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# Comparing Flexicurity in Denmark and Japan<sup>1</sup>

by

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## 1. Introduction

Flexicurity – the contraction of the English words; Flexibility and Security – is currently the most popular concept for employment and labour market reforms in the European Union. This is clearly testified in the March 2006 Presidency conclusions of the European Union that calls for the member states to pursue reforms in labour market and social policies under an integrated flexicurity approach, and commits the European Commission to establish a common set of principles on flexicurity. According to the European Council the benefits of such a flexicurity approach are improved adaptability of workers and enterprises, more open and responsive labour markets, more productive workplaces, and positive interdependencies of competitiveness, employment and social security (Council of the European Union, Brussels, 18 may 2006; p. 13).

In recent years, Denmark has become the prime example of a real-life flexicurity labour market. The Danish case of flexicurity is a combination a flexible labour market with liberal hiring-and-firing procedures on the one hand, and relatively generous social security and active labour market policies on the other hand. In general terms, Denmark has succeeded in combining a universal, generous and redistributive welfare state with a competitive labour market and productive labour force. The recent international academic and political interest in this “happy marriage” of flexibility and security – or the “golden triangle” as it is sometimes labelled - coincides with relatively good macro-economic and labour market performance (Madsen 1999, 2002, 2003, 2006; Bredgaard et al 2005, 2006). The most important implication of Danish flexicurity is a shift from job security towards employment security (Wilthagen 1998; Wilthagen & Tros 2004), i.e. protecting transitions on the labour market rather than protecting jobs.

In this report we will compare what seem to be two completely different cases of flexicurity; the Danish and the Japanese case. Traditionally, the Japanese labour market model has been characterised by the practice of life-time employment for the regular workforce, consensual labour-management relations, and high working-time and functional flexibility within large internal labour markets (Kato 2001; Passet 2003). In the 1980s, the Japanese production and employment system was held up as a ‘best practice’ and model which the European community could learn from, particularly by combining job security with a high degree of (internal) flexibility. However, the burst of the so-called “bubble economy” in the 1990s, and the recession and stagflation following in its wake, has put Japan under pressure for employment reforms (Passet 2003).

Despite improvements in recent years, the employment situation is still considered as being difficult (JILPT 2006). The Japanese problem definition focuses on unemployment (especially among young people) and the increase in the number of non-regular workers creating disparities in economic opportunities. During an economic crisis there are also strong pressures for increasing flexibilities within internal labour markets (like working time reductions, wage cuts, and changes of task and duties within the organisation) and the (internal) social security system comes under pressure. This is indicated by a high feeling of job-insecurity even among people in regular employment (Passet 2003, Boyer 2006). On top of this Japan has to deal with the problems of an ageing society, which create a need for a higher employment-rate (especially for women) and a higher involvement of the high proportion of young people outside regular employment.

The main question of this report is whether a new balance between flexibility and security could be a viable solution for reforming the Japanese employment system. Especially contrasted to the Dan-

ish flexicurity-model with external numerical flexibility, external (public) social security and less employment protection legislation (EPL).

In the next section we will define and discuss our analytical framework; the concept of flexicurity (section 2). Then we proceed by describing the Danish case of flexicurity, and its social and institutional preconditions (section 3). Then we provide a fresh account of the Japanese employment system and labour market model by applying the main concepts from the flexicurity literature (section 4). In section 5 we conclude on the relevance of contrasting the Danish model of flexicurity to the Japanese labour market, and describe the possible policy implications.

## 2. The flexicurity framework

In this section we will explore the concept of flexicurity and describe how various understandings of it coexist (as political strategy, a certain state of affairs, and an analytical concept), and how it is possible to mix forms of flexibility and security into different combinations.

It should be noted that the idea of flexicurity is relatively new, both as a political strategy and as a research area. To put it bluntly, economists have often tended to take a one-sided view of the positive consequences of flexibility for labour markets, enterprises and employees, and have tended to see social and employment security as barriers to competitiveness and economic growth. On the other hand, labour market and social policy researchers (e.g. political scientists and sociologists) have usually focused more on the positive consequences of security for redistribution and welfare, but have rarely taken into account its consequences for the flexibility of the labour market or enterprises.

The fundamental idea of the flexicurity concept is that flexibility and security are not contradictory, but mutually supportive. Critics have said that flexicurity is really nothing more than a paraphrase of the traditional antagonism between capital and workers; employers demanding more flexibility and employees demanding more security as compensation (cf. Ozaki 1999). However, the idea behind the flexicurity approach is that flexibility is not the monopoly of the employers, just as security is not the monopoly of the employees. In modern labour markets, employers are realising that they have an interest in stable employment relations and in retaining employees who are loyal and well-qualified (thereby recouping human capital investments). On their part, many employees are realising that to be able to adjust their work life to more individual preferences they too have an interest in more flexible ways of organising work, e.g. to balance work and family life (Wilthagen and Tros 2004). So, the foundation is there for a new interaction between flexibility and security.<sup>2</sup>

While flexicurity was first coined as a concept in the Netherlands to describe a particular piece of legislation on labour regulation, the concept has also increasingly been used to describe the Danish labour market model as a combination of liberal employment protection legislation, high social security, and extensive active labour market programs. In several reports, the International Labour Organisation (ILO) has pointed to Denmark as a good example (Auer 2000; Auer and Casez 2003; Egger and Sengenberger 2003), and the OECD has repeatedly mentioned the Danish combination of

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<sup>2</sup> As an empirical concept, the phrase flexicurity was first coined in the Netherlands in the mid-1990s. Holland had a restrictive system for dismissal of permanent employees. Employers had to ask for permission to dismiss workers either from the local Centres for Work and Income or the local courts; furthermore employers are partly responsible for financing the unemployment and disability benefit systems through social contributions. Permanent full-time employees were covered by relatively high job protection, which induced enterprises to increase flexibility in the workforce by hiring groups of temporary workers on fixed-term contracts (flexibility at the margins). Generally these “atypical” workers had a lower level of social security (e.g. rights to unemployment benefit, pensions and holidays) and a lower level of job security than permanent full-time staff. The idea of the Dutch flexicurity legislation, which took effect in 1999, was to correct this imbalance between an inflexible labour market for core workers and an insecure labour market situation for the contingency workforce. The protection against dismissal for permanent workers was modified, the system requiring permits for temporary work agency was abolished, and the job protection of atypical employees was strengthened. Another important aim was to encourage a development from job security towards employment security, in particular through a more active labour market policy. The inspiration for this legislation came partly from a collective labour agreement between the employers, the trade unions and the temp agency START from 1993, partly from an agreement in the ‘Labour Foundation’, which is a central body for consultation between employers’ organisations, trade unions and the government. The Dutch legislation on flexicurity is therefore a typical example of the tradition for corporatist coordination (Wilthagen 1998; Wilthagen & Tros 2004).

a flexible labour market and high social security as a best practice (e.g. OECD 2004: Chapter 2). Recently, the European Commission has embraced the concept of flexicurity, most evidently in the Presidency Conclusions of the European Council stating that the member states should pursue reforms in labour market and social policies under an integrated flexicurity-approach, while the Commission will explore the development of a common set of principles on flexicurity (Council of the European Union, may 18, 2006, p. 12).<sup>3</sup>

One important reason for the increasing popularity of the concept is probably the very fact that the concept is so hard to define, and consequently different actors can mould the concept to fit their own interpretations and interests. Here lies one possible explanation as to why flexicurity has become a semantic magnet to which the EU Commission and the OECD, for example, have found themselves attracted. This lack of conceptualization and concretization implies a certain political ambiguity and timidity.<sup>4</sup>

## 2.1. Defining flexicurity

In the literature, at least three different – but overlapping – understandings of flexicurity can be identified: flexicurity as a policy strategy, as a state of affairs on the labour market, and as an analytical concept. One possibility is to define flexicurity as ”social protection for flexible work forces” (cf. Klammer & Tillman 2001; Ferrera et al. 2001) or as the “normalization of atypical work” (Wilthagen 2005). The most precise and probably the most widely used definition of flexicurity come from Ton Wilthagen and his colleagues. Wilthagen defines the concept as a policy strategy:

*“...that attempts, synchronically and in a deliberate way, to enhance the flexibility of labour markets, work organisation and labour relations on the one hand, and to enhance security – employment security and social security – notably for weaker groups in and outside the labour market, on the other hand”* (cf. Wilthagen 1998; Wilthagen & Rogowski 2002; Wilthagen & Tros 2004).

In order to obtain the label ‘flexicurity’, the strategy, policy or program must be synchronous (contain elements of both flexibility and security at the same time), deliberate (the actors must be conscious about this mutuality) and aimed at vulnerable groups (people on the margins of or outside the labour market).

A second definition of flexicurity has subsequently been developed to include a certain state of affairs or condition on the labour market, more precisely:

*“(1) a degree of job, employment, income and ‘combination’ security that facilitates the labour market careers and biographies of workers with a relatively weak position and allows for enduring and high quality labour market participation and social inclusion, while at the same time providing (2) a degree of numerical (both external and internal), functional and wage flexibility that allows for labour markets’ (and individual companies’) timely and adequate adjustment to changing conditions in order to enhance competitiveness and productivity”* (Wilthagen & Tros 2004: 170).

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<sup>3</sup> In the 2006 edition of *Employment in Europe* the European Commission has devoted a chapter to analysing flexibility and security in the EU labour markets.

<sup>4</sup> As Jean-Claude Barbier concludes about the political use: “No political document published by the Commission or the OECD has – so far – been able to present a coherent, comprehensive and detailed economic model of a ”nexus” between flexibility and security” (Barbier 2006).

This definition is among other things inspired by the Danish case, where it is difficult to speak of any deliberate policy strategy.

The third understanding of flexicurity is as an *analytical framework* that can be used to analyse developments in flexibility and security and compare national labour market systems. One important insight from Wilthagen and his colleagues is that both flexibility and security are multi-dimensional concepts. Taking a point of departure in Atkinson’s well-known model of the flexible firm (Atkinson 1985, Atkinson and Meager 1986), a distinction can be made between four forms of flexibility: (1) Numerical flexibility (adaptation of the number of employees), (2) functional flexibility (between different work tasks), (3) working time flexibility and (4) wage flexibility. The innovative aspect of the flexicurity concept is to link this with different forms of security: (1) Job security: security enabling the worker to remain in the same job. (2) Employment security: security to remain in employment, but not necessarily in the same job or with the same employer. (3) Income/social security: security which maintains one’s income under conditions of unemployment, illness and accident. And (4) combination security: the possibility to combine working life with private life (e.g. child-care leave).

With this point of departure, the possibilities of combining flexibility and security are often presented in a matrix showing several possible combinations (cf. Wilthagen & Tros 2004):

*Figure 1: The flexicurity matrix*

|                          | Job security | Employment security | Income security | Combination security |
|--------------------------|--------------|---------------------|-----------------|----------------------|
| Numerical flexibility    |              |                     |                 |                      |
| Working time flexibility |              |                     |                 |                      |
| Functional flexibility   |              |                     |                 |                      |
| Wage flexibility         |              |                     |                 |                      |

Wilthagen’s matrix offers a heuristic tool which can be used to identify different flexicurity policies or combinations of flexibility and security for certain arrangements. It can also be used to identify relationships between flexibility and security in different national labour market regimes. Other dimensions of the concept concern the level (national, regional, local or individual) and the range of coverage of different groups and sectors (the entire labour market, sectors, job types or groups). Finally, flexicurity arrangements can be established through different forms of regulation: law, collective agreements or individual work contracts. Interpreted this way, flexicurity is a complex and multi-dimensional concept that implies integration of different policy fields. Flexicurity arrangements are embedded in broader national contexts (welfare state models, collective bargaining sys-

tems, national traditions), just as there are many different forms of flexicurity both in Europe and within individual countries.<sup>5</sup>

## 2.2. Identifying flexicurity

Here we also hint at one of the weaknesses of the flexicurity matrix: the fact that it is used both to identify national labour market regimes and specific arrangements (programs, instruments, schemes) at different levels. It would not be difficult to imagine forms of flexicurity at the firm, branch or sector level which will be in conflict with (or counterproductive for) national flexicurity configurations. There can be contradictions between security arrangements provided by the firm (which will tend to promote job security and thereby functional and working time flexibility), and security arrangements provided by the state (which will tend toward promoting employment security and thereby external numerical mobility). In this way, we may lose the perspective of the dynamics which exist between different types of flexicurity arrangements at different levels.

Our approach to this problem is to apply the matrix to identify relationships between flexibility and security in different national labour market regimes. With this point of departure, more explanatory or deeper factors behind the description of regimes can be explicated so as to show the significance of arrangements with different forms of regulation (law, contract-based, public services, etc.), levels (regionally, locally or individually) and locations (the entire labour market, sectors, job types, groups, etc.). Added to this is the entire understanding of the necessary social conditions, the importance of which has been emphasized by Barbier (2006). We must therefore ask: Why and how have the established arrangements emerged (by negotiations, compromises or redistribution of resources)? What are the conditions for future arrangements? The institutionalisation of policies seems just as important as the specific policy strategy or design (Larsen 2005).

