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**From corporate-centred security to flexicurity  
in Japan**

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Research Unit

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## Preface

The primary goal of the ILO is to contribute with member States to achieve full and productive employment and decent work for all, including women and young people, a goal which has now been widely adopted by the international community.

In order to support member States and the social partners to reach the goal, the ILO pursues a Decent Work Agenda which comprises four interrelated areas: Respect for fundamental worker's rights and international labour standards, employment promotion, social protection and social dialogue. Explanations of this integrated approach and related challenges are contained in a number of key documents: in those explaining and elaborating the concept of decent work,<sup>1</sup> in the Employment Policy Convention, 1964 (No. 122),<sup>2</sup> and in the Global Employment Agenda.

The Global Employment Agenda was developed by the ILO through tripartite consensus of its Governing Body's Employment and Social Policy Committee. Since its adoption in 2003 it has been further articulated and made more operational and today it constitutes the basic framework through which the ILO pursues the objective of placing employment at the centre of economic and social policies.<sup>3</sup>

The Employment Sector is fully engaged in the implementation of the Global Employment Agenda, and is doing so through a large range of technical support and capacity building activities, advisory services and policy research. As part of its research and publications programme, the Employment Sector promotes knowledge-generation around key policy issues and topics conforming to the core elements of the Global Employment Agenda and the Decent Work Agenda. The Sector's publications consist of books, monographs, working papers, employment reports and policy briefs.<sup>4</sup>

The *Employment Working Papers* series is designed to disseminate the main findings of research initiatives undertaken by the various departments and programmes of the Sector. The working papers are intended to encourage exchange of ideas and to stimulate debate. The views expressed are the responsibility of the author(s) and do not necessarily represent those of the ILO.

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<sup>1</sup> See the successive Reports of the Director-General to the International Labour Conference: *Decent work* (1999); *Reducing the decent work deficit: A global challenge* (2001); *Working out of poverty* (2003).

<sup>2</sup> In 1964, ILO Members adopted Convention No. 122 on employment policy which states that "With a view to stimulating economic growth and development, raising levels of living, meeting manpower requirements and overcoming unemployment and underemployment, each Member shall declare and pursue, as a major goal, an active policy designed to promote full, productive and freely chosen employment".

<sup>3</sup> See <http://www.ilo.org/gea>. And in particular: Implementing the Global Employment Agenda: Employment strategies in support of decent work, "Vision" document, ILO, 2006.

<sup>4</sup> See <http://www.ilo.org/employment>.

## Foreword

Today, several factors including globalization, the advancement of technology, and demographic changes require rapid labour market adaptation. With the increasing volatility of the labour market, workers face new risks that are not covered by traditional labour market security instruments. Thus, policymakers and academia alike recognize today the need of new types of security that correspond to the risks in the labour market. The workers' growing demand for a better work and life balance adds a further dimension to the complexity of labour market today. A difficult challenge is to design and implement policies and regulations that suit the needs of both employers and workers.

The present paper adds some new insights to the existing research on flexicurity by exploring the relevance and adaptability of this model to the Japanese labour market. The paper acknowledges the uniqueness of the flexibility-security nexus in Japan, consisting of a corporate-centred approach to security and high internal, functional and wage flexibility. The rapid economic growth of post-war Japan was based on the voluntary practice of companies to grant long-term stable employment. Market pressure associated to changes in the global market, however, challenged the traditional Japanese model, forcing companies to resort increasingly to hiring workers on non-regular contracts in order to save costs. Today, non-regular workers, who are largely left out of the traditional security provisions in the labour market, account for more than a third of the employed in Japan. Having analyzed the Japanese labour market with regard to its potential for a viable transition to flexicurity, the author argues that strengthening active labour market policies and expanding social security coverage would help achieving decent work for all and ensuring social justice in Japan.

The key message resulting from the analysis presented in this report is that growing labour market flexibility in the Japanese labour market needs to be complemented by an appropriate model of labour market security. The present paper also emphasizes that social dialogue is a vital component of any sustainable policy reform towards flexicurity.

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## Abstract

During the time of post-war high economic growth and in the aftermath of the first oil crisis, Japan developed its current employment system based on the practice of long-term employment. Security in the labour market was thus designed on the premise of (male breadwinners') stable employment. Corresponding labour market institutions emerged in order to reinforce this model. The market liberalization and corporate governance reforms of the 1990s, however, affected corporate behaviour and challenged the traditionally stable employment system and led to a remarkable rise of non-regular employment that has put the traditional security provisions in the labour market under strain. The current pattern of labour market segmentation weakens the foundations for economic growth and decent work. The Japanese labour market is required to identify new types of security that correspond to the needs of businesses for workforce adjustment and the new risks that workers face in a more flexible labour market. As in many developed countries, readjusting the balance between flexibility and security in the labour market appears to be the main challenge in labour market policy-making. The present paper provides insights into the capacity of the "flexicurity" model to provide for a balanced alternative to the model presently in practice.

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## Abbreviations

ALMP	Active Labour Market Policy
EU	European Union
EPL	Employment Protection Legislation
GEA	Global Employment Agenda
ICT	Information and Communication Technology
ILO	International Labour Organization / Office
JILPT	Japan Institute for Labour Policy and Training
JTUC-RENGO	Japanese Trade Union Confederation
MHLW	Ministry of Health, Labour and Welfare
OECD Development	Organisation for Economic Co-operation and
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific



# 1. Introduction

Globalization and the advancement of technology have been key drivers of changes in labour markets and policy responses. Market liberalization and the expanding fabric of supply chains and trade networks, together with improved means of transport and the revolution in information and communication technologies, have changed patterns of production in and competitions between companies. The fast movement of capital has added another dimension of change to labour markets as companies face pressure for quick adjustment in order to ensure survival and prosperity. Similarly, resource reallocation from declining sectors to emerging and growing sectors at the macro level is also essential for countries to stay competitive. For these reasons, among the first wave of policies proposed by international economic actors (such as the OECD and the international financial institutions) aiming to cope with these developments was the promotion of flexibility of the labour market. The gist of these policy recommendations was to reduce employment protection for the sake of quicker adjustment which was expected to lead to greater economic growth. The initial labour market policy responses to the challenges posed by globalization and technological advancement had a tinge of neo-liberalism.

These policies were contested, for example, by the European Union which looked instead for a way to maintain its European Social Model while adapting to the challenges of globalization. Increasing emphasis is being placed on balancing flexibility and security in the labour market as policymakers and researchers recognize the need to adequately respond to the challenges of globalization. In addition, recent research findings dismissed the claim that labour market flexibility increases labour productivity and economic growth. Indeed, Auer et al. also revealed a positive effect of employment stability on labour productivity<sup>5</sup> (Auer et. al. 2005: 324-332). The same was observed by Storm and Naastepad (Storm and Naastepad: 2007). These studies showed the importance of balancing flexibility and security in the labour market. Cazes and Nesporova similarly analyzed Central and Eastern European labour markets from the perspective of flexicurity and argued that balancing flexibility and security is economically and socially rational (Cazes and Nesporova: 2007). These studies confirmed that flexibility alone cannot maximize labour market and socio-economic performance.

As a result, a new labour market policy concept - *flexicurity* - has emerged and gained momentum in Europe. Indeed, the European Commission adopted the common principles of flexicurity in 2007. While there exists no “one best definition” of flexicurity, and many schools of thought and denominations (e.g. transitional labour markets, protected mobility, securing of professional trajectories, flexi-curity, etc.) have committed to exploring its essence, all agree that flexicurity aims to achieve an optimal balance between labour market flexibility and security with fairer distribution of security among all categories of workers (European Commission: 2006). A recent definition proposed by Wilthagen and Tros states that flexicurity is (Wilthagen and Tros: 2004):

a degree of job, employment, income and combination security that facilitate 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 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

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<sup>5</sup> A positive effect of tenure on productivity eventually decreases.

changing conditions in order to maintain and enhance competitiveness and productivity.

A more straightforward definition given by Auer sees flexicurity as:

a new combination of employment security (delivered by the private and the public sector) and activating social protection, negotiated by the social partners, which should permit “protected transition” towards new jobs for those adversely affected by change triggered by globalisation and technological change.

One could therefore say that flexicurity as a model promotes a more sustainable balance between labour market security and flexibility (as opposed to models emphasizing only one or the other) as it is a solution that better reflects the interests of all stakeholders (market, state and social actors). It also provides for institutions and programmes, such as unemployment benefits, active labour market policies and public employment services, which tackle labour market security risks. Some authors narrowly define flexicurity as employment security combined with social security provided to a flexible workforce (Keller and Seifert 2004, Tangian 2005, European Foundation for the Improvement of Living and Working Conditions 2007). In countries where workers on contingent contracts do not enjoy social security this narrow definition may serve to promote policies towards flexicurity. This paper, however, works with the broader definition of flexicurity (as provided by the European Commission and Auer et al.) since labour market security concerns both non-regular and regular workers.

#### **Box 1**

##### **Elements for flexibility and security dimensions**

###### **Flexibility**

###### *External numerical flexibility:*

The difficulty/ease of hiring and firing employees and the extent to which fixed-term employment contracts can be used.

