effective interaction between state and private actors – a regulated system of “competition between [public] employment offices and private placement services”, as it is referred to in the statutory material. This newly differentiated concept is characterized by a reciprocal “backup, supplementation and relief function” which seeks to compensate for the respective weaknesses of private and state placement, and to enable their respective strengths to come to the fore, thus achieving “precisely tailored placement” results.

Moreover, the state's control functions in respect of private actors have been scaled back. Until 2002, owing above all to a historically founded fear of private placement abuse, a preventive reservation on the granting of permission had applied, meaning that only those with an official permit could become active. This restrictive provision has now been replaced by the principle of economic freedom, with the registration of a job service business no longer subject to control. The state has thus dispensed with any form of selection but continues to reserve the right to prohibit a business on grounds of unreliability (pursuant to § 35 GewO – Industrial Code). Personnel leasing firms only require a permit if they wish to become part of the Personnel Service Agency scheme.<sup>8</sup>

## *VII. Obligating the employer*

A new approach taken by the reforms is also to obligate employers on a heightened scale. The law speaks of “interaction between employers, employees and Employment Agencies” (§ 2 SGB III). Employers are thus, in principle, required “when making their decisions [to take into account] in a responsible manner their effects on the employment of personnel and unemployed persons and, hence, on recourse to employment promotion benefits”. In concrete terms, this subjects employers to the duty to furnish information. Moreover, they are to utilize all possibilities of providing further vocational qualifications to their staff. Conversely, the Employment Agencies are likewise to keep employers abreast of the latest training and labor market developments.

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<sup>8</sup> Cf. *Rixen*, Das neue Sozialrecht der Arbeitsvermittlung nach der Reform der Bundesanstalt für Arbeit, NZS 2002, pp. 466 ff.

### *VIII. Strengthening the personal responsibility of those concerned: from “joblessness” to “job seeking”*

The basic conception underlying the reforms is not only to view the increased inclusion of “involved” and “non-involved” third parties as a new beginning. Also the relationship between the state and those affected shows that a shifting and re-weighting process has been initiated. No longer is the benefit side, the payment of support benefits, to be in the foreground but rather the actual placement activity. Thus the jobseeker is no longer perceived at the passive, receiving end but as being actively involved in the elimination of the unemployment risk. The law expressly lays down that the mediation of training and employment takes precedence over the mere furnishing of income replacement benefits in the event of unemployment (§ 4 SGB III). This valuation is also reflected in the new obligation under which even employees who are still in work but can foresee its termination must report to the Employment Agency. An infringement of this obligation entails a reduction in the employee’s future claim to unemployment benefit (§ 140 SGB III).<sup>9</sup>

If unemployment is perceived as a structural problem of post-industrial society based on division of labor, this means the unemployed cannot be “blamed” for the occurrence of the unemployment risk. Rather, one must assume that it is indeed in the own interest of those hit by unemployment to make every attempt to find work again. Even if these basic assumptions are upheld, it is nevertheless deemed necessary under the amended – and, especially in this regard, highly contested – regulation to implement legal control measures to counteract a possible passivity of those currently without a job or likely to be unemployed in the foreseeable future.

Hence, in summary, the following schema of newly defined rights and duties emerges: The state no longer has a placement monopoly; it cooperates with third parties, at times also competing with them. To avoid abuse, a control option has been retained, even if this no longer involves preventive reservations of permission. Jobseekers are now offered a wide array of possible placement instruments. Thus they are entitled to promotion but, as the reform slogan goes, simultaneously exposed to demands. They are not supposed to succumb to the occurrence of the “unemployment” risk, but must actively seek employment, as must society as a whole. They need not, like Baron Munchausen in his marvelous tall tales, pull themselves out of the morass by their own shock of hair. But they must accept the helping hand extended to them.

It is for this reason that non-cooperation in employment promotion measures is generally sanctioned by a reduction in benefit levels. That likewise applies to the refusal to accept reasonable job offers. Which nevertheless does not signify a new division of responsibility or its unilateral reassignment. But even if unemployment is viewed as a problem of society as a whole, the individual as a member of that society can be expected to participate in overcoming this – for him, both collective and personal – problem just as the state

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9 Cf. *Bieback*, *Fördern und Fordern – Kontinuitäten und Brüche im Arbeitsförderungsrecht der Hartzgesetze*, *Kritische Justiz* 2003, pp. 25 ff.

authorities are called upon to do so. All parties are to make an effort, each according to their own strength and potential.



**\*German Labor Promotion  
– Economic Aspects –**

*Ulrich WALWEI*



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\* German original translated by Esther Ihle, MPI Sozial Law, Munich

## The Role of Private Actors in Ensuring Social Security: Economic Aspects of Labor Promotion

- Situation: persisting labor market crisis in Germany
- Reforms aim at paradigm change in labor market policy
- More market in job placement services
  - Deregulation of private placement
  - Outsourcing of public placement
- Outlook: labor promotion before privatization?

### EU Labor Market Indicators (2002): Unemployment Rates

Unemployment (in % of labor force 15+)

2.8 (NL)	<b>5.4 (J)</b>	6.3 (OECD-20)	<b>8.2 (D)</b>	11.4 (ES)
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Youth unemployment (in % of labor force 15-24)

5.7 (CH)	<b>9.7 (D)</b>	<b>10.0 (J)</b>	13.4 (OECD-20)	26.3 (I)
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Long-term unemployment (in % of labor force)

0.3 (N)	<b>1.7 (J)</b>	2.1 (OECD-20)	<b>4.1 (D)</b>	5.1 (B)
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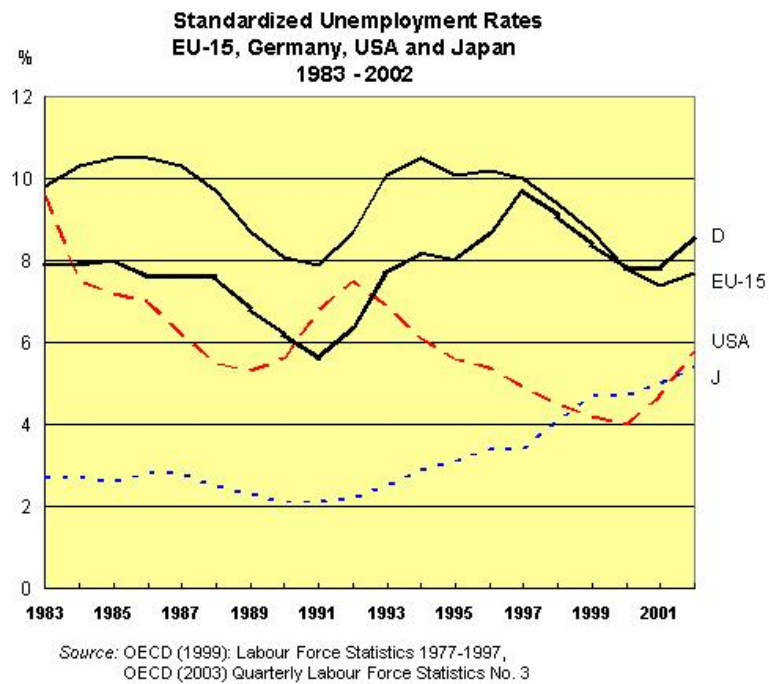
Unemployment of low-skilled workers \* (in % of labor force 25-64)

3.1 (NL)	<b>5.9 (J)</b>	7.4 (OECD-20)	11.9 (F)	<b>13.5 (D)</b>
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**Source:** OECD Employment Outlook 2003, OECD Labour Force Statistics 2003 - for assessing long-term unemployment

Note: \* 2001

OECD-20: EU States (without L) + Canada + USA + Japan + Switzerland + New Zealand + Norway



### EU Labor Market Indicators (2002): Labor Force Participation Rates

Labor force (in % of population 15-64)

55.6 (I)    **65.3 (D)**    68.2 (OECD-20)    **68.2 (J)**    78.9 (CH)

Female labor force (in % of population 15-64)

42.0 (I)    **56.5 (J)**    **59.0 (D)**    60.7 (OECD-20)    73.9 (N)

Older labor force (in % of population 55-64)

25.8 (B)    **38.4 (D)**    48.5 (OECD-20)    **61.6 (J)**    68.4 (N)

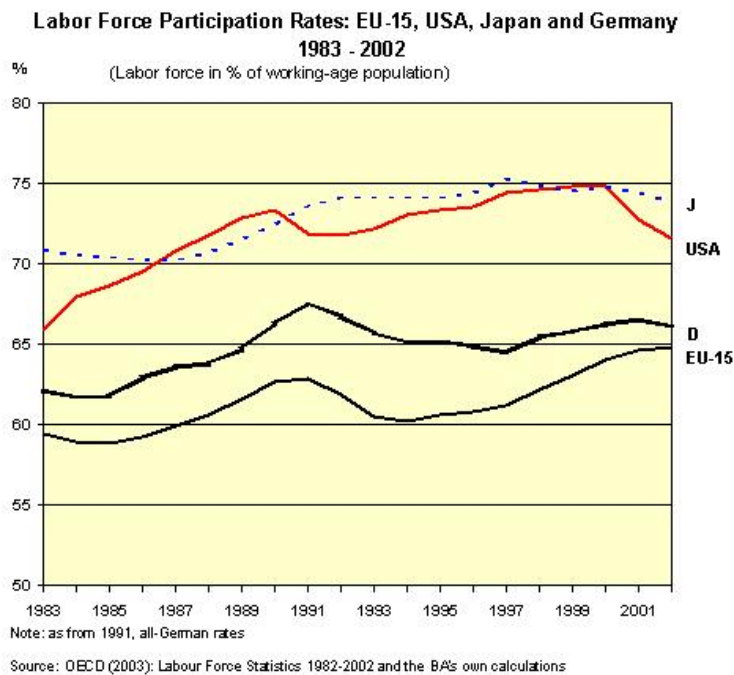
Low-skilled labor force \* (in % of employable population 25-64)

48.8 (I)    **51.8 (D)**    59.8 (OECD-20)    **67.6 (J)**    73.3 (P)

**Source:** Employment Outlook 2003

\* 2001

OECD-20: EU States (without L) + Canada + USA + Japan + Switzerland + New Zealand + Norway



## Timetable for Labor Market Reforms

- 1.11.2002 "Job Floater" (by KfW bank; meanwhile discontinued!)
- 1.1.2003 **Hartz\* I**  
Deregulation of temp work; PSAs\*\*; stricter job acceptance criteria; "Ich-AG"\*\*\*; training coupons
- 1.4.2003 **Hartz II**  
Mini- and midi-jobs; preparation of Job Centers
- 1.1.2004 **"Labor Market Reforms"** (Agenda 2010)  
Duration of unemployment benefit; protection against dismissal; Crafts and Trade Code
- 1.1.2004 **Hartz III**  
Reform of Federal Employment Agency (BA); simplifications of labor promotion law
- 1.1.2005 **Hartz IV**  
Amalgamation of unemployment and social assistance

\* Peter Hartz: head of the reform commission; \*\* Personnel Service Agencies; \*\*\* incentives for self-employment

## **Essential Starting Points for Labor Market Reforms (1)**

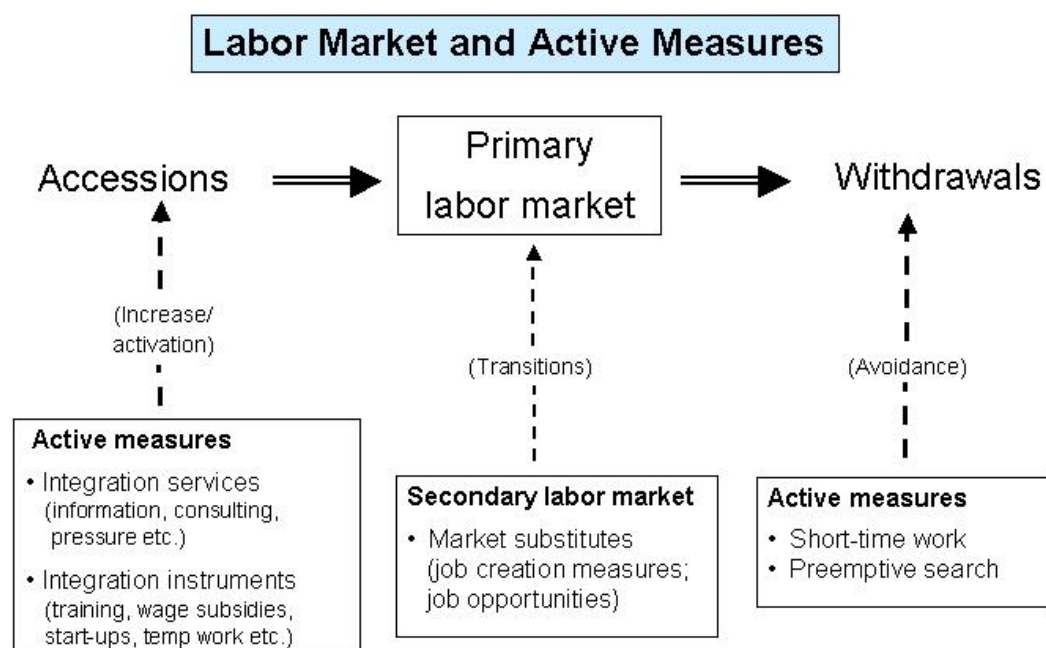
- Flexibilization of the labor market
  - Through labor law deregulation (threshold for protection against dismissal in small enterprises; extension of loan employment; temporary contracts for older employees )
  - Through reduced contributions in low-wage sector (mini- and midi-jobs)

## **Essential Starting Points for Labor Market Reforms (2)**

- Creation of incentives for jobless persons and improvement of employability
  - Benefit cuts (shorter duration of unemployment benefit to older employees; amalgamation of unemployment/social assistance)
  - Activation through stricter entitlement criteria (early notification, job acceptability, commitment, integration agreements)

## Essential Starting Points for Labor Market Reforms (3)

- Realignment of active labor market policy
  - ➔ Reorganization (reform of the Federal Employment Agency; Job Centers; more competition – also via “coupon solutions”)
  - ➔ New instruments geared to the “primary labor market” (“Ich-AG”, i.e. incentives for self-employment; personnel service agencies – PSAs)





	1994	2002
<b>Employment promotion measures</b>	<b>1.09</b>	<b>1.04</b>
- <b>Employment creation measures</b> (job creation measures, structural adjustment measures)	0.91	0.46
- <b>Promotion of regular employment</b> (notably wage subsidies)	0.14	0.43
- <b>Promotion of self-employment</b> (transitional allowance for start-ups)	0.04	0.14
<b>Short-time work to bypass operational difficulties</b>	<b>1.00</b>	<b>0.23</b>
<b>Participants in % of labor force (total)</b>	<b>2.09</b>	<b>1.26</b>
Labor force (domestic concept) in thousands: 37 304 (1994), 38 671 (2002)		

Source: Official communication of the Federal Employment Agency (BA) - "Arbeitsmarkt 2002";  
Calculations by the *Institut für Arbeitsmarkt- und Berufsforschung*

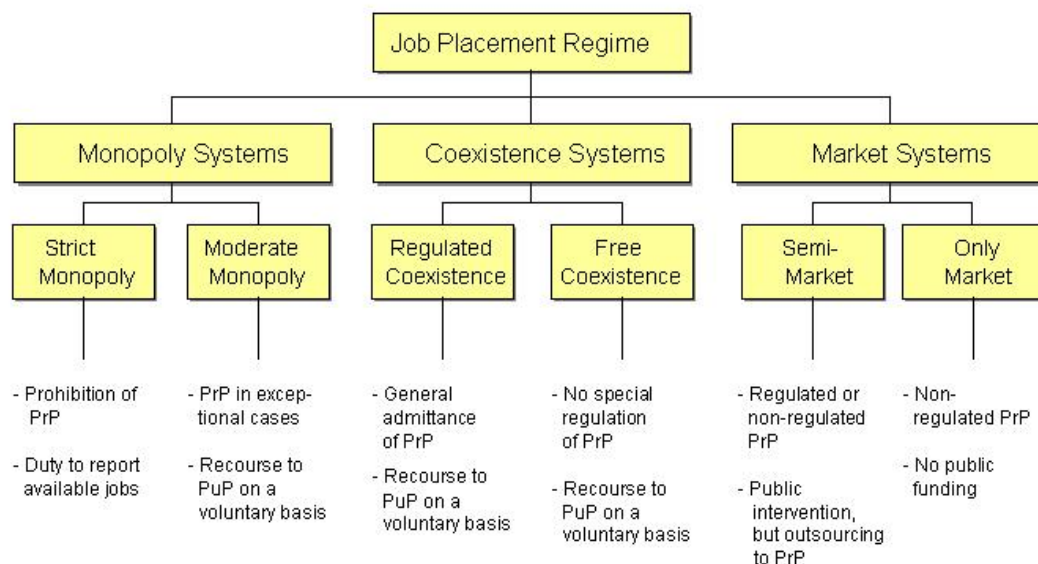
IAB-VV1-4/2003

## Economic Theory Underlying Employment Promotion

- Lacking labor market transparency  
(insufficient information on suitable jobs and applicants)
- Mismatch between job supply and demand  
(between regions and in certain areas of qualification)
- Lacking readiness of unemployed persons to take risks  
(in respect of investment in education and start-ups)
- Stigmatization and hysteresis  
(sorting processes owing to large job deficit)

## Job Placement as a Private Service and a Public Task

- **General**
  - Marketable service
  - Experience required on account of quality uncertainties
- **Private placement**
  - Guided by considerations applying to individual economic units
  - Contribution to market equilibrium – but attended by restricted market transparency (exclusive nature of information)
- **Public (state-financed) placement**
  - Intervention in response to “market failure”
  - Effective and efficient use of public funds



*Note:*

PuP = public placement  
PrP = private placement



## Deregulation of Job Placement in Steps

- Till 31.3.1994: Placement monopoly, with commissioning of private recruitment agencies in exceptional cases
- 1.4.1994: Admittance of private placement for executives
- 1.8.1994: General admittance of private placement (subject to permission and professional requirements)
- 1.1.1998: Admittance of private consulting and private placement services for apprentice posts
- 1.4.2002: Abolition of permission obligation; partial admittance of fees on the employee side

## Recourse to and Success of Various Company Search Options 1994, 1998, 2003 - in % -

Search paths	West Germany						East Germany					
	Search path taken			Successful search			Search path taken			Successful search		
	1994	1998	2003	1994	1998	2003	1994	1998	2003	1994	1998	2003
Company's own advertisements	51	52	42	42	36	28	24	27	20	16	15	14
Response to advertisements of job-seekers	6	9	3	3	2	0	6	4	6	2	3	1
Internet job offers			20			7			24			5
<b>Public placement</b>	<b>32</b>	<b>41</b>	<b>33</b>	<b>13</b>	<b>17</b>	<b>15</b>	<b>37</b>	<b>49</b>	<b>42</b>	<b>22</b>	<b>32</b>	<b>23</b>
<b>Private placement</b>	<b>2</b>	<b>8</b>	<b>8</b>	<b>1</b>	<b>2</b>	<b>2</b>	<b>2</b>	<b>2</b>	<b>9</b>	<b>1</b>	<b>1</b>	<b>6</b>
Notice on company gate	3	3	10	1	1	0	2	3	5	1	1	0
In-house advertising of vacancy	14	20	28	2	4	2	7	7	12	2	2	3
Selection from among proactive applicants	18	23	23	12	14	15	18	15	25	17	11	17
Suggestions from staff	25	28	24	16	16	17	36	27	29	27	17	19
Undeclared				10	8	14				12	18	12
<b>Sum total</b>	<b>151</b>	<b>184</b>	<b>191</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>132</b>	<b>134</b>	<b>172</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: IAB-FB4 (IAB survey on aggregate job offer)

## Relationship Between Public and Private Job Placement

- Little competition, largely complementary (at most, intersection between commercially run temp-work agencies and public job placement)
- Private recruitment mainly on behalf of company search requests
- Commercially run agencies primarily recruit persons seeking a job change (notably, executives and qualified staff)

## Germany on the Way From the “Coexistence Model” to a Mixed Market

- 1.1.2002: “Job-AQTIV”<sup>\*</sup> Act (on the reform of labor market policy instruments):
  - Placement entrusted to third parties (§ 37a SGB III – Social Code III)
- 1.4.2002: “Placement scandal”:
  - Introduction of placement coupons
- 1.1.2003: Hartz<sup>\*\*</sup> reforms:
  - Personnel Service Agencies
  - Training coupons
  - Commissioning of institutions with integrative measures (§ 421i SGB III)

<sup>\*</sup> AQTIV: German for Activation, Qualification, Training, Investment and Placement; <sup>\*\*</sup> Peter Hartz: lead of reform commission

### BA Expenditure on Outsourced Services

Instruments	2002		2003	
	in million €	in % of active benefits	in million €	in % of active benefits
Placement assigned to third parties (§ 37 a SGB III)	174.2	0.8	351.4	1.7
<b>Placement coupons (§ 421g SGB III)</b>	<b>13.6</b>	<b>0.1</b>	<b>47.1</b>	<b>0.2</b>
<b>Personnel Service Agencies (§ 37c SGB III)</b>			<b>174.5</b>	<b>0.8</b>
Training coupons (§ 77 (3) SGB III)				
Contributions to further training (without subsistence money)	2704.0	12.2	2028.6	9.7
Commissioning of other institutions (§ 421i SGB III)			12.1	0.1
Rehabilitation services (§ 109 SGB IX)	42.2	0.2	44.2	0.2
<b>Total</b>	<b>2934.0</b>	<b>13.3</b>	<b>2657.9</b>	<b>12.7</b>
Without training coupons	230.0	1.0	629.3	3.0
Total active BA benefits	€ 22.1 billion		€ 20.9 billion	
Total BA expenditure	€ 56.5 billion		€ 56.8 billion	

Source: Federal Employment Agency (BA); 2004

### Placement Coupons as a New Form of Integration Aid (1)

#### Measure:

- Introduction in April 2002 (time-limited until end of 2004)
- Entitlement: unemployed persons after 3 months' unemployment, also participants in job creation/structural adjustment measures (ABM/SAM)
- Performance-related premium of € 1,500 to 2,500 (depending on job-seeker's previous term of unemployment)

#### Aim:

- Additional placement options for unemployed persons
- Efficient placement system through more competition

## Placement Coupons as a New Form of Integration Aid (2)

### *Previous Results and Ex-ante Evaluation:*

- High number of coupons issued - but only seldom cashed in
- 50 % of integrated job seekers in employment relationships of at least six months' duration
- Substantial take-along effects assumed (many sponsored job seekers might have found employment anyway)
- Restraint on the part of well-established agencies (presumably because of relatively low premium)
- Considerable potential for misuse (part of the premium becomes due even after short duration of employment)



### Issued and Cashed-in Placement Coupons

	2002	2003 (1.1.- 31.12.)	2004 (1.1.-31.7.)
Issued coupons	206 900	482 400	434 000
Cashed-in coupons	12 900	35 400	27 800
Proportion of cashed-in coupons as a percentage of all issued coupons	<b>6 %</b>	<b>7.3%</b>	<b>6.4%</b>

Source: Federal Employment Agency (BA)

## Personnel Service Agencies (PSAs)

### ➤ *Measure:*

- Placement-oriented supply of temporary workers commissioned by the Federal Employment Agency (award procedure)
- PSAs work with contractually agreed employee numbers (and defined categories of persons)
- Fee payment by lump compensation and placement premiums

### ➤ *Aims:*

- Fast and improved reintegration of unemployed persons with placement impediments
- Aid (inter alia, further qualification) during non-loan periods
- In addition: opportunity to assess availability

## Personnel Service Agencies (PSAs)

### ➤ *Previous Results and Ex-ante Evaluation*

- Excessive expectations raised by Hartz Commission: 2002 Report assumed 500 000 annual entries
- BA planning for 2003: 800 PSAs providing 50 000 entries to PSA employees
- Current situation:
  - approx. 27 600 employed in October 2004 (reflecting difficult business environment and "Maatwerk failure")
  - approx. 64 000 withdrawals from June 2003 to October 2004; of which 20 700 (= approx. 32 %) in compulsorily insured employment
- Conflicting aims in the selection of PSA applicants (ambitious integration aims create "cream-off" incentive)
- Risk of squeezing out commercially run temp-work agencies



## **Effects of Optimized Job Placement and Intensified Job-Seeking by Unemployed Persons**

- Improved quality of labor market equilibration
- Faster staffing of existing vacancies and contribution to the reduction of unnecessary overtime
- Coverage of latent labor demand
- Changes in the “waiting line” through enhanced intervention in labor fluctuation
- “Clearing” of unemployment statistics

## **Upshot: Labor Promotion Before Privatization?**

- The success of labor market policy does not depend on proof of placement; decisive is the admission into employment
- Wage replacement benefits as a complementary activation tool (for promoting and demanding proactive job seeking)
- Public and private service providers: competition, cooperation and increased outsourcing
- Pressure on Federal Employment Agency through institutional experiments (outsourcing under § 421i SGB\* III and option model in SGB II)
- Reputation gains for all personnel service providers through more diversity

\* SGB: German Social Code

**\*Japanese Labor Market – Legal Aspects**  
**On the Most Recent Reforms to Labor Standards Law,  
Worker Dispatching Law and Employment Insurance Law**

*Hisaaki FUJIKAWA*

**I. Problems**

1. Employment promotion and legal policy
2. Employment situation and the labor market services industry
3. How do we view the role of officials and private actors?