Another weakness with both the definition and the matrix has been pointed out by Leschke, Schmid and Griga (Leschke et al. 2006). The juxtaposition of different forms of security and flexibility as a trade-off tend to neglect the more general positive effects beyond the ‘marriage’ between the individual forms. The flexibility gains of employers does not necessarily mean a loss of security among employees; and security gains of employees does not necessarily mean flexibility losses of employers. The flexicurity nexus can also reflect a mutually supportive or complementary relationship; e.g. job security can induce employees to be loyal to the employer and to invest in firm-specific human capital, thereby increasing functional flexibility, as in the Japanese case. Alternatively, in the Danish case, where high income and employment security give people greater willingness to take risks,

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<sup>5</sup> As an analytical frame, flexicurity is closely related to another popular labour market concept, the idea of the *Transitional Labour Markets*, TLM (Schmid & Gazier 2002). The basic assumption in the TLM approach is that the boundaries between the labour market and various social systems (such as the educational system, the unemployment system, pension system, private households) must become more open towards transitional states between paid employment and productive activities outside the market. The aim is a new form of full employment, which is different from (male) full-time, life-time employment with the same employer, but is instead a “floating equilibrium” of a 30-hour working week over a lifetime, for both men and women. That is, a development from job security to employment security similar to the ideas behind the flexicurity concept. In this context flexicurity is seen as an implementation strategy – or even as the end goal – for a TLM labour market, as it is assumed that the transitions between the labour market and other social systems will only be possible if adequate security is provided for the individual (Schmid & Schömann, 2004). “Good transitions” are regarded as temporary stepping stones for the individual, which may lead to social inclusion, and which secure productivity and competitiveness for employers (cf. also Bredgaard & Larsen 2006).

and thereby also greater desire for job change and job retraining, which again ensures higher job mobility and a more skilled labour force. But the nexus can also be vicious; e.g. when hire and fire policies lead to high insecurity, under-investments in human capital, lower effective demand, and even lower fertility rates (Leschke et. al 2006: 3). Lesche et. al (2006) proposes to identify empirical outcomes between flexibility and security as complementary, vicious or trade-offs.

### 2.3. Why compare Denmark and Japan?

There have been – and still are - major differences between the Japanese and Danish labour market model, which should be taken as a starting point for our research. The Danish employment system is oriented towards the external labour market (with low job protection and high numerical flexibility combined with public income and employment security). Traditionally, the Japanese employment system has been oriented towards the internal labour market, where life-time employment was combined with internal flexibility, especially for the core workforce. These different start-points are illustrated in the figure below.

Figure 2: Idealised combinations of flexibility and security in Japan and Denmark

|                             | <i>Internal security</i> | <i>External security</i> |
|-----------------------------|--------------------------|--------------------------|
| <i>Internal flexibility</i> | Japan                    |                          |
| <i>External flexibility</i> |                          | Denmark                  |

*Internal flexibility* comprises the types of flexibilities managed on internal labour markets. In this case; (1) working time flexibility (overtime, short-time, and part-time work), (2) functional flexibility (internal job changes, transfers, change of functions and tasks, flexible work organisation, and on-the-job learning), and (3) wage flexibility (pay systems, bonuses, outsourcing). *External flexibility* refers to numerical flexibility on the external labour market (external job changes, temporary layoffs, fixed term contracts, temp agency work, atypical employment etc.). *Internal security* refers to the securities managed and provided by employers and corporations in internal labour markets. This is typically expressed as job security (like employment protection for permanent and atypical workers, including procedures for dismissal, notice period, severance pay), but it may also include income/social security of the employer and corporations and combination securities (like company leave policies). Finally, *external security* refers the type of securities managed and financed by the state government (the public budget) like active labour market policies, public funded income and social security.

In this report we describe the traditional and as well as current balance of flexibility and security in Denmark and Japan. While the Danish labour market model has repeatedly been analysed as a (best) case of flexicurity, the Japanese case has not so far been explicitly interpreted as a case of flexicurity, and the concept seems to provide an adequate and systematic description of some fundamental characteristics of both labour market models, and possible routes to follow in the future. In the following we begin by describing the main elements of the Danish case of flexicurity and the possibilities for policy transfer and learning. Then we proceed to analyse the Japanese case of flexicurity; the traditional combination of job security and internal flexibility in life-time employ-

ment, the current challenges of the labour market model, and suggestions for possible reform paths to take.

### 3. The Danish case of flexicurity

The period since the mid-1990s has been a ‘golden age’ for the Danish labour market. This is often referred to as the Danish ‘job miracle’ (Cox 1998, Torfing 2004), which made commentators wonder whether Denmark had realised the “*inflation-free growth economy at full employment*” (Madsen 1999). It has turned out to be possible to achieve low unemployment<sup>6</sup> without the attendant problems of wage increases and inflation, while at the same time maintaining important welfare arrangements, despite significant pressure. In the most recent European survey, the employment rate in Denmark ranks as the highest in the European Union: In 2004, 75.7% of persons aged 15-64 years were in employment in Denmark (compare to 63.3% in EU25 and 68.7% in Japan). From having previously considered high and persistent unemployment an almost chronic state, Denmark is now close to full employment, according to several commentators. There are reports of increasing labour shortages and warnings that the labour market is close to full capacity utilisation. Like in Japan, the key political agenda is to increase effective labour supply and counter the demographic challenge of a shrinking and ageing workforce (the Welfare Commission 2006).

Recently, these favourable labour market outcomes have been ascribed to the unique Danish combination of flexibility and security. The combination of well-managed macroeconomic policies, labour market reforms, high flexibility, a well-educated workforce and well-functioning tripartite cooperation based on social and political consensus has won the “Danish labour market model” renown. In several reports, the UN’s international labour organisation, ILO, has pointed out Denmark as a shining example (Auer, 2000; Auer & Casez, 2003; Egger & Sengenberger, 2003). In connection with the EU employment strategy, and in individual EU members such as Germany and France, Denmark has been used as a textbook example of how a member state has proved able to combine a dynamic economy, high employment and social security. In the international debate on “flexicurity” - or ways of combining flexibility in the labour market with social and employment security - the Danish case is quoted frequently (Wilthagen 1998; Wilthagen & Tros 2004; Madsen, 2003, 2004; OECD, 2004, chapter 2).

The Nordic countries are counterevidence to the common assumption that high taxation is detrimental to competitiveness and economic prosperity. Denmark was in 2005 ranked as the best place in the world to conduct business over the next five years despite emerging labour shortages, the high level of public spending and taxation, and xenophobic anti-immigration policies (The Economist Intelligence Unit 2005). In recent years the Nordic countries have, despite high tax rates, consistently been at the top of the World Economic Forum’s growth competitiveness index (World Economic Forum 2005, 2006).

#### 3.1. The “golden” triangle

The Danish combination of flexibility and security is often described as a ‘golden triangle’ (see Figure 3 below). Danish flexicurity combines high mobility between jobs with a comprehensive social safety net for the unemployed and an active labour market policy. In fact the mobility (measured by job mobility, job creation, job destruction and average tenure) is remarkable high by international comparisons (Bingley *et al.* 2000; Auer and Cazes 2003; Madsen 2005). Since the early 1980s, where data are available, the number of job creations and job destructions amount to on av-

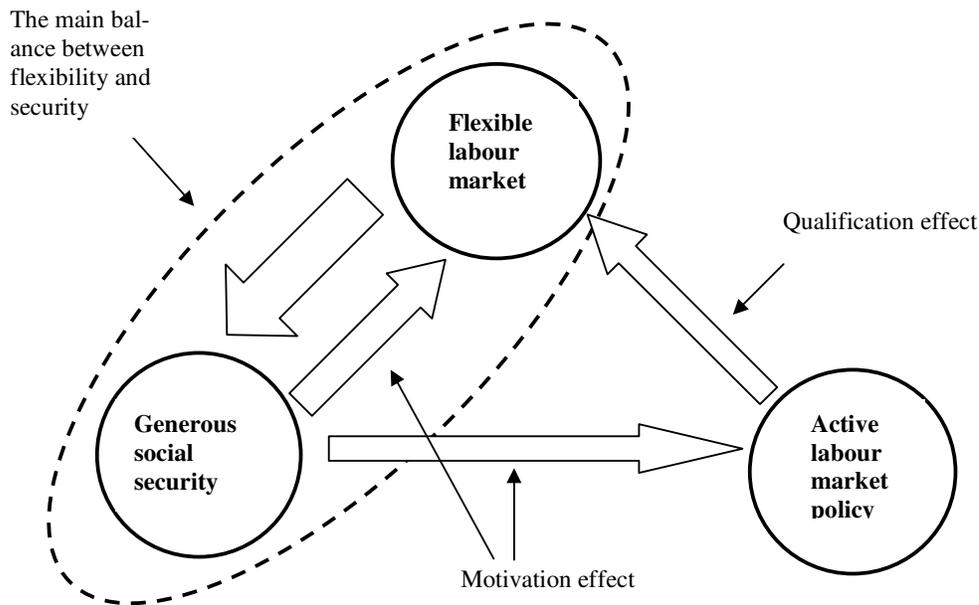
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<sup>6</sup> Following the national Danish unemployment registers, unemployment reached a record low at 3.9% of the workforce (equivalent to 107.000 full-time persons) in December 2006, which is the lowest level recorded since oil crises hit western economies in the early 1970s.

erage 10 percent of all jobs being created or destructed every year, and around one third of the labour force being newly recruited or dismissed within the last year (Ministry of Employment 2005; Arbejderbevægelsens Erhvervsråd 2004). Another indicator of numerical flexibility is the average tenure with the same employer (cf. Auer & Cazes 2003). Denmark is among a group of countries with a rather low tenure (around 8.5 years in 2005), comparable to the United Kingdom. In contrast, the average tenure of 12 years in Japan in year 2000 is almost 50% higher than in Denmark (Auer 2006). As a final indicator the average number of jobs held per worker in Denmark is the highest in EU-25; almost 6 jobs in Denmark, compared to 4 jobs on average in EU-25. More than 70% of people in Denmark think that changing jobs every few years is good; compared to 40% in EU-25 (European Foundation 2005).

The high degree of mobility from employer to employer is probably linked to the relatively modest level of job protection. Low job protection is consistent with the Danish industrial structure, with its predominance of small and medium-sized enterprises (i.e. small internal labour markets). And it is also in line with the long liberal tradition of the Danish welfare state (Madsen 1999, 2005), which, among other things, is attributable to the tradition whereby the social partners have been left to regulate most of the terms and conditions important to the labour market themselves, as opposed to the state regulation found in other countries. So, an important precondition for this Danish labour market model is a tradition for corporatist labour market regulation (Andersen and Mailand 2005). Another reason for the high job mobility could also be a greater willingness to take risks among workers as a result of the comprehensive social safety net. Despite one of the lowest levels of job protection among OECD countries (OECD 2004; Madsen 2005), there is a feeling of high job security among all subgroups of Danish workers (OECD 1997; Auer and Casez 2003; Auer 2006).

**Figure 3: The “Golden” Triangle**



In Figure 3 (above) the arrows between the corners of the triangle illustrate flows of people. Even if the unemployment rate is low by international standards, Denmark has a near European record in the percentage of employed who are each year affected by unemployment and receive unemployment benefits or social assistance (around 20%). But the majority of these unemployed persons manage to find their own way back into a new job.<sup>7</sup> Those who become long-term unemployed end up in the target group for the active labour market policy, which – ideally – assist them in finding employment again. The figure illustrates two of the most important effects in this connection. On the one hand, as a result of the active labour market measures, the skills of participants in various programs (e.g. job training and education) are upgraded and this improves their chances of getting a job. On the other hand, the measures can have a motivational effect in that unemployed persons who are approaching the time when they are due for activation may intensify their search for ordinary jobs, in the event that they consider activation a negative prospect.

The social security system in the form of unemployment benefits and social assistance for the unemployed together with the highly flexible labour market form the main axis of the model, in the sense that both elements have been characteristic of the Danish labour market for many years. Recognition of the employers' right to hire and fire at will dates back to the September Compromise of 1899 when the labour market organisations (the employers association and trade union movement) entered into an agreement that focused on labour market disputes and how to solve them, as well as the appropriate role of organisations in the system. This established centralised negotiations and mechanisms for resolving disputes and also laid the foundation for the practice of self-regulation by labour market parties in most matters of importance to the labour market (Larsen & Jørgensen 2002).

As in Finland and Sweden, the Danish unemployment benefit system is based on the Ghent system. It has its roots in the early 1900s, and in its present form dates from the late 1960s. A generous (by international standards) and primarily government-financed benefit support system was established in 1969 and fairly wide frameworks for support were adopted. The unemployment benefit system is administered not by the state, but by the independent unemployment insurance funds (*arbejdsløshedskasserne*) which are de facto affiliated to the trade unions. Unemployment benefits and the government's role in financing them were increased, eligibility requirements for insurance and unemployment benefits were eased, and high levels of compensation for lost income were secured. In return, employers were exempted from compensating redundant employees, as this responsibility was taken over by the state. Consequently, employers have never had to guarantee employment and pay for redundancies, and the hiring and firing costs of Danish businesses have remained very low (Bredgaard et. al 2005).