###### *Internal (i.e. within the firm) numerical flexibility*

The difficulty/ease of changing the quantity of labour used in a firm without having recourse to either hiring or separations (i.e. through changes in working hours, use of part-time or overtime work, etc.).

###### *Functional flexibility*

The difficulty/ease of changing the working organisation or the ability/inability of workers and enterprises to adapt to new challenges (multi-tasking, job rotations etc.).

###### *Wage flexibility*

The degree of responsiveness of wage costs to economic conditions.

###### **Security**

###### *Job security*

The expectation regarding the job tenure of a specific job.

###### *Employment security/employability security*

The expectation regarding remaining in work (not necessarily with the same employer).

###### *Income security*

The degree of income protection in the event that paid work ceases.

###### *Combination security*

The ability/inability to combine paid work with other private or social activities.

(Source: Wilthagen et al. 2003; Wilthagen and Tros 2004, cited in European Commission 2006)

Flexicurity essentially emphasizes labour market security for all workers. This aspect has been largely ignored or even denounced by the proponents of neo-liberalistic economic reforms who tend to see labour market institutions as the cause for labour rigidity resulting in slow economic growth (Forteza and Rama: 1999). In fact, most of the EU member states, in conformity with pro-flexibility policy proposals, loosened labour market regulations in the 1990s and experienced a sharp increase in temporary employment. The biased distribution of security and the burden of increasing labour market flexibility resulted in labour market segmentation. This was followed by calls for flexicurity since it redresses the issue of labour market dualism or social exclusion by various measures such as providing social protection to flexible workers and limiting the consecutive renewal of fixed-term contracts.

It is important to note that labour market security, as stressed by the proponents of flexicurity, differs from job security and employment security in that it combines employment security (including through the change of employers) with social protection (Auer 2007b: 4-5). Increasingly volatile due to the processes of globalization and the advancement of technology, the demand for labour can be better met with “security based on broader shoulders”, as opposed to relying excessively on stable employment (ibid: 3). Vladimír Špidla, Commissioner for Employment, Social Affairs and Equal Opportunities of the European Commission, describes labour market security as worker-oriented security (European Commission 2007: 3). This notion does not exclude the possibility of some workers enjoying job/employment security with a single company. Flexicurity intends to provide a safety net for workers marginalized in the labour market and those negatively affected by the volatile nature of present-day labour demand.

Some observers argue that security should come before flexibility (Lee and Eyraud: forthcoming), since some policymakers misunderstand flexicurity as a combination of loose firing regulations and income protection for laid-off workers (UNESCAP 2006: 179). As the discussion above shows, flexicurity is not a trade-off between job security and income/social security. In addition, the flexibility promoted by the flexicurity model is multi-faceted: external, internal, functional, and wage flexibility. While external flexibility is not compatible with job/employment security, other types of flexibility, namely internal, functional and wage flexibility as practiced by companies in Japan, may enhance employment security as they allow employers to make the necessary adjustments without cutting jobs.

Flexicurity is not a fixed policy formula but a shared policy goal and a common principle among EU member states towards a labour market with more and better jobs (European Commission 2007). Since EU member states differ greatly in terms of labour market institutions, socio-economic environment and cultural background, different pathways towards implementing flexicurity apply. Countries with segmented labour markets, for example, may strive to achieve flexicurity by distributing flexibility and security more evenly among various types of workers. Countries with a large number of informal workers may decide to achieve the same through emphasizing active labour market policies and encouraging life-long learning (ibid: 28-35, Wilthagen 2008). Social dialogue is essential for finding viable solutions.

In order to promote decent work, the ILO has chosen flexicurity to be one of the elements of its Global Employment Agenda<sup>6</sup> (GEA), which aims to put “employment at the heart of economic and social policies” (ILO 2003: iii). Although the concept of balancing flexibility and security of the labour market is high on the agenda of labour market analysts today, the flexicurity model has not been fully considered as a possible

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<sup>6</sup> The governing body of the ILO adopted the Global Employment Agenda

solution to labour market challenges outside of Europe. For this reason the ILO encourages further research into the potential for achieving flexicurity in other parts of the world, developed and developing countries alike. The present research paper, as part of ILO's continuous efforts to that end, sheds light on the potential of introducing flexicurity as a solution to the current labour market segmentation in Japan.

In the 1980s, the Japanese production and employment system became largely admired and accepted as a credible model for the rest of the world. This praise, however, faded during the economic stagnation in the 1990s. Japan has considerably increased its labour market flexibility in recent years by amplifying non-regular employment,<sup>7</sup> especially among youth and women, without changing much in its pattern of security provision in the labour market. With this, clear signs began to emerge that the model was under strain, namely an increase in the number of low-wage earners and a widening income gap, leading to a weakened consumption growth and a decline in population. This research paper analyzes the Japanese labour market from the viewpoint of flexibility and security distribution. It illustrates the rise and the fall of the corporate-centred approach to security and then suggests policy directions in order to more evenly distribute labour market security and flexibility among various types of workers.

Chapter 2 is devoted to the current Japanese employment system and corporate-centred approach towards security in the labour market. It focuses on factors that created and bolstered the Japanese employment system. Security in the Japanese labour market, both *de jure* and *de facto* employment protection (including training opportunities and social insurance), has been developed on the premise of a long-term employment relationship between regular workers (predominantly male) and companies. The Japanese corporate finance and transactional practices limited market pressure on management, which enabled companies' commitment to stable employment. The labour policies and court judgements additionally reinforced the practiced norm of long-term employment.

Chapter 3 focuses on the crisis in the Japanese model of labour market governance. The foundation of the Japanese model with its unique relationship between companies and banks has undergone changes whereby the stability of employment came under pressure. The Japanese labour market fostered a polarisation between regular and non-regular workers marked by a sharp difference in compensation and by limited mobility between employment types. These changes have engendered fractures in the corporate-centred approach to security as the share of workers who are left outside of the traditional safety net of the labour market increases. The failure of the current employment security system to adapt to the rapidly changing environment poses challenges to sustainable economic growth and sound social development.

Chapter 4 analyzes and discusses the distribution of security and flexibility in the Japanese labour market and puts forward ideas for an effective combination of the two. The cross-country comparison along national expenditure on active labour market policies and the rigidity of employment protection presented in the section confirmed that a balanced approach towards labour market security and flexibility would improve labour market performances and socio-economic outcomes. It appears necessary to enhance labour market security so as to ensure sustainable socio-economic development.

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<sup>7</sup> See Annex I for a description of the various types of non-regular employment practiced in Japan. This paper uses the terms non-regular employment, atypical employment, and precarious employment interchangeably.

Chapter 5 summarizes the analysis and concludes the discussion, reiterating policy recommendations and encouraging an enhanced social dialogue on the issue. Seen from a flexicurity perspective, Japan has a long way to go before achieving an optimal balance of security and flexibility in the labour market. A substantive social dialogue and strong political commitments to reform are a precondition to the sustainable transition to a labour market that is fairer in the distribution of security and flexibility and more adaptable to changes.

## 2. Corporate-centred security

This section depicts the rise and the elements of corporate-centred security as found in the Japanese labour market. In understanding security (granted mostly to regular employees with an open-end contract) in the Japanese labour market, it is worthwhile to note several features of the Japanese employment system. Distinctive corporate finance mechanisms in Japan have largely defined the Japanese employment system, including the provision of security. This is because long-term stable employment relationships would in fact not have prevailed without the stable and continuous provision of funds. Stable employment relationships in Japan are supported by a corporate-centred approach to skill formation and welfare; functional and internal flexibility (as responses to business cycle); employment laws (including principles established through case law) and employment policies. This section deals separately with each of these elements.

### 2.1 Corporate finance

Two salient financial practices of Japanese firms, the main bank system<sup>8</sup> and cross-shareholding, reinforced management stability and thus enabled firms' commitment to stable employment. The practices of the main bank system diffused in the beginning of the post-war high economic growth period of Japan (from the mid-1950s to the beginning of 70s). A main bank was the bank that formed a loan syndicate with other banks and played a leading role in the examination of loan applications, in the monitoring of repayment capacity, and in the carrying out of bailout operations (Scher 2001: 8, Lazonick 2005: 73, Hoshi 1994: 285-309). It generally held an implicit but long-term tight relationship with the borrower. In addition to a close transactional relationship, a main bank often owned large shares of borrower companies and sent bankers to client companies as executives. This close relationship between main banks and companies alleviated the asymmetry of information (with regard to the solvency of borrower companies) and reduced the cost of financial distress, which promoted investment<sup>9</sup> (Hashimoto et al. 2006: 96, Hoshi 1994: 305). Therefore, the main bank system could provide stable long-term funding/investment in/loans to companies.