**II. Procedures leading up to the 2003 reform**

1. Reform history of the Labor Standards Law
2. Reform history of the Worker Dispatching Law
3. Reform history of the Employment Insurance Law

**III. Reform of the Labor Standards Law – three main points**

1. Amendment of permit and application procedures for placement agencies
2. Regulation through job placement agencies themselves
3. Cost-free job placement

**IV. Reform of the Worker Dispatching Law – four main points**

1. Regulation governing dispatching undertakings
2. Dispatch periods
3. Enhanced responsibility of the dispatcher
4. Enhanced responsibility of the employer

**V. Reform of the Employment Insurance Law – three main points**

1. Fundamental framework conditions
2. Benefits to generally insured jobseekers
3. Other benefits

**VI. Appraisal**

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\* German original translated by Esther Ihle, MPI Sozial Law, Munich

This report deals with the legal policies and the role of private actors and official authorities in the field of employment promotion on the basis of the most recent reforms to Labor Standards Law, Worker Dispatching<sup>1</sup> Law and Employment Insurance Law.

## *I. Problems*

What problems does our subject matter address? To answer this question, it is necessary to illuminate employment promotion and the setting in which it occurs.

### *1. Employment promotion and legal policy*

What is employment promotion? As far as I know, no attempt has been made to discuss this concept in a consistent manner in Japan. Yet, in order to reflect on the overall theme of legal policy and the distribution of tasks between private actors and official authorities, it is imperative to do so. For the purposes of this report, I define employment promotion as the effort to stabilize personal life as well as society and the economy by ensuring that the employment situation of individuals is as adequate as possible and that the supply of and demand for labor is balanced along macroeconomic lines.

Viewed from this angle, legal policies underlying employment promotion must be geared to: 1) the demand for labor, namely the maintenance, extension and revival of that demand; 2) the supply of labor, namely recruitment and development of available manpower; and 3) the labor market itself, thereby regulating information, participation, mobility, withdrawal, adjustments, solutions to “mismatch” situations etc. Concrete legislation and policy measures should conform to these requirements. Hence, we see that the implications of employment promotion are very extensive both in qualitative and quantitative terms.

What, then, is the situation of employment promotion itself?

### *2. Employment situation and the labor market services industry*

As in Germany, the legal policy situation of employment promotion in Japan is difficult. The major issue is to find employment for long-term unemployed persons, who are especially numerous among youths and older jobseekers.

More and more young persons are jobless in Japan, the main reason being the large number of withdrawals after only a brief period of employment. This situation is augmented by companies' restrictive recruitment policies, above all with a view to fresh graduates from high school or university. In addition, reference is often made to the prob-

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<sup>1</sup> In Japan, “worker dispatching” is the designation for temporary work.



lematic attitude toward work and lacking motivation on the part of the young generation. The phenomena of “inner withdrawal” or “parasitic conduct” are sometimes cited as a societal predicament in Japan. All that could pose a threat to Japan’s society and economy in the future. And so an atmosphere of crisis prevails. Youth unemployment in the Japanese labor market is also closely related to the issue of professional qualifications, the lack of which leads to more unemployment.

Unemployment among older workers is also on the rise: their number has quadrupled in the past ten years and the quota has tripled. Long-term unemployment encumbers the budget, diminishes the willingness and ability to work and, hence, obstructs the way out of a jobless life.

In such a setting, labor market services are in high demand, with the legal reforms described further on playing a certain role. To be noted first of all is that manifold service types and functions have developed in the public and private sectors. They include job advertisements, job-seeking assistance, placement activities, aid in taking up work, unemployment insurance, worker dispatching, commissioning of recruitment, to name only a few. The market scope of such private services comes to about ¥ 2.3575 trillion, with advertisements accounting for ¥ 576 billion, placement activities for ¥ 109.5 billion and dispatching for ¥ 1.6720 trillion. The service industry has evolved into a major sector of the Japanese labor market. With additional liberalization and flexibilization measures pending, it is expected to grow even further.

Despite such seemingly contradictory developments, we should resist the urge to jump to causal conclusions. Instead, we should acknowledge these significant implications when contemplating the role of private actors and official authorities.

### *3. How do we view the role of officials and private actors?*

Meant here is the division of roles between official authorities and private actors. The so-called societal orders, including the legal policies underlying employment promotion, bear the following traditional features:

1. Mistrust of the market, as reflected in the controlling function of “the officials”. The thinking here is that if employment promotion were left to the “unordered” market principle, entrepreneurs could ruin each other in the competitive arena, thus ultimately harming consumers. The government or its authorities are therefore called upon to control supply and demand in the respective markets through the issue of permits. On the opposite side, there is the trust in the self-regulatory power of the market and a mode of thought that prefers the principle of private action.

2. Need for an anticipatory, uniform and comprehensive order that is related to the above notion of official regulation. Before it is too late, participation in a given market should be controlled in advance in a homogenous and extensive manner. This also has to do with the notion of discretionary administration. At the opposite end are retroactive and

ad hoc forms of control. In this context, the justification of administrative actions and transparency of responsibility constitute vital requirements.

3. Regulation in the form of paternalism and interference, which in turn is closely connected to the second point. The opposite here would be self-empowerment and minimal controls.

4. Non-profitability. The organizations involved and their activities in the market ought to be non-profit-oriented. Hence, the efficiency principle is not a prime issue here. In concrete terms, that signifies a ban on private corporations' participation in the market. This line of thinking stands in opposition to the objectives inherent in profitability and the performance principle.

5. Form of organizational support. Organizations that are licensed by the competent supervisory authorities or meet the requirements specified by them are entitled to a variety of subsidies. On the opposing side, we find equal treatment and individual subsidization.

Society frequently demands the clear separation of private and official roles. In my view, it is not possible to draw such a demarcation line. For, in the end, the question is where the two poles can achieve some form of balance in their individual properties. As I see it, the legal policy governing employment promotion is on the way to finding an optimal adjustment of that balancing point.

In the light of the above-outlined factors, the following report takes the most recent reforms to Labor Standards Law, Worker Dispatching Law and Employment Insurance Law as illustrative "material". This material is limited to the discussion of the above factors – not only for reasons of conciseness but also because these points are of major relevance to our subject.

## *II. Procedures leading up to the 2003 reform*

### *1. Reform history of the Labor Standards Law*

The 1999 reform:

The "Private Employment Agencies Convention" (ILO C 181) was ratified by Japan, and formerly prohibited private fee-charging placement services have now largely been permitted except for one specific area of exception. Thus the basic lines of employment placement policy have been altered on a wide scale. Enterprises providing fee-charging placement services have been officially recognized, their appropriate mode of operation secured and the protection of workers (jobseekers) defined accordingly. In enacting the reform legislation, the Labor and Welfare Committee of the Upper House declared an additional resolution, demanding that after three years from entry into force of the reformed Labor Standards Law, the future treatment of job placement services for part-time and short-term workers was to be extensively reviewed. In addition, thought was to be given to the enforcement of the law, thereby reassessing the pertinent regulations, if necessary.

December 2001:

The “First Report of the General Deregulation Conference” recommended an easing of the restrictions on job placement fees as well as the deregulation of cost-free placement services. Prior to that, in August, a review of the employment placement order had been launched by the Labor Standards Subcommittee under the auspices of the Labor Policy Council.

December 2002:

The “Second Report of the General Deregulation Conference” declared the need for a fundamental deregulation of employment placement and outlined the proposed methods of procedure. The Labor Standards Subcommittee submitted its proposal to the Labor Policy Council in the same month.

February 2003:

The Ministry of Health, Labor and Welfare introduced a draft reform, underscoring the need for such revisions in dealing with the critical unemployment situation and the manifold job opportunities that could be met by enabling employment placement agencies to foster quick, smooth and adequate links between labor supply and demand.

## *2. Reform history of the Worker Dispatching Law*

The 1999 reform:

In the face of increased labor market fluctuation and the rising demand for temporary work on the part of both employers and employees, a regulation was needed to protect dispatched workers. Among other things, this led to a revision of the so-called negative list.

2001:

The “First Report of the General Deregulation Conference” proposed the revision of the Worker Dispatching Law with a view to its deregulation, in order to diversify temporary work options and extend the dispatching of workers.

From August 2001:

The Labor Standards Subcommittee under the Labor Policy Council launched a review of the worker dispatching system and of employment placement as a whole.

2002:

The “Second Report of the General Deregulation Conference” stressed the reform’s need to prolong time-limits on dispatch periods or to abolish time-limits altogether, thus extending the permissible scope of dispatched work.

February 2003:

On the basis of the proposals, the Ministry of Health, Labor and Welfare presented a draft reform. It was aimed at the protection of dispatched workers, taking due account of both employment security and the appropriate maintenance of worker dispatching services.

### *3. Reform history of the Employment Insurance Law*

1974:

The Employment Insurance Law was the successor to the Unemployment Insurance Law. The payment of equal insurance contributions by employers and employees formed the core of that revision.

1994:

Benefits in support of employment stabilization were introduced; these were not based on the precondition of unemployment. In 1998, additional vocational training benefits were adopted.

2000:

The defined benefit days in terms of basic salary were revised extensively and contribution rates raised.

Employment Insurance funding had been in an extremely critical situation for ten years. The real unemployment rate exceeded the 5% mark, benefit recipients had increased and contribution income declined. Since 1994, the budget had been in deficit.

Financial resources were nearly depleted by the end of 2002; insurance funds had reached a critical point. It may indeed have been difficult to predict such a serious long-term stagnation but belated measures in dealing with the problems were also part of the cause.

2002:

The Tripartite Group for Employment Insurance now initiated discussions and presented an interim report detailing individual points of a proposed reform. In addition, the so-called elasticity article (§ 12-5 of the Law on the Levy of Employment Insurance Contributions) was enacted, thus enabling contribution rate modifications by plus/minus 0.2% under specific conditions. From October, insurance contributions were raised to 1.75% (with the contribution to unemployment benefit accounting for 1.4%).

2003:

The final report of the Group was submitted to the Labor Standards Subcommittee, which proceeded in drafting the reform law. The report rests on three pillars: 1) rapid re-employment, 2) flexibility of employment patterns and working styles, and 3) benefits with a prime focus on the difficult reemployment situation.

These developments leading up to the 2003 reforms can be subsumed by such keywords as deregulation, financial distress, labor market flexibility, extended job opportunities, protection of industrial workers and enhanced employment security. What reforms, then, did actually occur as a result of this process.

### *III. Reform of the Labor Standards Law – three main points*

#### *1. Amendment of permit and application procedures for placement agencies*

- Uniform permits. Permits are issued to placement agents (§§ 30-1 and 33-1 Labor Standards Law).
- Scope of fee-charging employment placement and other services. Undertakings need only submit an application to the Ministry of Health, Labor and Welfare (§ 32-1).
- Cost-free placement. A special law enables the establishment of organizations that provide free services to their members; only an application is required (§ 33-3 revised). Chambers of Industry and Commerce, Agricultural Cooperatives etc. are expected to take part in the scheme.
- Cost-free recruitment. Now, only an application is required (§ 36-3 revised).

#### *2. Regulation through job placement agencies themselves*

- Tasks of agents responsible for job placement. The responsible placement agency has now been clearly defined as the agency which administers the entirety of services in conjunction with employment placement (§ 32-4).
- Prohibition rule. The ban on job placement in respect of such undertakings as restaurants, inns and hotels, as well as money lending businesses and other catering services has been lifted. A supplementary provision has been adopted here.
- Security deposit. The deposit required to compensate for damages suffered by job-seekers as a result of illegal commercial placement activities has been abolished.

#### *3. Cost-free job placement*

- Extension of free placement services. For instance, training establishments can now place equally qualified jobseekers other than university and school students free of charge (§ 33-2). Jobseekers included in this category are specified by the Ministry of Health, Labor and Welfare. According to the Ministry's plans as at November 2003, these are: 1) persons who have undergone and completed clinical training in university clinics and 2) recipients of authorized training measures (vocational training under public vocational development institutions).
- Municipal organizations can render placement services free of charge by applying to the Ministry of Health, Labor and Welfare (§ 33-4 revised).
- Regional recruitment principle. The former principle that “[i]n recruiting workers, the employer must make an effort to ensure that employees can commute normally from their place of residence to the workplace” has today lost its meaning and therefore been rescinded.

#### *IV. Reform of the Worker Dispatching Law – four main points*

##### *1. Regulation governing dispatching undertakings*

- Extension of dispatching work to the manufacturing sector. This was formerly prohibited under a supplementary provision “pending further notice” and has now finally been liberalized. Nevertheless, the dispatch period in the first three years after entry into force of the reform law is to be limited to one year (additional provision no. 5). Until further notice, the permit application or the notification form, respectively, must state that the dispatched worker is to be hired out to a client company engaged in manufacturing (additional provision no. 4).
- Presentation of information with a view to potential employment. This constitutes a newly defined worker dispatching model (§ 2-6). The dispatcher thus seeks to inform the dispatched worker, either before or after commencement of the service, about the service recipient and a potential engagement in the respective occupation. Moreover, the prospective employment of the dispatched worker is discussed between the dispatched worker and the employer before the service ends. Thus it has become possible to formulate the intention of establishing a regular engagement or employment relationship prior to the end of the dispatch service or even to declare a fixed employment intention. In this case, the provision that employers are not allowed to select certain employees becomes obsolete (§ 26-7).
- Simplified permit and notification procedures. Permission and notification, respectively, have been transferred to the undertaking (§§ 5-1 and 16-1).

##### *2. Dispatch periods*

- Extension of services without restricting dispatch periods. Fundamentally, the dispatch period is limited to one year. Nevertheless, this limitation does not apply to 26 specialized services stated in the so-called positive list, as well as to fixed-term projects and replacement services for employees on parental leave. Now also included are services with fixed employment days (fewer than regular monthly working days) and replacement services for nursing staff on vacation.
- Prolongation of dispatch periods. Employers can now extend dispatched workers’ term of engagement by up to three years in the same line of work. If the intended duration of dispatch is to exceed one year, a special procedure must be applied.

##### *3. Enhanced responsibility of the dispatcher*

- Extension of the duty to disclose working conditions. “The first working day must be stipulated because this affects the limitation of the dispatch period” (§ 34-1-3 revised). In cases where the dispatch period is altered after conclusion of the dispatch contract, the dispatcher must without delay inform the worker, as well as the employer, of the

new day of work commencement (i.e. the day that affects the limitation of the dispatch period; § 34-2 revised).

- Precursory duty to inform of the termination of dispatch. The dispatcher is not allowed to dispatch workers beyond the day fixed by the limitation of the dispatch period and is now obliged to notify both the employer and the dispatched worker accordingly thereof (§ 35-2-2 revised). The dispatcher must inform the dispatched worker one month in advance or, alternatively, one day prior to the day affecting the dispatch period that it will not dispatch the worker any further.
- Additional duty for the responsible dispatcher. The tasks of the responsible dispatcher have been supplemented by the duty to contact the staff in charge of safety and health at the workplace or the employer, respectively, in order to ensure that the relevant rules are complied with (§ 36-5).

#### *4. Enhanced responsibility of the employer*

- Requirement of the client company's advance decision concerning the dispatch period. If the employer wishes to engage a dispatched worker for one and the same job at its place of operation or some other location for a period in excess of one year but no longer than three years, it must stipulate the desired period in advance (§ 40-2-3 revised). Before doing so, the employer must first hear the trade union representing more than half of the company staff or, in the absence of union representation, the representative of the staff majority (§ 40-2-4 revised). The workers' representation must also be heard if the dispatch period is altered.
- Additional duty for the responsible employer. See the additional duty of the dispatcher (§ 41-4).
- Direct application for employment of the dispatched worker. This applies to cases in which the employer wishes to engage the dispatched worker beyond the limited dispatch period of one year (§ 40-4 revised) and to take on the same worker for the same job beyond the non-restricted dispatch period of three years (§ 40-5 revised). If the employer has thereby contravened the Worker Dispatching Law, the Ministry of Health, Labor and Welfare will initially counsel and advise the employer (§ 48-1). If the employer neglects to rectify the situation, the Minister will advise him to submit an employment application on behalf of the dispatched worker (§ 49-2). If the employer again fails to do so, the Ministry can make this publicly known.

### *V. Reform of the Employment Insurance Law – three main points*

#### *1. Fundamental framework conditions*

- Recognition of unemployment. A newly added amendment requires “that recipients of [unemployment] benefit have personally spoken with a job provider or have been of-

ferred a job by the labor office or other job placement agency or have attended a vocational training course or made at least some attempt at finding work” (§ 15-5).

- Obligation of recipients of jobseekers’ benefit. The new regulation sets forth that recipients of jobseekers’ benefit must make an effort to find work by unfolding and enhancing working capability, as necessary, while sincerely and avidly seeking work (§ 10-2).
- Measure to counter illegal benefit receipt. In tightening sanctions against benefit abuse, the returnable sum has been raised by “up to the twofold amount” (§ 10-4-1). Private placement agencies are likewise subject to repayment in cases of abuse (§10-4-2).
- Raising of insurance contributions. Employment insurance contributions have been further increased to 1.95%; however, this measure was not implemented in 2003 and 2004.

## *2. Benefits to generally insured jobseekers*

- Modification of daily rates of basic earnings. These have been lowered for benefit calculation. Thus the daily basic earnings rate forms the basis for the assessment of the benefit rate: the higher the daily rate, the lower the benefit rate. Previously, the benefit rate ranged between 80% and 60%; following the reform, it is now within the range of 80% to 50% (§ 16-1-2).
- Standardization of benefits. Benefits to short-term and other types of insured are to be standardized through modifications in favor of the short-term insured (§ 17-4). The minimum earnings limit for fulltime employees has been halved from ¥ 4,290 per day to ¥ 2,140. Correspondingly, the maximum daily salary rate, based on age, has likewise been lowered (§ 17-4).
- Modification of daily salary rates. Previously, if an employee withdrew from employment after attaining the age of 60, the daily rate of basic earnings was calculated by comparing daily salary rates prior to and after the age of 60 and then taking the higher daily salary rate. This special regulation has been abolished. A new provision in cases of salary loss or decrease owing to leave of absence or working time reduction during maternity or family care periods is to compare the daily salary rates between the two time points and then to take the higher daily rate in calculating the basic benefit rate.
- Benefit duration. The distinction between “special beneficiaries” who lost their jobs owing to bankruptcy/redundancy and “other beneficiaries”, as well as between short-term insured and normally insured persons, no longer conforms to actual circumstances. Consequently, benefit days have been standardized (§§ 22 and 23). Simultaneously, benefits to persons with multiple needs have been augmented.



### 3. *Other benefits*

- Benefits to older long-term insured persons. The distinction between normally and short-term insured persons has been dispensed with, and the daily rates of basic earnings have been standardized for 30 or 50 days respectively (§ 37-4).
- Benefits to promote employment. Previously, there were four benefit types: reemployment support, allowance to prepare for reemployment, allowance for moving expenses and allowance for job-seeking in distant regions. The benefit in support of reemployment and the preparatory allowance have been consolidated to form the new employment promotion benefit (§§ 10-4 and 56-2). Also new is the reemployment benefit paid to those who find a job before the duration of unemployment benefit ends.
- Benefit in support of pedagogic training. This benefit has been substantially reduced; at the same time, young persons' opportunities for accessing it have been extended.
- Benefits on behalf of the permanent employment of older workers. Benefit conditions and benefit rates in the case of "basic benefits for permanent employment in advanced age" and "benefits for reemployment in advanced age" have been altered in favor of the insured (§§ 61 and 61-2). Regulatory provisions have been adopted in respect of the latter benefit to avoid overlapping with the aforementioned reemployment benefit (§ 61-2-4).

The three aspects of employment security, efficiency development and employment welfare were not at issue here. The report of the Employment Insurance Working Group nevertheless demands "the setting of priorities and the implementation of rationalization measures in order to achieve a politically relevant result in the face of the current grave unemployment situation."

## VI. *Appraisal*

The above-outlined reforms were essentially conducted in a smooth transition. Additional material for an in-depth discussion of our subject was not available. Proceeding from the broad overview of the presented statutory revisions, I close by pointing out four important aspects.

1. The above reforms to the Labor Standards Law can be viewed as a kind of final polish. As it were, they draw a line under the distribution of roles between private and official actors in this field. The boom in the private job placement sector has not, however, contributed to solving the labor policy issues of youth and long-term unemployment. Thus it remains imperative to verify the results of policy objectives when considering the roles of private actors and official authorities. This is often overlooked in the process of deregulation. Nor should we scholars forget our own role in seeking to accomplish policy goals.

2. The most important aspect of the reforms to the Worker Dispatching Law involves the two areas in which the dispatching business has been extended. It is to be queried, however, whether such lagging measures can appropriately deal with the purported de-

mands of a functionally changing labor market. In reality, it seems that dispatching coupled with the intention of prospective employment, which was so highly advocated in practice, has already gone out of fashion. The market constantly takes on new forms. Instead of suffocating new market forms by spanning a network of nontransparent regulations, it would be better to place more trust in the market and to intervene only when necessary.

3. The main focus of the reforms to the Employment Insurance Law is on the granting of reasonable benefits and the setting of priorities. Thus measures are confined to fine tuning. The willingness to work must be assessed stringently; simultaneously, the aspect of self-empowerment remains indispensable. In distributing tasks between private actors and official authorities, it should not be overlooked that also employees and jobseekers themselves play a vital role in the process.

4. On the whole, we can say that the statutory reforms discussed here continue to rest on merely fine-tuning, lagging, uninspired and unverified measures. If such a deadlock is not broken, Japanese legal policy in terms of our subject has no future.

# Employment Security in Japan – An Economic View –

*Kazutoshi KOSHIRO*

I. Introduction

II. Economic Implications of Employment Security in Japan

III. Recent Employment Changes in Japan after the 1997 Depression: What Changed?

IV. What will happen in the near future?

Note: The following Arabic serial number in the text corresponds to the graphic representation the text below.

## *I. Introduction*

Japan is one of the advanced countries which provide for a considerable degree of employment security. When the economy had been growing, employment security was believed to be one of the social apparatuses which guarantee social stability and economic efficiency at the same time. Lifetime employment was believed to be an effective way of human capital formation and skill development among the leading economic sectors. However, since the 1990s, due to the growing competitive threats of globalization and the appreciation of the national currency, large Japanese firms that had once been proud of the “lifetime commitment” system seem to have been obliged to modify the system to a considerable extent.

First of all, the core workforce protected by employment security was slimmed down in many large companies. Secondly, non-regular employees who are not entitled to employment security have grown significantly. Thirdly, professionals with high-tech skills have become mobile, moving among competing companies. Fourthly, reflecting these changes in employment system, the pay and remuneration system based on years-of-service has moved in the direction of payment-by-result or pay-by-performance.

Nevertheless, successful large companies such as Toyota, Canon and Kao still insist that they will keep “lifetime employment” in so far as their core workforce is concerned. They will achieve this by two means: increasing “non-regular employees” (part-time and temporary workers), not only in their own plants, but also more widely among their supporting suppliers; and modifying their pay system toward a more performance-oriented one.

Finally, we have to pay attention to new social problems that have been arising due to the economic stagnation since 1997, namely, (a) how to meet the increasing cost of social security; (b) how to integrate the growing number of irregular employees who are mostly left outside of job security and social security and (c) how to deal with the increasing number of young people who are not in education, employment or training (NEET). In this presentation, the author will try to clarify these problems, concentrating on the economic aspect of employment security and leaving the problem of social security for another time.

## *II. Economic Implications of Employment Security in Japan*

1. In Japan, an employer is guaranteed the freedom of contract and hiring or not hiring any worker within the limit of the Constitutional requirements for public interest. An employer can reject a person because of his or her ideology or belief. An employer is also guaranteed the right to dismiss an employee by giving prior notice of 30 days or paying thirty days' wages (Article 20, Labor Standards Law). However, in fact, an employer can-

not dismiss any worker without fulfilling the requirements and procedures established by many court decisions since the 1950s.

The Labor Standards Law (LSL) was revised in 2003 so as to implement the essence of these court decisions. Article 18-2 of the LSL stipulates that "a dismissal should be deemed as abuse of the right to dismiss and, hence null and void, in case of lack of just cause as being regarded as socially not justified."

2. The doctrine of the abusive use of the right to dismissal was established by court decisions between 1950 and 1977, of which the two decisions by the Supreme Court in 1975 and 1977 were the most important.

"Lifetime employment" is in fact a practice established by large Japanese companies on the bases of both the "employment contract of an indefinite term" and "the doctrine of the abusive use of the right to dismissal."

With respect to redundancy, the court decisions clarified the four preliminary conditions necessary before redundancies are introduced. These are: (a) the real necessity to reduce the work force; (b) exhausting other alternatives; (c) fair procedures and (d) prior consultation with the union. The amended Labor Standards Law (Article 18-2) is understood to incorporate these court decisions.

In addition, many serious labor disputes arose against redundancy dismissals in the 1950s and the early 1960s, forcing employers to avoid outright redundancies. High economic growth since the middle of the 1950s also enabled them to expand and maintain employment except for a few cases. So long as GDP continued to expand, Japanese employers were able to maintain "lifetime employment".