On the other hand, the active labour market policy with its emphasis on upgrading skills and job training is relatively new. In its present form, it originates in the labour market reform of 1993-94 and subsequent initiatives. The labour market reform of 1994 marked a significant shift, from a

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<sup>7</sup> Despite the long duration (4 years) and generosity (up to 90% replacement rate) of the Danish unemployment benefit system; there is a relatively low incidence of long-term unemployment. As an indication, the proportion of unemployed who experienced unemployment for more than 6 months in 2005 was 44% and the proportion experiencing unemployment for more than 12 months was 26%. The corresponding figures for EU-15 were 61% and 44% respectively. The incidence of long-term unemployment in Japan is placed in between Denmark and the EU-15 average: Around 50% of the unemployed experience unemployment for more than 6 months, and around 33% for more than 12 months (OECD 2006: 267).

passive to an active labour market and social policy. In this case, the trade unions in particular had to make concessions, by accepting a decrease in the period of eligibility for unemployment benefits, and, not least, losing the right to regain eligibility by participating in activation measures. In return, an individually tailored activation policy was supposed to increase the chances of the unemployed individual to return to employment. It could be argued that the trade unions thus accepted that the shift away from lifelong income security to a higher degree of employment security, the latter combined with motivational elements such as tightening the rules for work availability and the duty of activation (Madsen 1999, 2005; Larsen & Jørgensen 2002; Bredgaard et. al 2006).

Besides the employment security provided by an active labour market policy, an important role in the functioning of Danish flexicurity is played by education policy (Lassen 2002). Again, the social partners are highly involved and institutionally committed to the planning and implementation of education policies, in particular continuing vocational training (CVT) policies. A specific institutional characteristic of the Danish CVT policy is that it provides services and training for both the employed and the unemployed. Under the formal responsibility of the Ministry of Labour (now Ministry of Education) but administered by the social partners, continuing vocational training of unskilled workers was established in 1960, and a similar system was established for skilled workers in 1965. Even if the social partners plan and administer the CVT system, the state is its main financier, just as is the case with the unemployment benefit system. This financing system externalises the costs of training and education from the firms, and indirectly serves as a government subsidy to the competitiveness of Danish industry. Partly as a result of this financing arrangement and the extensive rights of participation in CVT, Denmark has for a number of years ranked among the top performers in Europe in relation to participation in CVT activities (Eurostat 2005; OECD 2005). Since the CVT system is predominantly financed by the public budget, CVT activities are more likely to provide general rather than firm-specific skills, which are transferable on the external labour market. Also, by allowing unemployed workers to improve their general skills during economic downturns, firms are in a better position to compete once the economy improves (Campbell and Pedersen 2005).

In sum, the development of the Danish welfare state and labour market points towards an interesting hybrid between the flexible, liberal welfare states characterised by high numerical flexibility (liberal hiring-and-firing rules) and the generous Scandinavian welfare regimes of high social security (relatively high benefit levels) (Madsen 1999, 2003, 2005, 2006). The hybrid model manages to reconcile the dynamic forces of the free market economy with the social security of the Scandinavian welfare states. Some writers may be inclined to call this hybrid unstable and bound eventually to head off in one or the other of the two directions (Hall and Soskice 2001). However, it is evident that this hybrid model is a result of a long evolutionary development, and is supported by relatively stable institutions and class compromises.

Even though the term flexicurity is new, it is in fact only trying to describe and rephrase some deep-rooted characteristics of the Danish labour market. Therefore the causalities involved are complex and must be understood as mutual interrelations with a strong element of path dependency. The positive outcomes of the Danish model are not just related to a simple causality from, for instance, a low level of employment protection to economic success. Without the security elements, which support the willingness to accept structural change and risk-taking both by employees and employers, the Danish model would probably not have been able to achieve its current level of employment and competitiveness. Another important factor is the successful balancing of the macroeconomic policy and trends in the global economy. Managing to keep inflation low during an economic boom

must also be attributed to the emergence of a new agenda for collective bargaining and wage formation, which meant that the labour market was able to adjust to the shift from high unemployment to high employment and still keep wage increases at a moderate pace, which in turn meant that the Danish economy did not stray from the international shift towards low inflation (Bredgaard et al. 2005, 2006).

One important challenge of Danish flexicurity is to include everyone capable on the labour market. The large number of job changes means that individual workers are repeatedly being tested for their productivity and work potential. This constant selection process leads to some groups of employees being gradually excluded from the labour market if they fail to live up to the expectations of employers. A large group of workers are thus more or less permanently balancing on the edge of the labour market or outside it. The price for a highly efficient and mobile labour market with an extensive safety net might be that a large part of the potentially active population of working age is gradually excluded from the labour market and become welfare recipients. The composition of the group of people on transfer income has changed considerably. Immigrants from third-world countries make up a growing share of social assistance recipients; they have considerably lower employment and participation rates than ethnic Danes, and this constitutes a major and so far unresolved integration and labour market problem.

### **3.2. Learning from Denmark?**

Danish flexicurity is not the result of a deliberate plan carried out over a short period in the 1990s. Essential parts of the model date way back to the September Compromise in 1899 and to welfare reforms in the 1960s. It is these specific historical conditions that make it difficult to transfer Danish experiences directly to other contexts. An important message, though, is that imposing strong restrictions on the freedom of employers to hire and fire employees is not the only way to provide security for the individual in the labour market. Quite the contrary, it is possible to combine a dynamic labour market with a high degree of income and social security.

The booming literature on policy transfer and Europeanisation illustrates the options for, but also the barriers to, policy learning either directly from neighbours or from policies advocated by supranational bodies like the European Union (Dolowitz and Marsh 2000; Olsen 2001). Inspired by Vivien Smith (2002) one can list a number of factors, which determine the transferability of policies into a given country. These include its economic vulnerability exemplified by presence or absence of economic crisis and the political institutional capacity, which is inherent in the principal policy actors' ability to impose or negotiate change. Important factors are also policy legacies and preferences, which determine the 'fit' of potential policies with longstanding policies and institutions and with existing preferences. Related to the latter is also the flexibility or robustness of the national policy discourse, determining the ability to change preferences by altering perceptions of, for instance, economic vulnerabilities and policy legacies.

With direct reference to the transferability of flexicurity policies, Wilthagen (2005: 265) has also stressed the importance of political institutional capacity in the form of mutual trust between the social partners and the government, when it comes to developing flexicurity policies. Adequate central and de-central level platforms and channels for coordination, consultation and negotiation are also highly important.

The importance of these points is of course related to the core of the flexicurity concept: moving from one configuration of levels of flexibility and security to another will involve one of the parties (typically the employees) accepting some form of increased flexibility (and thus uncertainty) in their working life in order to receive compensation in the form of improved security arrangements provided by employers or the state. For the employees this obviously implies the risk of being cheated by accepting more flexibility, without gaining the reward in the form of increased security. Trust created by historical experiences with bargaining processes and maybe supported by some form of state guarantee is necessary.

The issue of economic vulnerability enters the bargaining process around flexicurity arrangements as a double-edged sword. On the one hand, economic crisis can be the factor which changes political preferences and puts the need for labour market reform high on the political agenda. On the other hand, an economic crisis is rarely a situation in which economic resources for improving workers' security are abundant. Higher public spending on income security or policies providing more employment security will for instance be hampered by fear of increasing deficits on the public budgets. Such worries can be countered by pointing to the fact that this public spending must be conceived as investment that will be repaid through the longer term growth stimuli from a more flexible labour market.

Finally, one can point to the fact that the pre-existence of a certain institutional infra-structure will facilitate specific flexicurity arrangements. For example, a comprehensive public system for adult education and training will make it easier to develop flexicurity arrangements, which involves employment security in the upgrading of skills of unemployed workers or workers at risk of unemployment. Also, a well-developed system of childcare is indispensable for creating security for working parents and thus for a flexible supply especially of younger women on the labour market.

These more general points are all of crucial importance when considering the options for policy learning from flexicurity in other countries. Obviously they are also relevant when considering the transferability of the lessons from the specific Danish version of flexicurity. One important, albeit rather general, message is evidently that a sizeable welfare state with high levels of both taxes and social benefits is not incompatible with a dynamic and well-functioning labour market.

The high degree of flexibility on the Danish labour market is thus supported indirectly through a number of welfare state services such as a comprehensive educational system, including adult vocational training and education, a well-developed childcare system, (relatively) well-functioning and publicly financed health care, etc. In a labour market perspective, many of these welfare schemes can be viewed as investments in well-functioning structures, rather than costs.

Translating Danish flexicurity into a direct policy prescription to be used in times of rising unemployment, the main message is that the first handle to pull should not be the one labelled 'more job protection'. This will only hamper the restructuring of production and employment, which is necessary in order to regain growth and low unemployment. But in order to support reallocation of workers to firms and sectors with growth potential and in order to combine restructuring with economic and social equality, security arrangements must be in place. Income support to the unemployed is a minimum requirement. But apart from income security, the security arrangements must focus on assisting the unemployed and those at risk of unemployment in getting back to employment.

However, it is not the aim of this report to provide detailed prescriptions on how to implement flexicurity policies in specific national contexts. This is a complex task better left to national analysts and policy-makers in the respective countries. Here a better comprehension of best practices with respect to flexicurity policies from other countries, including Denmark, can act as an important source of inspiration and can lay the ground for shifts in national discourses, which over time may lead to a 'subtle transformation of states' (Jacobsson 2004). The main attraction of Denmark in this context is therefore its uniqueness as a country that has implemented an encompassing version of a specific form of flexicurity. And as any teacher will know, one real-life example tells more than a torrent of abstractions.

## 4. Flexicurity in Japan

In the following we will apply the flexicurity framework to characterise the relationship between different forms of flexibility and security in Japan. First, we begin by characterising the traditional combination of job stability and internal flexibilities that permeated the life-time employment practice. Second, we proceed by discussing the current labour market challenges of the Japanese employment system. Empirically, we will rely on existing research reports and data material to provide a fresh account of the Japanese labour market and employment system in a flexicurity perspective.<sup>8</sup>

### 4.1. Lifetime employment and job security

Japan is well known for its life-time employment system. In relation to the concept of flexicurity, it provides high (albeit informal) job security, where job stability and low external numerical flexibility is traded off against high internal flexibility. This internal flexibility consists of in-house mobility within jobs and across tasks, on the job training and retraining, seniority wages and working-time flexibility. Thus, the Japanese labour market system has traditionally been focused on job stability and maintenance of employment within firms. This type of internal labour market flexicurity is in sharp contrast to the external labour market flexicurity of the Danish system, and the institutional differences are reflected in average tenure and tenure distribution, as reported below (cf. ILO 2005).

*Table 1: Average tenure and tenure distribution in selected countries*

|                | Average tenure (years) | Workers with less than 1 year's tenure (%) | Workers with more than 10 year's tenure (%) |
|----------------|------------------------|--|---|
| Greece         | 13.6                   | 9.8  | 52.1  |
| Japan          | 12.2                   | 8.3  | 43.2  |
| Italy          | 12.2                   | 10.8                                       | 49.3  |
| France         | 11.2                   | 15.3                                       | 44.2  |
| Germany        | 10.6                   | 14.3                                       | 41.7  |
| Denmark        | 8.3                    | 20.9                                       | 31.5  |
| United Kingdom | 8.2                    | 19.1                                       | 32.1  |
| United States  | 6.6                    | 24.5                                       | 26.2  |

Sources: Data for Europe from 2002 based on Eurostat; US data from 1998 based on national sources. Data for Japan from 2000, cf. Ono 2006.

The tenure data for Japan are similar to those of a number of continental and southern European countries (Greece, Italy and France), while Denmark more closely resembles the liberal Anglo-Saxon countries (United Kingdom and United States). A variety of factors accounts for these differences (like the age composition of a country, differences in GDP growth, differences in company size structures, the stringency of employment protection legislation, union presence etc.). For our purposes, the most interesting explanatory variable of job tenure is the stringency of employment protection legislation. The formal and informal rules of recruiting and dismissing are embodied in the Japanese practice of life-time employment, which we describe below.

<sup>8</sup> In addition we have conducted interviews with senior researchers at the Japan Institute for Labour Policy and Training (Hirokazu Fujii and Shunichi Uemura) and with representatives of the human resources division of the IT-company Sorun Corporations (Koji Nakajima) and the labour relations division of Toyota (Katsuhiko Ogino). Our initial findings have been presented at a seminar at the JILPT and to the councilor for the Minister of Health, Labour and Welfare (Nakano Masayuki).

After World War II when Japan was in economic and material ruin, the establishment of economic security and protection of minimum standards of living was the highest priority of the government (Araki 2002).<sup>9</sup> Although Japanese firms developed flexible mass production and quality circles based on American organisational models, other procedures, such as job evaluation and the lay-off system, were not adopted due to their incompatibility with Japanese traditions and norms. Instead of legal enforcement, employers and enterprises developed internal enforcement mechanisms based on long-term labour relations and joint labour-management consultation. This means that even during downturns, corporations have refrained from dismissing employees (Passet 2003: 161).