Cross-shareholding practices within a group of companies,<sup>10</sup> business partners and banks started in the mid-1950s and became widespread in the mid-60s. Faced with capital market liberalization, companies mutually held shares to prevent hostile takeovers. This practice also had an effect in cementing transactional relationships (Scher 2001: 2) since shares were seldom sold on the stock exchange. Around 60-70% of the total of shares were not subject to market transactions due to the prevalence of these royal shareholders up until 1998 (Lazonick 2005: 61). Despite a provision in the

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<sup>8</sup> For detailed information on the main bank system, see Aoki and Patrick eds. *The Japanese main bank system* (1995).

<sup>9</sup> Lazonick implies that the venture capital role that a main bank system played enabled young small and medium enterprises (SMEs) to survive and grow without cash-flow problems, which was an indispensable engine for economic growth (Lazonick 2005: 73-74).

<sup>10</sup> A group of companies with tight transactional relationships via cross-shareholding in Japan is often referred as *Keiretsu*. *Keiretsu* appeared as horizontally (or vertically)-integrated alliances, often being centred around a major bank (main bank). It effectively discouraged a hostile take over attempt over a member company of a *keiretsu*. The scope of hiring, human resources development, assignment, and employment adjustment go beyond the boundary of a company to include group companies. This "quasi-internal labour market" is observed among large companies in Japan (Sato 1999: 41).

Commercial Code that stipulates that companies belong to their shareholders, Inagami noted that shareholders' interests were "not ignored, but they are not prioritized"<sup>11</sup> (Inagami and Whittaker 2005: 27). As such, most Japanese companies had a tradition to keep dividend propensity low and constant. Together with the indirect finance mechanism, cross-shareholding practices increased the management stability of companies by discouraging hostile takeover attempts (Hashimoto et al. 2006: 102-110, Scher 2001: 2, Lazonick 2005: 57).

## **2.2 Long-term employment as the base of the Japan model**

It was the stable access to capital through the main bank system and the practice of cross-shareholding that largely shaped the foundation of the Japanese employment system, establishing the practice of long-term employment (Sheard 1994: 339, Scher 2006: 2). The main bank system and mutual shareholding practices insulated managers from market pressure, enabling them to run businesses with long-term goals and to invest in R&D and human capital (concentrating on the training of employees). Japan's practice of long-term stable employment emerged in the early 1950s and formed the basis for an "employment society"<sup>12</sup> (Sugeno 2002: 48). Long-term employment was based on mutual (and tacit) understanding that employers would exercise dismissal restraint and regular (or core) employees would commit to long-term service (Japan Institute of Labour 1999: 8). It was a practice typical to Japan that school-leavers would join and work for the same company (or within the same group of companies including daughter companies) until retirement (Sugeno 2002: 120). While it was obviously not the case that every worker enjoyed long-term employment guarantees in a company; nearly half of male workers, and 52.8 per cent of male workers with tertiary education at the aged 55-59, had employment tenure over 30 years (Table 1). This evidence suggests the practice of long-term employment is still a norm in Japan. This base has led to the development of distinctive Japanese employment practices that matched the long-term employment relationship. The skill formation, wages, industrial relations, labour market policies and the case law governing employment reflect the practice of long-term employment.

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<sup>11</sup> The Japan Productivity Centre (JPC), a tripartite (employers, workers, and academic experts) non-profit organization that promoted productivity movement in Japan, upheld a principle that "the fruit of productivity increases should be distributed fairly among labor, management, and consumers in accordance with national economic conditions" (JPC, cited in Koshiro 2000: 63).

<sup>12</sup> Sugeno sees Japanese society as employment-centred society since more than 80 percent of workers are the employed.

**Table 1: Employment tenure by age category (ten persons, shares in bracket)**

Age/Tenure	Total	20-24 years	25-29 years	over 30 years
<b>Men , education and industry total</b>				
age 45-49	1'633'85	38'649 (23.7 %)	41'717 (25.5%)	10'121 ( 6.2%)
age 50-54	1'624'82	12'939 ( 8.0 %)	30'683 (18.9%)	55'667 (34.3%)
age 55-59	1'819'48	10'617 ( 5.8 %)	13'046 ( 7.2%)	82'182 (45.2%)
<b>Women , education and industry total</b>				
age 45-49	658'170	5'460 ( 8.3%)	7'732 (11.7%)	1'969 ( 3.0%)
age 50-54	652'570	4'815 ( 7.4%)	4'045 ( 6.2%)	7'389 (11.3%)
age 55-59	687'050	7'860 (11.4%)	4'463 ( 6.5%)	8'812 (12.8%)
<b>Men with tertiary education, industry total</b>				
age 45-49	65'813	27'147 (41.2%)	14'194 (21.6%)	70 ( 0.1%)
age 50-54	52'034	4'970 ( 9.6%)	20'338 (39.1%)	10'111 (19.4%)
age 55-59	42'915	2'072 ( 4.8%)	3'531 ( 8.2%)	22'642 (52.8%)
Source: Basic wage structure survey 2006, MHLW				

## 2.3 Skill formation and wages

The long-term employment relationship model renders investment in skill development and retention economically rational for companies (Sato 1999: 41) as it allows enough time for companies to receive returns from human capital investment. Moreover, the skills developed through on-the-job training (OJT) are often firm-specific (Inagami 1999: 11) and therefore boost directly the firm's productivity. Consequently, vested investment in human capital in the past tended to discourage dismissal from employment even in times of economic downturn as long as it was expected not to last long. Indeed, the main bank's bailout measures<sup>13</sup> helped to maintain firm-specific skills, in a stark contrast with the liquidation and/or merger options that financially distressed companies faced in the U.S. (Hashimoto et al. 2006: 98).

Wages and benefits in Japan are usually designed to encourage long-term tenure. A typical wage curve is marked by wage suppression (wages fall below the workers' productivity) at the start of one's career; and a stark increase in the latter half of one's career. Various benefits are in place to reward long-term tenure. The entitlement to annual paid leave, for example, often starts at the statutory minimum (10 days a year) and increases in accordance with the years of service. Retirement benefits also swell progressively with the length of tenure. The impact of age and seniority on wages is greater in Japan than in other developed countries (Sato 1999: 57). The seniority-based wage guarantees an increase in employee's purchasing power towards the later stages of life as well as reflecting the improvement in their skill and ability. These compensation

<sup>13</sup> Bailout package includes interest waiver, advising on and drawing up turnaround plans, corporate restructuring, outplacement, and negotiation with other creditors. Main bank sent more bankers to decision-making posts of borrower companies when default risk became highly visible (Hashimoto et al. 2006: 97-98).



practices increase job-switch costs<sup>14</sup> and are partly the reason why mid-career job changing is not very common in Japan.

## 2.4 Employment adjustment: internal, functional, and wage flexibility

The commitment of companies to long-term employment has led to the development of distinctive employment adjustment procedures and methods in response to business cycles in Japan. When companies face a dwindling demand, they first limit overtime work and then stop mid-career recruitment. If these measures turn out to be insufficient, companies try to adjust employment internally and decrease the number of new graduates they recruit. If all of these measures fail, they stop renewing contracts of non-regular workers<sup>15</sup> since this may cause less legal complications and skill-transition losses than dismissing core workers. Temporary lay-offs, soliciting voluntary retirements and the dismissal of regular employees are measures of last resort. These measures are often accompanied by outplacement services and a retirement allowance with a premium to mitigate the impact on the dismissed employees (Ministry of International Trade and Industry ed. 1981: 45-52, Sugeno 2002: 67).

Since companies dismiss regular employees only when all other measures have been exhausted, they rely more on functional, internal and wage flexibility rather than on external flexibility. Inagami points out that Japan ranks first among developed countries in terms of the functional flexibility of the employment system (Inagami 2000: 254). Transfers (*haichitenkan*) serve as a buffer against the negative impacts of the business cycle. A transfer may refer to the re-assigning of a worker to a different task or geographical location. The practice of loaning personnel<sup>16</sup> (*shukkou*) and transferring the permanent domicile<sup>17</sup> (*tenseki*) of an employee adds functional flexibility that extends beyond the boundary of a company. It is important to note that both *shukkou* and *tenseki* function as a 'coordinated outplacement'. Most macro data analyses of employment adjustment fail to reflect the impact of functional flexibility, often leading to the conclusion that employment adjustment in Japan is by far slower than that in the United States. However, Abe, using data from 4,466 individual companies which operated

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<sup>14</sup> Switching careers penalizes workers by reducing their retirement allowance by a large margin since the amount of the allowance increases progressively with seniority. If a worker changes jobs at the age of 40, she/he foregoes 43.8 to 52.4 per cent of the retirement allowance that she/he would have received had the worker not switched jobs. Consequently, the worker's lifetime earnings would be 14.9 per cent less (JILPT 2006c: 205-214)

<sup>15</sup> Inagami explains this process in a corporate community model where non-regular workers are non-members of the community, thus subject to less protection (Inagami 1999: 8). Kucera notes that "Japanese firms' reliance on internal flexibility is not an alternative to, but rather is complemented by, external flexibility. This external flexibility is provided disproportionately by women workers, who serve as a buffer workforce (Kucera 2001: 31)

<sup>16</sup> Sugeno classifies loaning of personnel into four types based on the purpose for the loan: 1) Aid: a firm loans its employee to a daughter or related firm for managerial or technical assistance; 2) Human resources development: the loan is made with the aim of developing the employee's skills and career through additional experience; 3) Post assignment: when there is a shortage of managerial positions, a mother or core firm loans its mid-career or senior employees to a daughter or related company assigning them to positions above the managerial level; 4) Employment adjustment: a company may send redundant employees to a daughter or related company that has vacant positions (Sugeno 2002: 143-144).