Large companies as well as public enterprises had also realized through their experiences since the 1920s that long-term employment or job security tended to promote human capital accumulation through continuous OJT and to stimulate employees' loyalty to employers. These positive effects of job security were widely accepted by employers in those countries which industrialized late and which wanted to catch-up with advanced technology. Borrowed technology tended to stimulate the development of firm-specific skills inside each firm. Thus, "lifetime employment" practices in Japan far preceded the human capital, or incentive theory in labor economics.

3. Among the total employees of 54 million, the extent of "lifetime employment" is in fact limited to only 15 million employees in large private companies and public services. On the other hand, 14 million employees are working as "non-regular employees." The largest number of employees is in neither type of large organization but rather is employed in small- and medium-sized companies. Presumably they are protected by a labor contract of an indefinite term, but their employment is in fact not secured, so workers themselves seek to move to better jobs if they can. At the same time, it should be emphasized that there are many medium-sized or somewhat larger companies that have unique technology and are successful in the world market. These companies even nowadays tend to maintain long-term employment as well as the seniority-based wage systems.

4. An international comparison of employment security indicates that the degree of protection is almost equal between Germany and Japan, both being a little stricter than the average, but not among the strictest in the advanced countries. A recent study of OECD

(2004: pp.72-~73) gives an updated overall summary index of strictness of employment protection regulation. According to it, Japan became closer to the weakest end (the United States), while Germany remains closer to the strongest end (Portugal). This new index includes regulations on temporary forms of employment, in which Japan put into effect a considerable degree of deregulations in the 1990s.

5. Wages in Japan's manufacturing industry had increased every year until the 1997 depression due to the "Spring Offensive" by labor unions. Hours worked have also decreased through collective bargaining and legal enforcement which achieved the 40-hour week by 1997. Moreover, the yen has been revalued and appreciated since 1971. As a result, the hourly wage rate converted to the U.S. dollar has increased significantly. Between 1970/I and 1995/II, it increased at the annual rate of 11.8 %, and even after that, it increased at the annual rate of 8.9 % between 1970/I and 2004/II. This means that the Japanese manufacturing industry had to increase labor productivity at the same rate in order to maintain international competitiveness, or not to increase the unit labor cost. Actually, many manufacturers were not able to maintain international competitiveness to such an extent and were obliged to discontinue operation, at least inside Japan, and to reduce employment.

6. This Figure illustrates the percentage of establishments which introduced some form of employment adjustment measures. These include reducing overtime, stopping unscheduled additional recruitment, transferring redundant workers, farming-out, encouraging vacations, terminating part-time and temporary workers, temporarily suspending work and early retirement.

7. This Figure illustrates similar actions by employers during the recessions in 1997-98 and 2000-2002.

8. These figures show that Japanese firms have tried to avoid redundancies and their attendant conflicts through various measures. After the first oil crisis in 1973, many econometric studies clarified that the employment adjustment speed was slower in such countries as Germany and Japan that protect employment by statutory regulations or court decisions. On the other hand, in those countries such as the United States and the United Kingdom that maintain the principle of employment-at-will, the employment adjustment speed was faster. The Table here shows the result of an analysis by the EPA in Japan in the early 1990s.

9. According to an analysis by Japan's Economic Planning Agency, the quarterly speed of employment adjustment of regular employees in the manufacturing industry in Japan between 1974 and 1993 was 0.04 compared with 0.45 in the United States, 0.21 in the United Kingdom and 0.14 in Germany. Converting them into an annual speed, they were 0.15 in Japan, 0.9 in the U.S., 0.618 in the U.K., and 0.453 in Germany respectively.

However, in terms of labor input (number of employees times hours worked), the annual adjustment speed was 0.684 in Japan, 0.99 in the U.S., 0.83 in the U.K., and 0.70 in Germany. This means that American firms were able to adjust their labor input to the optimum level almost in one year, whereas Japanese firms needed four years and German firms about three years respectively.

In order to compensate for rather strict employment security, Japanese companies make their labor utilization more flexible by extensively using overtime on the one hand, and by

exploiting internal functional flexibility (multiple job assignments, wider transfers, recurrent retraining, etc.) on the other.

10. The number of regular employees of major Japanese companies such as Japan Iron and Steel, Mitsubishi Heavy Industries, Hitachi and Toshiba, which traditionally maintained "lifetime employment" for many decades, have gradually been reduced, mostly through attrition, since around 1970, especially since the first oil crisis in 1973. The most impressive is the case of Japan Iron and Steel which reduced its regular employees from more than 80,000 to less than 20,000 during the past 30 years. Mitsubishi Heavy Industry also reduced its regular employees from 80,000 to 33,000.

11. There is another group of major companies that have increased and maintained their regular employees during the past 30 years, such as Toyota, Matsushita, Sony and Canon, although Toyota and Sony recorded their peak employment by the early 1990s. As well, Canon and Matsushita recently increased their regular employees. On the other hand, there has been serious employment reduction at NEC since 1998. The top management of the first four companies above says that they will maintain "lifetime employment" of their core workers, although they are going to abandon seniority-based wages.

12. In 1974, the government introduced employment subsidies to employers (industries) which suffered from recession and were obliged to reduce their workforce. The employment subsidies were financed by a new special account in the unemployment insurance. If employers in a designated depressed industry are obliged to suspend employees due to more than a 10 % reduction of output, but endeavor to maintain employment, they will be able to get employment subsidies (1/2 of wages in the case of large companies and 2/3 in the case of small- and medium-sized companies) from the government.

The total amount of employment subsidies actually paid exceeded 60 billion yen during the period 1974 to 1995, but was reduced in the following years, and finally overhauled in October 2001. Subsidies are now paid to individual employers only, instead of all the employers in the designated industry. This has meant that subsidies were cut significantly in recent years.

### *III. Recent Employment Changes in Japan after the 1997 Depression: What Changed?*

13. Despite the wide-spread impression of the economic failure of Japan in the 1990s, Japan's economy has continued growing at the average annual rate of 3.1 % between 1980 and 1997. It only suffered from serious setback in 1997 and 2001, but, even then, continued growing slowly at the annual rate of 0.7 % between 1997 and 2002. In the Fiscal Year 2003, real GDP increased by 3.2 % (nominal GDP by 0.8 %). Between 1990 and 2001, Japan's GDP grew at the average annual rate of 1.35 %. In comparison, German GDP grew at the average annual rate of 1.8 % between 1990 and 2001.

14. However, in Japan the most serious problem since 1997 has been continued deflation which caused the Nominal GDP to become smaller than the Real GDP.

15. Reflecting the economic downturn since 1997, the number of the unemployed increased from 2.1 million in 1997 to 3.59 million by 2002, whereas the number of self-employed and family workers decreased significantly from 11.66 million in 1997 to 9.81 million by 2003. On the other hand, the number of employees stood almost at the same level as in the period prior to the depression (53.91 million in 1997 and 53.31 in 2002). As a result, the number of the total employed persons began to decrease slowly from 65.57 million in 1997 to 63.16 in 2003.

16. Total employment (the number of employed persons) in major economies usually increases as GDP grows. In Japan, it increased at about 0.3 percent as GDP grew by 1 % until 1990. But, the employment elasticity decreased to only 0.13 between 1990 and 2001.

In contrast, the total employment in USA, UK, and France grew at the employment elasticity of about 0.4 during the period 1990-2001. Only in Germany did employment fail to increase in proportion to the GDP growth in that period, perhaps because of difficulties due to political unification.

17. In Japan, employment began to decrease in 1997. The total employment decreased by 2.41 million between 1997 and 2003, but 3/4 of this number were self-employed and family workers, most of whom were aged and preferred to retire instead of seeking new employment. Thus, unemployment increased only by 1.2 million, while the labor force decreased by 1.21 million, meaning that about a half of those who lost employment retired from the labor market and affiliated to the Not-in-Labor-Force which increased by 4.17 million during the same period.

18. Despite the severe depression since 1997, the number of employees did not decrease significantly. Several large financial institutions went bankrupt in this period, but the total number of employees decreased by only about half a million between 1997 and 2003.

19. In contrast and more importantly, the number of self-employed and family workers, including small farmers, shops, and factories, has been decreasing for more than four decades, and the speed of decline accelerated since the collapse of the Bubble Economy in 1990. Only in 2004 can a slight recovery of self-employment be noticed.

20. Reflecting these changes, the decline in the Employment Rate among the total population aged 15 and over accelerated since 1997. It was once about 65 % at the end of the High Economic Growth Period, and stood at about the 62 % level for about two decades, but went down to below 60 % in 1999 and became less than 58 % by 2003. However, it should be noted that the employment rate in Japan is still higher than that of Germany, France and the U.K. according to the OECD definition, which is calculated according to the total working population aged between 15 and 64.

21. The employment rate is very high in Nordic countries, Iceland being at the top. The three major European countries lie below the level of Japan.

22. Japan's labor force participation rate is also higher than that of France, Germany or the U.K. It should be emphasized, however, that Japan's labor force participation rate also began to decrease in 1997, now recording the lowest historic level of about 60 %.

23. The labor force participation rate differs largely between men and women. The male labor force participation rate had declined from the highest level at 86.0 % in 1957 to



74.8 % by 2003, whereas the female labor force participation rate had also declined from the peak of 56.7 % in 1955 to 47.7 % in 1972. Then the latter started to recover, reaching 50.2 % in 1992. But, it has been declining again slowly to the level of 48.3 % in 2003. This reflects the less favorable labor market conditions since 1997, especially for women.

24. The female labor force participation rates differ markedly by age group. Among teen-agers, it has declined sharply as the result of their increased participation in higher education. Many middle-aged women reentered the labor market after child-raising. More than 70 % of women aged between 45 and 49 now participate in the labor market. However, most of them are working as part-timers, and are not protected by the principle of "lifetime employment".

25. In Japan, one of the most conspicuous features of the labor market is that the labor force fluctuates anti-cyclically to business conditions. During a period of economic downturn, people, especially women, tend to retire temporally from the labor market without seeking jobs. Nor do they claim unemployment benefits because many of them were working part-time, thus not eligible for benefits. Therefore, the non-labor force increases when business conditions are slack. The ratio of the non-labor force to the total population aged 15 and over has sharply increased since 1998, exceeding 39 % by 2003.

26. The average ratio of non-labor force to the total male and female population aged 15 and over exceeded 40 % in 2003.

27. The unemployment rate started to climb since the middle of the 1990s, and reached the record high of 5.8 % in April 2003. Then, it began to decrease gradually to below 5 % by the end of 2003. In August 2004, it declined to 4.7 % (seasonally adjusted).

28. The average ratio of the non-labor force to the total population aged 15 and over exceeded 40 % in 2003. Even among men, the ratio had increased to the level of 26 % by 2003. For women, it again exceeded 50 % in 1999 and increased to 52.3 % by November 2004.

29. More than half of female employees are now working as part-timers. Even among male employees, part-timers now account for about 16 %. Among the total male and female employees, more than 30 % are now working as part-timers. They are paid less than regular employees doing similar jobs and they are mostly not protected by either unemployment or social insurances. The expansion of non-regular employment seems to be an inevitable outcome of preserving job security for the core workforce, and the trend is likely to continue with the increasing competition under globalization as well as the appreciation of the yen.

#### *IV. What will happen in the near future?*

30. Another aspect of employment security is the tendency to preserve jobs for middle-aged and older workers, so depriving young people of employment opportunities. Genda (2004:86,109) stresses that employment security among older workers tended to displace new recruitment of young workers. The number of jobless youngsters who are designated

as “NEET” increased during the past decade. They work irregularly and part-time, unable to develop a career, and not covered by social insurances. This means that they cannot get married. Now, an increasing number of young men and women, some of them regular employees, remain unmarried in their twenties and early thirties, which accelerates the already declining fertility rate.

It is only fair to mention another aspect of Japan’s ageing workforce, which is the impact it will have on the economy in the future. It is estimated that between 2007 and 2009, about 5.4 million employees out of 6.9 million “baby-boomers” who were born in the period 1947-49 are going to retire at the age of 60, which is still the mandatory retirement age in many companies. This means that about 1.1 million workers will retire from the labor market by 2010. One economist pessimistically describes the impact such a large-scale retirement will have on the economy as follows: among other things, the GDP may decrease as a result of the decrease of labor input; companies will have to bear increased financial burdens for their retirement allowances; the savings rate will go down further (*Highuchi*, 2004).

However, is it too optimistic to expect that the mass retirement of the baby-boomer generation would create employment opportunities for young people who have been blocked from regular employment during the past decade?

31. Among young people between the ages of 15 and 35, the number that is not in employment, education or training (NEET) has almost doubled in the past decade. They are not “Freeters” (a Japan-made word meaning free part-timers) in the labor force, but are classified as “Not in Labor Force”, though they sometimes work irregularly.

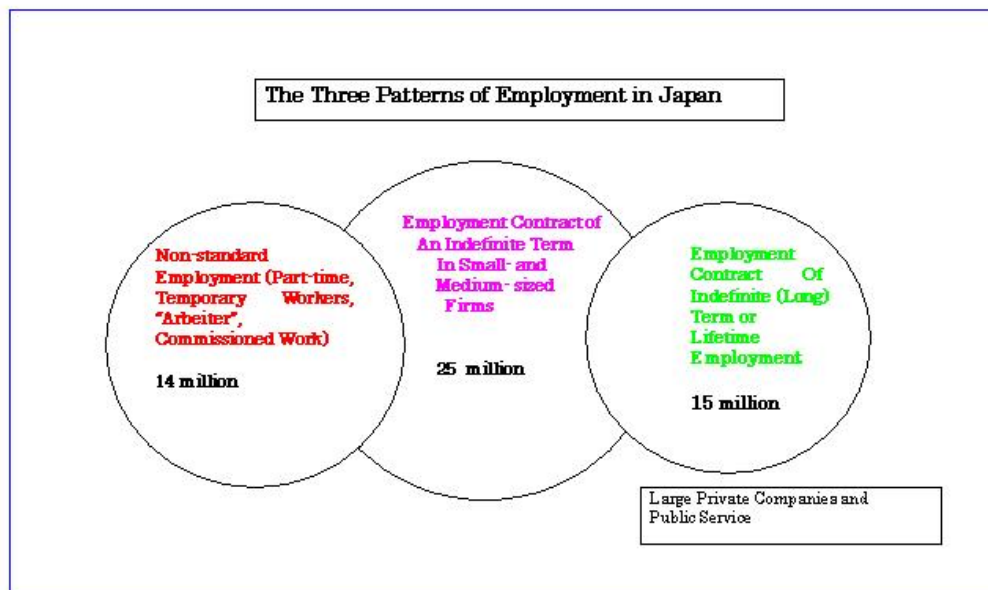
32. In 2000, the number of young people classified as NEET was estimated to be 760,000. The number of the unemployed in that year was 1,460,000. This means that, among the Not in Labor Force category, there is in fact another group of hidden “unemployed”. Recently, among young men and women aged 19, more than 4 % were classified as NEET (*Kosugi and Hori*, 2003: pp.3-4). Most of them were not married, categorized as “parasite single”, meaning that they depend on their parents for a living. How to encourage them to be integrated into society is one of the most serious social problems in the country today. Solving this problem must be given high priority.

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See 3.



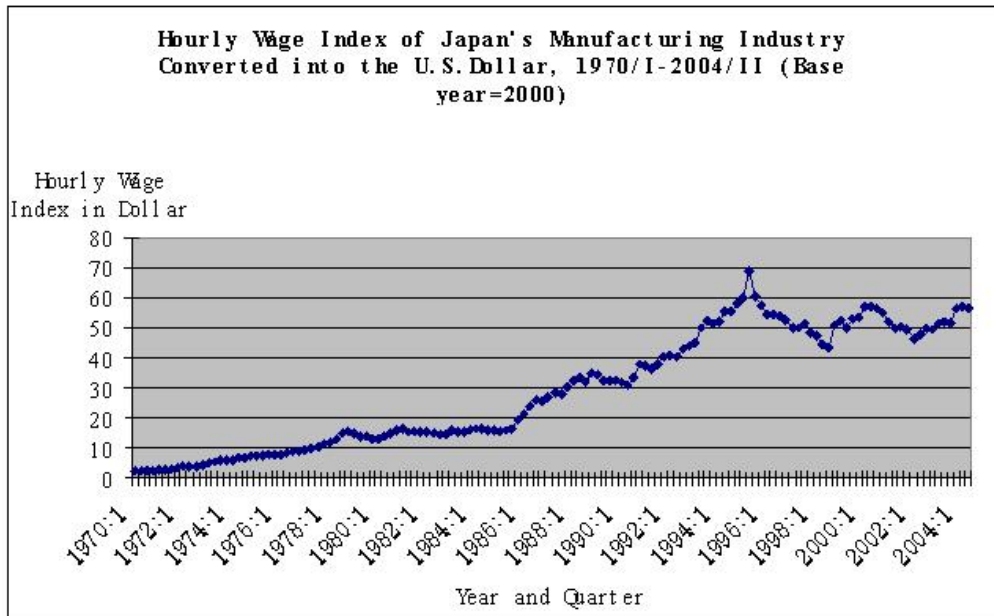
See 4.

### An International Comparison of Employment Security, 1998



## Employment Security in Japan – An Economic View

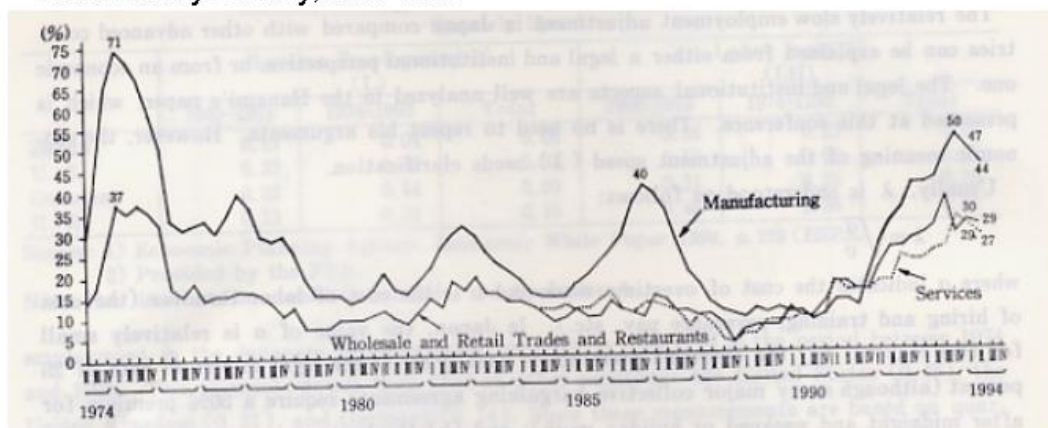
See 5.



Source: Toyo Keizai Shinpo Sha, Economate 2000q3.

See 6.

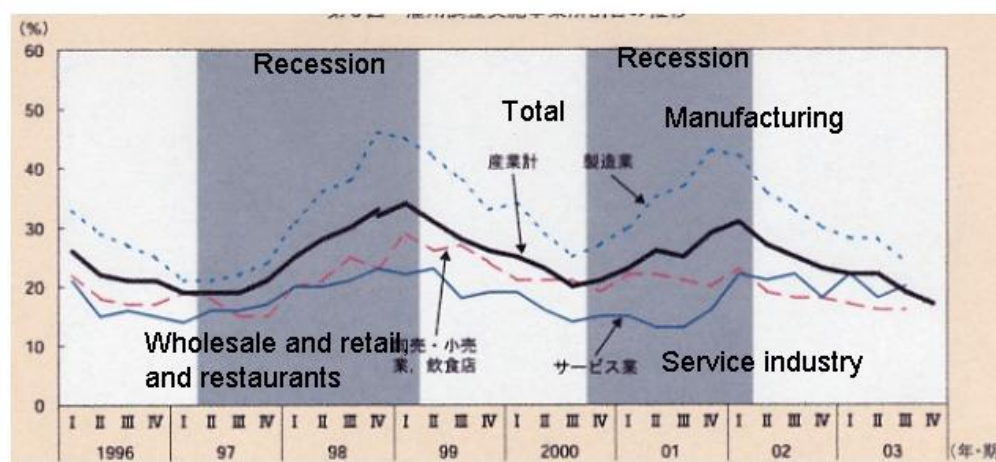
### The Percentage of Establishments Introduced Some Employment Adjustment Measures by Industry, 1974-1994



Source: Ministry of Labor, quoted from K.Koshiro, "The Link between Labor-Management Relations and Job Security," Yokohama National University, *Economia*, 46-1, May 1995, p.8.

See 7.

# Percentage of Establishments Introduced Some Employment Adjustment Measures by Industry, 1996-2003



Source: Ministry of Health, Labor and Welfare, White Paper on Labor Economy, 2004, p.7

See 8.

## An International Comparison of the Employment Adjustment Speed

Table 3: The Speed of Employment Adjustment in the Manufacturing Industry of Major Countries  
—Quarterly Speed—

	Regular Employment 1) (L)			Labor Input 2) (LH)		
	1960-1973	1974-1993	Total	1960-1973	1974-1993	Total
Japan	0.13	0.04	0.08	0.16	0.25	0.11
U. S.	0.32	0.45	0.33	0.53	0.68	0.57
Germany	0.22	0.14	0.09	0.31	0.26	0.15
U. K.	0.13	0.21	0.15	0.46	0.36	0.31

Source: 1) Economic Planning Agency, *Economic White Paper 1994*, p. 219 (ESP).  
2) Provided by the FPA.  
Note: For details of econometric analysis, see Appendix A.

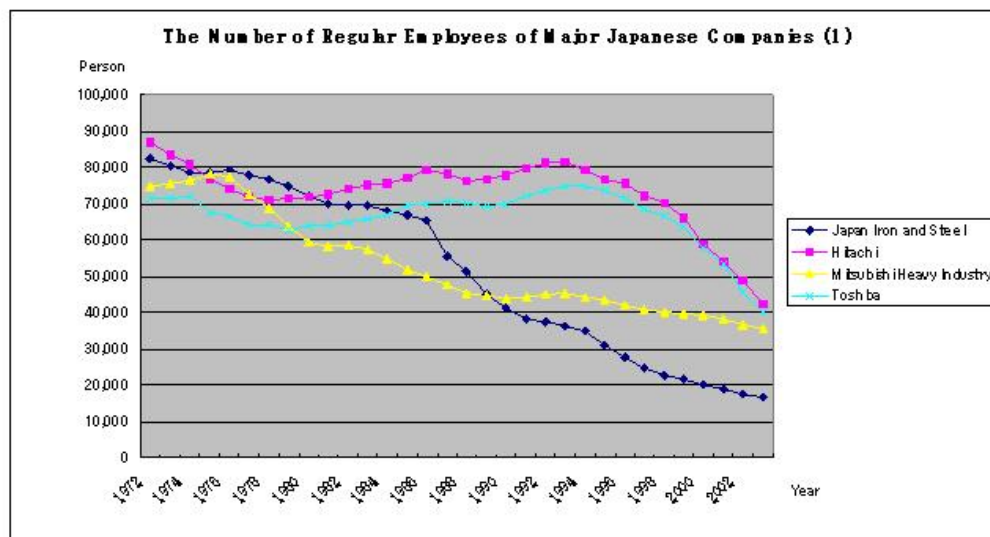
Source: K.Koshiro, "The Link between Labor-Management Relations and Job Security," Yokohama National University, *Economia*, 46-1, May 1995, p.6.



See 9.

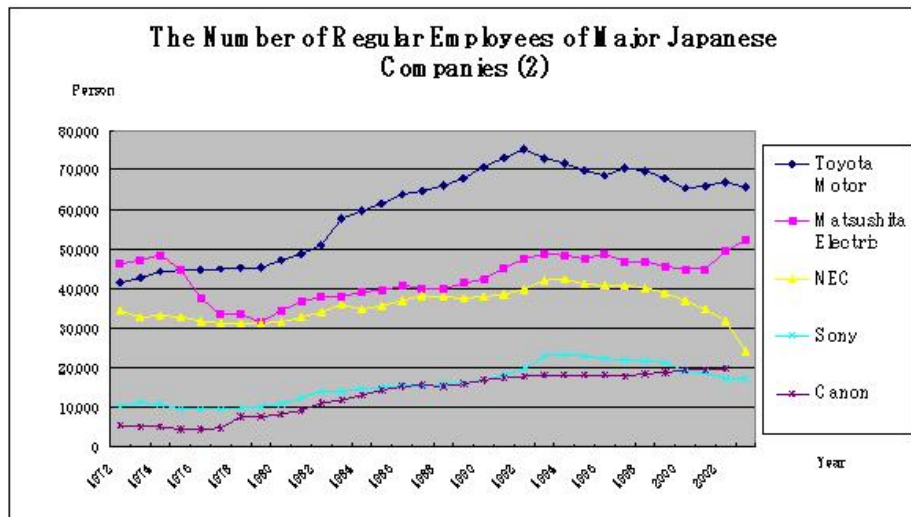
- According to an analysis by Japan's Economic Planning Agency, the quarterly speed of employment adjustment of regular employees in the manufacturing industry in Japan between 1974-93 was 0.04 compared with 0.45 in the United States, 0.21 in the United Kingdom and 0.14 in Germany. Converting them into an annual speed, they were 0.15 in Japan, 0.9 in the U.S., 0.618 in the U.K., and 0.453 in Germany respectively.
- However, in terms of labor input (number of employees times hours worked), the annual adjustment speeds were 0.684 in Japan, 0.99 in the United States, 0.83 in the United Kingdom, and 0.70 in Germany. This means that American firms were able to adjust their labor input to the optimum level almost in one year, whereas Japanese firms needed four years and German firms about three years respectively.
- In order to compensate for rather strict employment security, Japanese companies make their labor utilization more flexible by extensively using overtime on the one hand, and by exploiting internal functional flexibility (multiple job assignments, wider transfers, recurrent retraining, etc.) on the other.