In Japan, lifetime employment is not a contractual state. It does not emerge from employment protection legislation or collective agreements, but is rather to be considered an informal and mutual expectation between employers and workers.<sup>10</sup> As a rather unique feature of Japanese recruitment practices, employers hire workers immediately after graduation (so-called infancy) and retains them in open-ended contracts until retirement (typically at age 60). In return workers are expected not to seek and apply for jobs in the external labour market and to remain loyal and committed to the company. One typical expression of these mutual expectations (or self-imposed rigidities) in Japanese firms is Dore (1996: 8): “*By self-imposed rigidities, I mean the acceptance, by managers, of a wide range of constraints on their freedom of action – lifetime employment guarantees, tight seniority constraints on promotion, acceptance of the need to engineer consent, to maintain close consultation with employees or their unions – that acceptance of constraint being rewarded by a ‘commitment’ on the part of employees which greatly facilitates the firm’s ‘flexible’ adaptation to new technologies and new market opportunities*”. Dore goes on to explain how committed employees, not fearful of dismissal, are more willing to accept a complete change of job function, to undergo training, less likely to leave the firm, and more willing to accept wage restraint when the company faces difficulties.

As mentioned, judicial practice and not legislation is the foundation for Japanese job security.<sup>11</sup> The courts gradually accumulated case laws that restricted the right of dismissal by requiring employers to provide “just cause”. 1979 case law established four conditions to be met before regular employees could be dismissed: (1) employers should be faced with compelling and unavoidable necessity for dismissals; (2) they should have made every effort to avoid dismissals (e.g. transfers to affiliated companies, terminating employment of temporary and part-time workers, facilitating early retirement, reducing overtime and suspending new hires); (3) they should consult with trade union representatives and employees about dismissals; and (4) they should establish reasonable standards and apply them fairly when selecting workers for dismissal (Araki 2002: 26). By implication, even dur-

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<sup>9</sup> In 1946 the Ministry of Labour was established, and the year after a number of protective laws was enacted, among them the Labour Standards Law.

<sup>10</sup> By measuring employment protection *legislation* (protection of permanent workers against individual dismissal, specific requirements for collective dismissal, and regulation of temporary forms of employment), the summary indexes of the OECD tend to underestimate job security in Japan. Therefore, Denmark and Japan are actually placed next to each other in the 2003 index, among the countries with below average job protection (the index does indicate, however, that protection of permanent workers is less strict in Denmark than in Japan) (OECD 2004).

<sup>11</sup> Japan has no courts specially designated for labour disputes; therefore, all labour and employment related lawsuits must be filed in ordinary courts. The number of labour cases is extremely small compared to other industrialized countries. This could be related to the fact that there are high costs in relation to judicial procedures for the individual in terms of money and time, and also some socio-cultural and psychological hesitancy over litigation (Araki 2002: 11-12, 28).

ing economic downturns and restructuring, dismissals of regular workers has become the very last resort after other types of internal devices for flexibility and cost-reduction have been applied (like transfer, dismissal of non-regular workers, reduction of overtime, hiring freeze) (Araki 2002: chapter 2).<sup>12</sup> These requirements for economic dismissals are more strict than in other industrialised countries, which is further stressed by the fact that in cases of unjust dismissal, Japanese employers are not only obliged to pay wages during the whole period of dismissal, but also to reinstate the dismissed employee (Araki 2002: 27).

It should be noted that while lifetime employment is perceived as a main pillar of the Japanese employment system, in practice, it applies only to a minority of the labour force. Despite difficulties in measuring lifetime employment, Ono (2006) estimates that roughly 20% of the labour force can be defined as lifetime workers (i.e. workers who were employed immediately after school graduation, and has never been employed by a firm other than the current one). This rate covers substantial differences by gender, firm size, and education level. At its extreme, the proportion of lifetime workers among male university graduates in large firms is 55%, and the 30 years survival probability of male workers in government is 65% (Ono 2006: 34).<sup>13</sup> The fact that only one in five workers can be classified as lifetime employees does not mean that the remaining are non-regular fixed-term workers. Actually, more than 70% of the workforce is permanently employed in open-ended contracts.

During and after the recession of the 1990s, however, the proportion of standard workers declined from 80.2% in 1991 to 69.6% in 2003. In absolute numbers, standard workers declined by 2 million, while the number of non-standard workers expanded by 6.1 million (Ono 2006: 11). Since 2003, the decline in standard (regular) workers has continued, and the number of non-regular workers has climbed to 33.2% of the total number of employees (16.63 mil. in first quarter 2006). Nonetheless, Ono (2006) shows that the proportion of lifetime workers as a percentage of the labour force (defined as those who were employed immediately after school graduation and have been continuously employed by the same employer) has actually increased across all age categories during the period 1980 to 2000. The proportion of workers in lifetime employment is much higher among men than women, among middle-aged and older workers than younger workers, among large companies, and among white-collar executives (Ono 2006). In a study of retention rates, Kato

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<sup>12</sup> Since 2000, several district courts have significantly changed the interpretation of the four requirements above to make it easier to dismiss regular workers. Rather than insisting that all four requirements should be met for economic dismissals, the courts should consider if a dismissal is abusive even if for instance unions have not been consulted. This new interpretation provoked heated debate, and it is still too early to judge if the new interpretation will replace the traditional interpretation (Araki 2002: 26-27).

<sup>13</sup> As a result of lifetime employment practices, Japanese employers seem to have a stronger preference for “organisational growth” (maintaining the human resources of the organisation) than maximising profits in order to satisfy shareholders. This is also related to the fact that the financial institutions (including banks and insurance companies) own a high share of the total stock outstanding of listed companies, and there are usually one or a few influential city banks for each listed company that own up to the maximum. Because a large proportion of the equities held by banks and other corporate entities are extremely stable, the managements of Japanese firms are insulated from takeover raids through the open market. Individual stockholders only have minority shares, and do not have any effective voice in the corporate governance structure (Aoki 1990: 14ff.).

(2001: 494) finds “*little evidence for serious erosion of the practice of life-time employment*”.<sup>14</sup> This is also confirmed by data on separation rates (measuring the total number of separations divided by the total number of employed persons) showing that the outflow of workers changed very little from 1991 to 2003, although it increased modestly for part-time workers, for large firms (1.000+ employees) and regular male workers (Ono 2006: 29). As Kato (2001) explains the burden of downsizing during the economic slowdown in the 1990s have fallen disproportionately on younger and middle-aged employees with short tenure, particularly women. Rather than dismissing workers, large firms in Japan have been trying to restructure and downsize by relying on transfers of their employees to their subsidiaries and related firms and by cutting on new recruits (Kato 2001: 489).

In summary –and despite the prolonged recession of the 1990s - there seems to be job stability in the core of the labour market (among middle-aged and older male workers), while there is increasing fluctuation at the margins (or peripheries) of the labour market (especially among young persons and women in non-regular employment). This implies a stronger bifurcation of the labour market with increasing social and economic disparities (the current challenges of the Japanese employment system are described in greater detail in section 4.2. below). It also implies that the practice of lifetime employment is still the dominant norm in recruitment and personnel management of employees in Japan, and is not necessarily substantially eroding despite current challenges.

#### **4.1.1. Internal flexibility**

Under the lifetime employment practice, employees are trained in-house and promotions and wage increases are based on seniority. The actual operation of this personnel system is rather flexible, as this quote illustrates: “...when business is slow, rather than resorting to drastic employment adjustment measures such as sudden dismissals, a variety of measures such as limitations of overtime hours, reassignment of employees, restraint in or discontinuation of hiring new employees, and loaning or transferring employees to affiliated companies has been implemented” (JLIPT 2006: 33). Rather than relying on hire-and-fire policies on the external labour market, Japanese corporations have responded to variations in the business cycle by applying a range of internal flexibility buffers, which we briefly describe below.

Variations in working hours create internal flexibility for Japanese enterprises. In general, actual working hours are fluctuating with the business cycle; during a recession working time for core workers is reduced to avoid dismissals (especially overtime hours). Alternatively, during economic booms working time is increased (workers are paying back their debts for not being dismissed during recession). Changes in the composition of working hours have played a significant part in adjusting working hours. Until the enactment of the revised Labour Standards Law in 1988, the change in total working time was strongly dependent on changes in overtime hours. Although changes in overtime work still play an important cyclical role, there has also been a sharp decrease

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<sup>14</sup> Beyond Japan, the thesis on the end of stable and permanent jobs does not find convincing empirical support either. Auer (2006) conclude on the basis of the existing literature that OECD-countries have a varying, but substantial share of long-term employment relationships and are characterized by a degree of stability in their employment systems that is remarkable in respect to the dominant view of a much more volatile labour market (see also Auer & Cazes 2003). Auer, furthermore, presents recent data for EU-15 showing that average employment tenure has hardly changed between 1992 and 2005 (10.48 years and 10.74 years respectively). The World Employment Report 2004-05 (ILO 2005) also document that the differences in tenure between countries are resilient over time.

in regular working time (Passet 2003: 165).<sup>15</sup> Many companies are gradually shifting towards a five-day, 40 hours working week, and increasingly use part-time and short-time workers (cf. section 4.2). Despite the legal shift towards a five-day and 40 hours working week in 1987, actual working hours has remained extremely long in Japan.<sup>16</sup> The most important reasons being that overtime is incorporated into the employment system as a means to absorb business fluctuations without resorting to economic dismissals, and because there is a low take-up of annual paid leaves and holidays (Araki 2002; Japan Labour Review 2006: 3(3)).<sup>17</sup> Thus, variations in working time functions as an important internal flexibility buffer for Japanese companies.

Seniority wages are also closely linked to the lifetime employment system. In Japan, wages are determined by length of service, age and educational background. It can be understood as a method deferring payment of wages that provides employees with an incentive to remain employed with the same company for a long time. In principle, wages are set below marginal productivity for those who have been employed for a relatively short time, while wages are offered above marginal productivity for those who have been employed for a longer time (Kazuo 2004; Araki 2002). This seniority-based wage system means that wages are not determined by the work performed or job content; by implication the amount of wages remains the same even if a worker is internally transferred to a different job or the job content is altered (Araki 2002: 70). The Japanese seniority wage system is, furthermore, unique in the fact that it covers not only white-collar workers, but also blue-collar workers, which has traditionally contributed to reduce wage and income disparities (for recent changes of the wage system, see section 4.2. below).

The final internal flexibility device underpinning the lifetime employment system is functional flexibility; understood as the employers scope for transferring workers between job functions and tasks (both horizontally and vertically), internal job changes, flexible work organisation, multiple skills of the employees, and on-the-job learning (Bredgaard et al 2006; Lesche et al 2006; Wilthagen & Tros 2004). Functional flexibility in Japan is based on in-house training of employees over the long term. It consists primarily of informal on-the-job training and internal job rotation. It is compatible with lifetime employment, since corporations making firm-specific human capital investments are interested in retaining core workers on a long-term basis to recoup their investments. In general, the system works as follow: Newly recruited graduates are typically trained by experiencing different types of work in several departments within a company or corporate group (multiple skills). Through such broad job rotation, companies can evaluate employee's performance and determine the type of work for which they are best suited. These assignments and transfers are carried out together with the management of seniority-based promotions as well as internal competi-

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<sup>15</sup> Annual working hours have declined by some 400 hours since the 1960s. Still international comparisons show that Japan has about the same annual working hours as the United States (around 1.950 hours in 2002), which is considerably higher than most European countries (JILPT 2006; OECD 2006). In Japan there is in comparison to European countries a higher proportion of non-scheduled working hours and lower proportion of annual paid leaves taken (JILPT 2006: 47).

<sup>16</sup> As an indication of the long working hours in Japan, the proportion of workers working more than 50 hours a week in year 2002 was 28% compared to 20% in the United States, 15% in the United Kingdom, 5% in Denmark, and 1.4% in the Netherlands (Messenger 2004 quoted in Ogura 2006).