<sup>17</sup> In a loan of personnel, the employment contract continues with the worker's current employer regardless of the company or companies a worker is loaned to. However, in the case of a permanent transfer of domicile, the employee's contract is terminated and (s)he enters into a new contract with the new firm that (s)he is to work for.

between 1978 and 1995 in Japan, rejects the assumption that long-term employment system, seniority-based wages, and union opposition slow down employment adjustment (Abe 2005: 123-148).

Companies in Japan reserve large room for labour cost adjustment with regard to the wages of regular employees. The amount of a bonus, given mostly to regular employees, shows a high elasticity in the face of changing macro economic conditions and corporate performance as well as, to a lesser extent, individual performance. A bonus often accounts for a significant part of one's annual salary, reaching up to a third of the salary for workers holding a university or higher-education degree and those employed by large companies. Enterprise-based unions moderate or forgo wage demand when the company is faced with declining demand for its product(s); or even accept wage cuts in exchange for employment maintenance (Inagami and Whittaker 2005: 33).

## **2.5 Enterprise unions**

The Japanese employment system, a unique combination of long-term employment (low numerical flexibility) and internal resolution of external shock (high qualitative flexibility), has had a strong influence on the organization of trade unions. Enterprise-based unions in Japan outnumber craft unions and industrial trade unions by a large margin. Inagami explains this is due to the level of capacity of enterprise-based unions to negotiate the required adjustments of working conditions in order to maintain regular employment within the internal labour market. Issues such as transfers, technology adaptation, and wage cuts (whether due to an extension of the contract into retirement age or the reduction of working hours) cannot be effectively negotiated between the company and a craft or an industry trade union (Inagami 2000: 255). Tabata estimates that the trade unions in Japanese companies show higher elasticity and flexibility with regard to changes in the economic environment as compared to craft unions and industrial trade unions in Europe and the United States (Tabata 1991: 225).

## **2.6 Employment law and policies**

Established case law that governs practices in employment relationships has reinforced the long-term employment system in Japan (Inagami 1999: 8). Although Article 20 of the Labour Standard Law stipulates that employers may dismiss workers with 30 days' notice<sup>18</sup> without legal obligation of providing severance pay, case law has restricted dismissal by the doctrine of the abusive right of dismissal. Courts consider four factors in judging the validity of a dismissal: 1) a high economic necessity for the dismissal, 2) all other means to avoid dismissal has been exhausted, 3) the employees to be dismissed are objectively selected, and 4) a prior consultation with unions and employees has taken place (Sugeno 2002: 69). These judicial principles are partly integrated in Article 18-2 of the Labour Standard Law in 2004 to the effect that the Law invalidates dismissals in the case of decisions that are considered to be irrational, subjective, or inconsistent with the current social norms.<sup>19</sup> While restricting undue dismissal, case law has endorsed internal and functional employment adjustment methods by admitting a company's authority over personnel issues, including re-

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<sup>18</sup> If employers dismiss with less than 30 days of notice, they compensate workers with payment equivalent to the number of days that fall short of the statute notice period.

<sup>19</sup> A dismissal may be declared null and void as unacceptable under the current social norms if the reason for the dismissal is minor and thus dismissal is too severe, or if the dismissal decision was unfair and inconsistent compared to other similar cases (See JILPT, <http://www.jil.go.jp/kobetsu/book/83.html> [14 March 2008]).

assigning tasks/jobs and transferring workers, except in cases where there is a proven abusive use of these rights (Sugeno 2002: 121). In addition, a Supreme Court ruling<sup>20</sup> in 1968 and following judicial court rulings established that disadvantageous modifications of employment rules are acceptable even in the absence of the individual consent of workers in so far as the changes can be deemed necessary and reasonable (ibid.: 358-361). The above-mentioned court rulings indicate that courts admit (through case law) the companies' authority to adjust employment rules and working conditions in response to market fluctuations. The absolute authority afforded to companies (as exemplified in the above-mentioned court rulings) over personnel issues may be seen as complementary to their commitment to ensuring long-term employment for their workers.

Inagami points out that post-war labour policies encouraged the practice of long-term employment (Inagami 1999: 8). After the first oil crisis the Ministry of Labour set a new policy direction that aimed to achieve employment security via assisting with the employment maintenance of companies (Higuchi 2001: 404-405). The employment policy intended to prevent or minimize job losses relying on the success of companies' efforts to resolve redundancies within the quasi-internal labour market.<sup>21</sup> Thus the government subsidized employers for employment adjustment to this end (Saguchi 1995: 388, Hamaguchi 2008: 15). The employment adjustment subsidy, for example, applied to employers who, at times of dwindling business, commit to employment maintenance by means of temporary release from work or temporary transfer to other companies.

## 2.7 Corporate-centred security

### *Employment security*

Security in the labour market has developed through centring around enterprises much in the same way as the employment system itself has developed. Regular employees enjoy security via both stable employment and social security. According to OECD measurements, the employment protection legislation (EPL) for Japanese regular employees is not as high as it is often believed to be. The index for Japan (2.4) is slightly above the OECD average (2.2) (OECD 2004: 117). This is because it is not the legal employment protection, but rather the employment practices (i.e. company's voluntary commitment to long-term employment) and social norms that provide a core of employment security. Inagami and Whittaker's illustration of the Japanese company as a community firm is based on the premise that Japanese companies, much like communities, provide sufficient security, particular environment, and tacit (workplace) norms, (including task assignment, promotion and compensation) to its (core) members (Inagami and Whittaker 2005). If one takes the average employment tenure<sup>22</sup> as a proxy for *de facto* employment security, Japan boasts one of the highest employment security systems. Note that high *de facto* employment protection does not imply rigidity of work organization or a slow rate of labour market adjustment. Employees are kept at times of hazardous market forces through flexibility in the assignment of tasks and the deployment to alternative workplaces. In-house training, the major channel for skill upgrading and multi-skilling, enhances employment security. Companies bundle their

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<sup>20</sup> Supreme Court Judgment on the Shuuhoku Bus case, 25 December 1968.

<sup>21</sup> An extended internal labour market includes the internal labour market of related companies.

<sup>22</sup> Average employment tenure in 2002 (in years): Japan 12.2, France 11.3, Germany 10.7, Denmark 8.4, UK 8.1, and US 6.6 (data in 1997) (Source: Auer et al. 2005: 322 Table 1).

commitment to long-term employment and investment in human capital of employees. Enterprise unions represent full-time regular employees and protect employment, though their strategies to do so remain flexible since they accept unfavourable changes of working conditions in exchange for employment.

### *Social insurance*

In addition to the employment security discussed above, full-time regular employees<sup>23</sup> in Japan enjoy more generous and less costly social insurance. Employers offer an earnings-related employee pension insurance (*Kouseinenkin*, *Kyousai nenkin* in the case of public servants). It is required under law that all incorporated companies and enterprises of five or more regular employees provide employee pension insurance. Employers are obliged to bear half of the insurance premium.<sup>24</sup> Some companies further complement employee pension insurance through an employee pension fund or a corporate pension scheme (*Kigyō nenkin*). According to the Social Insurance Agency, the average annual payout of the national pension scheme<sup>25</sup> for the 2005 fiscal year was JPY (Japanese Yen) 636,000 (USD 5,679) per eligible pensioner, while the employee pension insurance program paid out JPY 1,976,000 (USD 17,964) per eligible pensioner (Social Insurance Agency 2007: 25). Obviously, the national pension alone would not suffice to sustain life in retirement.

The employee health insurance schemes<sup>26</sup> are available in the public and private sector, and cover employees and their dependents. Employers bear half of the insurance premium payment. The national health insurance covers those who are not covered by the employee health insurance. While insurance premiums vary depending on the chosen insurance schemes, the health insurance generally covers 70 % of one's medical expenses. In addition, the employee's health insurance provides a disability allowance equivalent to two thirds of one's salary from the fourth day of disability up to one year and a half if the insured is unable to work due to a non-work related<sup>27</sup> sickness or injury. Similarly, a maternity allowance, which replaces up to two thirds of one's salary for fourteen weeks, is payable to mothers who wish to take maternity leave.

The employment insurance provides security against income loss in the event of unemployment. As a rule employment insurance applies to all workers, except part-time workers employed under 20 hours a week, and workers in small enterprises in agriculture, forestry, or the fishing industry that employ less than five persons. Provided that a worker has been insured for over six months (during the last year of employment) prior to their separation and has demonstrated their willingness and ability to work (but

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<sup>23</sup> Note that part-time workers whose prescribed working hours are longer than three quarters of those of full-time regular employees are also eligible to employees' pension insurance and employee health insurance schemes.