See 10.



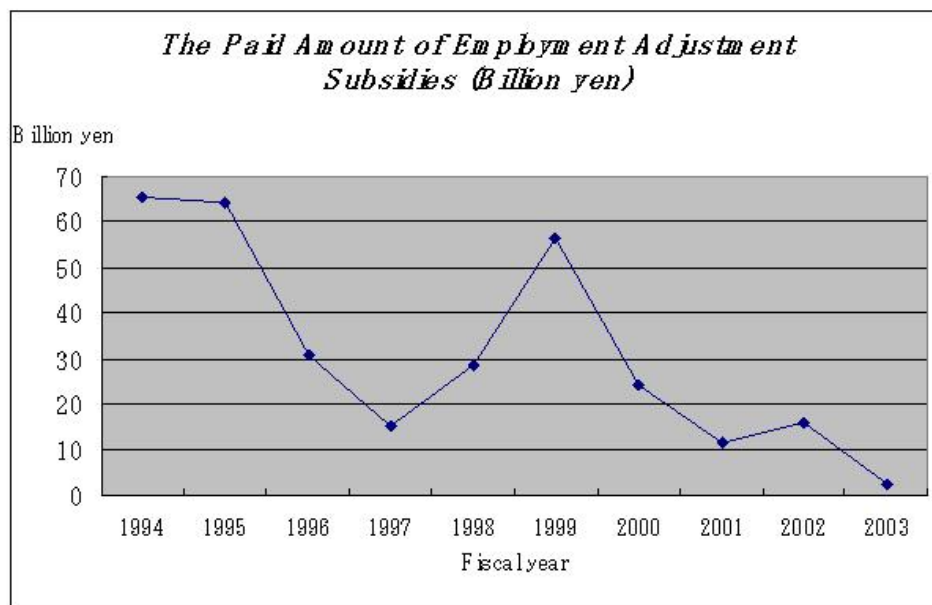
Source: Original data are based on the Nihon Keizai Newspaper, NEEDS Financial Data.

See 11.



Source: The same as Figure 10.

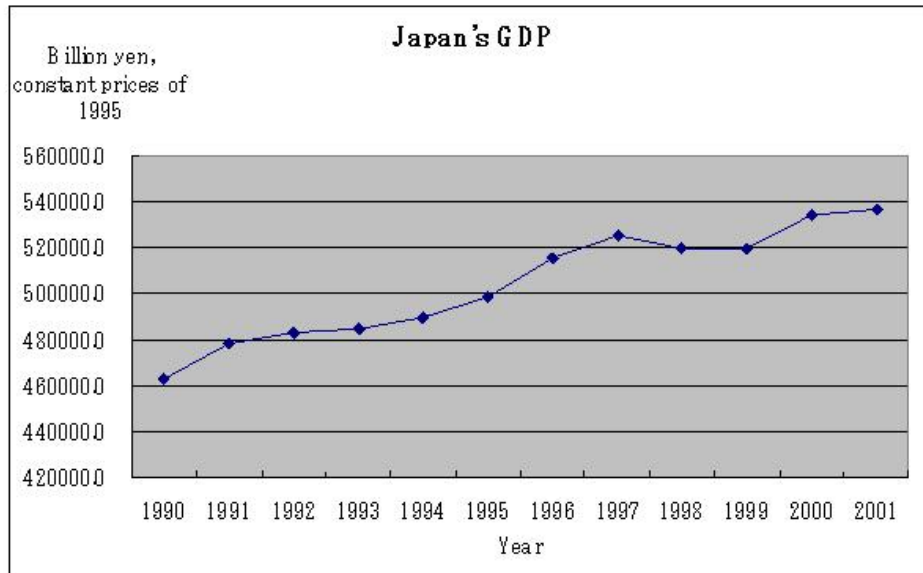
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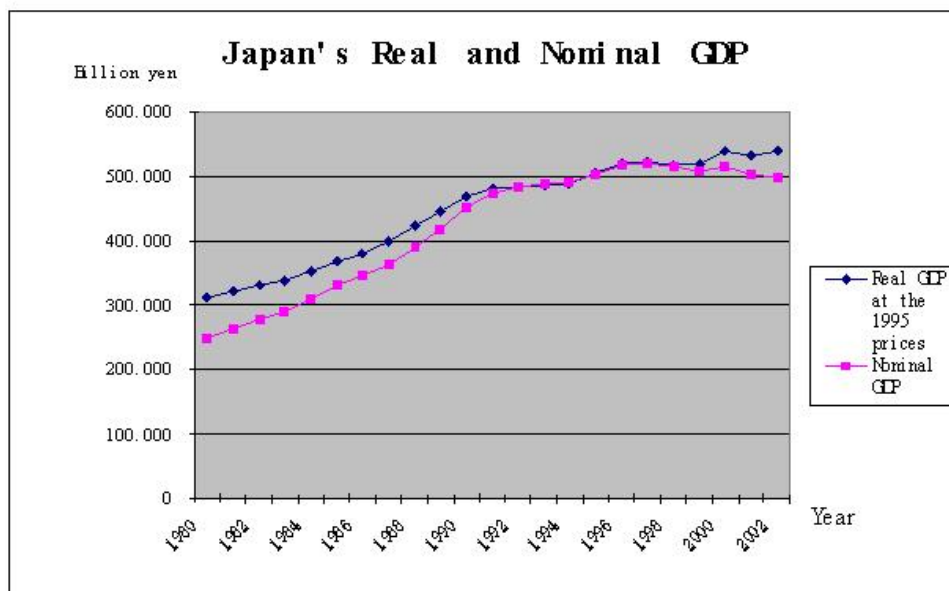
Source: Department of Employment Policy, Ministry of Health, Labor and Welfare.



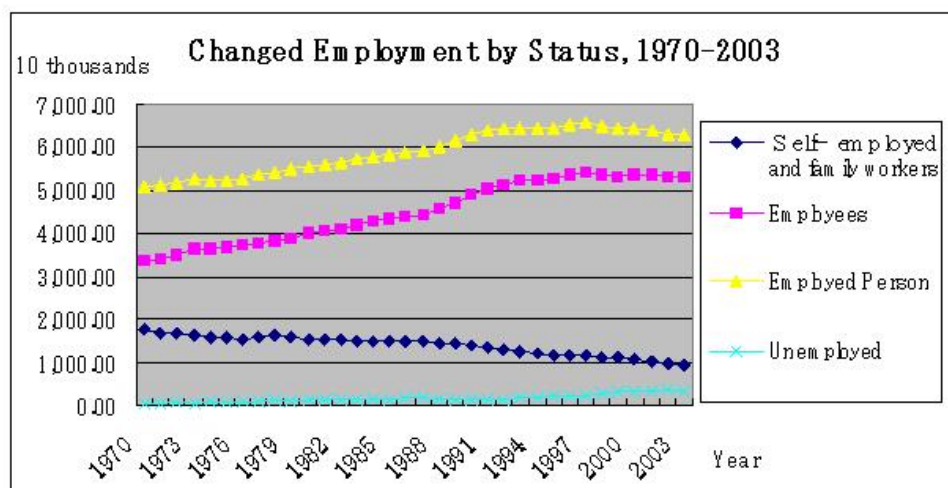
See 13.



See 14.



See 15.



See 16.

- Employment Elasticity against GDP  
~ An International Comparison~

Country	Observation Period	Employment Elasticity/ GDP	t-value	Adjusted R <sup>2</sup>
Japan	1975-90	0.29	53.28	0.9947
Japan	1980-97	0.32	33.14	0.9848
Japan	1980-2002	0.29	20.66	0.951
Japan	1990-2001	0.13	2.09	0.2024
USA	1990-2001	0.434	36.17	0.992
UK	1990-2001	0.438	21.5	0.983
France	1990-2001	0.374	7.36	0.869
Germany	1990-2001	X	- 0.49	- 0.082

Source: Computed from the following data: For Japan, the original data are based on Toyo Keizai Shinposha, Economate. Others are from ILO, Year Book of Labour Statistics; United Nations, National Accounts, Part II.

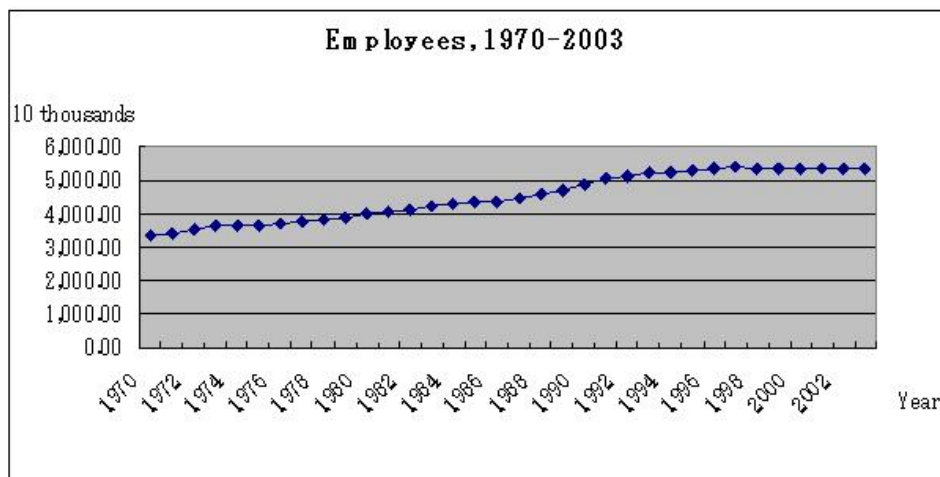
See 17.

## Changes of Employment since 1996 (million)

• Year	Labor Force	Employed persons	Empl- yees	Self- employed	Unem- ployed	Non Labor Force
• 1996	67.11	64.86	53.22	11.64	2.25	38.52
• 1997	67.87	65.57	53.91	11.66	2.30	38.63
• 1998	67.93	65.14	53.68	11.46	2.79	39.24
• 1999	67.79	64.62	53.31	11.31	3.17	39.89
• 2000	67.66	64.46	53.56	10.90	3.20	40.57
• 2001	67.52	64.12	53.69	10.43	3.40	41.25
• 2002	66.89	63.30	53.31	9.99	3.59	42.29
• 2003	66.66	63.16	53.35	9.81	3.50	42.85
• 8/ 2004	67.10	63.95	53.83	10.12	3.14	42.65
• Changes						
• Between						
• 1997-2003	-1.21	-2.41	-0.56	-1.85	+1.20	+4.17

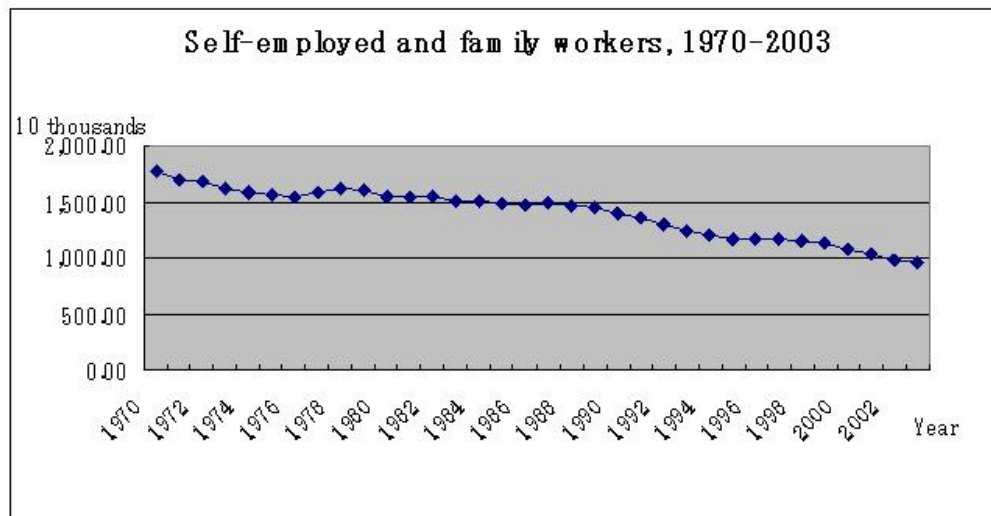
Source: Statistics Bureau, Ministry of General Affairs, Labor Force Survey.

See 18.



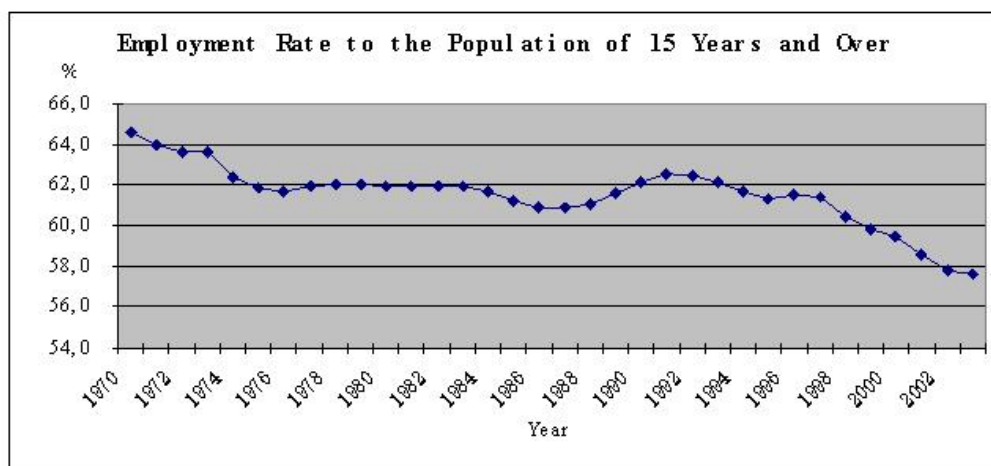
Source: Bureau of Statistics, Ministry of General Affairs, Labor Force Survey.  
Quoted from ECONOMATE

See 19.



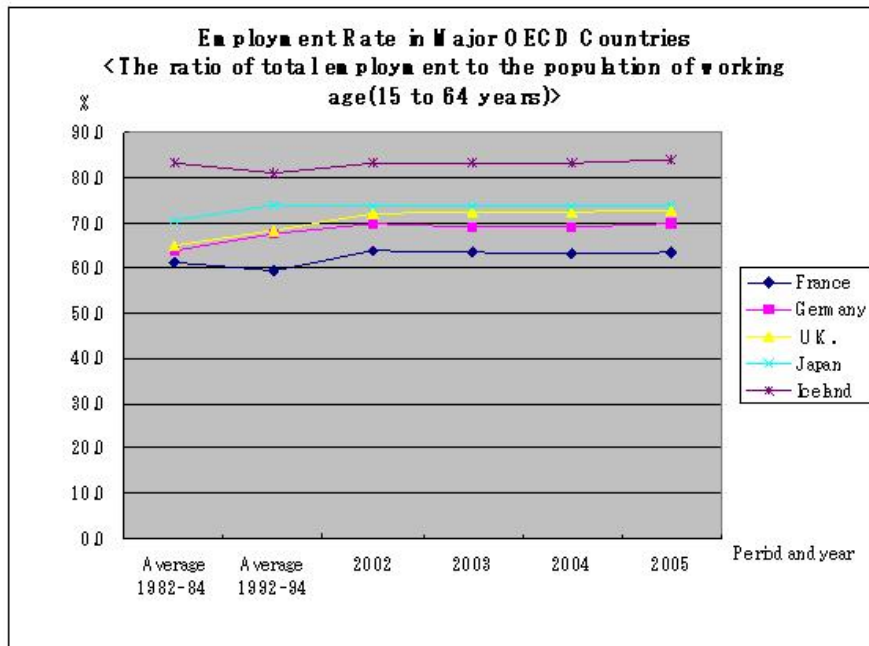
Source: The same as before.

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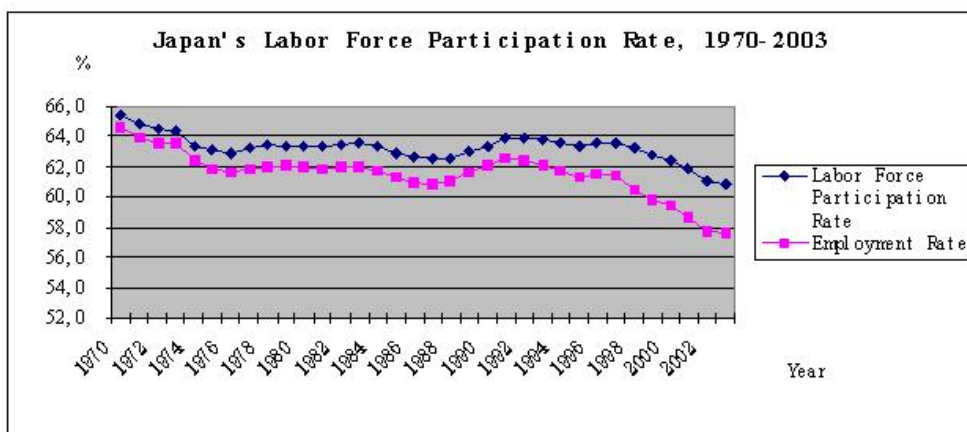
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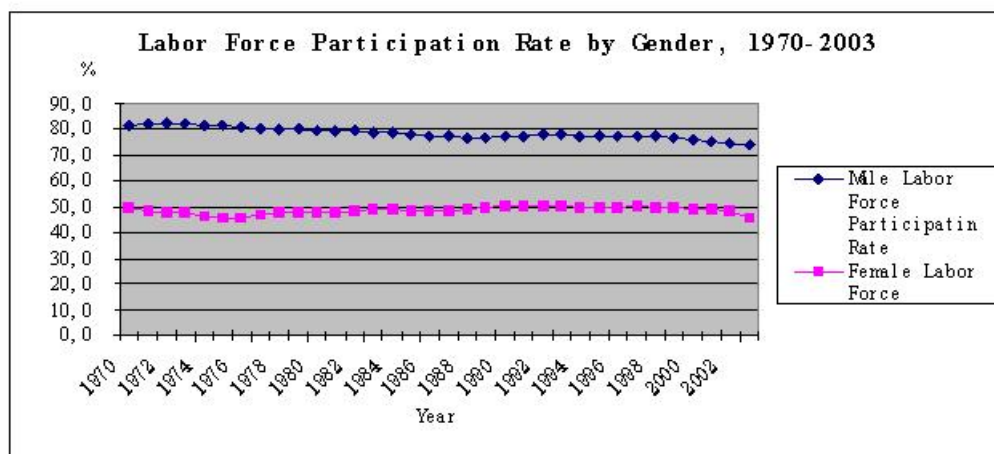
Source: OECD, Main Economic Indicators.

See 22.



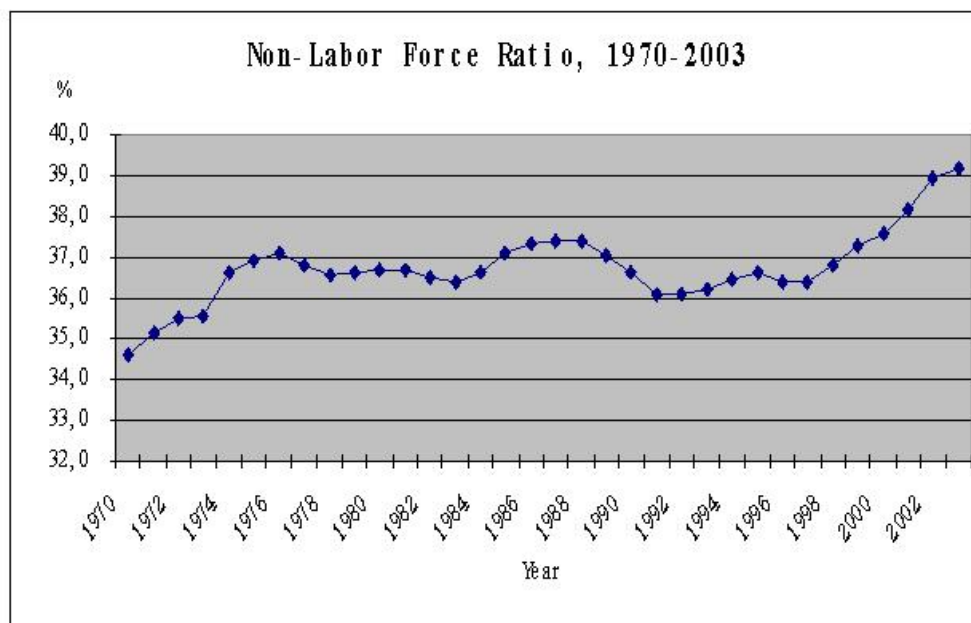
Source: Bureau of Statistics, Ministry of General Affairs, Labor Force Survey.  
 Quoted from ECONOMATE

See 23.



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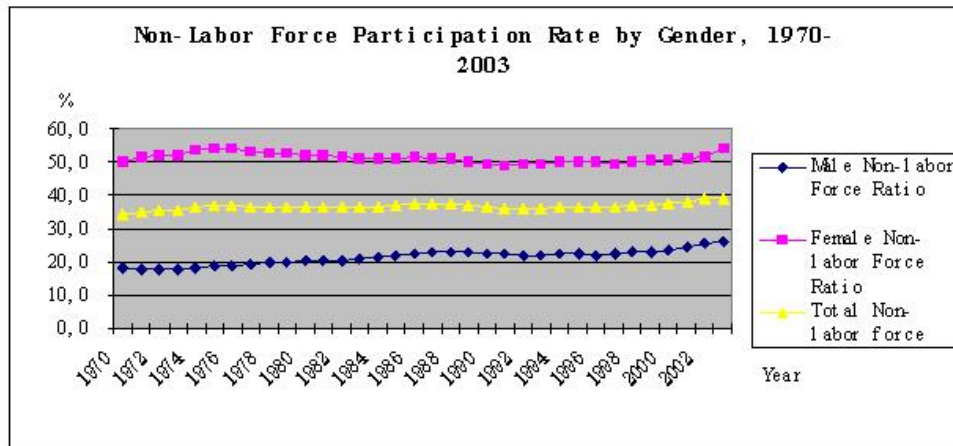
See 24., 25.



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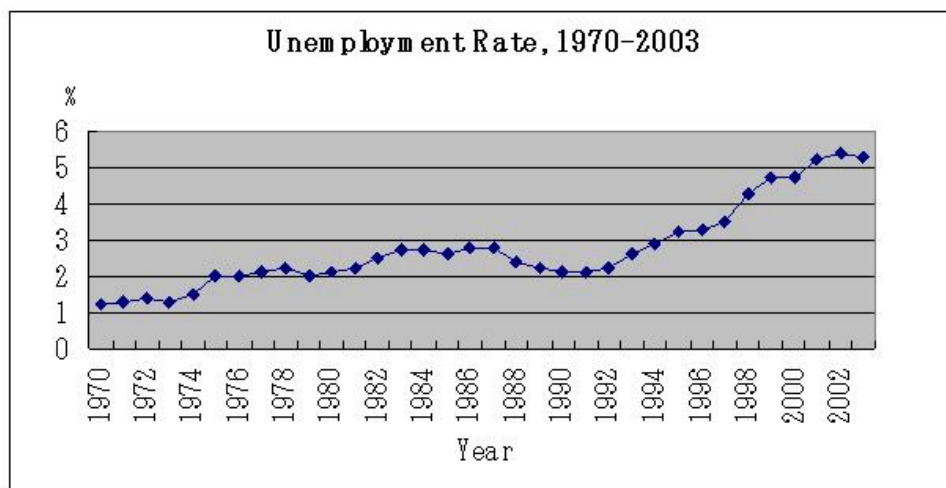
## Employment Security in Japan – An Economic View

See 26.