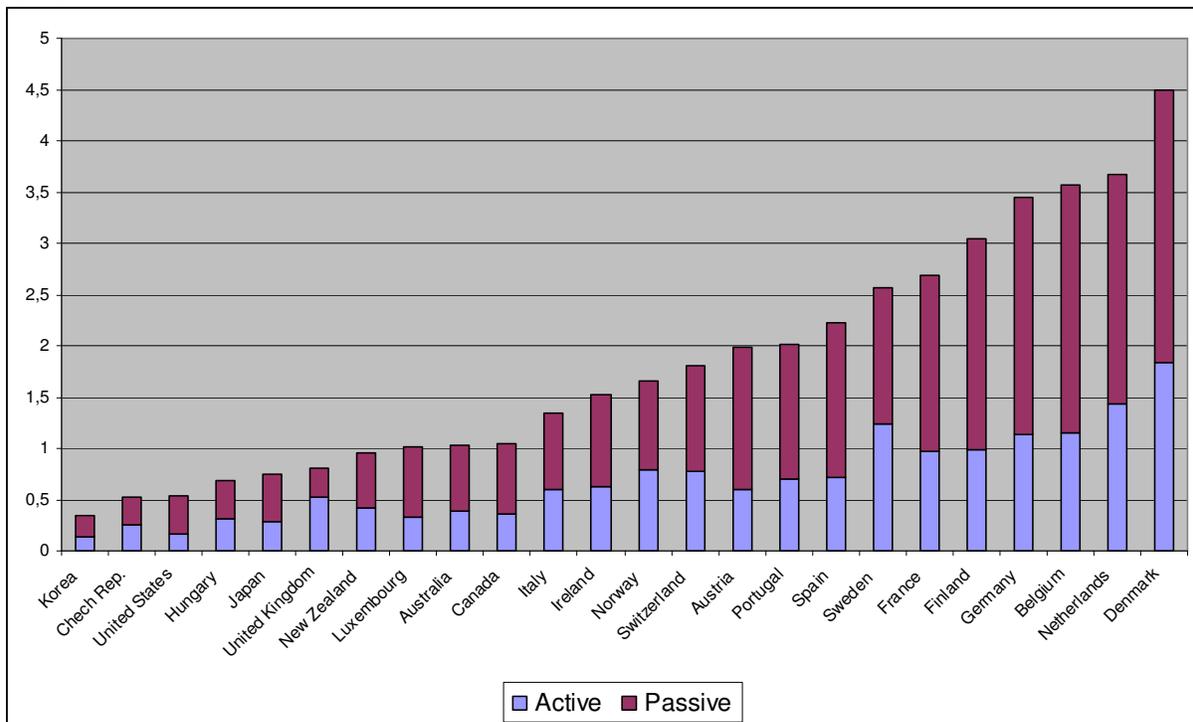
<sup>17</sup> Workers are by implication subject to unlimited overtime once labour and management have reached an agreement allowing overtime. Even if there is a upper limit of 360 hours per year, there are no sanctions for violating this limit. Finally, the overtime premium is extremely low compared by international standards, and there is a high level of unpaid overtime.

tion. In general, an employment contract usually will not specify concrete conditions of employment, which makes functional adaptations possible (Araki 2002: 57).

#### 4.1.2. Income and employment security

This system of high internal flexibility and job security is mirrored in a system of low external security. Since private companies and public institutions have traditionally delivered job security through lifetime employment, there has been no pressing need for a pervasive system of social security or employment security. Therefore, labour market policies have, until recently, been few, and put in place mainly to maintain job stability. Labour market policies have focussed on subsidising job maintenance (employment insurance) rather than job creation or unemployment reduction (Passet 2003: 160).<sup>18</sup> Passet (2003: 160) describes that: “For example unemployment insurance is ”employment insurance” in Japan, supporting employment maintenance rather than compensating layoffs. The outcome is good protection of insiders, with public labour market policies supporting policies concerning short-term work, training and transfers between jobs”. This is indicated by the fact that Japan has one of the lowest expenditures on labour market policies (as a percentage of GDP) among OECD-countries, while Denmark has the highest (see figure below).

Figure 4: Expenditures on labour market policies in OECD-countries (passive and active, percentage of GDP), 2004



Source: OECD (2006): *Employment Outlook*.

<sup>18</sup> Since 1975, the employment adjustment subsidy has played a central role in Japan’s employment policy. When enterprises in designated industries strive to maintain employment during a downturn, this subsidy can be granted in the form of partial payment of wages, and to cover temporary leave allowances or to subsidize training of employees (Passet 2003: 200).

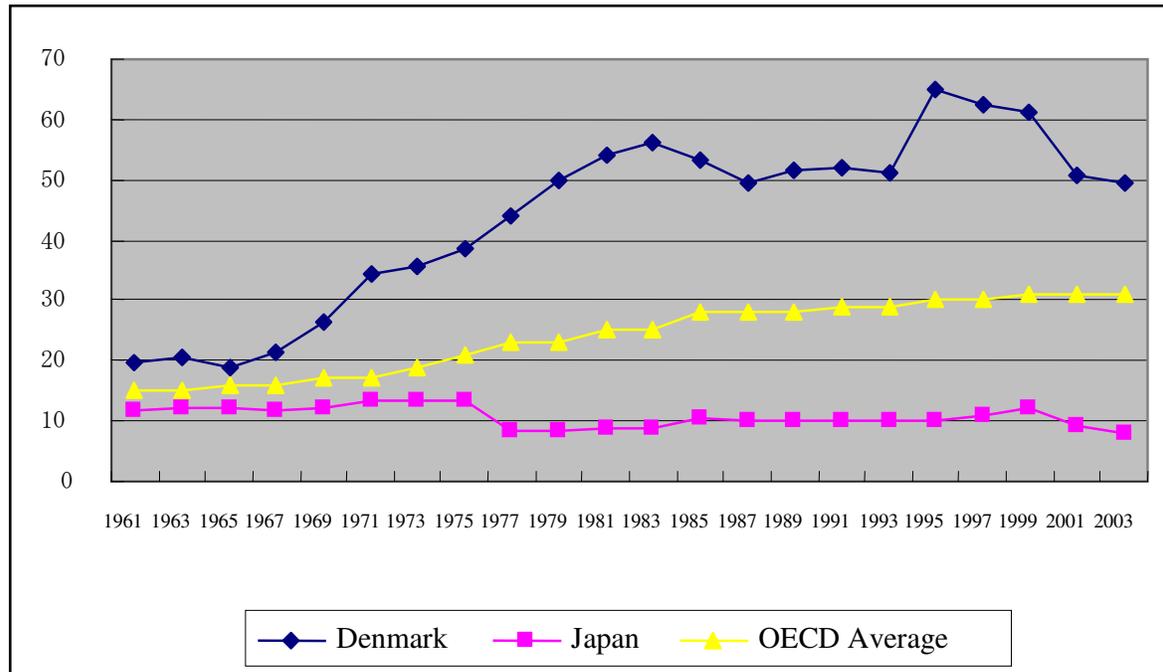
In 2004, total expenditure for labour market policies was 4.5% of GDP in Denmark (1.83% of GDP for active labour market policy), while the comparable figures in Japan was 0,74% (0.28% of GDP for active labour market policies). In Denmark, the central government finances around 2/3 of expenditures for unemployment benefits and active labour market policies out of general taxation, while contributory premiums of insured members of unemployment insurance funds (*arbejdsløshedskasser*) finance the remaining. Thereby, employers and corporations do not guarantee employment and pay for redundancies, and the hiring and firing costs of Danish businesses are very low. Further, the costs of training and education of ordinary employees is also to a high extent borne by the central government treasury, and indirectly serves as a government subsidy to the competitiveness of Danish industry. In contrast, 70-80% of government revenues for unemployment benefits and active labour market policies in Japan come from contributory benefits (the government pays the remaining from the national treasury). Premiums for unemployment benefits are collected 50% from employers and 50% from employees, while premiums for labour market policies are collected only from employers.<sup>19</sup> This heavy dependence on premiums makes Japanese labour market policy sensitive to the fluctuations of the business cycle. During recession when unemployment increases, the premiums of employers increase as well, which makes it difficult to break a vicious circle, and gives corporations strong incentives to avoid dismissals.

When these differences in expenditures are combined with replacements rates and maximum duration of unemployment insurance it becomes abundantly clear that the Danish system of unemployment protection provides a much higher degree of income security than the Japanese system. OECD (2006) has calculated historical time series and summary measures on the gross replacement rate in percentage of former wage. The summary measure is defined as the average of the gross unemployment benefit replacement rates for two earnings levels, three family situations and three durations of unemployment. The figure below gives an indication of the differences between Denmark and Japan in this respect.

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<sup>19</sup> On top of this, premiums shared equally by employers and employees also finance the majority (87.5%) of the so-called employment continuation benefits covering benefits for re-employment of older workers as well as child care and family care leave benefits.

Figure 5: OECD summary measure of benefit entitlements



Source: OECD, Tax-Benefit Models (2006). Own calculation of OECD average.

It shows that in Japan throughout the period from the 1960s to 2003 the gross replacement rate has been almost constant around 10%. In comparison gross replacement rates in Denmark has increased from around 20% in the early 1960s to 65% in 1995, and then declining to 50% in 2003.

Further, the duration of unemployment insurance is 90-360 days in Japan and there is no last resort safety net after exhaustion.<sup>20</sup> In Denmark, the duration of unemployment benefits is 4 years, after which social assistance is available (means-tested, indefinite duration, but conditional upon participation in active measures). Finally, it should be noted that the Japanese unemployment insurance system has extremely strict conditions for eligibility, which is indicated by the fact that the ratio of benefit receipt to total unemployed was only around 1/3 at the end of the 1990s (Passet 2003: 205).<sup>21</sup>

In that respect, the relative lack of a labour market policy in Japan for reintegrating unemployed on the open labour market, and providing income support during unemployment spells, is consistent with the practice of lifetime employment. The differences between the unemployment security sys-

<sup>20</sup> The duration of unemployment benefit entitlements increases with age and years of contribution, and also depends on the reason for unemployment (voluntary job leavers have shorter benefit duration than involuntary dismissed or disabled persons). For instance, middle-aged (45-64 years) disabled persons with more than one year's contribution are entitled to the maximum 360 days, while voluntary job leavers with less than 10 years contribution and young people (less than 35 years) with less than 10 years contribution are only entitled to 90 days unemployment insurance.

<sup>21</sup> It is also worth noting that Japanese enterprises finances the retirement pension system of their workers paid in proportion to the number of years of service at a specific company and depending on the reason for retirement (voluntary versus mandatory or company requested retirement). Again, this retirement system promotes the longtime employment system.

tems indicate that in Japan social security is mainly provided through employment maintenance.<sup>22</sup> Rather than externalising the costs of dismissals, unemployment, sickness and retirement to the society (in Denmark; the public budget), Japanese corporations have to a high extent internalised these costs. In contrast to Denmark, public policies in Japan, whether on employment protection legislation, labour market policies or social and welfare policies have a relatively small impact on the labour market.

The Japanese employment system characterised by the practice of lifetime employment, job stability and internal flexibilities in large internal labour market proved to be efficient in the period after the Second World War. Unemployment rates remained low throughout the period until the recession of the 1990s, and the employment system provided high job security and stability for regular workers. The lifetime employment system was also conducive to an industrial relations system favourable to successful employee participation which contributed to the post-war success of Japanese firms, and has inspired many corporations in the world to experiment with employee involvement and labour-management cooperation (Kato 2001: 491). However, with the collapse of the bubble economy in the early 1990s, Japan's long-term employment practice and employment policies have faced significant challenges, as we describe in the next section.

#### **4.2. Current challenges for the balance between job security and internal flexibility**

From 1955 and onwards Japan experienced high annual economic growth, making Japan an economic superpower. The Japanese life-time employment practice worked as an efficient employment system in this period. However, the recession starting in the early 1990s with low economic growth, intensified global competition and changing attitudes and preferences among workers has put the lifetime employment model and the traditional flexicurity-balance between internal flexibility and (internal) job security under pressure. The major problem seems to be, that it is very difficult to maintain and guarantee internal job security without the steady economic growth that traditionally has characterised the Japanese society. Although the companies have made persistent efforts to keep up to the expectations of life-time employment during the recession, this has turned out to be quite difficult. The traditional Japanese “flexicurity-balance” seems in this respect to have become unbalanced.

In the next section we first have a closer look at the pressure on the internal flexibility system that previously served as a “buffer”, when labour costs had to be reduced under economic downturns. Second, we proceed by analysing the challenges of an apparently higher external numerical flexibility on the Japanese labour market, in some part created by the insufficiency of the internal flexibility system to cope with longer periods of recession. This includes, among other things, the challenges of unemployment and the increase in non-regular workers and the accompanying problems with economic inequalities and poverty, created by lack of external security-arrangements (employment and income security) for people outside regular employment.

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<sup>22</sup> Since the mid-1980s, the government has, however, repeatedly implemented plans to reduce job disparities between prime-age male workers on the one hand, and the female labour force, the young, middle-aged and older workers on the other hand. The largest programs pay either wage subsidies to increase job opportunities for disabled and older workers, who are referred by the public employment service, or pay subsidies to enterprises continuing to employ workers beyond retirement age. There are also smaller employment programs for depressed regions and employment in SMEs (Passet 2003: 198-99).