<sup>24</sup> Insurance premium is set at 14.6 per cent of one's salary (as of June 2007).

<sup>25</sup> In addition to the National Pension (*Kokumin nennkin*, or *Kiso nenkin*) that covers all registered residents aged 20 and over. Monthly national pension contribution is JPY 14,100 (USD 128). The full amount of pension (40 years of contribution) is JPY 66,008 (USD 600) per month (as of June 2007).

<sup>26</sup> All incorporated companies and companies with five or more regular employees are required to offer employee's health insurance.

<sup>27</sup> Work-related sickness, injury, disability, and death are covered by workers' accident compensation insurance which is financed solely by employers' contribution.

has not been able to find a new job), then they are recognized as unemployed by the relevant public employment security office. A basic allowance for a pre-determined period is payable to them depending on their respective age, the length of insurance coverage, and the reasons for their separation (see Annex II). In addition to this principle function, the insurance offers wide-ranging benefits in order to facilitate employment maintenance (Hamaguchi 2004: 133-135), job-search activities, capacity development, etc. Article 1 of the Labour Insurance Law that stipulates the purposes of Japan's employment insurance reads as follows:<sup>28</sup>

The purposes of the Employment Insurance are to stabilize living and employment of workers and to facilitate job-seeking activities by providing much needed benefits for workers who are unemployed, who are having trouble securing a living or who are receiving job-related training, and to prevent unemployment, redress the employment situation, increase employment opportunities, develop and improve worker potential and promote the welfare of workers.

Employment insurance projects have played a key role in stabilizing employment and have provided the financial means for implementing employment policies (Higuchi 2001: 405). The projects consist of two pillars: employment stabilization projects and capacity development projects. The former prevents or minimizes unemployment by supporting employers who maintain jobs. The latter lends aid to employers who provide educational training<sup>29</sup> to their employees. Employers alone contribute to employment insurance projects in the amount equivalent to 3/1,000 of employees' wages.

To summarise the discussion thus far, the Japanese employment system is largely centred on long-term employment relationship. The main bank system and mutual shareholding practices largely mitigated market fluctuations/threats, enabling managers to focus on long-term growth. In this context, (male breadwinners') stable employment relationship has become a tacit but well-established norm among workers, employers and policymakers. Japanese firms have developed internal and functional flexibility to cope with the business cycle. Employment adjustment takes place within the quasi-internal labour market and external labour market is assigned a minor role in this regard. Laws and judicial precedents governing employment relationship and employment policies reinforced these practices. The enterprise-based unions have found their own niche in the Japanese model that emphasises internal adjustment of labour input. Security in the labour market, both *de facto* employment security and social insurance, is contingent on the regular full-time employment.

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<sup>28</sup> Source: The Japan Institute of Labour. The text is provisional translation by a specialist, not the official translation. [http://www.jil.go.jp/english/laborinfo/library/documents/lj\\_law11.pdf](http://www.jil.go.jp/english/laborinfo/library/documents/lj_law11.pdf) [10 July 2007].

<sup>29</sup> The benefit for educational training provides financial support directly to individual workers who undergo training or education to develop their capacity. The benefit subsidizes twenty per cent of educational training costs up to a hundred thousand Japanese Yen (USD 909) if the beneficiary has been insured for more than three years. The benefit was scaled down since October 2007.

### 3. Corporate-centred security under strain

This section focuses on some of the major changes in capital market and management practices and illustrates how these changes have affected employment and security provision in the Japanese labour market. As discussed in the previous section, indirect finance and cross-shareholding practices enabled the diffusion of long-term employment, which is the very foundation of the Japanese employment system and corporate-centred security. However, as companies emphasized direct finance and shareholders gained power over managers since the mid-1990s, pressure on costs has increased and stable employment has come under pressure. Particularly motivated by these changes, companies have shifted the traditional pattern of profit distribution to the shareholders' favour and rapidly increased the share of non-regular workers. Employers combine various employment types to save costs and increase their adaptability to changing business environment. Labour market reforms since the mid-1990s have enhanced labour market flexibility, reflecting business as well as diverse workers' needs. However, non-regular workers have been largely left outside of the traditional security provision in the employment system. The corporate-centred approach to security faces a need for reform in order for the labour market institutions to respond to the changes in the labour market.

#### 3.1 Shift toward direct finance and pressure from the market

Four main factors accelerated the dissolution of the stable cross-shareholding practice in Japan. First, a decade-long economic stagnation in the 1990s resulting from the collapse of the bubble economy significantly worsened the financial situation of companies. Financial necessity compelled companies to sell their assets, including cross-held shares. Second, the plunge in share prices<sup>30</sup> and stagnation in the stock exchange market that followed, and the shift to current value accounting (from historical cost accounting rules) of 2002 revealed unrealized capital losses in shares. This made it particularly difficult for companies to retain shares (Asami 2004: 17). Third, the Basel Capital Accord and the Shareholdings Restriction Law of 2001 introduced limits on the shareholding of banks, which accelerated the dissolution of cross-shareholding and the erosion of the main-bank system. Fourth, the recently established vogue of capital efficiency-oriented and pro-shareholder management has convinced companies to give up on cross-shareholding because of low dividend returns (Abe 2005: 151). As a result the majority of market shares changed hands from stable (and conservative) local shareholders to more demanding foreign investors. Indeed, foreign investors' shareholding at market value has rapidly increased since 1990, reaching a historic high of 28.0% of the total market value in 2006 (Tokyo Stock Exchange: 3). At the same time the main bank system is experiencing a decline with this shift from indirect finance to direct finance. Restrictions on the issuing of bonds have gradually lowered since 1987 and were finally abolished in 1996. There was a 23% increase between 1998 and 2006 on the outstanding number of corporate straight bonds.<sup>31</sup> Profitable firms and firms with large collateral significantly reduced their dependence on banks (Hoshi 1994: 305).

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<sup>30</sup> Nikkei index (stock average) was 38,712.88 at the beginning of 1990, which fell to 20,221.86 in the course of the year. It hit 14,309.41 in 1992, marking over 63 per cent loss of the stock value within three years (Source: Nikkei).

<sup>31</sup> 41,837 billion JPY (USD 380.3 billion) in 1998 and 51,617 billion JPY (USD 469.2 billion) in 2006, according to Japan Securities Dealers Association (JSDA).

As direct finance became more significant, the notion of corporate governance gained popularity and a need for reforms was keenly recognized. Recent corporate governance reforms have emphasized the power and interests of shareholders (Dore 2007: 1, Asami 2004: 18, Nissei Life Insurance Research Institute: 2005) and the 'stakeholder model' has been losing ground to the 'shareholder model'.<sup>32</sup> The major 2002 Corporate Law revision in fact made corporate governance "more shareholder-friendly in Japan than in America or Britain" (The Economist June 30<sup>th</sup> 2007: 76). The threat of takeover has become real, and managers have responded to this by working to thwart any major shareholder exits or drops in the share price (Dore 2007: 4-5). Increased dependency on the capital market has reversed the companies' stance to concentrate on indices that shareholders watch closely, such as the rate of return on asset (ROA) or the rate of return on equity (ROE), rather than on sales (Inagami: interview,<sup>33</sup> Shinotsuka: speech<sup>34</sup>). Moreover, some foreign investment funds actively demand their dividends<sup>35</sup> and/or target cash-rich companies for a hostile takeover.

Changes in corporate finance with the aim of emphasizing market principles inevitably affect the employment system and the provision of labour market security. As discussed earlier, Japanese long-term employment was linked to the particular financing practices of Japanese firms. Abe argues that job maintenance in times of business stagnation would be impossible without the shared understandings of owners and creditors (Abe 2005: 151) as it is less likely that profit-seeking shareholders would tolerate a surplus work force that reduces the company's profit. In fact, the higher the dependency of a company on direct finance, the faster the speed of employment adjustment tends to be (Abe 1999, cited in Higuchi 2001: 71). Shareholder pressure inevitably affects employment stability.<sup>36</sup>

As shareholders increased their power over management, the picture of profit distribution in large Japanese companies<sup>37</sup> changed significantly, marking

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<sup>32</sup> Inagami revealed that a third of Japanese managers supported 'the enlightened shareholder value model'. According to him, the model "asserts that the primary objective of a firm is to expand shareholder value over the medium to long term by attaining business prosperity, and considers it imperative for the firm to establish amicable relations with various stakeholders as a means of accomplishing this objective"(Inagami 2001: 228). Judging from his findings, most companies seem to place their position somewhere in-between Stakeholder model and shareholder model.

<sup>33</sup> Interview on 6 December 2006

<sup>34</sup> Speech on employment situation delivered on 5 October 2000. She was a member of policy board of the Bank of Japan then. Her speech is downloadable at [www.boj.or.jp/type/press/koen/ko0010d.htm](http://www.boj.or.jp/type/press/koen/ko0010d.htm). [25 January 2008].