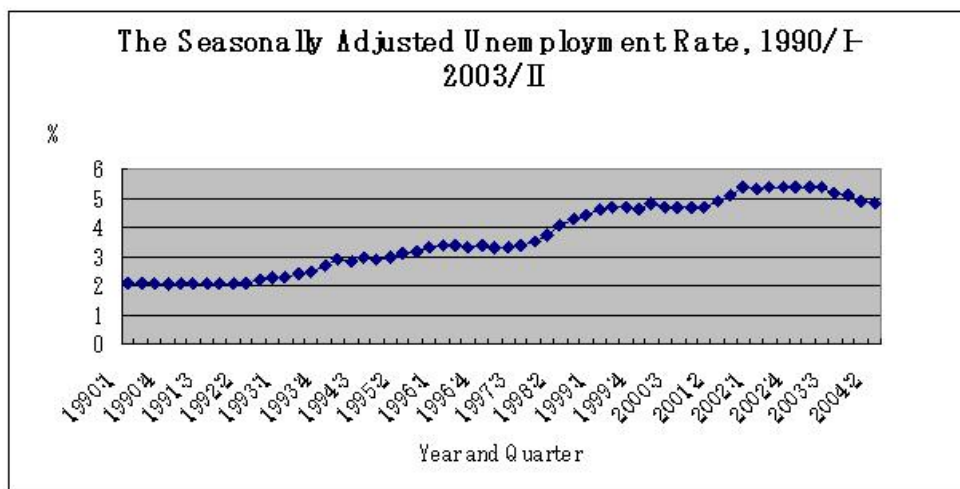
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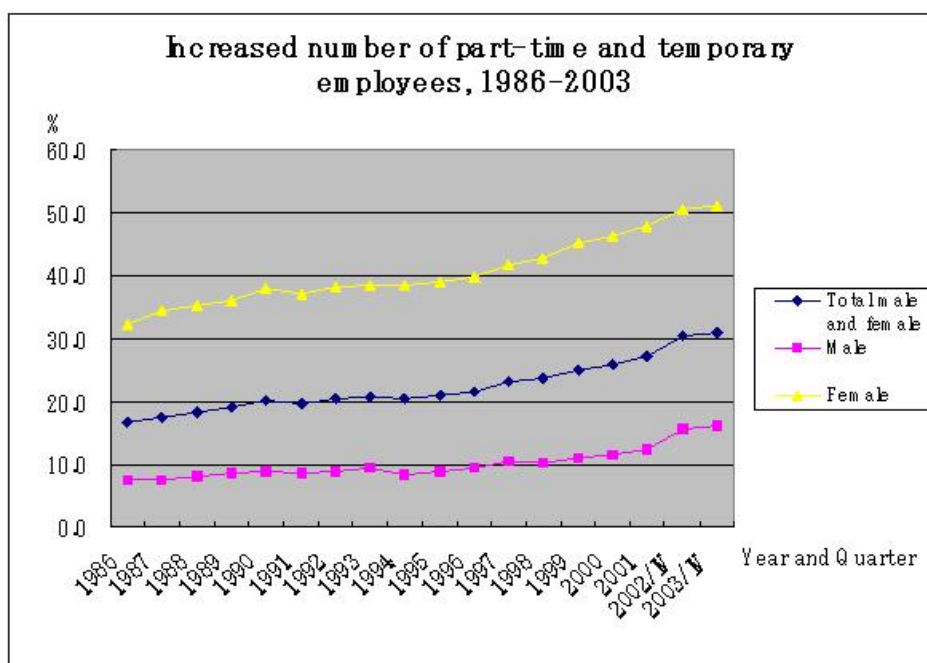
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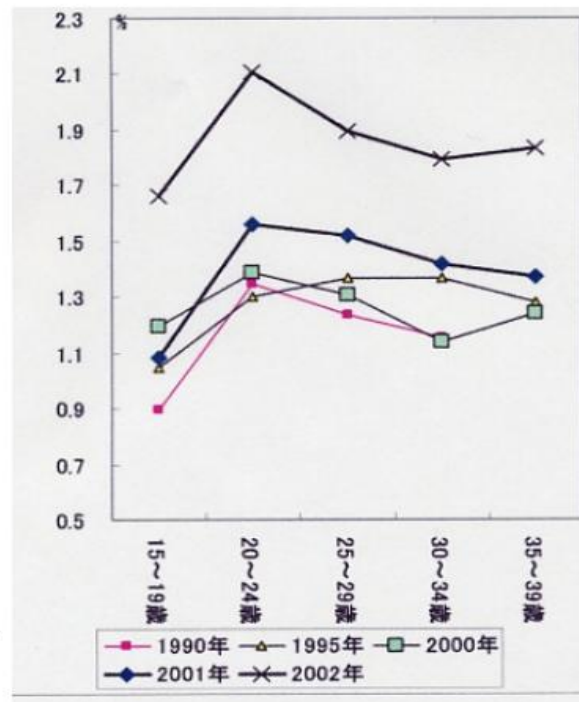


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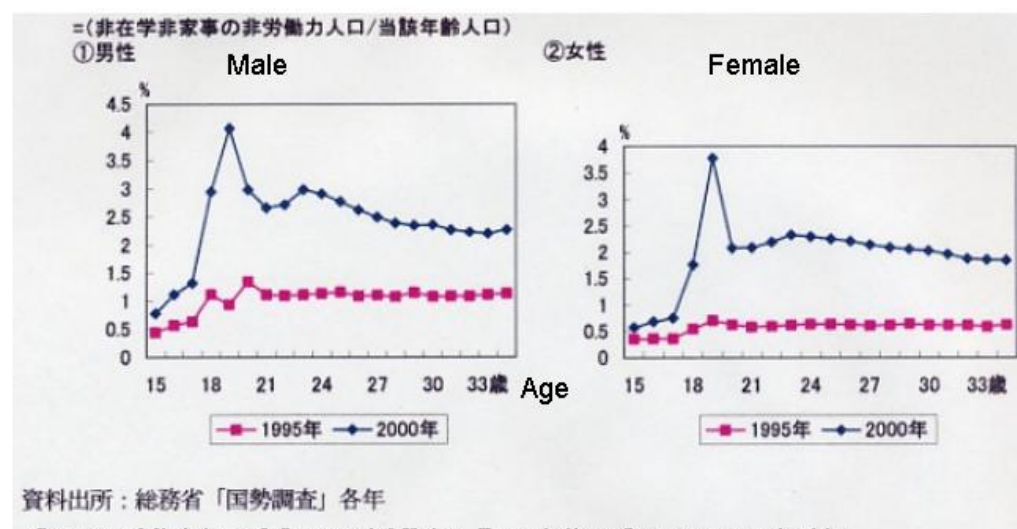
The Percentage of NEET among the Non-Labor Force by Age Group



Source: Kosugi and Hori (2003) p.3

See 32.

The percentage of those who are not in schools or engaging in household work among "Not in Labor Force" in 1995 and 2000



Source: Ministry of General Affairs, Population Census; quoted in Kosugi and Hori (2003).



# \*German Old-Age Pension Insurance – Legal Aspects –

*Bernd von MAYDELL*

## I. Introduction: on the dimension of private elements

## II. Privatization trends in social security systems

1. Enhanced need for private provision owing to benefit reductions in public systems of standard coverage
2. Demand for private coverage owing to exclusion
3. Private provision as an element of social security concepts
4. Assignment of social security tasks to employers
5. Social security through public and/or private institutions
6. Supplementary insurance by private institutions
7. Need for statutory regulation of substitutive and supplementary forms of private coverage
8. State social benefit institutions as competitive actors
9. Approximation of private and public (state) institutions
10. Privatization elements in the organization of benefit providers, and in relations between social benefit institutions (e.g. sickness funds) and benefit providers (e.g. physicians)
11. Mobility and social protection

## III. Significance and functional mode of private elements in the present German pension system

1. Necessary background: the entire pension system
2. Standard basic security
3. Supplementary insurance
4. How the second and third pillars interact with standard basic protection

## IV. Perspectives on the development of private provision

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\* German original translated by Esther Ihle, MPI Sozial Law, Munich

## *I. Introduction: on the dimension of private elements*

The grave challenges facing social security systems all over the world have heightened demands for privatization, with this concept used in highly disparate connotations. Hence, it is first necessary to expand on what is meant by the private element.<sup>1</sup>

Proceeding from the participants in a social law relationship, at least one private actor is always involved, namely the citizen entitled to social security. If the state leaves the coverage of a social risk up to its citizens, this can be referred to as a form of privatization if that risk was formerly covered by social insurance or some other state-organized system. An example here is occupational protection under statutory pension insurance after the reform of invalidity insurance.<sup>2</sup>

The private criterion can moreover relate to the insurance institution. Social security is generally operated by institutions under public law. Yet this function can also be performed by private institutions such as life insurance companies, employers or even the family. Accordingly, one may speak of institutions being privatized.

In the main, social security institutions simultaneously determine the legal relations between the parties involved. Public law institutions and beneficiaries thus enter into a public law relationship structured by legislation and administrative acts, whereas the relationship with private institutions is typically defined by a private law contract. Allocation to one or the other can, however, lead to delineation problems in specific cases – for instance under mandatory insurance in Germany, given that the public law obligation to insure can also be complied with by concluding a private insurance contract.

Finally, privatization can also apply to the form of funding. On the one hand, the requisite funds can be raised by compulsory public levies (taxes, contributions); on the other, by private (insurance) premiums, contributions or other payments, say, on the part of employers.

## *II. Privatization trends in social security systems*

These privatization trends<sup>3</sup> are mutually conditional. Consequently, they should at least be mentioned here if they do not directly relate to organizational structure.

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1 Cf. v. Maydell, Privatisierung sozialer Sicherheit. Erscheinungsformen und Entwicklungsperspektiven, *Arbeit und Sozialpolitik* 7 – 8/99, pp. 12 ff.

2 Regarding former law, cf. v. Maydell, Die soziale Sicherheit für den Fall der Invalidität, in: *Kruse/Reinhard/v. Maydell* (Eds.), *Invalidität im Rechtsvergleich*, 1998, pp. 93 ff., 110 ff.

3 For an instructive overview, see *Fuchs*, Möglichkeiten und Grenzen der Privatisierung sozialer Risiken, in: *Deutscher Sozialrechtsverband* (Ed.), *Die Finanzierung der Sozialleistungen in der Zukunft*, Schriftenreihe Bd. 45, 1999, pp. 79 ff.; cf. also *Riphagen*, Privatisierung als opgave en als probleem, in: *Sociaal recht: De grenzen verkend*, 1994, pp. 381 ff.

*1. Enhanced need for private provision owing to benefit reductions in public systems of standard coverage*

In all European states, the social environment is characterized by reductions in social benefits.<sup>4</sup> The main underlying reasons are constraints on public budgets and efforts to lower ancillary wage costs, which are especially high in European industrialized countries.

Benefit reductions can be targeted to the level of benefit amounts. Pertinent examples can be found in the newspapers almost everyday. For instance, back in autumn 1997, the French ministry of labor and social affairs submitted a bill on the streamlining of its deficit-ridden social insurance system that triggered a series of major expenditure cuts.<sup>5</sup> Similarly, in October 1997, the German federal parliament adopted a pension reform law<sup>6</sup> which was to launch the successive lowering of old age pension levels from 70% to 64% in the forthcoming years.<sup>7</sup>

Yet benefit reductions can also occur by tightening eligibility conditions. That was the procedure adopted for invalidity pensions in a number of countries, in that requirements governing the recognition of invalidity were heightened. A notable specification was to gear impaired earning capacity only to physical state of health and to leave the labor market situation out of consideration. Examples of such reforms<sup>8</sup> can be found in the Netherlands, the United Kingdom, and in Germany under the amended pension reform law of 1999. Another sweeping change in benefit prerequisites was the raising of retirement age limits, as in Italy<sup>9</sup> for instance, but also in most other European states.

A further instance of very extensive benefit curtailment was survivors' insurance in the Netherlands,<sup>10</sup> which not only produced a savings effect but also took account of altered patterns of family life.

Measures of this kind entail a lowering or deferral of individual claims to public social benefits. At the same time, they create or extend the demand for supplementary private coverage to compensate for these deficits in the state systems. Mass advertising for private life and health insurance has heightened public awareness of these connections.

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4 On this form of gradual privatization, cf. *Fuchs* (note 3), p. 85.

5 Cf. report in the daily *FAZ*, dated 10.10.1997, p. 21 „Aubry stellt Gesetzentwurf der Sozialversicherung vor“.

6 See report in the *FAZ*, dated 10.10.1997, p. 2, „Niedrigeres Rentenniveau und höhere Leistungen für Familien“.

7 This so-called demographic factor in the pension formula was suspended at the end of 1998 by the new federal government; however, in order to decrease pension insurance expenditure, a lower adjustment rate (in accordance with the inflation rate) was again considered in July 1999 for the years 2000 and 2001.

8 For a comparison to invalidity protection, see *Reinhard/Kruse/v. Maydell* (Eds.), *Invalidität im Rechtsvergleich*, 1998.

9 *Hohnerlein*, *Der italienische Sozialstaat zwischen Krise und Reform*, in: *Sozialer Fortschritt*, 1997, pp. 16, 19.

10 *Kötter*, *Das niederländische Wohlfahrtsmodell – kein Vorbild mehr?*, in: *Sozialer Fortschritt* 1997, pp. 12, 14.

## 2. Demand for private coverage owing to exclusion

A similar effect is produced by the fact that certain groups of persons are not covered by the regular state systems and must therefore rely on alternative forms of provision<sup>11</sup> if they do not want to become solely dependent on minimum social protection (social assistance). The former development of social security systems displayed a tendency toward universality in terms of persons covered. Nevertheless, in all states there are groups who opt out of the standard social security system, although differences do exist between national schemes covering all citizens and the coverage provided under social insurance.<sup>12</sup> A trend of the past few years reflects a rise in the number of persons excluded from the regular system because they fail to meet insurance or residence prerequisites. Examples are:

- Persons outside a regular full-time employment relationship – in the main, part-time employees, the so-called new self-employed,<sup>13</sup> clandestine workers and minor employees. These persons' situation is problematic because social insurance systems are frequently based on the normal case of full-time employment and provide only pro rata benefits (e.g. pensions) for atypical employment relationships, if they are covered at all.
- Persons without a – permanent – residence permit and, hence, lacking full social protection.

And here again, an alternative form of private provision must be sought by such employees who are not regularly engaged and thus not entitled to claim full social insurance coverage under the standard systems. Measures to combat unemployment and efforts to lower the cost of labor portend the steady growth of this category of persons.

## 3. Private provision as an element of social security concepts

The rising demand for private forms of provident provision coincides with calls for an extension of private coverage from the economic perspective. One economically viable solution is seen in the accumulation of capital, notably in the field of pensions. Furthermore, many economists regard private capital formation as a better way of coping with the demographic problem.<sup>14</sup> Whether or not the alleged advantages of capital cover funds over pay-as-you-go schemes actually exist, cannot be illuminated here; at any rate, these arguments have contributed to the broader acceptance of security concepts such as the

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11 See *Fuchs* (note 3), p. 84.

12 For an opposing view, see *Sakslin*, Worker versus Citizen? – Why not forget them both, in: *Pieters* (Ed.), *Social Protection of the next generation in Europe*, EISS Yearbook 1997, 1998, pp. 153 ff.

13 In Germany, the attempt was made to delimit the insurance obligation for this group of persons through a narrower definition of self-employment: cf. *Bengelsdorf*, Die neue Scheinselbständigkeit – zur schwierigen Handhabung des § 7 IV SGB IV, in: *NJW* 1999, pp. 1917 ff.

14 Regarding the reform proposals on statutory pension insurance in Germany, cf., e.g., 2. Symposium des Instituts für Altersvorsorge 1998; similarly, *Steinmann*, Die Pyramide auf die Füße stellen, in: *GDV* (Ed.), *Altern mit Zukunft*, 1997, pp. 28 ff.

three-pillar model.<sup>15</sup> Worth noting is that the World Bank emphasized and advocated this concept in its study entitled “Averting the Old-Age Crisis”.<sup>16</sup> It should be added, however, that this view is by no means new. The idea of a retirement security model consisting of three pillars has been embraced by many states. That even goes as far as its constitutional embodiment in Switzerland. Moreover, it is generally accepted that a mix between private capital formation as a means of old-age provision and pay-as-you-go-based public systems should be preferred over the uniform systems.<sup>17</sup> The only question is their proportion to each other. Currently, there is a strong tendency, supported above all by the World Bank, to diminish the public pillars and expand the private sector of old-age provision.<sup>18</sup>

The private pillars include private life insurance and personal asset formation, on the one hand, and the diverse company pension schemes, on the other. Even if opinions on the ideal mix between these elements vary in macro- and micro-economic terms, the strengthening of private provision is obviously being propagated at present, even if this course of action is not viable for the entire population.

These demands are not confined to the social policy sector; they also come to bear on government measures, say, to promote private provision through tax incentives. Even so, some states (France, Germany)<sup>19</sup> display an opposite tendency by restricting tax relief in

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15 To what extent the three pillars can be maintained in the long run is viewed differently; thus, e.g., *Gilbert and Park* (Privatversicherung, Leistungen und Ausrichtung: Tendenz und grundsätzliche Auswirkungen für die soziale Sicherung in den Vereinigten Staaten, in: *Internationale Revue für Soziale Sicherheit* 1996, H. A, pp. 21 ff) think it likely that developments in the U.S. will lead to a two-tier pension system, with reduced social security (1st tier) supplemented by private pensions (2nd tier), especially in middle and upper income brackets.

16 Policies to protect the old and promote growth, 1994; also cf. *James*, Den Schutz verbessern und das Wachstum fördern: eine Verteidigung der Rentenreformthese der Weltbank, in: *Internationale Revue für Soziale Sicherheit* 1996, H. 3, pp. 3 ff.; for some critical comments on the World Bank proposals, see *Beattie/Mc Gillyvray*, Eine Strategie voller Risiken: Reflektionen über den Reformvorschlag der Weltbank, in: *Internationale Revue für Soziale Sicherheit* 1995, H. 3-4, pp. 5 ff.; *Singh*, Rentenreform, Aktienmarkt, Kapitalbildung und Wirtschaftswachstum: Kritische Beurteilung der Weltbankvorschläge, in: *Internationale Revue für Soziale Sicherheit* 1996, H. 3, pp. 25 ff.

17 Regarding the public-private mix, cf. *Bernstein*, US income maintenance programs public and private: Mostly a mixture in both, in: *American and European Perspectives on Social Security*, EISS Yearbook 1995, 1996, pp. 67 ff.; on this, cf. *Kohl*, The public/private mix in the income package of the elderly: A comparative study, in: *Reforms in Eastern und Central Europe*, EISS Yearbook 1992, 1993, pp. 445 ff.

18 The scale on which state pensions can be replaced by private coverage is discussed and solved very differently. With a particular view to the situation in developing countries, see *Williamson/Pampel*, Ist die Privatisierung der sozialen Sicherheit sinnvoll für die Entwicklungsländer, in: *Internationale Revue für Soziale Sicherheit* 1998, H. 4, pp. 3 ff. In most cases, the co-existence of both pension forms is considered favorable, although abrupt changes are regarded as problematic: cf., e.g., *Espina*, Reform of pension schemes in the OECD countries, in: *International Labour review* 1996, pp. 181 ff.; in the process, state social security is expected to change but ultimately be sustained, thus *Midgley*, Ist die soziale Sicherheit irrelevant geworden?, in: *Internationale Revue für Soziale Sicherheit* 1999, H. 2, pp. 111, who nevertheless advocates a critical stance on social security issues.

19 According to proposals by Finance Minister *Eichel* (June 1999), the yield on life insurance policies is to be subject to income taxation in future.

the light of budgetary constraints. The fulfillment of the Maastricht criteria governing the single currency might also be a motive here.

#### 4. Assignment of social security tasks to employers

The employment relationship, also forming the basis for company pension schemes, has always been of importance to employee social security. Nevertheless, the various forms of risk protection under labor law for the contingencies of accident, old age, sickness, and so forth, have largely been superseded by the social security systems;<sup>20</sup> in the transformation states of Central and Eastern Europe,<sup>21</sup> that did not occur with any great vigor until the decision in favor of market economy had been taken.

At the same time, a reversion to company social benefits can be noted in some industrialized states, retirement pension plans again being the chief example here.<sup>22</sup> In most states, employers are not bound by law to establish company pension schemes (Germany, Austria, etc.). Not so in Switzerland, where basic protection is complemented by the second pillar of occupational pensions, now organized on a mandatory basis.<sup>23</sup> Other states nevertheless have extensive collective agreements that constitute such an obligation. A special option is offered in the United Kingdom,<sup>24</sup> where contracting out provides the statutory alternative of choosing private company funds instead of national social insurance. That such a development can lead to considerable problems is demonstrated by actual cases of pension fund defaults (cf., notably, the Maxwell Case<sup>25</sup>).

Income maintenance in the event of sickness and invalidity is another interesting example of social policy tasks that have been assigned to the employer. For instance in the Netherlands,<sup>26</sup> the employer has been obliged to compensate for employee income losses

20 On issues arising from the co-existence of labor and social law, cf. *Riphagen* (note 3), pp. 281 ff.

21 Cf. v. *Maydell*, Die Systeme der sozialen Sicherheit in den Staaten Mittel- und Osteuropas, in: GVG (Ed.), Neue Aufgaben für die Systeme der sozialen Sicherheit in der Bundesrepublik Deutschland durch die Öffnung Mittel- und Osteuropas. Bd. 24 der Schriftenreihe, 1992, pp. 18 ff.

22 See *Lusenti*, The complementary pension fund system in the United Kingdom, the Federal Republic of Germany and Switzerland: some observations, in: *Crijns* (Ed.), *Liber in Memoriam Prof. Veldkamp*, 1992, pp. 193 ff.; also see IVSS (Ed.), Zusatzrentensystem: Europäische Perspektiven, Dokumentation Soziale Sicherheit Nr. 21, 1994; and see *Lutjens*, Privatisering van de pensioenvoorziening, in: *Sociaal recht: de grenzen verkend* (FS de Leede), 1994, p. 305.

23 Cf. *Fuchs*, (note 3), pp. 97 ff.; v. *Maydell*, Strukturen und Probleme der neuen Schweizer Berufsvorsorge aus der Sicht des Auslandes, in: *ZversWiss* 1985, pp. 281 ff.; *Mrusek*, Defizite auch in der soliden Schweiz, in: *FAZ*, dated 12.1.1006, p. 12.

24 Cf. *Schulte*, Großbritannien – Das Ende des Wohlfahrtsstaates?, in: *Sozialer Fortschritt* 1997, pp. 30 ff.

25 Cf. report of the Secretary General of IVSS: „Entwicklung und Tendenz in der sozialen Sicherheit 1993 – 1995, Teil 2, Analyse neuerer Entwicklungen, in: *Internationale Revue für Soziale Sicherheit* 1996, H. 2, pp. 17/50 ff.

26 Cf. *Kötter*, Von alten und neuen Rezepten, Radikalkuren und Wechselbädern – die Reform des niederländischen Gesundheitssystems, in: *ZIAS* 1998, pp. 391, 394; *Noordam*, Die Lohnfortzahlung im Krankheitsfalle. Zwischen Sozialleistung und Arbeitgeberpflicht: Die neue Gesetzgebung in den Niederlanden, in: *ZIAS* 1997, pp. 53 ff.



during sickness. One reason for this measure was no doubt to stimulate employers' financial interest in ensuring preventive healthcare in the company, simultaneously improving their ability to counter abuse. The Netherlands regulation is not so very new, given that in Germany continued remuneration during the first six weeks of illness has been practiced for over a century.

Invalidity insurance in the Netherlands<sup>27</sup> likewise features an interesting regulation in this context that entered into force on 1 January 1998. Employers are entitled to opt out of the statutory invalidity system and to provide invalidity coverage themselves, with private reinsurance being permitted. Here again, the underlying intent is to enhance employers' direct economic interest in reducing invalidity cases. Whether or not these expectations will be met, remains to be seen.

### 5. Social security through public and/or private institutions

Besides employers, private insurance companies can likewise assume the organizational function of providing social benefits upon occurrence of social risks. To do so, however, an express statutory regulation is required.<sup>28</sup>

The Chilean model<sup>29</sup> under which government pension institutions have been extensively replaced by private establishments has so far not been adopted in Europe.<sup>30</sup> There are nevertheless several examples of private insurance companies taking the place of public social benefit institutions on specific conditions, with this function referred to a substitution. Apart from the important role of private insurers under occupational accident insurance in many states,<sup>31</sup> health and long-term care insurance constitute additional areas of operation. Substitutive structures in the European Union are found in the Netherlands

27 See *Klosse/Kötter*, *Alter Wein in neuen Schläuchen? – Das „privatisierte“ System der Invaliditätsversicherung in den Niederlanden*, in: DVR 1998, pp. 507 ff.

28 On legal requirements governing the activation of private institutions, cf. *Bieback*, *rechtliche Probleme der Kooperation und Ausgliederung von Funktionsbereichen der Sozialversicherungsträger*, insbesondere der Krankenkassen, in: VSSR 1998, pp. 177. 193 ff.

29 Cf. *Fuchs* (note 3), pp. 93 ff; *Mesa Lago/Arenas de Mesa*, *Fünfzehn Jahre nach der Privatisierung des Rentensystems in Chile: Evaluation, Lehre und zukünftige Aufgaben*, in: DRV 1997, 495 ff.; for a comprehensive view embracing the South American examples, also see *Tamburi*, *Privatvorsorge und Rentenfonds*, in: *Internationale Revue für Soziale Sicherheit* 1993, H. 2, pp. 77 ff.

30 The model is nevertheless discussed in many states inside and outside of Europe, including the reform states in Central and Eastern Europe and Turkey: cf. *Sözer*, *Privatisierungstendenzen in der türkischen Sozialversicherung*, in: ZIAS 1997, pp. 30 ff.