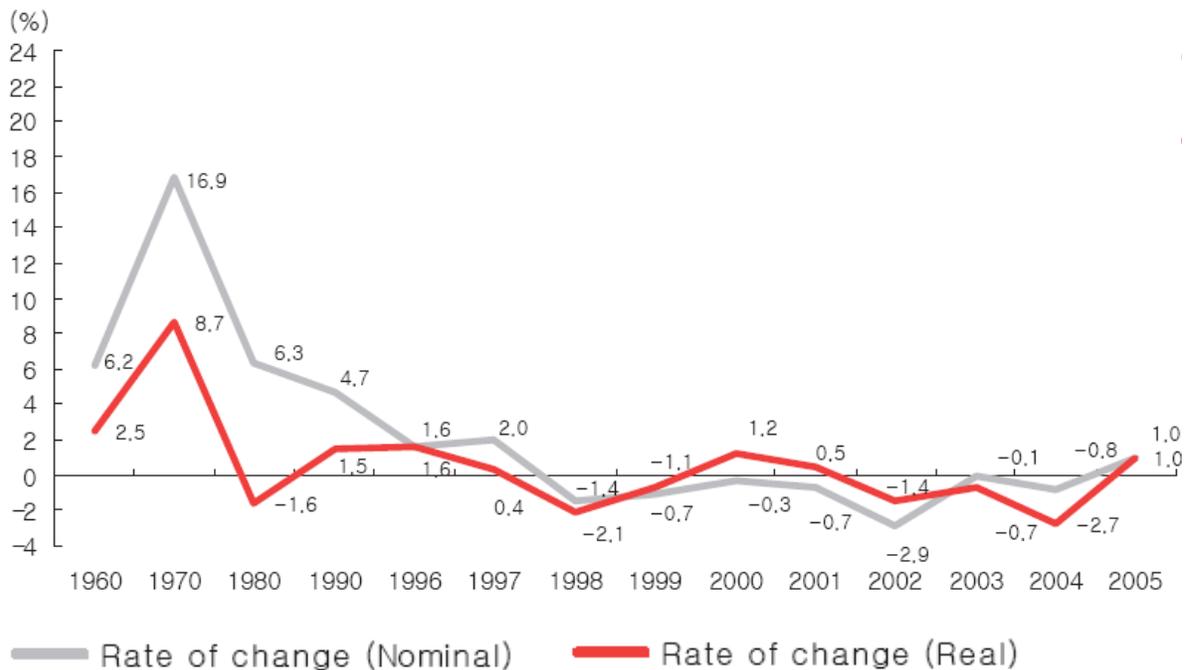
### 4.2.1. The pressure on the internal flexibility system

The life-time employment system first of all tries to meet the demands for flexibility through high internal flexibility, which is traded off against high job security for the regular workforce. The internal flexibility consists of wage flexibility, working time flexibility and functional flexibility. The companies make huge efforts to live up to the expectations of delivering life-time jobs, and to avoid dismissals of regular workers. During economic recessions this creates pressure on the adaptability of the internal flexibility system, and results in wage cuts, reduction of (paid) working hours, less internal upward job mobility (promotion) to mention the most important flexibility buffers to put in use. During the recession the use of these “buffers” have been very profound. The utilization and impacts of these three types of flexibility forms will be investigated more in detail in the following.

#### *Wage-flexibility*

Rather than reforming the life-time employment system, Japanese companies stick to use other forms of internal flexibility. In contrast to their counterparts in the US, Germany and the UK, industries in Japan are more prone to keep labour excess during an economic downturn. They instead use wage-rate flexibility linked to variation in working hours and bonuses as well as transfers to lower-wage positions as the most important buffers to economic fluctuations on the labour market (Passet 2003: 165). This has during the recession resulted in a general very low wage-development, as seen in the figure below.

Figure 6: Rate of Change in Monthly Cash Payment



Source: Japan Institute for Labour Market Policy and Training: “Japanese Working Life Profile 2006/2007, Labour Statistics”.

The low general wage-development (especially concerning the latest years development) also reflects the rise in the composition ratio of part-time employees on low wage levels, which is used by the companies to lower labour costs. In 2005, high wage increases for ordinary workers meant that the lowering effect caused by the increase in the composition ratio of part-time employees was reduced, and as a result, for the first time in five years, there was an increase in the total cash earnings, up by 0.6% year-on-year (JILPT 2006). One consequence of this is a widening of the wage disparities between regular employees and non regular employees (JILPT 2006).

One important change concerning wages is that companies are increasingly introducing performance-based wage systems, in addition to attaching less importance to seniority (JILPT 2006). With the rapid ageing of the workforce and the planned postponement of mandatory retirement age from 60 to 65 years, the seniority wage system will result in substantial increases in personnel cost (Kazuo 2004). As stated by Araki: “*Employers can no longer maintain both long-term employment as well as the seniority-based wage system. According to various opinion surveys, a de facto consensus exists between management and labour concerning the preservation of long-term employment. Therefore it is more likely that the seniority-wage system, rather than the long-term unemployment system, will be modified*” (Araki 2002: 73). And this is what seems to be happening. Performance based wage systems extensively replace seniority-based wages. One important consequence of this is, that the implicit contract between employer and employees of setting wages below marginal productivity for newly employed in return for wage above marginal productivity for long-time employed is broken. The impact of this could be higher job-insecurity for the younger employees, having no assurance of longer terms benefits of accepting a low starting salary, as well as senior workers losing earned privileges serving the same employer for life (Passet 2003). Internal security is lost on behalf of internal flexibility to lower labour cost during an economic downturn,

### ***Working-hour flexibility***

According to the philosophy behind the life-time employment system, a tendency of decreased weekly working hour can be observed through out the recession period. And an increase in non-scheduled working-hours the last couple of years can be observed reflecting the economic recovery (JILPT 2006).

The major explanation for the overall reduction in scheduled working hours during the economic downturn is largely due to the increase in persons with shorter working hours (the percentage of people working less than 35 hours increased from 18% in 1992 to 24% in 2004). At the same time, non-scheduled working hours (both paid and unpaid) constantly exist in a large number of Japanese companies, and in some extreme cases result in “death from overwork” (*karoshi*).<sup>23</sup> The percentage of those working more than 60 hours is also marginally increasing (from 11% in 1993 to 12% in 2004), thus indicating an increasing polarisation of working hours (JILPT 2006: 98).

The variation in working-hours and wages gives an uneven distribution on groups and status of work, and is one of the major challenges for the Japanese labour market. Especially if job-insecurity and economic disparities should be avoided in order to increase the general participation of people on the labour market.

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<sup>23</sup> Although the Labour Standards Act prescribes an annual maximum of 360 overtime hours per workers, there is no penalty for violating the standards (JILPT 2006: 47).

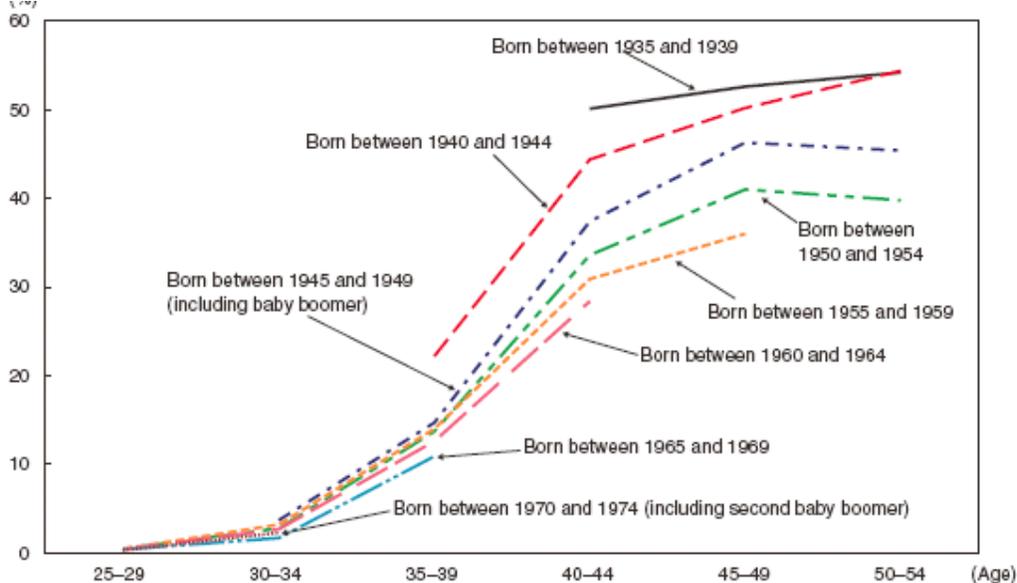
### **Functional flexibility**

Functional flexibility consists of job quality, mobility within jobs and across, reduction of job boundaries and flexibility in job design, training and retraining. In Japan, functional flexibility can also be used to meet demands of flexibility and the need for lowering labour cost. The traditional implicit agreement in the life-time employment system are, that the employee gradually moves up in the job-hierarchy, at the same time as skills and competencies are developed primarily through on the job training within the firm. Increasing functional flexibility in accordance with the companies' efforts to reduce labour cost, especially make young and older workers vulnerable.

The reason why young and older employees are vulnerable to functional flexibility in the life-time employment system is that companies in Japan try to adapt to an economic downturn by hire freeze and relative low mandatory retirement age for older workers (see below in section on external numerical flexibility). When cut backs primarily are made by curtailing new hiring, the consequence for the young employee is, that no one younger than themselves enters the company. In 2003, the number of new graduates hired had fallen by 53% from its 1997-level, contributing to the rise in the unemployment rate in the 15-24 age group to 10% (OECD 2005: 175)

This makes it hard to change job functions or move up in the job hierarchy (by acquiring more advanced knowledge and skills). There are also fewer opportunities for on-the job training because of the lack of time and money. In that case, the normal attractive career prospective for young workers in life-time employment becomes less attractive. The statistics seems to confirm this situation (see below).

*Figure 7: Cohort Comparison of Management Position by Age Bracket (university graduates)*



Source: White Paper on the Labour Economy 2005, Ministry of Health, Labour and Welfare

The figure shows the proportion of university graduates in management positions, the younger generations they are, the lower the rate are occupying management positions, even among the same age

class. Just to give one example, around three times as many born 1950-1954 were holding a management position when they were in their early 30s, compared to the ones born 1970-1974.

In general for promotion, the average age by job grade is rising for all grades, reflecting a changing company age structure, with an increasing number of middle-age and older persons (Ministry of Health, Labour and Welfare 2005).

Especially this problem concerning the recruitment of young people to life-time employment under an economic recession put the life-time employment system under pressure. Fewer young people are recruited for regular work in general, but the low changes in functional flexibility even make it less attractive to the ones hired. The intensive Japanese discussions on young workers changing attitude to work seems related to this pressure on the internal flexibility system. Although it is probably only part of the explanation (Yuji 2001).

Also the older workers are more vulnerable in terms of job positions, when the life-time employment system is under pressure. On the one hand, the companies prefer a low mandatory retirement age if they are going to secure life-time employment (among other things in order to reduce exceeding labour costs due to the seniority-wage system) (Yuji 2001). On the other hand, the public authorities stress the importance of a higher retirement age in response to the greying of the Japanese population. Hence, the Older Persons Employment Security Law (revised in 1994) now prohibits the setting of a mandatory age under 60, and the law includes a provision concerning the employer's duty to endeavour to raise the mandatory retirement age or to continue to employ those reaching mandatory retirement age but still desiring to work for the same employer until the age of 65 (Araki 2002). However, many older workers in practice separate from their employers before reaching mandatory retirement age in the functional flexibility forms of *Shukko* or *Tenseki*.<sup>24</sup> As stated by Araki in this respect: "*The recent increase in Shukko and Tenseki certainly indicates a transformation of the long-term employment system*" (Araki 2002: 29). Together with the other changes in functional flexibility it tends to generate insecurity for the older workers in general (Passet 2003).

To sum up, the internal flexibility works as effective and adaptable buffers under recession, but the prolonged period put the internal flexibility under a severe pressure. This pressure is so high, that the very core of the life-time system seems to be endangered, namely the trust of the Japanese flexicurity balance between life-time job security and acceptance of high internal flexibility. In fact, the Japanese labour market is hit by the paradox that the feeling of job-insecurity is among one of the highest in the world, despite the high job security inherent in the life-time employment system (Passet 2003, Boyer 2006). This has probably to do with the changing work conditions due to the extensive use of internal flexibility, but of course also a result of the Japanese dual labour market structure and the increasing use of external numerical flexibility. As shown in the next section, external numerical flexibility comes in use as the last resort, when the internal flexibility reaches its limits in order to maintain the life-time employment system.

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<sup>24</sup> *Shukko* refers to transfers to another company while maintaining the workers status with the original company. *Tenseki* refers to transfers to another company dissolving the employment relation with the original company (Araki 2002:132).