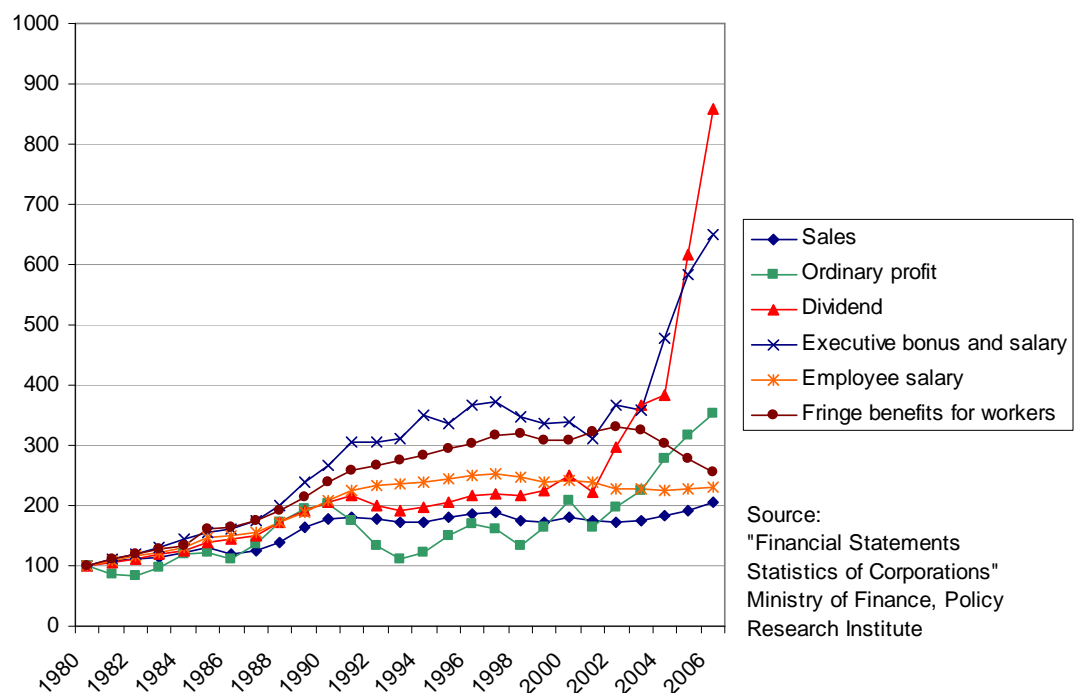
<sup>35</sup> For example, a U.S. investment fund requested a large Japanese confectionery company to quintuple semi-annual dividend insisting that the company's too large internal reserve should be shared by its owners (Yomiuri Shinbun: May 2, 2007). A British investment fund demanded a Japanese energy company to increase dividend from JPY 30 to JPY 100 per share (Yomiuri Shinbun: June 09, 2007).

<sup>36</sup> Even a mere threat of hostile takeover may threaten employment. A Japanese food company that became a target of a hostile take over bid (TOB) initiated by an American investment fund provides an example. The targeted company promised more than a three-fold increase in operating profits in its mid-term business plan (JPY 0.7 billion in financial year 2007 to JPY 2.5 billion in FY2013) in order to prevent the TOB. The plan proposes streamlining the business and instituting early retirement as a means of increasing the company's profit.

<sup>37</sup> Companies with capital equal to 1 billion Japanese Yen or more. They accounted for 0.2 per cent of companies in Japan and hired 16.3 per cent of the total employees in FY 2006.

the advent of shareholder capitalism (Dore 2006: 150-153, Inagami: interview<sup>38</sup>). Since FY 2001 the dividends paid out to shareholders and the rewards presented to their principle agents or executives have surged (Figure 1). In fact, dividends paid to shareholders roughly quadrupled and executive rewards doubled between FY 2001 (the last cyclical bottom) and FY 2006. Meanwhile, despite the five-year consecutive increase in ordinary profit, employee salaries recorded a slight decline and fringe benefits a considerable drop (Figures 1 and 7). Obviously, companies sought to satisfy shareholders first by increasing ordinary profit (even under stagnant sales growth) and by allocating a larger share of profit to shareholders, which required companies to cut costs rigorously.

**Figure 1 Index of profit distribution (FY 1980 = 100)**



There are signs that employment relationships are slowly but steadily becoming market-driven as companies shift (if only in part) the market burden to their employees. For example, companies today seem to be in the process of gradually shifting the responsibility for skill-development over to their employees through emphasizing employability. Cappelli noted that American firms emphasized 'employability' when they imposed the principles of the 'new deal'<sup>39</sup> on their employees (Cappelli 1999: 29-30). A similar phenomenon has emerged in Japan. The human resource development policies of Japan have emphasized individual initiatives in skill development since the mid-1990s (Hamaguchi 2004: 115). A report issued by Nippon Keidanren (Japan Business Federation) has portrayed companies as 'supporters' of employee initiatives

<sup>38</sup> Interview on 6 December 2006

<sup>39</sup> The 'new deal' is characterised by a market-focused employment relationship. Employment last as long as market conditions allow an employer to retain the employee. Obtaining skills considered to be the worker's responsibility in order to be employable.



aimed at enhancing their own skills and careers (Nippon Keidanren 2006b). Indeed, one third of employers believe that skill development is the employee's responsibility.<sup>40</sup> Another evidence for increasing influence of the market on employment relationships can be found in pension schemes. Since the Defined-contribution Pension Law came into force in 2001, an increasing number of companies have shifted from a defined-benefit pension plan to a defined-contribution pension plan. According to MHLW,<sup>41</sup> 9,783 companies had implemented a defined-contribution pension plan by January 2008; enrolment was estimated to reach about 2.6 million employees at the end of 2007. Although the defined-contribution plan increased pension portability, employees have to take market risks in order to manage their pension assets. Changes in seniority wages serve as another example of market influence on employment. Wages reflect more corporate as well as individual performance rates than they used to. A survey by JILPT revealed that over 56% of the surveyed companies with 200 or more employees had introduced the practice of performance pay (Table 2). The diffusion of performance pay has widened wage discrepancies among skilled-workers (MHLW 2007: 228). Together with the performance-based pay system, a change in the demographic composition of the population (with a tendency towards an aging society) has exerted pressure on the age-wage profile (Box 1). Another example of market pressure on employment relationships is the observation of a rapid decline in the share of regular employees with companies moving to cut costs and increase employment flexibility. This phenomenon will be discussed in more detail in the following subsections.

**Table 2 Long-term employment and performance pay (2004)**

	Performance pay	
	Yes	No
<b>Long-term employment</b>		
Yes	38.1 %	30.3 %
No	18.3 %	12.3 %

Source: JILPT (<http://www.jil.go.jp/column/bn/colum060.htm>) [17 March 2008]

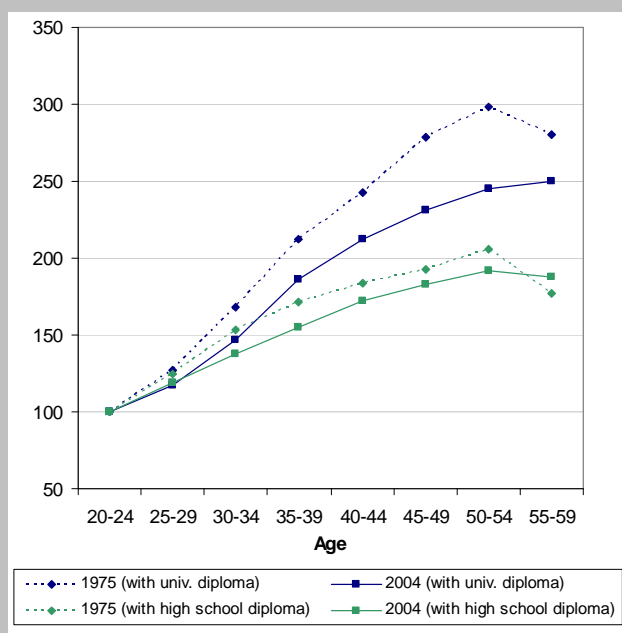
<sup>40</sup> Source: Basic survey on skill development 2004, MHLW

<sup>41</sup> Pension Bureau of MHLW: <http://www.mhlw.go.jp/topics/bukyoku/nenkin/nenkin/kyoshutsu/sekou.html> [17 March 2008].

## Box 2 Demographic change and seniority wages

The demographic change at hand, marked by an aging population and birth rate decline, modified the nature of seniority-based wages in Japan. The ratio of those aged 65 and above to the total of Japanese population climbed from 9.1% in 1980 to over 20% in 2005. The National Institute of Population and Social Security Research estimate that by 2025 this ratio will reach 30.5% (projection based on medium population growth). Consequently, the average age of employees is steadily increasing<sup>42</sup> with implications for a significant rise in personnel costs under the seniority wage system. Responding to the increasing personnel cost, some companies have continuously emphasized the importance of merit and performance, rather than years of service, in wage determination since the latter half of the 1990s. According to JILPT, over 56% of the surveyed companies (boasting 200 or more employees) had implemented a performance-based pay system in 2004. As a result, a seniority effect on wage increase was weaker for male (and similarly for female workers although not shown in the figure) university graduates in 2004 as compared to those of 1975 (Figure 2). Since a performance-pay system mainly targets white-collar managers, the drop in wages for high school graduates was less pronounced.