31 Examples are the Netherlands, Norway and New Zealand; regarding different schemes, cf. *Saint-Jours*, *L'organisation du régime des accidents du travail: Partie integrant de la sécurité sociale ou régime à part?* In: *Problems of transformation of social protection systems in Central and Eastern Europe*, EISS Yearbook 1993, 1994, pp. 83, 95 ff.; on regulation in Belgium, see *van Langendonck*, *Handboek Sociale Zekerheid* 4th ed. 1997, pp. 262, 293. In Germany, too, the idea of privately organized accident insurance has been discussed: cf. commentary by the BG-Chemie (Employers' Liability Insurance Association in the chemicals branch), „Privatisierung der Berufsgenossenschaften ist kein taugliches Mittel“, in: FAZ, dated 17.6.1998, p. 21.

and Germany. Since substitution here involves insured persons who would otherwise be subject to statutory insurance if they had not concluded a private insurance contract, the parties concerned are not fully free in their formulation of contractual conditions. This becomes especially clear under the newly introduced long-term care insurance scheme in Germany.<sup>32</sup> Privately health-insured persons not covered by the statutory scheme must also have their long-term care risk insured by the private carrier. The legislation stipulates, however, that private long-term care insurers are not allowed to conduct risk assessments, are bound by the rates applicable to statutory long-term care funds, and must basically award the same benefits. This exemplifies the legislator's particular social responsibility when assigning the coverage of social risks to private insurance. As a rule, this responsibility is met by setting minimum standards that must be complied with.

## 6. *Supplementary insurance by private institutions*

The aforementioned example of substitutive health and long-term care insurance demonstrates that private insurers can assume the tasks of public institutions. Yet the much more frequent and significant cases are those where employers or private insurance companies perform the function of supplementary coverage. The ways in which basic and supplementary insurance is coordinated thereby differs considerably. Company retirement schemes have already been addressed in conjunction with the three-pillar concept where they supplement the first state pillar. Aside from Germany and the Netherlands, the supplementary function also distinctly prevails in most health insurance systems,<sup>33</sup> where the vast majority of private health insurance companies are confined to this task.

Supplementary insurance is affected to a particular degree by cuts and restrictions in basic protection. Thus the significance of supplementary coverage grows as these interventions are intensified – attended by the ever more pressing question of how far the legislator should go in defining such supplementary forms.<sup>34</sup>

A special form of private supplementary insurance has recently been launched in the Swedish pension system,<sup>35</sup> whereby a certain percentage of pension contributions is allocated to a funded supplementary scheme governed by private law. A similar model is planned in Poland; the supplementary voluntary pension scheme introduced in Germany under former labor minister Riester<sup>36</sup> is likewise based on the funding principle.

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32 Cf. Kötter (note 10).

33 Singular attempts to introduce supplementary coverage under private insurance law have also been made for the unemployment risk: cf. Schumacher, Placebo für Privilegierte. Deutschlands erste private Arbeitslosenversicherung ist eine gute Idee, nützt aber nur wenigen, in: *Die Zeit*, dated 19.1.1996, p. 23; also see report on the insurance package offered by Volksfürsorge: „Mehr Zustimmung als Ablehnung für private Arbeitslosenversicherung“, in: *FAZ*, dated 18.1.1996, p. 16.

34 On the very extensive and detailed regulations adopted for the privatized form of invalidity insurance in the Netherlands, cf. Klosse/Kötter (note 27) DRV, pp. 507 ff.

35 Cf. Köhler, Die Reform der gesetzlichen Rentenversicherung in Schweden, in: *DAngVers* 1999, pp. 78 ff.

36 Cf. Forster, Private Zusatzrente im Visier, in: *SZ*, dated 26/27.6.1999, p. 25.

If supplementary insurance is not mandatory, however, legislative interventions going in this direction have the adverse side-effect that employer readiness to set up such schemes will decline. Company pension plans in Germany are an example here.

#### *7. Need for statutory regulation of substitutive and supplementary forms of private coverage*

The Maxwell Case in Great Britain<sup>37</sup> demonstrates that such reflections on legislative action in the field of supplementary insurance are not merely theoretical. In fact, state regulatory efforts in respect of private pension forms are manifold and also involve positive support, for example by giving favorable tax treatment to supplementary insurance arrangements. That is all the more necessary, the more basic coverage is reduced. On the other hand, public budget constraints at the same time place restrictions on such state support, as is shown by the contemporary example of France.

Additional regulations focus on the supervision of private insurance schemes, but also on insurance conditions or other benefit modalities. The German long-term care insurance scheme has been cited above in this context. Such statutory measures stem from the state's social protection obligation, which remains intact even if social security is no longer guaranteed by state institutions. If the social state permits other organizational forms in place of state social security, it must ensure that social protection is not impaired as a result. Such state interventions nevertheless affect the fundamental principles of private legal relations founded on individual freedom of contract.

On what scale the conferment of social policy tasks to private actors, say, employers or private insurance companies, require additional regulation is exemplified by substitutive health and long-term care insurance, as well as by the consigning of invalidity protection to employers in the Netherlands<sup>38</sup>. Here, the legislator must take every precaution to prevent employers from applying medical selection procedures upon engaging workers in order to minimize the invalidity risk.

Shifting social protection to private institutions can have consequences for the state – not only because of heightened regulatory needs, but also because of a possible need to form contingent reserves in the public budget.<sup>39</sup>

A particular need for regulation with a view to supplementary insurance can arise within the European Community to prevent disparate national rules from erecting barriers to mobility.<sup>40</sup> Also, the ensuring of equal treatment can call for additional controls.<sup>41</sup>

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37 Cf. note 25; on the adverse experiences of UK insured who opted for private coverage instead of the national pension, cf. *Schulz*, *Konsequenter Rückzug des Staates. Die britische Sozialgesetzgebung ist von beeindruckender Kargheit*, in: *FAZ*, dated 18.1.1996, p. 10.

38 On the extensive regulation in the Netherlands, cf. *Klosse/Kötter* (note 27).

39 This interesting aspect is examined for the UK by *Casey*, *Die Auswirkungen privater Renten auf die öffentlichen Finanzen: Eine Analyse mit besonderem Bezug auf das Vereinigte Königreich*, in: *Internationale Revue für Soziale Sicherheit* 1998, H 4, pp. 65 ff.

## 8. *State social benefit institutions as competitive actors*

If, on the one hand, private actors are increasingly included in the social security system, there will be a tendency, on the other, to perceive state social benefit institutions as competitors and, hence, to approximate them – gradually – to private law subjects. To be borne in mind here are judgments of the European Court of Justice on individual cases that contested whether social security institutions, such as employment offices, could be deemed undertakings within the meaning of the EC Treaty.<sup>42</sup> Under national law, there are often tendencies to regard public sickness funds as competing not only with private health insurance companies,<sup>43</sup> but also with each other. This aspect of competition is also utilized by the German legislator to achieve savings effects.<sup>44</sup> Yet to what degree such a form of competition will actually function is disputed; the results so far have been unconvincing. It should be noted in any case that such competition will be highly limited since social benefits are still largely stipulated by the lawmaker.

## 9. *Approximation of private and public (state) institutions*

The above developments bring in their wake that differences between private and public/state social security institutions are being leveled. Above all the health insurance systems in Germany and the Netherlands clearly reflect this trend. That these two countries are mentioned here is no surprise since they are the only EC member states offering substitutive private health insurance – thus allowing for competition between private and statutory funds.

This line of development will have to be monitored further, notably by asking whether existing regulatory concepts based on fundamental differentiation between private and public institutions ought to be modified, if only selectively. That competitive ideas can lead to odd arrangements – at least from a European standpoint – is evidenced by attempts in the United States to make unemployment and welfare administration more effective by entrusting care for the unemployed, with the prime aim of their reintegration into the labor

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40 See *v. Maydell/Schulte*, Regulierungsbedarf ergänzender Gesundheitssicherungssysteme aus sozialrechtlicher Sicht, in: ZVersWiss 1992, p. 513.

41 Cf. *Moffat/Luckhaus*, Occupational pension schemes, equality and Europa: A decade of change, in: Journal of Social Welfare and Family Law 20 (1) 1998, pp. 1 ff.

42 Cf., e.g., ECJ judgment of 23-04-1991, Case C-41/90 *Höfner*; also cf. investigations on health insurance: *Schulz*, Krankenkassen als Adressaten des Kartellrechts, in: NZS 1998, pp. 269 ff., and on accident insurance: *Giesen*, Sozialversicherungsmonopol und EG-Vertrag. Eine Untersuchung am Beispiel der Gesetzlichen Unfallversicherung in der BRD, 1995.

43 On the constitutional framework governing the co-existence of private and statutory health insurance: Verfassungsrechtliche Vorgaben, in: ZSR 1990, pp. 344 ff.

44 On competition between statutory and private sickness funds, cf. *Dolle-Helms*, Die Entdeckung des Service. Gesetzliche und private Krankenkassen streiten immer heftiger um die Kundschaft, in: Die Zeit, dated 8.4.1998, p. 37; also cf. *Berthold*, Die Zukunft des Sozialstaats, in: Deutscher Sozialrechtsverband (Ed.), Die Finanzierung der Sozialleistungen in der Zukunft, Bd. 45, 1999, pp. 53, 65 ff.

force, to private enterprises receiving success-oriented fees. The media reported on such a project that was put into practice in the State of Milwaukee.<sup>45</sup>

In Germany, a variation of this concept was contemplated by suggesting the payment of premiums to social assistance administrations for every beneficiary who was successfully reintegrated into the workforce.<sup>46</sup>

*10. Privatization elements in the organization of benefit providers, and in relations between social benefit institutions (e.g. sickness funds) and benefit providers (e.g. physicians)*

If social benefits comprise not only payments but also in-kind benefits and services, the providers of these benefits form a third party alongside the institutions funding them and the beneficiaries themselves. Benefit providers can be organized in various ways. Organizations under public law (e.g. the Association of Compulsory Health Insurance Physicians in Germany, state-run or municipal hospitals, etc.) may thus be flanked by private law arrangements, such as private clinics or private practitioners, pharmacies, suppliers of curative treatment and aid, and the like. Accordingly, privatization can take place on two levels: that of the organizational form<sup>47</sup> of benefit providers and that of relations between benefit-funding institutions and benefit providers.

Relations between funding institutions, notably sickness funds, and benefit providers, for example physicians, are regulated in very different ways. Predominantly, these relations are of a corporatist nature, structured by framework contracts; in part, they even come under public law, as in the case of the German law governing CHI physicians. A relaxation of the relevant regulations is to achieve cost reductions through more competition. That applies not only to social insurance systems but also, say, to the UK National Health Service, where market elements have been incorporated into benefit provision.<sup>48</sup>

Hence, the healthcare sector in particular serves to show how public law institutions are increasingly resorting to private law instruments and thus creating a tight network between (public) social law and private law – an arrangement for which the term “l'économie mixed” has been coined.<sup>49</sup>

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45 *Bauer*, Die Wohlfahrtsköniginnen danken ab. Wie Milwaukee seine Sozialhilfeempfänger zur Arbeit zwingt, in: *SZ*, dated 13.10.1997, p. 20.

46 Plans already exist to activate private placement companies that will be paid to procure jobs for social assistance recipients; regarding such a project, cf. *Feierabend*, Kreis stimmt für „Maßarbeit“ in der Sozialhilfe, in: *General-Anzeiger für Bonn und Umgebung*, dated 17/28.9.1997, p. 7.

47 An example here is Turkey, where state hospitals are increasingly being replaced by private clinics; cf. report „Im türkischen Gesundheitswesen immer mehr private Unternehmen“, in: *FAZ*, dated 26.1.1998, p. 21.

48 Cf. *Schulte*, Das Gesundheitswesen in Großbritannien, in: *ZIAS* 1998, pp. 342 ff.

49 Cf. investigations by *Knapp/Wistow*, Le développement de l'économie mixed dans le domaine des soins de santé et de l'action sociale en Angleterre, réussites et échecs, *Glennerster/Le Grand*, Le développement des quasimarchés dans le domaine de la protection sociale, und *Letourmy*, Les formes économiques de la régulation des dépenses de santé en France : le gaspillage négocié, in: *MIRE* (Ed.),

This competition is moreover influenced by European law, given that the fundamental freedoms guaranteed by the EC Treaty (notably the free movement of goods and services, and the freedom of establishment) will eventually loosen up previous, territorially restricted structures of benefit provision within the EU.<sup>50</sup>

### *11. Mobility and social protection*

Social security systems face the challenge of growing personal mobility, which is legally founded on the guarantee of freedom of movement under the Treaty on European Union. Such mobility has above all led to the development of a coordination network that is constantly being elaborated. Furthermore, mobility impacts the member states' social security systems in a number of additional ways. These make it necessary to review the still largely practiced principle whereby monetary benefits may be exported, while in-kind benefits and services are subject to territorial boundaries and may thus, in principle, be claimed abroad only in specifically regulated cases. This is of especial relevance to the principle's scope of application within the common market in the near future. Signs pointing to softening of existing restrictions can be found in the case law of the Court of Justice on the passive freedom to render services.<sup>51</sup>

Beyond that, privatization in this sector can perform the additional function of balancing differing levels of protection under national social security systems through private insurance contracts. In this way, private coverage could serve as a social flank of mobility.<sup>52</sup>

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Comparer les Systemes de protection Sociale en Europe, Vol. 1, Rencontres d'Oxford, France Grande Bretagne (o.J.), pp. 257 ff., 303 ff.

50 On this trend, which was reinforced by the 1998 ECJ judgments in the Cases Decker and Kohll, cf. v. Maydell, *Erbringung von Sozialleistungen und Marktfreiheit*, in: v. Maydell/Schnapp (Eds.), *Die Auswirkungen des EG-Rechts auf das Arbeits- und Sozialrecht der Bundesrepublik*, 1992, pp. 25 ff.; *ibid.*, *Auf dem Wege zu einem Gemeinsamen Markt für Gesundheitsleistungen in der Europäischen Gemeinschaft*, in: VSSR 1999, pp. 3 ff.; Kötter, *Die Urteile des Gerichtshofs der Europäischen Gemeinschaften in den RS Decker & Kohll: Der Vorhand zu und alle Fragen offen?*, in: Schulte, *Zur Kur nach Abano Terme, zum Zahnarzt nach Antwerpen? – Europäische Marktfreiheiten und nationales Krankenversicherungsrecht*, in: ZfSH 1999, pp. 269 ff., 347 ff.

51 Cf. note 50.

52 Cf. v. Maydell/Schulte (note 40) ZVersWiss 1992, pp. 513 ff.

### *III. Significance and functional mode of private elements in the present German pension system*

#### *1. Necessary background: the entire pension system*

The 20th century was marked by the constant development and extension of compulsory, state-regulated old-age security. That applies both to the groups of persons covered and to the level of protection. As a consequence, private forms of operation were repressed and could only attain some significance where the state system left gaps open or where a boosting of state benefits seemed necessary.

Therefore, the following remarks begin with the state pension system in its diverse functional modes, and address the tasks that still remain or have recently re-arisen for private insurance schemes.<sup>53</sup>

#### *2. Standard basic security*

Standard old-age security is mandatory for practically the entire population. Segmented according to groups of persons (employees, civil servants, certain categories of the self-employed), the protection rendered is governed by public law but displays considerable differences in its scope. For instance, the statutory pension insurance scheme<sup>54</sup> can no longer achieve its original objective of securing the prior standard of living. The self-employed are not subject to universal compulsory coverage. Apart from independent professional pension associations<sup>55</sup> and retirement assistance to farmers,<sup>56</sup> other occupational groups, such as tradesmen,<sup>57</sup> are covered under the statutory scheme.

The various standard security systems concur in that they are all regulated under public law and based on the principle of compulsory insurance. Elements of private organization, such as voluntary extended insurance or graded-up insurance under the statutory scheme, have scarcely been developed. Only in exceptional cases does private insurance assume the function of basic coverage (e.g. for individual groups of self-employed persons).

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53 On the implications for private provision as a result of the extension of social insurance, cf. *Heinze*, Soziale Sicherheit vor neuen Grenzziehungen zwischen öffentlichem und privatem Recht, in: Deutscher Sozialrechtsverband (Ed.), Soziale Sicherheit durch öffentliches und Privatrecht, Schriftenreihe Bd. 51, 2004, pp. 145 ff.

54 Cf. *Ruland*, Rentenversicherung, in: v. *Maydell/Ruland* (Eds.), Sozialrechts-Handbuch, 3rd ed. 2003, p. 901.

55 See *Boecken*, Berufständische Versorgungswerke, in: v. *Maydell/Ruland* (Eds.), Sozialrechts-Handbuch, 3rd ed. 2003, p. 1103.

56 See *Deisler*, Die agrarsoziale Sicherung, in: v. *Maydell/Ruland* (Eds.), Sozialrechts-Handbuch, 3rd ed. 2003, pp. 1142 ff.

57 On the development of social security for tradesmen, cf. *Tennstedt*, Geschichte des Sozialrechts, in: v. *Maydell/Ruland* (Eds.), Sozialrechts-Handbuch, 3rd ed. 2003, pp. 24 ff., 46 f., 60.

### 3. *Supplementary insurance*

Standard basic coverage is augmented by supplementary insurance schemes which are likewise structured along specific occupational lines. Here, company pension plans organized under private law play a major role,<sup>58</sup> with the employment contract, collective agreements or aggregate commitments forming the legal basis. A variety of implementation modes have been elaborated above all with a view to tax aspects<sup>59</sup> and include, besides direct employer commitments, support funds or pension funds, direct insurance and investment funds.

Like the various forms of individual provision, such as life insurance, company pension schemes are not mandatory. Nevertheless, claims to convert salary into retirement provisions constitute an initial step in this direction.

The principle of contractual freedom for company retirement schemes is extensively restricted by legislation. Notably, the German law governing company pensions lays down a number of mandatory provisions governing adjustment, insolvency protection, non-forfeiture, and the like. This is to safeguard the inherent purpose of old-age protection and has given rise to manifold tax regulations.

### 4. *How the second and third pillars interact with standard basic protection*

Standard basic coverage and supplementary schemes are bound together by the common function of providing for old age. Apart from this basic shared feature, the respective relations can be configured in highly different ways. An attempt at systematization brings to light the following case structures:

- *Constructive coordination*

Basic and supplementary schemes can be combined to form a kind of aggregate system, thus jointly serving the purpose of pension provision. This concept is referred to as aggregate pension commitments (*Gesamtversorgungszusagen*).<sup>60</sup> Nevertheless, such commitments, if involving a reduction of basic coverage, can lead to a disproportionately high increase in supplementary pension commitments, which is why they have become fairly rare.

- *Social policy coordination*

A targeted level of pensions can be formulated as a leading social policy objective entailing statutory measures toward its achievement. With this in mind, the 1984 pension commission had set the envisaged pension level at 70-90% of last-earned

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58 For a fundamental view, see *Steinmeyer*, *Betriebliche Altersversorgung und Arbeitsverhältnis*, 1991.

59 See *Förster*, *Die Rolle des Steuerrechts bei der Reform der Altersvorsorge*, in: 10. Münsterische Sozialrechtstagung. Reformen in der privaten und betrieblichen Altersvorsorge in der Krise des Sozialstaats, 2005, pp. 75 ff.

60 Supplementary pensions for public employees, which used to be aligned with civil servants' pensions, formerly provided such aggregate pensions.



net income. Developments of the past few decades have proven this goal unrealistic, however.

- *Supplementary or substitutive function of private provision*

Formerly, private supplementary provision was mostly regarded as performing an optional extra function in relation to basic coverage. With the introduction of the new supplementary scheme by former labor minister Riester (so-called *Riester-Rente*), this form of extra provision has been assigned a substitutive function. The 4% reduction in the pension level in the coming years is to be compensated by a corresponding rate of private provision entitled to favorable tax treatment. Since this form of retirement planning is optional, its substitutive function will of course depend on whether it is utilized. The interlinkage between standard and supplementary coverage in the form of the *Riester-Rente* is not, however, restricted to its replacement effect. If, for example, salary is converted for the purpose of private retirement provision, this leads to a reduction of income subject to contributions, and thus to a decline in social insurance contributions, which in turn affects the level of standard coverage.

#### *IV. Perspectives on the development of private provision*

The correlation between standard coverage and private provision is also important with a view to their development perspectives.

- The challenges facing standard pension systems are becoming more and more burdensome.<sup>61</sup> That applies above all to the demographic problem. Low birth rates and rising life expectancy place pension systems in an increasingly difficult situation. And this problem is compounded by changing work biographies and family structures, as well as by high levels of unemployment.
- The possibilities for standard systems to respond to these challenges are restricted. Besides a raising of retirement age limits, discussion centers on a further lowering of pension levels. Yet this course, too, can only be pursued along narrow lines. An additional decline in retirement benefits will cause a large number of insured to reach, or just barely exceed, the minimum protection level, thus abolishing incentives for, and justifications of, a contribution-based system for this category of persons. And that would entail grave problems of acceptance.

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61 See v. Maydell, Herausforderungen für die Altersvorsorge im 21. Jh., in: 10. Münsterische Sozialrechtstagung. Reformen in der privaten und betrieblichen Altersvorsorge in der Krise des Sozialstaats, 2005, pp. 1 ff.

- Restrictions of standard security call for increased private provision – for which the requisite funds are very often lacking, however. The proposed course of increased subsidization on behalf of more needy groups, as mapped out under the Riester scheme, is quite narrow in the face of large-scale public indebtedness, especially as these debts will in turn encumber the next generation.

## \*Japanese Pension Insurance – Legal Aspects –

*Hiroya NAKAKUBO*

- I. Public pensions and corporate pensions
  - 1. Public pensions in Japan: the national pension and the social security pension
  - 2. Significance of corporate pensions
- II. Reform of corporate pension legislation in 2001
  - 1. Reform background
  - 2. Defined Benefit Corporate Pension Law
  - 3. Defined Contribution Pension Law
- III. Three uncertainty factors for employees
  - 1. Non-payment or reduction of benefit upon dismissal as a disciplinary measure
  - 2. Alterations to the disadvantage of employees
  - 3. Payment security
- IV. Conclusion

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In contemplating the role of private schemes in pension insurance, corporate pensions no doubt take center stage. The position of corporate pensions lies somewhere between government-managed public pensions and contractually agreed private pensions between individual citizens and insurance companies. Corporate pensions assume an important function in providing income security to a large number of employees upon retirement. This function has evolved from severance pay, a key factor in traditional Japanese employment practice. In 2001, the relevant legal provisions were subject to a sweeping reform that marked the beginning of a new era. In the following, I will outline the major aspects and highlight a few controversial issues.<sup>1</sup> Since the individual regulations are highly complex, it is indeed difficult to elucidate them in full detail – I myself am not sure I could do so down to the last specification – but I will attempt to depict the overall situation and clarify where some of the problems lie.

## *I. Public pensions and corporate pensions*

### *1. Public pensions in Japan: the national pension and the social security pension*

Previously, Japanese pensions were divided into: 1) welfare pensions for civil servants (earnings-related); 2) social security pensions, usually for the staff of private enterprises (earnings-related); and 3) national pensions for the self-employed (defined contribution rate). With the large pension reform of 1985, national pensions were reorganized as a basic pension covering the entire population (first tier). Self-employed persons and full-time housewives continued to receive only this national pension as a public pension based on defined contribution rates. Both private-sector employees and civil servants kept their existing earnings-related social security and welfare pensions, respectively, as supplementary pensions (second tier) on top of the defined-contribution national (basic) pension (cf. graph at the end of this paper; henceforth I speak only of the social security, not the welfare pension).

The 1985 reform also introduced a major change in retirement age, that is, the commencement of pension payment. Thus the national pension continued to be paid from the age of 65 (and still is today). On the other hand, the retirement age for the social security pension had previously been paid to men from the age of 60. Since, however, the defined-contribution component of the social security pension had been converted into the general basic pension, the commencement of benefit payment was inevitably raised to 65 years. Under the new statutory provisions, the payment of the earnings-related part of the social security pension was likewise to start at the age of 65. In reality, owing to an additional

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<sup>1</sup> For several comments in this paper, the author gratefully acknowledges the publication by *Hideyuki Morito*, *Laws and Policies on Corporate Pensions (kigyo-nenkin-no-ho-to-seisaku)*, published by Yuhikaku, Tokyo 2003. Regarding the 1991 law reform, cf. “Betriebsrentenreform” (*kigyo-nenkin-kaikaku*), special issue of the journal “Jurist” No. 1210 (2001).

provision to the statute, both parts (also the pension corresponding to the defined-contribution part) continued to be paid as a “special benefit” to persons retiring at the age of 60, meaning the new provisions had no direct effect on those concerned. The special benefit, however, has been abolished in steps through statutory amendments: for the defined-contribution part in 1994 and for the income-related part in 2000. The public pension is now awarded on a uniform basis from the age of 65.<sup>2</sup>

Of course, the reason behind such a raising of retirement age levels in Japan is the demographic trend as reflected in an aging population and declining birth rates. Especially recent years have witnessed an acceleration of this trend, which has placed an enormous burden on pension funds. The contribution rate for the social security pension, including the national pension, currently at 13.58 % of salary, is paid fifty-fifty by employees and employers. Under the statutory amendment of 2004, it is to be progressively raised to 18.30 %. At the same time, the present benefit level of 60 % is to be lowered in stages to 50 %. In this way, national and social security pensions will be characterized by a higher retirement age and a lower benefit level, with increased expectancies for corporate pensions to fill the resultant gap.