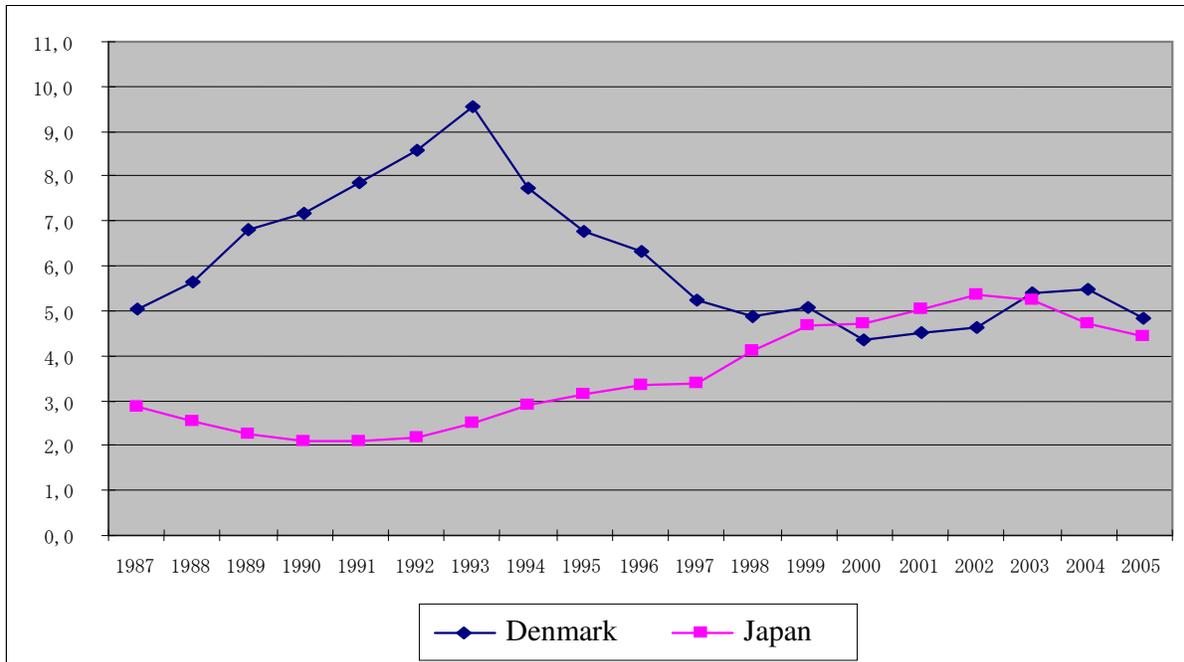
### 4.2.2. External numerical flexibility

External numerical flexibility involves the process of changes in the number of employees, and thereby also reflects the transition between firms and from employment to unemployment and back. Companies and supporting public policies have been targeted at maintaining life-time employment and the advantages attached to this, and numerical flexibility has been seen as the last resort. The main axis of the system has been the flexicurity balance between job security and internal flexibility. Nevertheless, despite an intensive use of internal flexibility buffers (and a corresponding decrease in internal security), external numerical flexibility has increased on the Japanese labour market. Two major indicators of this are unemployment and the increase in non-regular workers. The developments and impacts of these phenomena are analyzed in the following.

#### *The unemployment problem*

The labour market performance of both Denmark and Japan are well above the average in the OECD-area, when it comes to unemployment. The current outlook in the two countries is, nevertheless, interpreted quite differently. Despite almost similar unemployment rates (in 2005, 4.8% in Denmark and 4.4% in Japan) Denmark is currently considered to be heading for labour shortages and “full employment”, while Japan has departed from a prolonged period of “full employment”. In the 1990s Japan experienced unprecedented increasing unemployment rates. From 1990 and until the early 2000’s the unemployment rate more than doubled in Japan, while it was more than halved in Denmark (figure below).

Figure 8: Unemployment as a percentage of the labour force, 1987-2005



Source: OECD: *Employment Outlook 2006*.

The Japanese interpretation of unemployment being a severe problem could be a result of the different starting point compared to Denmark, making unemployment a new phenomenon in Japan.

But some other characteristics related to the Japanese employment system and life-time employment entail, that unemployment creates more serious problems. First, external social security is very weak, and not geared to deal with the problems of reintegrating unemployed people into employment or compensate the unemployed for loss of income. Hence, the Japanese benefit system has a low net-replacement rate and a short duration period compared to the Danish system. As shown in section 4.1.2 (figure 5) the OECD summary measure of benefit entitlements gives an indication of the major differences between Denmark and Japan in this respect.

Another serious problem is the composition of the group of unemployed. Japan struggle with relative high youth unemployment caused by lack of labour market entrances. With an 8% unemployment rate for the 15-24 year old and a growing number of *Freeters*<sup>25</sup> (from 500.000 persons in 1982, 1.500.000 in 1997 and 2.010.000 in 2006) and *NEET*<sup>26</sup> (from 400.000 in 1985 to 640.000 in 2005), this is a profound problem (cf. JILPT 2006), especially in the light of the challenges related to an ageing society.<sup>27</sup> Besides the problem that many young people are being unable to obtain regular employment or life-time employment, the unemployment problem also consist of, what could be labelled joblessness. This means that the number of people in non-regular jobs is rapidly increasing, at the same time as less people are moving from non-regular and part-time employment into regular employment.

This is clearly evidenced by the situation of women on the Japanese labour market. 60% of Japanese women withdraw from the labour market when their first child is born. The result is an M-shaped labour force participation curve (peaking at the 25 to 29 age group and in the 45 to 49 age group).<sup>28</sup> In fact, the lifetime employment system is not conducive to women's labour force participation. As mentioned, lifetime employment is traded-off for internal flexibility; including in-house training, flexible adjustment of working conditions, and long (unpaid) working hours. Such workplace practices makes it difficult for women to return to their original employer and resume their careers after childbirth, and makes part-time work more attractive to reconcile work and family obligations. Further, the tax and social security system as well as spouse allowances of firms discourage dependent spouses from increasing their working time. Finally, childcare facilities are limited (cf. OECD 2005: 181-186). All of these factors lead to lower participation rates of women, and a higher proportion of women in non-regular employment.

The unemployment, joblessness and the increasing dualism of employment has also been one important factor for the bigger disparities in economic opportunities that has emerged in Japan. By nearly any measure, Japan has increased the income inequality and is now above the OECD average (Mira d'Ercole 2006).

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<sup>25</sup> *Freeters* are people between the age of 15 and 34 who lack full time employment or are unemployed, excluding housewives and students. They may also be described as underemployed or freelance workers. These people do not start a career after high school or university but instead usually live as parasite singles with their parents and earn some money with low skilled and low paid jobs. The low income makes it difficult for *freeters* to start a family, and the lack of qualifications make it difficult to start a career at a later point in life.

<sup>26</sup> NEET is a contraction of Not in Employment, Education or Training. It includes the non-labor force population aged between 15 and 34, and those who neither do housework, nor attend school.

<sup>27</sup> Japan deal with the problems of an ageing society and declining fertility rates. For the first time in its history, the population is declining). This creates a strong pressure to increase participation rates (61% in 2004) and employment rates in order to avoid labour shortages. Two of the major untapped labour reserves are younger workers and women.

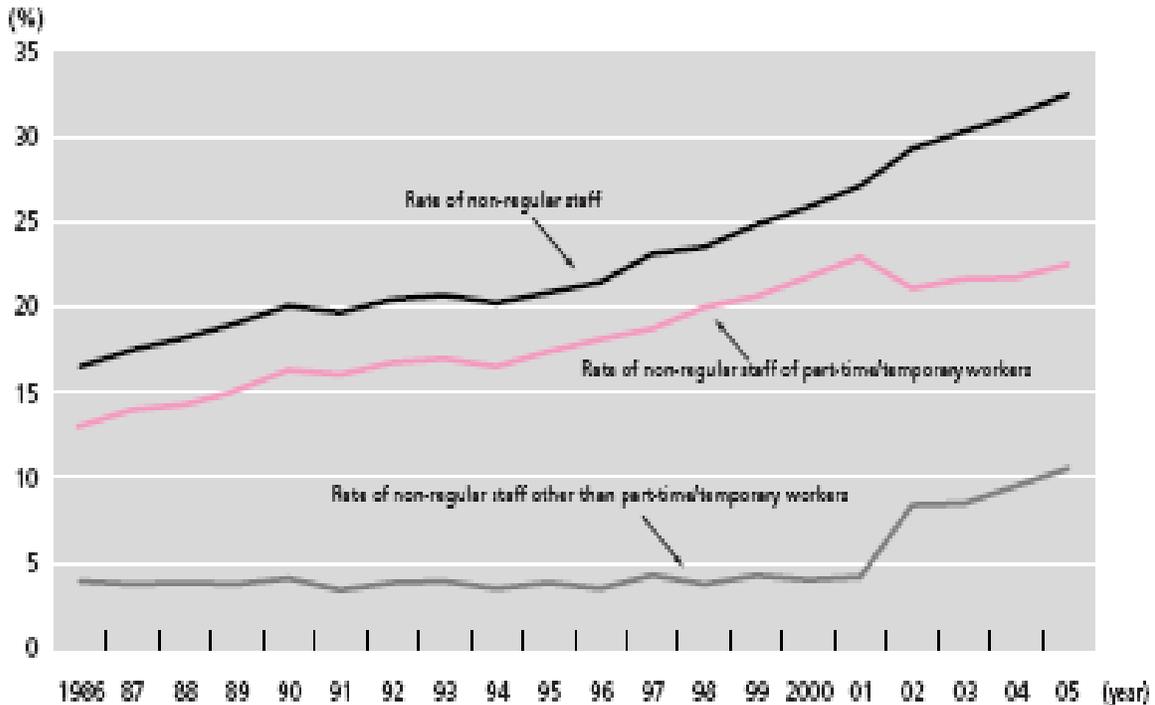
<sup>28</sup> Women have shorter tenure than most men, which is resulting in a gender wage gap (full-time regular female employee earns 35% less than her male counterpart on average) and in slower promotion for women. Women also account for 70% of non-regular workers, who earn considerably less than regular workers.

To sum up there are good reasons to interpret the employment situation as more difficult in Japan, although the level of unemployment is very similar between Denmark and Japan. The major problem in Japan is the lack of job openings into regular (life-time) employment for unemployed (especially the young) and people in non-regular employment. In that respect the unemployment problem is only the tip of the iceberg.

***Increase in non-regular workers***

Under the surface of the relative small unemployment problem in Japan (in an international comparison) there is a much more severe employment problem, namely the major increase in the number of non-regular (part-time, fixed term and dispatched workers), due to the lack of labour market entrances to regular work. This also contributes to the increasing disparities in economic opportunities in Japan. The figure below shows the changes in type of work in Japan.

*Figure 9: Breakdown of Employees by Status at Work* <sup>29</sup>



Source: The Japan Institute for Labour Policy and Training: Labour Situation in Japan and Analysis: General Overview 2006/2007.

The decline in regular (open-ended) employment, and the rise of non-regular work (part-time, temporary contracts, dispatched workers), reflects the employers needs for flexibility regarding adjust-

<sup>29</sup> Sources: *Special Survey of Labour Force Survey* (February survey) (1986-2001) and *Labour Force Survey (Detailed Tabulation)* (2002-2005), Statistics Bureau, Ministry of Internal Affairs and Communications. Notes: 1) Rate includes employees other than directors. 2) A reason for the drop in the rate of part-time workers in 2002 is that the survey questionnaire for the "Labour Force Survey (Detailed Tabulation)" was different from that of the prior "Special Survey of Labour Force Survey," and therefore, that some people who responded until 2001 that they were part-time workers may have answered in 2002 that they were, contract employees or entrusted employees.

ments to the recession. In fact, the regulations for hiring and firing temporary employees are relatively liberal.<sup>30</sup> In Japan, there are no legal restrictions on concluding or renewing a fixed-term contract (except that the term may not exceed one year) (Araki 2002: 33). The non-renewal of fixed-term contracts, therefore, provides an important source of external numerical flexibility for Japanese companies. Part-time workers (less than 35 hours a week) also provide important external flexibility – as well as cost-reductions - for employers. On an hourly basis, part-time workers are paid only 40% as much as full-time workers (OECD 2005: 180).<sup>31</sup> Finally, the regulations of dispatch workers (defined as a person who work for a client company but is hired out from a contracting company acting as his/her employer) has been liberalized since the mid-1980s, especially after the 1999 revisions (Araki 2002: 40ff.).

Previously, with steady economic growth the life-time employment model secured stable employment relations with loyal employees, who were given education and training within the firm. Good promotion prospects, seniority pay systems and other internal security arrangements created the incentives for these internal career tracks. Recruitment of newly graduated young people more or less corresponded to the retirement of older worker, and the need to adjust for structural changes and the business-cycles was done by internal flexibility arrangements (functional flexibility, working-hour-flexibility and wage-flexibility, as described above). However, the recession during the 1990s, and the intensified global competition, has created flexibility demands, that the life-time employment model not has been able to meet through internal flexibility buffers. Even so, many Japanese companies have tried to maintain the life-time employment model as long as possible avoiding dismissals by enhancing early retirement and make a stop for new hires into life-time employment.<sup>32</sup> In that respect, the lack of job-openings and the problems of increasing youth unemployment in the 1990s was the result of the strong job protection for middle-aged and older workers (Yuji 2001). Therefore, many young people had and have no other choice than to find non-regular work, although they would prefer regular standard work. In contrast to this, it is a common assumption that the increase in Freeters is a result of volunteer decisions and of new attitudes to work. Among other thing related to the concept of “parasite singles”, which means young singles living at home economically supported by their parents, and with low incentives to work. More volunteer job leaves could support this explanation, however, when cut backs primarily are made by curtailing new hiring, the consequence for the young employee is that upward (internal) mobility becomes limited, since few persons one younger than themselves enters the company. This situation makes a job shift more attractive.

To sum up, the recession period has put the life-time employment system under such a pressure, that the need for flexibility could not be met alone by internal flexibility. The consequences have been, that a larger proportion of the labour force now consist of non-regular workers (part-time, temporary contracts, dispatched workers) creating bigger economic inequalities. Still trying to maintain the life-time employment model in the companies however (by hire-stop and early retirement), means that especially the young employees form a smaller share of people in regular em-

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<sup>30</sup> This is also indicated by the relatively low summary score on the OECD index on regulation for temporary workers (OECD 2004: 115).

<sup>31</sup> Firms furthermore benefit from an additional 13% saving in non-wage costs since part-time employees are exempted from health insurance, pension contributions and unemployment insurance below certain thresholds, thus eliminating the need for co-payments from employers.