**Figure 2 General worker wages for male workers with high school and university degree in 1975 and 2004 (age 20-24 = 100)**



### 3.2 Increasing number of non-regular workers

A downward wage pressure arising from the greater market pressure and increasing competition on the global market has rendered companies more reliant on the use of cost-saving non-regular workers. This tendency has been accelerated by making a greater use of information and communication technology (ICT), by managers' policy to

<sup>42</sup> The average age of an employee went up by about four years between 1980 and 2005 (average age: men 36.8 and women 34.8 in 1980, men 40.7 and women 38.7 in 2005).

diversify employment types, and by pro-flexibility labour market reforms. While the number of non-regular workers has recorded a rapid increase, they have been largely left outside of the traditional labour market security provisions. Before analyzing problems pertaining to the current system of labour market security in the section 2.3, it seems necessary to explain the reasons (apart from shareholders' influence) behind this greater reliance of Japanese companies on non-regular employment.

### *Downward wage pressure*

The high economic growth since the late 1980s in newly industrializing countries (NIEs) in Asia, in combination with the zero-interest-rate policy and the growing pressure from external shareholders, has exerted downward wage pressure. The emergence of new economies has amplified market competition, generating a deflationary effect on product prices and thus exerting cost pressures on producers. This in turn has affected the wage-determination logic of trade-affected sectors in Japan such that a higher import penetration tends to hold down the average wages in a particular industry (Tachibanaki et al. 1995). Nippon Keidanren has pointed out that high wages in the Japanese manufacturing sector may harm its competitiveness on the global market (Nippon Keidanren 2006a: 46-47). Arguably, low interest rates exert additional downward pressure on wages. From February 1999 to July 2006 (with the exception of the time between August 2000 and March 2001) the Bank of Japan retained a zero-interest-rate policy. The long-term maintenance of low interest rates changes the most cost-minimizing combinations of labour and capital.<sup>43</sup> Theoretically, it adds even further pressure on wages, should companies decide to maintain employment.

### *Greater use of ICT*

The advancement of technologies has changed the organization of work, the demand for professional skills, and thus the nature of employment relationships. Studies revealed that the rapid adaptation to ICT has decreased regular employment and increased outsourcing and reliance on workers made available through temporary-staffing agencies (Abe 2005: 193-223, Higuchi 2001: 323-329). Higuchi, Sunada and Matsuura demonstrated that computerization has proven to be a major regular-employment-saving technological change in all sectors except the machinery manufacturing industry (Higuchi, Sunada and Matsuura 2005: 69-78). Business software packages have helped standardize tasks and lose a great deal of the firm-specific knowledge, experiences and skills that were previously required and constituted an important source of employment security for regular employees.

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<sup>43</sup> The average capital intensity (the ratio of total value of fixed assets to sales revenue) was higher during the "zero-interest-rate" period (1999-2005), as compared to the "post-bubble" economic stagnation period (1991-1998). For the manufacturing sector, this ratio went up from 0.94 to 1.00. Large companies (with capital of more than 1 billion Japanese Yen) recorded an increase in this ratio from 1.05 to 1.14 between the two periods. Since large manufacturing companies increased the capital input (while decreasing the input of labour), capital per employee (the ratio of the total value of fixed assets to the number of employees) recorded 32 per cent increase between the two periods. (Data source: Financial statements statistics of corporations, Policy Research Institute of the Ministry of Finance.)

## Employment portfolio

A policy proposal for human resource management, which was presented by one of the employer's organizations in 1995, modified the traditional employment practices (long-term employment and seniority wages). The Japan Federation of Employers' Associations<sup>44</sup> brought out a proposal for a future employment system - "employment portfolio", which advises member companies on how to optimize the use of regular employees (open-ended contract holders), specialists recruited under fixed-term contracts, and flexible workers such as part-time workers (Japan Federation of Employers' Associations: 1995). Table 2 indicates that companies intended to increase the shares of specialists and flexible workers in their employment portfolio. In fact, the share of regular employees has decreased to less than the two thirds of the employees excluding executives in 2007. This move was facilitated by labour market reforms that eased restrictions on non-regular employment.

**Table 3 'Employment portfolio' in 1995 and 2003 (%)**

Year	Status-quo			Three to five years later		
	open-ended contract holders	Specialist	Flexible workers	open-ended contract holders	Specialist	Flexible workers
<b>1995</b>	81.3	7.1	11.6	70.8	11.2	18.0
<b>2003</b>	75.5	10.7	13.8	63.5	18.6	17.8

Source: The 1995 data is based on a survey by Kanto employer's association. The 2003 data bases upon a survey by Tokyo employer's association. The two data do not bear strict comparison because the companies surveyed were not the same.

## Labour market reforms

Responding to the changes in the financial market and business environment, the Japanese government promoted labour market reforms since the mid-1990s as part of a rigorous policy drive towards relaxation of regulations that evolved in full swing through former Prime Minister Koizumi's structural reform. Reformers have introduced a top-down decision-making approach to labour policy-making, which is markedly different from the long-standing consensus-building approach to labour policy-making (Miura 2005: 169-174). In the traditional approach, tripartite (representatives of workers and employers, and academic experts or practitioners who represent public interests) committees<sup>45</sup> under the Ministry of Health, Labour and Welfare (MHLW) discuss and formulate labour policies (Hamaguchi 2007: 12). In 1995, a sub-committee on relaxation of regulation was formed under the General Administrative Agency of the Cabinet.<sup>46</sup> The

<sup>44</sup> Nikkeiren (Japan Federation of Employers' Associations) and Keidanren (Japan Federation of Economic Organizations) were amalgamated into Nippon Keidanren (Japan Business Federation) in May 2002.

<sup>45</sup> A committee is composed of the same number of members that represent workers, employers, and public interests. Academic experts are often appointed as committee members that represent public interests. Note that the tripartite body does not include government representatives. Prior to a committee meeting, a study group of experts analyzes issues and prepare a report on an agenda item of the committee. Social consensus building has been emphasized in labour policy making (Nakamura 2008: 17-18).

<sup>46</sup> The Cabinet Office since 2001

sub-committee and its successors, enjoying the strong support of the employer's organization, began to devise a reform agenda of the Cabinet. Unlike tripartite committees under MHLW, the sub-committee on relaxation of regulation and its successors tend to be composed of employers and academic experts who stress the market liberalization<sup>47</sup> (Miura 2005: 173). No labour union representative has served as a committee member since April 2001. Miura points out that the relaxation of labour market regulations was achieved fairly quickly since the process bypassed the practice of tripartite discussions in MHLW committees. Furthermore, the Council on Economic and Fiscal Policy<sup>48</sup> (CEEP), a consultative body headed by the Prime Minister, set up an expert group for labour market reform. Faced with these reforms, MHLW and JILPT jointly issued report prepared by academic experts that reaffirmed the importance of having a collective mechanism that brings together workers, employers, and academic experts for the formation of coherent and effective labour and employment policies (JILPT and MHLW 2007: 9-10).

As a result of the deregulation-oriented reforms, labour market policies have been geared towards permitting greater diversity in employment types, and greater flexibility in the labour market. Notably, the labour market reforms eased regulations over temporary employment agencies and fixed contracts. Until MHLW conducted a policy reform in 1985, triangular employment relationships used to be restricted under the Employment Security Law over concerns of potential labour exploitation. At the outset, the range of jobs that could be filled by dispatched workers was strictly limited to 13 different kinds of job. However, 13 more jobs were added to this list in 1996. An amendment passed in 1999 lifted further restrictions on job types with the exception of only five job categories.<sup>49</sup> Another amendment to the law which was enacted in 2004 relaxed the ceiling of the dispatch period and permitted staffing agencies to dispatch workers production lines. These series of reforms have burgeoned the worker dispatch business.

Under Article 14 of the Labour Standard Law the maximum duration of fixed-term employment contracts was restricted to one year. In 1998, an amendment to the Article increased the maximum contract term up to three years for two groups of workers – highly skilled workers and workers aged 60 and above. Another revision to the Article, introduced in 2003 and effective as of 1 January, 2004, further relaxed the ceiling on contract length. This revision allowed for fixed contracts to last as long as three years and changed the ceiling to five years for highly skilled workers and workers aged 60 and above.

The shareholder capitalism, the downward wage pressure, the greater use of ICT, the new policy of 'employment portfolio' and the pro-flexibility labour market reforms led to the increased use of non-regular workers.<sup>50</sup> JILPT noted that "a large number of

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<sup>47</sup> The legitimacy of the political decisions taken by these committees and the transparency in selecting committee member were questioned in a Diet session (Memorandum on questions No.30, 18 December 2006).

<sup>48</sup> The Council is chaired by Prime Minister. It has ten members including Chief Cabinet Secretary, Minister of State for Economic and Fiscal Policy. The Chairperson of the employers' organization is a member of the council.

<sup>49</sup> Port transportation, construction, security, medical work, and manufacturing.