## *2. Significance of corporate pensions*

Corporate pensions constitute private, voluntary old-age provision schemes established by enterprises on behalf of their employees. Such schemes are especially widespread among large corporations. The corporate pension differs from public pensions in a number of ways. It is paid in addition to the social security pension and thus improves employees’ domestic circumstances in retirement. That is also why it is labeled “third-tier” pension. Sometimes corporate pensions assume the function of a financial bridge-over until retired employees attain the statutory age level required to receive public pension benefit.

Corporate pensions in Japan are rooted in the concept of severance pay. Prior to World War II, it had been common practice among large corporations to pay fairly large lump sums to staff as compensation upon their withdrawal. This tradition was also upheld throughout Japan after the War by small and medium-sized companies – that is, in a time of reconstruction and economic boom. In the process, some companies reverted to paying out a part or all of such compensation in the form of pensions, thus forming the precursor to corporate pensions.

In the 1960s, the government, too, recognized the significance of corporate pensions and established two regulatory frameworks providing tax relief to the statutorily relevant corporate plans: “Qualified Pensions” (tax-qualified plans) and “Employee Pensions” (contracted-out plans).

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2 In 1985, women were already eligible for pension at the age of 55, that is, at an earlier age than men. Female retirement age has since been raised to 60 years. Ultimately, the general retirement age is to be set at 65 years – for men by 2025 and for women by 2030.

The system of Qualified Pensions is comparatively simple: enterprises pay contributions to external insurance companies or financial institutions on a contractual basis, their employees being the beneficiaries. If the contracts are approved by the president of the revenue authorities, the enterprises become eligible for tax relief. This system is favored especially by small and mid-sized companies.

Under Employee Pension schemes, companies – either alone or together with others – set up a “social security pension fund” that collects contributions and pays out the pensions. (The collected contributions are de facto not managed and invested by the fund itself, but by an insurance company or financial institution that has been commissioned to do so.) Fund creation requires the approval of the Ministry of Health, Labor and Welfare. Only large corporations as a rule establish funds on their own. The special feature of Employee Pension plans is that the social security pension fund provides not only third-tier pensions but also serves as a “substitute” for a portion of the second-tier social security pensions. Thus contributions to the latter are not paid to the government pension system, but are “contracted out”. The fund invests these contributions in place of the government and pays out the pensions at statutory level or with a certain supplement. This system functioned well as long as capital investment was still easy and increment value generated a *scale merit*. The persisting economic stagnation of the past few years and low interest rates, however, has especially burdened the public-law part of the fund, which prompted the legal reform discussed further on.

It is moreover not forbidden to introduce a third type of corporate pension besides the two described above. Frequently, this will be a “company-own” scheme based on internal capital reserves. As there are no third-party guarantees for such schemes, they are at risk particularly in the event of bankruptcy.

Both Qualified Pensions and Employee Pensions, as well as company-own pensions, may be based on two types of contribution payment: either employers alone pay contributions on behalf of their staff, or employees also contribute alongside their employer. As a rule, the majority of employers are sole contributories. According to 1997 statistics, employees contributed 4.0 % to tax-qualified plans, 27.6 % to contracted-out plans and 3.7 % to company-own schemes. The duration of pension benefit also differs: Employee Pensions are paid until the death of the insured, while the duration of benefit receipt under qualified and company-own schemes is predominantly limited to a ten-year term. Lifelong pensions are paid to 13.1 % of the beneficiaries of Qualified Pensions and to 22.8 % of those entitled to company-own pensions.

## *II. Reform of corporate pension legislation in 2001*

### *1. Reform background*

The 2001 Corporate Pension Bill introduced large-scale amendments to the above-outlined system. The underlying reason was that corporate pension funds were faced with immense difficulties resulting from a radical change of the economic environment following the collapse of the bubble economy.

Originally, corporate pension funds had been conceived on the assumption that capital could be invested at an annual interest rate of 5.5 %. In actual fact, however, returns on investment often exceeded that target. Then, in the 1990s, financial policy measures generated super-low interest rates, so that such previously high investment yields could no longer be expected. But since benefit levels were defined in advance for all corporate pensions, payment commitments had to be fulfilled on a constant basis irrespective of investment gains or losses. This led to grave concerns that reserves built up for future pension payments would cease to suffice. Moreover, the 2000 reform of accounting standards in compliance with international rules required enterprises to disclose also future pension payments as investments in their company reports – meaning problems could no longer be hidden and deferred.

Under the previous legal system, tax-qualified plans were clearly nothing but a regulatory measure of tax relief. They lacked governing factors such as investment management, information requirements and performance guarantees. Employee Pension Funds were administered quite carefully by comparison. Yet these plans, too, displayed a serious drawback: the substituted or “contracted out” portion of (public) social security pensions that had formerly generated high returns now heightened the losses on account of lower-than-expected interest earnings. Hence, enterprises now had to set off the losses using their own resources. Many of them were ultimately unable to bear the burden, and were thus forced to dissolve their pension funds and terminate the schemes. That triggered mounting demands for flexible and secure corporate schemes excluding the substituted portion of public pensions.

In order to take due account of interest rate risks, the ensuing proposal was to establish a defined-contribution pension scheme. It was to be modeled on the so-called 401(k) plan adopted in the United States 401(k) standing for the pertinent section of the US Internal Revenue Code). Under this scheme, companies pay specific amounts into the pension accounts of individual employees, with benefit levels varying according to investment returns. This concept based on individual calculation is meeting with growing interest in Japan given that former schemes guarantee no security in terms of the “portability” of pension claims – a factor that is becoming increasingly significant as the Japanese labor market becomes more flexible, and with occupational and employment mobility on the rise. Calls for the introduction of defined-contribution schemes were voiced also for rather self-serving reasons – to revitalize stock markets following the “burst of the bubble”.

It was against this background that two laws were enacted in 2001: the Defined Benefit Corporate Pension Law and the Defined Contribution Pension Law.

## *2. Defined Benefit Corporate Pension Law*

The Defined Benefit Corporate Pension Law comprises two types of corporate pension, namely the “Contract Type” and the “Fund Type”.

Under the Contract Type, companies take out contracts regulating pension benefits with financial institutions or insurance companies. Although this scheme resembles the previous Qualified Pension plan, here the employer must enter into an agreement with the relevant trade union<sup>3</sup> and obtain permission from the Ministry of Health, Labor and Welfare prior to contract conclusion. To guarantee the certainty of future benefits, the formation of reserves is obligatory; both the companies and the institutions managing and investing the capital funds are subject to legal provisions governing implementation and information duties. Hence, the legal provisions regulating this new scheme are much stricter than those governing the previous tax-qualified variant.

Under the Fund Type, single companies – either on their own or together with others – create a “corporate pension fund”, which also manages the scheme. This fund corresponds to the social security pension fund under the Employee Pension scheme with the one difference that it now only provides a third-tier pension, thus no longer substituting for a portion of the public benefit.

While the former Employee Pension Funds basically provide lifelong benefits, benefit duration under the new scheme, whether of the Contract or the Fund Type, can either be lifelong or for a specified duration of at least five years. The age of benefit commencement should in principle be between 60 and 65 years, and can be regulated by contract. Moreover, a portion of the pension may be paid out in a lump sum depending on contractual agreement.

Hence, corporate pensions of the Contract Type correspond to a more stringent form of the Qualified Pension and those of the Fund Type to the Employee Pension without the substitutional element. The Defined Benefit Corporate Pension Law in this way complements previous regulations with the two newly introduced Types and simultaneously provides for the termination of Qualified Pension plans after ten years. As a result, in order to sustain current Qualified Pensions for the future, their conversion into either the Contract or the Fund Type of defined-benefit corporate pensions is required by the end of March 2012.

In future, defined-benefit corporate pensions will only comprise three variants: 1) Contract Type, 2) Fund Type and 3) Employee Pension Type. A corporate scheme that maintains a social security fund of the Employee Pension Type but no longer wishes to substi-

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3 Employees are represented by the trade unions in which the majority of insured persons (employees) of that company are organized and, if the company is not unionized, by the representatives elected by the majority of the insured in that company. That also applies to collective agreements in conjunction with Employer-Sponsored defined-contribution schemes.



tute for the public portion of the pension may now switch over to a Contract or Fund scheme, thereby returning the resources of the substituted portion to the government.

The termination or repayment of the substituted portion has become common practice. According to an article in the Japanese economic journal “Nihon Keizai-shimbun” of 1 April 2004, 203 newly approved funds withdrew their substituted portions after September 2003, and 568 funds have received permission to do so in the near future.<sup>4</sup> At the end of March 2003, only 1,357 social security pension funds remained – that was 30 % less than at the end of 1996, when the most funds existed. This decline was attributed to the dissolution of funds or, alternatively, to the termination of the substituted portion of the public pension.

### *3. Defined Contribution Pension Law*

The second law passed in 2001 constitutes the first statutory regulation in Japan of pensions funded on the basis of defined contribution rates. The outstanding feature of this novelty is that the participants themselves invest the contributed capital, with the benefit level now depending on investment performance.

Statutory defined-contribution plans comprise the “Employer-Sponsored Type”, under which companies pay contributions on behalf of their employees, and the “Individual Type”, under which the participants themselves make the contributions. The second type was originally conceived for self-employed persons; however, if a company offers no corporate pension plan (e.g. Employee Pension Fund, defined-benefit interest rates, Employer-Sponsored defined-contribution scheme), employees may be insured on the basis of individually defined contributions.

To open an Employer-Sponsored defined-contribution plan, the employer stipulates the scheme’s terms on the basis of a collective agreement and reports these to the Ministry of Health, Labor and Welfare for approval. Only the employer pays contributions; the insured employees may not be called upon to contribute a supplementary amount.<sup>5</sup> The contribution is capped (in the case of participation in a defined-benefit corporate pension plan, the limit is set at 23,000 yen per month, otherwise at 46,000 yen; as at October 2004).

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4 An economic novel was also written on the subject, entitled “Paying Back the Substitution” (*daiko-henjo*) by *Main Koda*, published by Shogakkan, Tokyo 2004.

5 Following debate over the correctness of this aspect of the legislation, the subsequent decision was not to allow contribution payment by employees because corporate pensions do not constitute savings investments but a means of income security in retirement. Yet this decision was also strongly opposed by critics, arguing that if employees pay no contributions, the scope of investment will be so small that the pension benefit needed to support a decent living in old age cannot be warranted. A national daily newspaper reported on 24 September 2004: “At the end of June (2004), defined-contribution plans of the Employer-Sponsored Type registered 968,000 participants and those of the Individual Type 32,294 participants.” Although total participants numbered over a million, they fell far short of the predicted figure. Reasons are the too high costs of registration, investment management and information in proportion to the invested amount.

Under Individual defined-contribution plans, the Government Pension Fund Association under public law acts as the administering institution. Self-employed persons or employees not covered under a corporate pension plan apply for membership and themselves pay contributions, for which an upper limit is set (68,000 yen monthly for the self-employed and 18,000 yen for the staff of companies without corporate plans).

In any case, the individual participants decide on pension fund management and give the orders – in contrast to defined-benefit pension schemes where employer and financial institution make aggregate decisions. The banks and insurance companies responsible for concrete asset management are obliged to report the investment products and to disclose information required for accounting purposes.

In principle, old-age pension benefits may either be limited in time (more than five years up to 20 years) or lifelong. A portion or the entire benefit may also be converted into a lump-sum payment. After ten years from the first contribution payment, benefit eligibility commences with the age of 60. Beneficiaries who have reached the age of 65 receive their pension regardless of whether the ten-year contribution period has been completed.

An additional feature of defined-contribution plans is their portability. Every participant has an individually registered and administered account, which in the event of a job change is transferable to the Employer-Sponsored scheme of the new place of employment. If the new company does not operate such a pension plan or the participant becomes self-employed, the Government Pension Fund Association assumes pension account management on an individual defined-contribution basis. From October 2005, the transferability of pension assets will also become possible under other pension schemes, such as defined-benefit and Employee Pension plans.

### *III. Three uncertainty factors for employees*

With the enactment of the two above-cited statutes in 2001, Japanese corporate pension law has entered a new era. To recapitulate, four corporate pension schemes now exist: i) the former contracted-out Employee Pension Funds, ii) corporate pension plans with collectively agreed defined-benefit rates (Contract Type), iii) “corporate pension funds” with agreed defined-benefit rates (Fund Type) and iv) Employer-Sponsored defined-contribution pension plans – with Individual-Type schemes created as a supplement.

Of course, the so-called company-own pension plans are still allowed, and the tax-qualified plans are also to remain in place for the time being. But the four specified types are to constitute the principal schemes in future.

Yet even within this new framework, corporate pensions continue to bear several uncertainty factors for employees. Specifically, the three following criteria will unavoidably pose considerable challenges to the further development of Japanese severance-pay-based corporate pension schemes into a genuine and effective overall system. These problems have been expounded by Japan’s leading corporate pension research expert, Professor Hiroyuki Morito of Seikei University.

### *1. Non-payment or reduction of benefit upon dismissal as a disciplinary measure*

When employees are dismissed for disciplinary reasons, in many cases no compensation is paid (or it is heavily reduced). According to a Japanese Supreme Court ruling, severance payments are still considered a kind of reward for longstanding loyal services, meaning the Court recognizes the non-payment of compensation in the event of a disciplinary dismissal.<sup>6</sup> Even long-term loyal services are declared void in such cases.

Such an interpretation of severance pay has been retained for corporate pensions. Under each of the statutory frameworks for the individual schemes, corporate pensions are either not paid or reduced in cases of dismissal for disciplinary reasons if this is clearly provided for in the collective agreement.<sup>7</sup> In practice, such agreements are frequently made, implying that the function of severance pay as a means of labor administration has also been conferred upon corporate pensions.

Now whether pensions, which are supposed to secure employee income upon retirement, should be subjected to such treatment is a highly controversial subject. According to the US Employee Income Security Act, pension claims grow in proportion to years of employment and may not be curtailed in the event of any wrongdoing (“bad boy clause”).

Under Japanese Employer-Sponsored defined-contribution plans, any withholding of an employee’s accumulated pension assets is forbidden, also in the event of disciplinary dismissal, if that person was employed with the company for more than three years without interruption. The other pension schemes should likewise proceed along these lines in future.

### *2. Alterations to the disadvantage of employees*

Pensions are a long-term matter. Changes in a company’s economic environment or financial situation could make it difficult to sustain a previous scope of benefits at a current level, and thus necessitate modifications to the disadvantage of employees. Yet it is no simple thing for employees to accept curtailments of promised benefits. In procedural terms, benefit reductions require an amendment of agreed rates, which under the Contract Type are subject to collective agreement and under the Fund Type to a resolution by the fund representatives, followed by the approval or consent of the Ministry of Health, Labor and Welfare. But even after such a procedure, the prejudicial alteration by no means becomes automatically effective for the relationship with individual employees as participants. Further review is required.

In the United States, prejudicial alterations are not allowed in any circumstances for benefit amounts that have already accrued on the basis of past periods of employment. However, changes can be made freely for future periods. Decisive is the time point of

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<sup>6</sup> Case *Sanko-sha*. Judgment of the Supreme Court of 9 August 1977.

<sup>7</sup> Given that the substitutional element of Employee Pensions is of a public nature, neither non-payment nor reduction of benefit is permissible.

change. In Japan, with the exception of Employer-Sponsored defined-contribution schemes, there is no such line of reasoning that every employee should possess a specific claim to pension benefits on account of past employment.

Under the Law governing employment standards, the employer is obliged to stipulate general employment conditions, such as salaries or working hours, in company instructions. There has been considerable dispute as to the binding nature of instruction alterations that prejudice employees. The relevant judgment of Japan's Supreme Court has led to a regulation whereby such alterations are deemed binding if they are recognized as being sufficiently "reasonable" upon review of the scope of the disadvantage and its necessity.<sup>8</sup> The provisions under which "reasonableness" is to be ascertained incorporate several incongruent elements, making them indistinct and hard to predict. Furthermore, it is questionable whether such a legal theory can be applied in all cases. Put simply, this line of thought might be considered justified for company-own corporate pensions because these form part of the employment conditions of the given enterprise – but that does not hold true for external independent funds or insurance providers. If in the latter case company instructions nevertheless identify pension benefits as a constituent part of severance payment, any change to these benefits will be seen as a prejudicial alteration to the instructions, so that the aforesaid legal theory can be invoked. Moreover, there is discussion over whether the Court can in any way review the reasonableness of an alteration and deem it to be an unjustified disadvantage if this legal theory is not at all applied directly.

A further question is whether pension reductions are possible for former employees who have already retired and receive benefits. To date, no final conclusions have been reached here, except for a few lower court rulings concerning company-own pensions.<sup>9</sup> In practice, the consent of those affected is obtained; in future, however, numerous legal proceedings are likely to be instituted in this matter.

So far, the Corporate Pension Law lacks specific clauses on issues regarding prejudicial alterations. A clarification of these issues and the adoption of legally relevant measures, however, seem necessary for the further development of the corporate pension system.

### 3. *Payment security*

Every corporate pension scheme disposes of measures required to secure pension assets. Compared to company-own pensions based on internal reserves, corporate plans that call for external investments are safer since pension payments can still be effected in the event of the company's bankruptcy. If, however, the company is no longer able to fund the

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8 Case *Shuhoku-Bus*, judgment of the Supreme Court of 25 December 1968; Case *Farmers' Cooperative of the City of Omagari*, judgment of the Supreme Court of 16 February 1988; Case *Daishi Bank*, judgment of the Supreme Court of 28 February 1999.

9 Case *Kofuku-Bank*, judgment of the Regional Court of Osaka of 13 April 1998 (example of a case in which a benefit reduction was recognized); Case *Kofuku-Bank*, judgment of the Regional Court of Osaka of 20 December 2000 (example of a case in which the termination of benefit was ruled unlawful).

scheme, resulting in insufficient assets or even the scheme's ultimate termination, benefit payments will threaten to come to a stop.

To avoid such a scenario, Employee Pension Funds have recourse to a payment guarantee set by the Association of Social Security Pension Funds. The other pension schemes do not possess such arrangements. At the time the two corporate pension laws were passed in 2001, there were strong demands for the introduction of comprehensive payment guarantees modeled on the US system. Yet their proponents were unable to assert themselves because concerns about moral hazard weighed more heavily. In my view, moral hazard is not a convincing argument for rejecting the guarantee system, since separate action can be taken to offset that risk, this moreover being the more appropriate procedure. The point is rather that entrepreneurs tend to perceive corporate pensions solely as severance payments, leading to an inner emotional reluctance to accept the burdens of other companies that have failed (in the form of insurance premiums). And this has been known to obstruct the successful implementation of the system.

Trust in corporate pensions cannot be heightened as long as a benefit guarantee system is lacking. Given that these pensions are often the last support for retired employees, a solution to the problem is imperative.

#### *IV. Conclusion*

This has merely been a cursory description of the previous development and current situation of Japanese corporate pension schemes and related issues. To be noted in this context are two points that could chart the course for reflections on the future role of private schemes in the field of pension insurance: First, corporate pension plans constitute a private system that evolved from severance payments and now requires appropriate regulations designed to perform the increasingly important function of providing income security to retired employees. As, however, companies are under no obligation to establish corporate schemes, all too stringent regulations should not prevent them from doing so. An adequate balance is needed here. Second, the substitutional element of Employee Pensions has shown that substituting private plans for a portion of public pensions bears the risk of such plans malfunctioning if the economic environment deteriorates. Since public pensions represent the minimum guarantee of the government, appropriate counter-measures must be held ready for such adverse situations.

It is to be hoped that the comparison with German schemes will smooth the progress of a more profound analysis and help find an approach with which progressive improvements can be attained.

# A Balance Sheet Approach to Reforming Social Security Pensions in Japan

Noriyuki TAKAYAMA

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References

## *I. Introduction*

Japan already has the oldest population in the world. It has built a generous social security pension program, but since 2001, the income statement of the principal pension program has turned into a deficit. Its balance sheet suffers from huge excess liabilities, and distrust of the government commitment to pensions is growing. The Japanese are increasingly concerned with the incentive-compatibility problem.

This paper proposes a balance sheet approach to describing the current financial performance of social security pensions in Japan, along with comparing respective impacts from alternative reform measures through their balance sheets.

The balance sheet was invented about 700 years ago in Geneva, Italy and has since then become one of the two major accounting tools. Needless to say, the other one is the income statement.

Income statements are very popular, whereas balance sheets are not yet so, not even among policy-making authorities.

The balance sheet is quite a useful tool for assessing the financial situations with a view to the following three aspects:

First, it describes the current financial status in stock terms by presenting assets and liabilities in their respective compositions. Second, it implies how smoothly future financing will be carried out. Third, it illuminates impacts of alternative policy measures on future financing.

Before going into discussion, the paper gives a brief sketch of the Japanese social security pension program, summarizing Japan's major pension problems, while explaining the latest 2004 pension reform.

## *II. Brief Outline of Current Provisions*

Since 1980, Japan has repeatedly undertaken piecemeal pension reforms every 5 years, mainly due to great stresses caused by anticipated demographic and economic factors. Since then, too generous pension benefits have been reduced step by step, with an increase in normal retirement age from 60 to 65. The pension contribution rate has been lifted gradually, as well. Yet, current pension provisions still remain generous, facing serious financial difficulties in the future.

Japan currently has a two-tier benefit system, providing all sectors of the population with the first-tier, flat-rate basic benefit. The second-tier, earnings-related benefit applies only to employees.<sup>1</sup> The system operates largely like a pay-as-you-go defined benefit program.

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<sup>1</sup> A detailed explanation of the Japanese social security pension system is given by Takayama (1998, 2003b).

The flat-rate basic pension covers all residents aged 20 to 60. The full old-age pension is payable after 40 years of contributions, provided the contributions were made before 60 years of age. The maximum *monthly* pension of 66,200 yen per person at 2004 prices, (with the maximum number of years of coverage) is payable from age 65.<sup>2</sup> The benefit is indexed automatically each fiscal year (from 1 April) to reflect changes in the consumer price index (CPI) from the previous calendar year. The pension may be claimed at any age between 60 and 70 years. It is subject to actuarial reduction if claimed before age 65, or actuarial increase if claimed after 65 years.

Earnings-related benefits are granted to all employees. The accrual rate for the earnings-related component of old-age benefits is 0.5481 per cent per year, and 40 years' contributions will thus earn 28.5 per cent of career average monthly real earnings.<sup>3</sup>

The career-average monthly earnings are calculated over the employee's entire period of coverage, adjusted by a net-wage index factor, and converted to the current earnings level. The full earnings-related pension is normally payable from age 65 to an employee who is fully retired.<sup>4</sup> An earnings test is applied to those who are not fully retired. The current replacement rate (including basic benefits) for take-home pay or net income is about 60 per cent for a "model" male retiree (with an average salary earned during 40 years of coverage) and his dependent wife. Its *monthly* benefit is about 230,000 yen.

Equal percentage contributions are required of employees and their employers. The contributions are based on the annual standard earnings including bonuses. The total percentage in effect before October 2004 was 13.58 per cent for the principal program for private-sector employees (Kosei-Nenkin-Hoken, KNH). Non-employed persons between the age of 20 to 60 years pay flat-rate individual contributions. The current rate since April 1998 is 13,300 yen per month. For those who cannot pay for financial reasons, exemptions will be permitted. The flat-rate basic benefits for the period of exemption will be one-third of the normal amount.

Under the current system, if the husband has the pension contribution for social security deducted from his salary, his dependent wife is automatically entitled to the flat-rate basic benefits, and she is not required to make any individual payments to the public pension system.

The government subsidizes one-third of the total cost of the flat-rate basic benefits. There is no subsidy for the earnings-related part. The government pays administrative expenses as well.

The aggregate amount of social security pension benefits was estimated around 46 trillion yen for 2004, which is equivalent to about 9 percent of the country's GDP of the same year.

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2 1,000 yen = US\$9.42 = Euro7.81=UK 5.14, as at 6 April 2004.

3 A semi-annual bonus equivalent to 3.3 months salary is typically assumed.

4 The normal pensionable age of the KNH is 65, though Japan has special arrangements for a transition period between 2000 and 2025. See Takayama (2003b) for more details.



### *III. Demography and Its Impact on Financing Social Security*

In January 2002, the Japanese National Institute of Population and Social Security Research (NIPSSR) released the latest population projections. These indicate that the total population will peak at 128 million around 2006 and then begin to fall steadily, decreasing to about 50 % of the current number by 2100.

The total fertility rate (TFR) was 1.29 in 2003. There is still little sign that the TFR will stabilize or return to a higher level. Yet, the 2002 *medium variant* projections assume that it will record the historical low of 1.31 in 2006 and will gradually rise to 1.39 around 2050, progressing slowly to 2.07 by 2150. The number of births, currently about 1.12 million in 2003, will continue to decrease to less than 1.0 million by 2014, falling further to 0.67 million in 2050.

Because it has the longest life expectancy, Japan is now experiencing a very rapid aging of its population. The number of the elderly (65 years and above) is currently 24.3 million, according to 2003 figures. It will increase sharply to reach 34 million by 2018, remaining around 34-36 million thereafter until around 2060. Consequently the proportion of the elderly will go up very rapidly from 19.0 % in 2003 to 25.3 % by 2014, rising further to more than 30 % by 2033. Japan already has one of the oldest populations in the world.