<sup>32</sup> Actually close to the top of the economic crises in 2003, 36% of the companies replied in a survey, that they would basically maintain the life-time employment practice, 40% thought that partial adjustment was inevitable while only 15% thought that fundamental review was necessary (JILPT 2003).

ployment,<sup>33</sup> as well as work- conditions in some cases has become less attractive. Generally this has been a major factor behind the high feeling of job insecurity in Japan (Passet 2003).

As seen in this section there are numerous current challenges for the traditional flexicurity arrangement in Japan between internal flexibility and job security. As expected according to the logic inherent in the life-time employment model, the recession has changed the (flexicurity) balance towards more internal flexibility at the expense of job security (and the other security elements in this like seniority-wage, upward functional mobility, etc.). This in general creates job insecurity, but more serious is the extensive use of external numerical flexibility, which has been necessary despite all the efforts done to avoid this. It looks as if Japan is changing the balance of flexibility and security, although the overall problem seems to be, that there is no matching elements of security against the external flexibility. This creates increasing economic disparities and poverty as a consequence of unemployment and the increasing number of people in non-regular work. Especially young, women and older people are vulnerable to this situation. Facing the challenges of an ageing society, and the future need to increase the participation on the labour market in general, this development is in need to be turned around. The question is how. One possible way could be to consider new forms of flexicurity arrangements, which is the point of departure in our conclusions and policy implications.

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<sup>33</sup> This is confirmed by the fact that the ratio of regular employees relative to the total workforce population decreased for all age-groups under 30 years, and increased for all age-groups over 30 years between 1991 and 1998 (Yuji 2001: 33).

## 5. Conclusion and policy recommendations

In the post-war period, the Japanese employment system combining job security (lifetime employment) and internal flexibilities in large internal labour market has created a competitive and successful labour market model. Since the 1960s where this combination of flexibility and security became firmly rooted, the practice of avoiding dismissals has maintained high employment levels (especially for male breadwinners), job stability and low unemployment rates. Through the lifetime employment commitments of Japanese corporations an elaborate system of internal labour market flexibilities was developed. Core (regular) workers were recruited immediately after graduation and maintained in the same company or affiliated companies until retirement. This system gave strong incentives for building up in-house training and education systems, and created a committed and loyal workforce. Years of seniority were the basis for a predictable system of remuneration and promotion to senior positions within the company. Auxiliary public policies were constructed to supplement and maintain job stability and lifetime employment. By implication labour market policies primarily focused on subsidizing the maintenance of existing jobs (employment insurance).

As the Japanese economy fell into a prolonged recession in the 1990s it also called into question key elements of this Japanese flexicurity system; the practice of lifetime employment, seniority pay system, and internal promotion system. The steady economic growth and a constant influx of new graduates which were important preconditions of the lifetime employment system became increasingly difficult to maintain. In order to avoid dismissals but maintain competitiveness and reduce costs, Japanese companies stretched internal flexibility buffers to its limits. To avoid the automatic increases in salaries (also in the light of a rapidly greying workforce) the seniority-wage system is gradually being replaced by a performance-related pay system honouring merits and capabilities, while wage increases have remained low or even negative. Overtime work has been reduced to save labour costs. Downsizing and restructuring is also achieved by transfers of redundant workers to subsidiaries and affiliated companies. Further, companies have responded to the recession by freezing or reducing new hiring (especially of young graduates), which also reduce opportunities for upward mobility of those young people who are hired. The result of this is an increasingly unbalanced relationship between internal flexibility and internal security.

Despite the extensive use of these internal flexibility buffers, job stability became difficult to maintain and the use of external numerical flexibility increased. Since the 1990s, there has been a steady increase in recruitment of non-regular workers (part-time workers, temporary agency workers and dispatch workers). Non-regular workers increasingly perform the external numerical flexibility, which cannot be provided by regular workers, and, thus, function as shock absorbers to protect regular workers from fluctuating economic circumstances. Non-regular work is remunerated on a much lower level than regular work, which is one of the main explanations for increasing wage and income disparities in Japan. Furthermore, the job security (wages, bonuses, working conditions, transitions to regular employment) and income security (entitlements to unemployment insurance, health insurance, and retirement allowances) of non-regular workers is inferior to that of regular workers.

As a result of reluctance to hire new regular workers, unemployment rates started to climb in the 1990s, especially for young people. Even those young people who manage to enter the labour market are increasingly hired as non-regular workers, and tend to rotate between non-regular jobs (so-called *freeters*). At the same time, the number of young people not in employment, education or training (so-called *NEET*) has also increased. Thus, the youngest generations are hit the hardest by

the restructuring and downsizing of Japanese corporations, and are to a certain extent not granted access to lifetime employment guarantees and job security. Throughout the prolonged recession of the 1990s, it seems that the main priority of Japanese corporations has been to maintain lifetime employment and job stability for the core of labour market segments (especially male middle-aged workers). Downsizing and restructuring has instead resulted in increasing fluctuation at the margins (or peripheries) of the labour market, especially among young persons and women in non-regular employment. This implies a stronger bifurcation of the labour market with increasing social and economic disparities.

The need to adjust to the economic downturn has pushed the traditional Japanese flexicurity combination between internal flexibility and internal job security (and the benefits related to this) toward more (internal) flexibility in the effort to live up to the expectations of job security, avoiding dismissals of core workers. But the general need for labour adjustment to handle the prolonged recession has also involved a much stronger use of external flexibility measures creating unemployment and increasing use of non-regular workers. This more unbalanced combination of flexibility and security (especially external flexibility without or with limited external security) has resulted in an increasing feeling of job insecurity, even among core (regular) workers. Japanese workers have one of the world's highest feelings of job insecurity, despite the continued commitment of Japanese employers to provide lifetime employment and job security.

In recent years, there have been signs of improvements on the Japanese labour market; economic growth picking up, slightly decreasing unemployment rates, more new job openings, more graduates become regularly employed after completion of education, and a possible stagnation in the proportion of non-regular workers. However, there are a number of structural challenges confronting the Japanese labour market which would make a full-scale return to the traditional balance between internal flexibilities and securities unlikely. First, the labour force structure is changing drastically because of increased longevity and declining birth rates (fewer younger and more aged workers). The predicted labour shortages will compel Japanese employers to utilize more young, women and older workers, who have not fully participated in the labour market so far. Especially women and older workers will probably prefer more diversified and flexible work patterns to reconcile work and family life rather than traditional lifetime employment. Younger workers also seem to have a less negative attitude towards changing jobs on the external labour market than older generations. Second, Japanese industries are facing intensified global competition on the world market. This will probably lead to an era of slower economic growth, and constant needs to restructure, rationalize and downsize corporations. The traditional job security and lifetime employment will be increasingly difficult to maintain under such external conditions of intensified competition and slow economic growth. However, this does not imply a definitive departure from the core elements of the traditional combination of internal flexibility and job security, but rather the need to modify some elements of the Japanese employment system in order to maintain the unique qualities of internal labour markets and lifetime employment.

### **5.1. Policy options on a new balance between flexibility and security**

From this starting point there are at least three different paths towards labour market reforms in Japan: Unprotected mobility, normalisation of non-regular work, and protected mobility.

***Unprotected mobility:*** To keep up the existing flexicurity balance for core workers at the internal labour market and respond to the pressure on the internal flexibility, as well as the need for external flexibility, one option is to make it even easier to make numerical adjustments by using non-regular workers. Deregulation would then be the answer. Since the 1980s deregulation has been given high political priority in Japan to open up its domestic market for foreign competition. This deregulation drive also spilled over to labour law and employment reforms. Japan's inactive external labour market and labour laws were blamed for hindering structural reforms and restructuring of companies (Araki 2002: 221). Deregulation would imply to make it easier to hire and fire non-regular workers (part-time workers, fixed-term workers and dispatch workers). The level of protection for temporary workers is, nonetheless, already in the lower half of OECD countries, so there might not be much need for further deregulation. In any case, further deregulation would result in an even more unbalanced and dual labour market between insiders (core workers) with strong job protection and outsiders (periphery workers) with unregulated working conditions and insufficient job and income protection. This structural imbalance would disproportionately affect young people, women and older workers, and might discourage them from increasing their participation and employment rates. In terms of flexicurity, the traditional Japanese flexicurity balance for the core segment on the labour market might be maintained, but the increasing numbers of non-regular workers and unemployed persons would only experience flexibility and no (or low) security. As mentioned earlier, the main message of the European literature on flexicurity is that flexibility and security are mutually supportive; *in casu*, income, job and employment security are necessary preconditions for a well-functioning and flexible labour market for non-regular workers with possibilities for transitions into regular employment.

***Normalisation of non-regular work:*** The second option is to rebalance flexibility and security for non-regular workers by increasing their job security, income security and employment security. Let us recall the Dutch approach to flexicurity. Not unlike the current Japanese situation, the Netherlands in the mid-1990s had developed a segmented labour market divided between regular workers with high job protection, and an insecure labour market for atypical workers performing external numerical flexibility. The idea of the Dutch flexicurity legislation, which took effect in 1999, was primarily targeted at giving job protection for atypical employees (among other things by setting a maximum period for temp work contracts). Another important aim was to encourage a development from job security towards employment security, in particular through a more active labour market policy. At the same time the protection against dismissal for permanent workers was modified. In the Japanese case, this would imply enhancing the security of the non-regular workers, and thereby combine the existing flexibility for these groups outside the core labour market with new types of (external) securities. Such a flexicurity balance would serve as the precondition for making better opportunities for transition from non-regular into regular work, and turn around the tendency of increasing economic disparities in Japanese society. The challenge is the creation of two kinds of flexicurity; respectively for the internal labour market (with job-security and internal flexibility) and the external labour market (with numerical external flexibility and external employment and income security). While it is possible to enhance the income security of non-regular workers, it is more difficult to secure employment if the external labour market only serves as "buffer" for the core labour market, and if there are a low number of transitions between non-regular and regular employment status. If that is to be achieved, we are moving towards the third option transforming the job security and internal flexibility towards a model with higher numerical flexibility and income- and employment security; that is protected mobility.

(3) **Protected mobility:** The third approach to labour market reform requires a rebalancing of traditional flexibility and security in Japan, and a systematic activation of the external labour market. The inspiration can be found in the Danish approach to flexicurity by combining a more mobile labour market for core (regular) workers with an extensive active labour market policy for people in transition between jobs, and income security for non-regular as well as regular workers. We are well aware of the difficulties in whole-scale export of the Danish approach to flexicurity. For Japan, the main problem in learning from the Danish case of flexicurity is the complexities involved in moving from one configuration of levels of flexibility and security to another. This will typically involve one of the parties (especially core regular workers) accepting some form of increased flexibility (and thus uncertainty) in their working life in order to receive compensation in the form of improved security provided by employers or the government (especially employment security and income security). For the regular employees this obviously implies the risk of being hijacked by accepting more flexibility, without gaining the reward in the form of increased (employment and income) security. Mutual trust created by historical experiences with bargaining processes and maybe supported by some form of government guarantee seems necessary. Likewise, higher public spending on income security or policies providing more employment security might be hampered by fear of increasing deficits on the public budgets. Such worries may be countered by pointing to the fact that this public spending are investments that will be repaid through the longer term growth stimuli from a more flexible labour market. The composition of labour market expenditures could also be shifted from providing subsidies for job maintenance towards active labour market policies aiming at reintegrating the unemployed (including public vocational training system, individualised counselling and reintegration plans, and wage subsidy schemes for unemployed). The objective of this would ultimately be to improve the functioning of the external labour market, and create a smoother transition from unemployment to employment, which would also benefit non-regular workers (especially women and younger people).

One important, albeit rather general, lesson to learn from the Danish case of flexicurity is evidently that a sizeable welfare state with high levels of both taxes and social benefits is not incompatible with a dynamic and well-functioning labour market. The high degree of flexibility on the Danish labour market is thus supported indirectly through a number of welfare state services, which could serve as inspiration for welfare reforms in Japan:

- Adequate and public child care systems: A well-developed system of childcare is indispensable for creating security for working parents and thus for a flexible supply especially of younger women on the labour market.
- Building public vocational training systems: A comprehensive public system for adult education and training will make it easier to develop flexicurity arrangements, which involves employment security in the upgrading of skills of unemployed workers or workers at risk of unemployment. Public vocational training system provides transferable rather than firm-specific skills and competencies for both unemployed and employed persons, which will improve the functioning of the external labour market, and ensure a constant re-qualification of the workforce in the light of intensified global competition on the unskilled and labour-intensive parts of the labour market.
- Improving income and social security systems: Social security is a precondition of job mobility on the external labour market. High income replacement for unemployment increases the risk-willingness of workers, and tends to increase job mobility on the labour market.

In a labour market perspective, these welfare schemes and services can be viewed as investments in well-functioning structures, rather than costs. These general lessons of the Danish case of flexicurity might be used – not as a blueprint – but as inspiration and guiding principles for current welfare and labour market reforms in Japan. The main objective of such reforms would be to identify a more efficient and equitable combination of flexibility and security, where high-quality and secure transitions in and out of the external labour market complements the productivity and competitiveness of Japanese enterprises.

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