In Japan, nearly 70 % of social security benefits are currently distributed to the elderly. Along with the ailing domestic economy, rapid aging will certainly put more and more stresses on financing social security.

In May 2004, the Japanese Ministry of Health, Labor and Welfare, published the latest estimates of the cost of social security, using the 2002 population projections of the NIPSSR. According to the latest estimates, the aggregate cost of social security in terms of GDP was 17.2 % in 2004. It will steadily increase to 24.3 % by 2025, if the current provisions for benefits remain unchanged.

Of the various costs, those of pensions are quite predominant, amounting to 9 % of national income in 2004, with a further increase to 11.6 % expected by 2025. The cost for health care is 5.2 % in 2004, but will rapidly rise to 8.1 % by 2025.

The Japanese economy is still reeling from the effects of its “burst bubble”, and the decline in population will soon be reflected in a sharp decline in young labor, in a falling savings rate and in a decrease in capital formation, all of which will contribute to a further shrinking of the country’s economy.

### *IV. Some Basic Facts on Pensions*

Any pension reform proposal must take into account the current basic facts on pensions. Among others, the following five are especially crucial.

## 1. Persistent Deficit in Income Statement

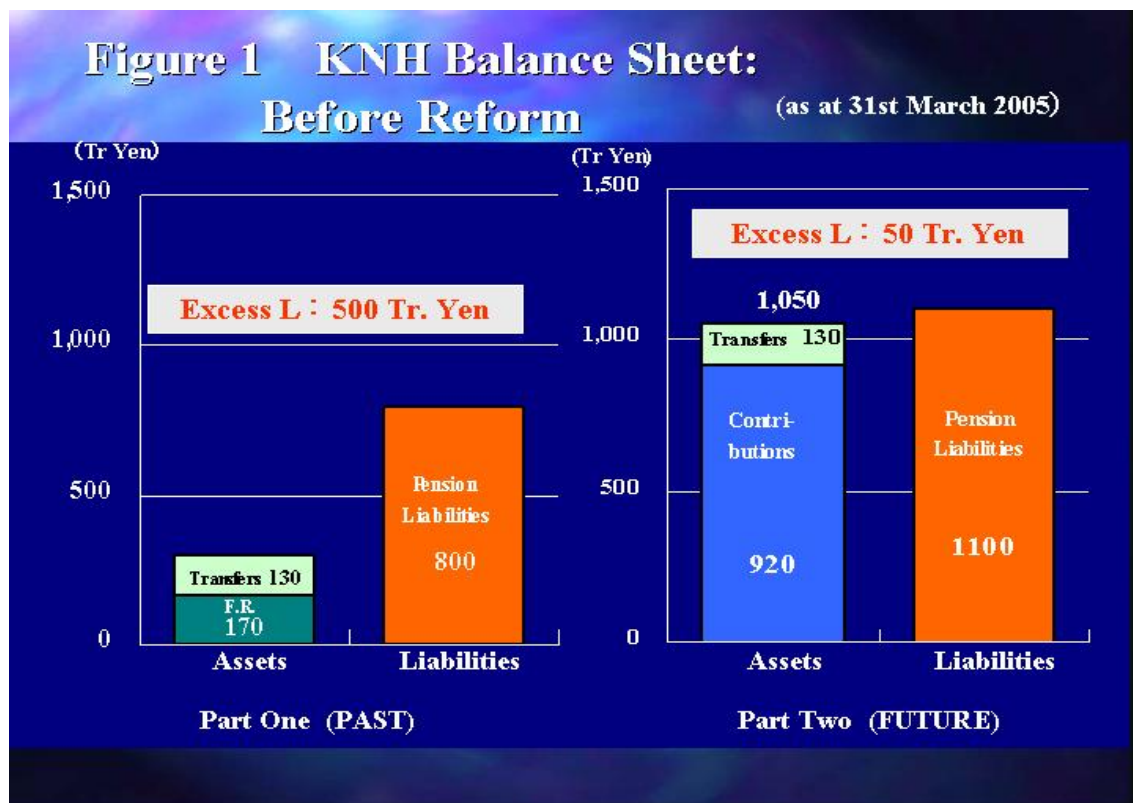
Since 2001, the KNH has been facing an income statement deficit. It recorded a deficit of 700 billion yen in 2001, and the deficit would be 4.2 trillion yen in 2002. It is estimated that the deficit will persist for a long time, unless radical remedies are made in the KNH financing.

## 2. Huge Excess Liabilities in the Balance Sheet

The KNH balance sheet is shown in Figure 1. In calculating the balance sheet, we assumed that:

- a) annual increases in wages and CPI are 2.1 percent and 1.0 percent respectively in nominal terms, while the discount rate is 3.2 percent annually,
- b) the current contribution rate of the KNH, 13.58 percentage points, will remain unchanged in the future, and
- c) the period up to year 2100 is taken into account.

Figure 1 indicates that as at 31 March 2005, there will be excess liabilities of 550 trillion yen, which is a quarter of the total liabilities.<sup>5</sup>



<sup>5</sup> Excess liabilities of all social security pension programs in Japan as at the end of March 2005 amounted to around 650 trillion yen, which is equivalent to 1.3 times Japan's annual 2004 GDP.

Part One of Figure 1 is assets and liabilities accrued from past contributions and Part Two is those accrued from future contributions. Figure 1 implies that, as far as Part Two is concerned, balance sheet of the KNH has almost been put in order. The funding sources of the current provisions will be sufficient to finance future benefits, and the only task left is to slim down future benefits by 4.5 percent.

But if we look at Part One of Figure 1, things appear quite different. The remaining pension liabilities are estimated to be 800 trillion yen, while pension assets are only 300 trillion yen (a funded reserve of 170 trillion yen plus transfers from general revenue of 130 trillion yen). The difference is quite large – about 500 trillion yen, which accounts for the major part of excess liabilities in the KNH.

500 trillion yen is more than 60 percent of Part One liabilities, equivalent to about 100 percent of GDP of Japan in 2004. In the past, too many promises on pension benefits were made, while sufficient funding sources have not been arranged. The Japanese have enjoyed a long history of social security pensions. However, contributions made in the past were relatively small, resulting in a fairly small funded reserve. Consequently, the locus of the true crisis in Japanese social security pensions is how to handle the excess liabilities of 500 trillion yen which were entitled from contributions made in the past.

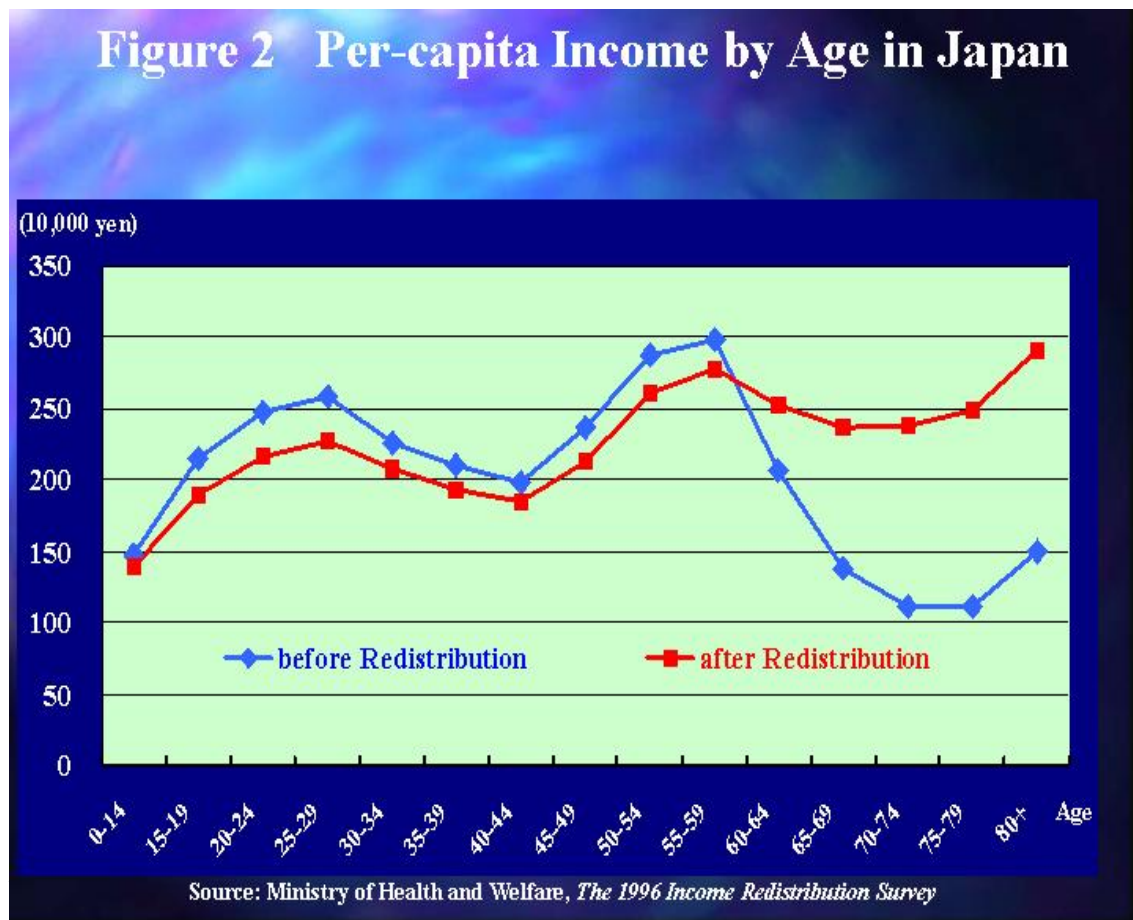
### *3. Pension Contributions: Heavy Burdens Outstanding*

In Japanese public debates, one of the principal issues has always been how to cut down personal and corporate income tax. But recently, situations have changed drastically. Social security contributions (for pensions, health care, unemployment, work injury and long-term care) were reported at 55.6 trillion yen (15.2 percent of national income) for FY 2003. This was apparently more than all tax revenues (43.9 trillion yen) of the central government for the same year. Since 1998, the central government has acquired more from social security contributions than from tax revenue. Looking at more details, we can find that revenue from personal income tax is 13.8 trillion yen and from corporate income tax is 9.1 trillion yen, while revenue from social security pension contributions stands out at 29.0 trillion yen. Needless to say, the last obviously places an immense burden on the public. The Japanese now feel that social security pension contributions are too heavy; they constitute the most significant factor in determining the take-home pay from the gross salary. On the other hand, managements have begun to show serious concerns about any further increases in social security contributions.

### *4. Overshooting in Income Transfer between Generations*

It may come as a surprise that the elderly in Japan are currently better -off than those aged 30 to 44 in terms of per-capita income after redistribution (see Figure 2). Undoubt-

edly, there must still be room for a reduction in benefits provided to the current retired population.

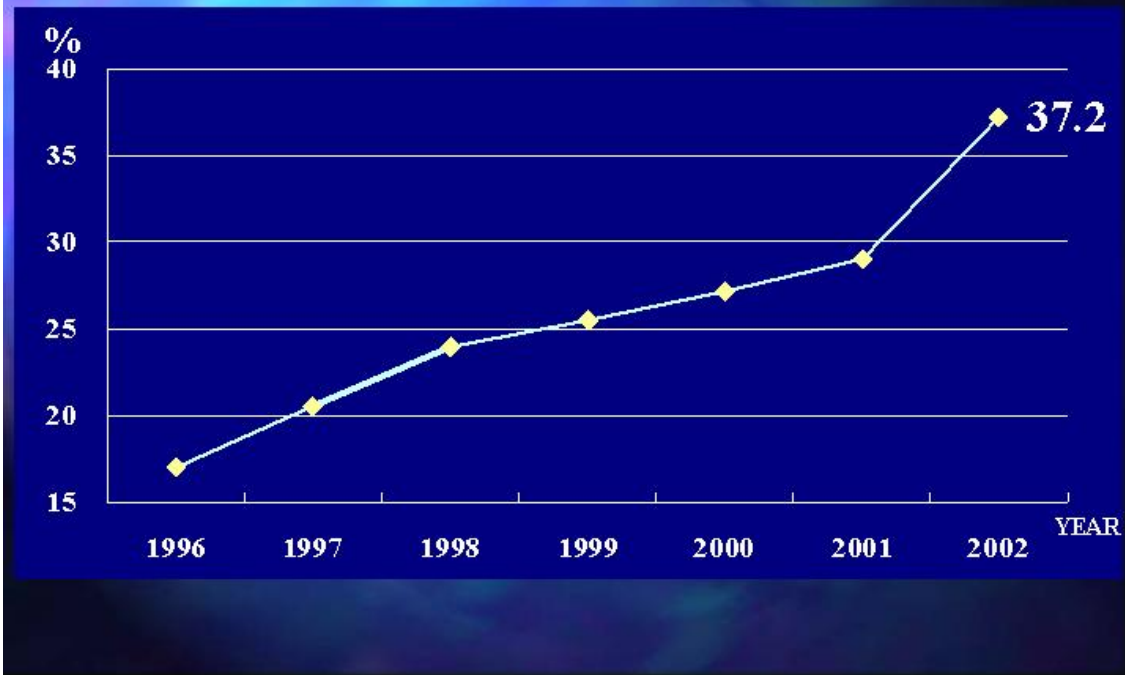


In the past 20 years, the Japanese government has made repeated changes to the pension program, increasing social security pension contributions and reducing benefits by raising the normal pensionable age, while reducing the accrual rate. Further piece-meal reforms of this will most likely follow in the future.

Many Japanese feel that the government is breaking its promise. As distrust of government commitment builds up, concern about such an “incredibility problem” is also growing.

In 2002, nearly 50 percent of non-salaried workers and persons with no occupations dropped out from the basic level of old-age income protection, owing to exemption, delinquency in paying contributions or non-application (see Figure 3 for increasing delinquency).

**Figure 3 Drop-out from SS Pensions (Non-employees)**  
Delinquency in Paying Pension Contributions



Also, employers are meticulously trying to find ways of avoiding the payment of social security pension contributions. Indeed, the aggregate amount of the KNH contributions has been decreasing since 1998, in spite of no change in the contribution rate.

Any further escalation in the social security contribution rate will surely induce a higher drop-out rate.<sup>6</sup>

#### *V. The 2004 Pension Reform: Main Contents and Remaining Difficulties*

In February 2004, the Japanese government submitted a new pension reform bill, which was passed by the Diet in June 2004. Its main contents are as follows:

1. The KNH contribution rate is to rise by 0.354 percentage point every year from October 2004, reaching 18.30 percentage points by 2017. After 2017, it will be kept at 18.30 percentage points.

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6 Contributions to social security pensions operate as “penalties on employment”. Further hikes in the contribution rate will severely damage domestic companies which have been facing mega-competition on a global scale, thereby exerting negative effects on the economy, leading to a higher unemployment rate, lower economic growth, lower saving rates and so on. Further increases in the contribution rate will be sure to decrease the take-home pay of actively working people in real terms, entailing lower levels of consumption and effective demand.

2. Social security pension benefits will be further reduced by 0.9 percent in real terms every year for the next 20 years. Consequently, the replacement rate for the “model” male retiree and his dependant wife will decrease step by step from currently 60 percent to 50 percent by 2023. This is due to the introduction of a “demographic factor” which takes into account the decreasing rate of the actively working population and longer life expectancy.

3. Transfers from general revenue are to be increased from one-third to one-half of the basic benefits by 2009.

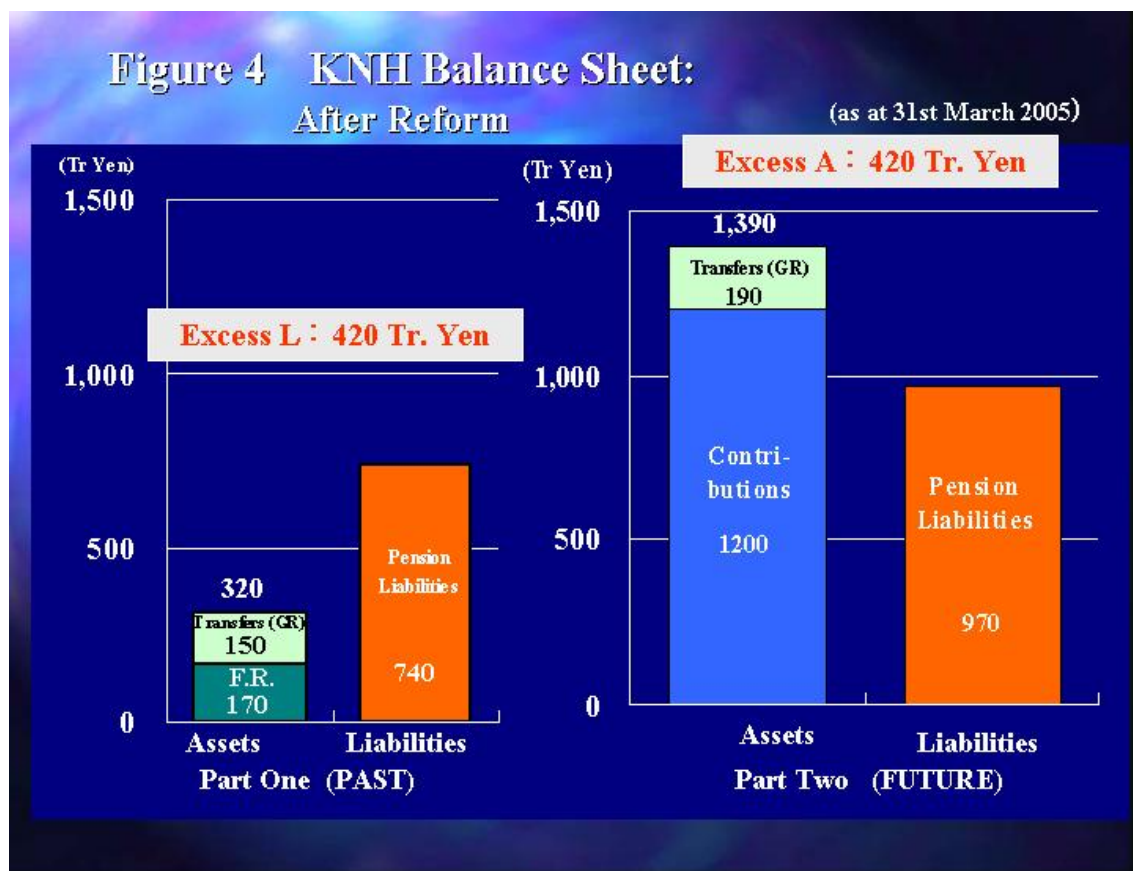
4. The earnings test is to be relaxed before age 65, while a new earnings test has been introduced for those of age 70 and over.

5. An earnings-split between husband and wife is to be introduced upon divorce.

6. More taxes will be levied on pension benefits from 2005.

7. There is no plan for any further increases in the normal pensionable age above 65.

The policy measures adopted in the 2004 pension reform bill will generate huge *excess assets* of 420 trillion yen in the Part Two balance sheet, thereby offsetting excess liabilities of the same amount in the Part One balance sheet as shown in Figure 4. Huge excess assets of the Part Two balance sheet imply that future generations will be forced to pay more than the anticipated benefits they will receive. Their benefits will be around 70 percent of their contributions and taxes, on the whole.



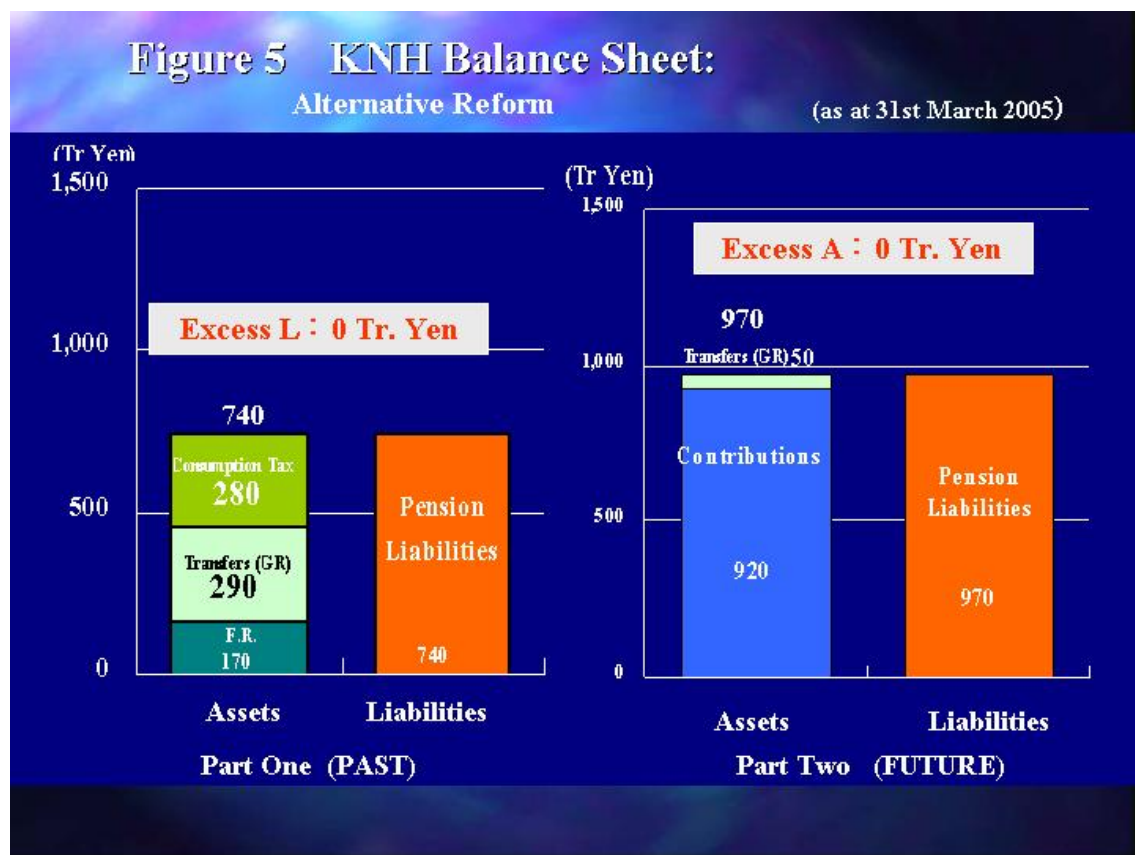


It seems as if we are cutting paper not with scissors but with a saw. Younger generations are most likely to intensify their distrust of the government. The incentive-compatibility problem or the drop-out problem will become graver. Management (Nippon Keidanren) and trade unions (Rengo) both oppose any further increases of more than 15 percentage points in the KNH contribution rate.

## VI. Switching to the National Defined Contribution (NDC)

The Japanese Ministry of Health, Labor and Welfare, shows a great interest in switching the system to an NDC. It believes, however, that such a switch will be realistic only after the KNH contribution rate reaches its peak level in 2017.

Switching to the NDC can be introduced in Japan very soon, however, if we *separate* the “legacy pension” problem from re-building a sustainable pension system for the future. Japan’s legacy pension problem looks like *sunk costs* in the economic perspective. It can be solved not by increasing the KNH contribution rate but by introducing a new 3 % earmarked consumption tax and intensive interjection of the increased transfers from general revenue (see Figure 5). Needless to say, current generous benefits have to be reduced more or less by the same percentage as implemented in the 2004 pension reform bill.



As far as the Part Two balance sheet is concerned, which relates to future contributions and promised pension benefits entitled by future contributions, a switch to the NDC is quite advisable. The KNH contribution rate will be kept unchanged at the current level of 13.58 percentage points. The notional rate of return can be set to equal the financial rate of return from investment (3.2 per cent per year in nominal terms).

With the NDC plan, the incentive-compatibility problem can be avoided. Indeed, every penny counts in the NDC, and this would be the most important element when we switch to an NDC plan. It will be demonstrated to the public that everybody gets a pension equivalent to his/her own contribution payments.

The NDC is expected to be rather neutral toward retirement decisions. The labor force participation rate for the Japanese male elderly still remains at a considerably high level (71.2 percent in 2003 for those of age 60 to 64) as compared with other developed countries, however. The shift to NDC can induce later retirement also in Japan, but its effect may not be so significant.

A move to NDC leads to lower replacement rates at age 65. That can be compensated by working longer, until age 67 or so, or by more voluntary saving. The Japanese government has decided to give more tax incentives to the existing defined contribution plan from October 2004 onward.

## *VII. Concluding Remarks*

The Japanese are increasingly concerned with the “taste of pie” rather than the “size of pie” or the “distribution of pie”. When it comes to social security pensions, the most important question is whether or not they are worth buying. It has become a secondary concern how big or how fair they are. The basic design of the pension program should be incentive-compatible. Contributions should be linked much more directly with old-age pension benefits, while the element of social adequacy should be incorporated in a separate tier of pension benefits financed by sources other than contributions.

The current (and projected future) income statement has been a major tool for describing the financial performance of social security pensions all over the world. It can only supply half of the story, however. The balance sheet must be the other indispensable tool to enable people to understand the financial status of pensions and to evaluate varying financial impacts from different reform alternatives. The balance sheet of occupational pensions is a “must” item for corporate financial accounting. Why not for social security pensions?

The balance sheet accounting for social security pensions is already available in Sweden, Japan, Singapore and the U.S. The significance of the balance sheet will be recognized increasingly as it is drawn up in a growing number of countries.



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