<sup>50</sup> White paper on labour economy 2001 pointed out that innovation in information and communication technology has increased use of non-regular workers because of standardization of tasks. <http://www.hakusyo.mhlw.go.jp/wpdocs/hpaa200101/body.html> [17 January 2008]

companies began actively using non-regular employment as part of their cost reduction initiatives” during the prolonged period of economic stagnation that followed the collapse of the bubble economy (JILPT 2005: 39). The OECD echoed this observation, additionally pointing to further costs that companies could save by hiring non-regular workers who are not covered by enterprise-based social insurance schemes<sup>51</sup> (OECD 2006: 101). Indeed, 51.7 per cent (multiple answers) of companies that hire non-regular workers indicated the saving on wages as a key reason for hiring non-regular workers and another 22.5 per cent gave as primary reason the saving on non-wage labour costs.<sup>52</sup> The flexibility to cope with fluctuations in demand came as the second most frequently cited reason. It is also important to note that the supply side factors have partly driven this increase in non-regular workers.<sup>53</sup> Non-regular workers accounted for more than one-third of the employed in 2007 (not counting those holding executive posts), whereas in 1985 they accounted for 16.4 per cent (Table 4). More than half of the working women in Japan today are non-regular workers, around three-quarters of them are part-time workers.

**Table 4 Increase in the number of non-regular workers (ten thousand persons)**

	Employees, excluding executives (A)	Non-regular staff (B)			Share of non-regular staff (B/A) (%)
		Total	Part-time workers, <i>Arubaito</i> *	Agency workers	
<b>February 1985</b>	3999	655	499	-	16.4
<b>February 1990</b>	4369	881	710	-	20.2
<b>February 1995</b>	4780	1001	825	-	20.9
<b>February 2000</b>	4903	1273	1078	33	26.0
<b>2005 yearly average</b>	5007	1633	1120	106	32.6
<b>2007 yearly average</b>	5174	1732	1164	133	33.5

\* temporary workers most of whom are students  
Source: Labour Force Survey, Statistics Bureau

<sup>51</sup> The Employees’ Pension Scheme and health insurance do not cover almost half of non-regular workers. A third is not covered by employment insurance.

<sup>52</sup> Source: General Survey on diversified Types of Employment 2003, MHLW.

<sup>53</sup> According to General Survey on Diversified Types of Employment 2003 conducted by MHLW, 30 to 40 per cent of contract workers and dispatched workers chose their particular type of employment because they could not find jobs as regular employees. About 40 per cent of contract workers chose their employment type so as to be able to use their specialized skills and job-related certifications. Many married women ostensibly choose part-time work *as a coping strategy* to bring additional income to their household while at the same time managing family responsibilities at home. The perception that married women ‘voluntarily’ choose part-time work is to a certain extent false since their labour market participation behaviour cannot be separated from the expectations of Japan’s social norms in which women play a disproportionately larger role in handling household responsibilities. The time-budget survey results duly reflect these norms. While working women spend 129 and 174.6 minutes per day for housework and care activities in their early thirties and late thirties respectively, men in their thirties spend no more than 10.8 minutes for these household tasks.

### 3.3 Corporate-centred security under strains

The increasing share of workers on precarious contracts has posed a fundamental challenge to corporate-centred security in Japan. Non-regular workers experience a higher turnover (see Annex III) and are often excluded from the labour market security. Changes in the workforce composition, namely the greater labour participation of women and young non-regular workers, called for an overhaul of security provision in the labour market. The following subsections shed light on the decline of the corporate-centred security model due to increasing market pressures.

#### *Women's greater labour participation*

One of the basic assumptions of the Japanese employment system and corporate-centred approach to security in the labour market was that regular and stable employment covers the majority of workers and non-household-heads take up non-standard employment as a buffer to the business cycle. The system implicitly presupposed a male breadwinner with a non-working homemaker, reflecting prevailing social norms and women's marginal position in the labour market. This assumption was evident in the design of social insurance and seniority-based wages alike. The social insurance package covers the employee's spouse unless the spouse's income exceeds a certain threshold.<sup>54</sup> An age-wage profile is often designed so as to sufficiently cover the living expenses of a household. Women's marginal position in the labour market was largely due to the social norm that expected women to take greater responsibility at home and the two-track system of recruitment and placement. Women used to be disproportionately placed on the 'clerical track' (*ippanshoku*) and only rarely on the 'managerial track' (*sougoushoku*), where men dominated (Wirth 2001: 101-102). Human resource management in Japan seems to lack flexibility in accommodating workers' need to combine work and family responsibilities. Adjusting working hours without giving up a regular employment still remains as a challenge. As a result, the typical labour participation pattern for women is that they join the labour force after graduation and withdraw upon marriage or childbirth. They re-enter the market as part-time workers after a long period of a career break.<sup>55</sup> This created a dualistic labour market that assigned non-regular workers a secondary position in the labour market. As more women are joining the labour force<sup>56</sup> and aspire to a professional career, employment practices have to be changed. In fact, the removal of gender biases in the labour market is urgently needed in order to ensure compensation for the impact of a declining working-age population (OECD 2008: 11). Yet, the glass ceiling is quite thick, impeding women's upward mobility in the organization's hierarchy. The far-reaching consequences of male-centred employment practices and norms become obvious with the observation that women occupied only 1.7 per cent of managerial posts in the central government in 2005 and 3.6 per cent in private companies in 2006 (National Personnel Authority and MHLW).

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<sup>54</sup> Dependant spouse of salaried workers in the private sector and government employees (e.g. homemakers) are insured without an obligation to make a premium payment unless their annual income exceeds 1.3 million (USD 11,818) Japanese Yen. Throughout the paper, an exchange rate USD 1 = JPY 110 is applied.

<sup>55</sup> Source: The first longitudinal survey on newborn babies in the 21<sup>st</sup> century, MHLW.

<sup>56</sup> Women's labour force participation rate (age 15-64): 52.5 per cent in 1980, 60.6 per cent in 2006.

## Youth non-regular workers

Non-regular employment has been rapidly diffusing among youth, including non-students (Table 5). Non-regular employment used to be seen as a secondary economic activity aside from main activities (i.e. study, homemaking) to earn supplemental income. This perception has rapidly lost ground in recent years as non-regular employment encroached on a non-traditional pool of workers - the youth. Deficits in regular employment for the youth may have contributed to the diffusion of non-regular employment among the age group. Indeed, unemployment rate for youth is higher than other age groups (Figure 3). Starting a career with non-regular employment poses considerable disadvantages in the career development of young people since, as non-regular workers, their access to training and upward mobility in the labour market remains limited. Table 5 demonstrates the extent of gender bias in flexible employment shown in the incidence of non-regular employment is by far higher among women than among men.

**Table 5 Share of non-regular workers among youth (excl. executives)**

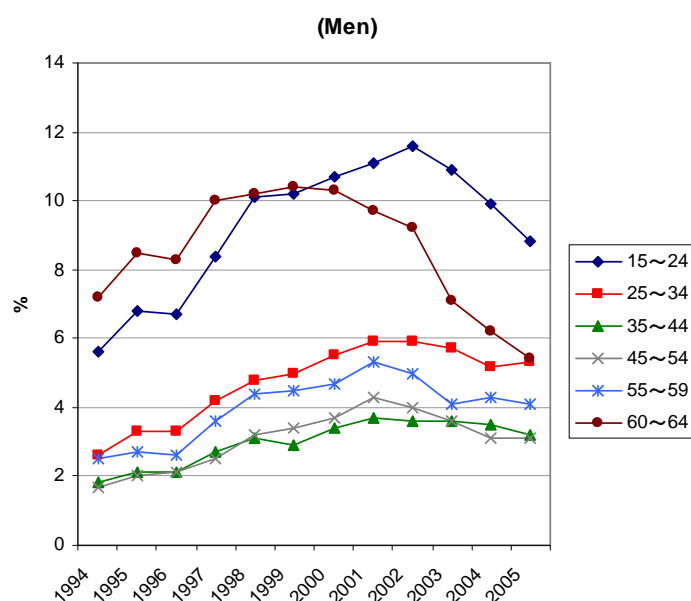
	Men			Women		
	Age 15-24	15-24 (excl. students)	25-34	Age 15-24	15-24 (excl. students)	25-34
<b>1989</b>	20.4%		3.8%	19.9%		24.5%
<b>1991</b>	21.4%		2.8%	20.3%		25.3%
<b>1993</b>	22.5%		3.7%	23.5%		27.1%
<b>1995</b>	23.8%		2.9%	28.3%		26.7%
<b>1997</b>	29.5%		5.1%	34.8%		28.4%
<b>1999</b>	33.7%		6.2%	39.8%		31.6%
<b>2001</b>	41.8%	20.3%	7.1%	44.9%	28.3%	34.9%
<b>2003</b>	41.1%	26.0%	10.1%	49.8%	38.4%	37.7%
<b>2005</b>	44.4%	28.9%	13.1%	51.3%	39.6%	38.3%
<b>2007</b>	45.6%	29.5%	13.9%	50.2%	37.3%	42.4%

Source: Labour Force Survey, Statistics Bureau

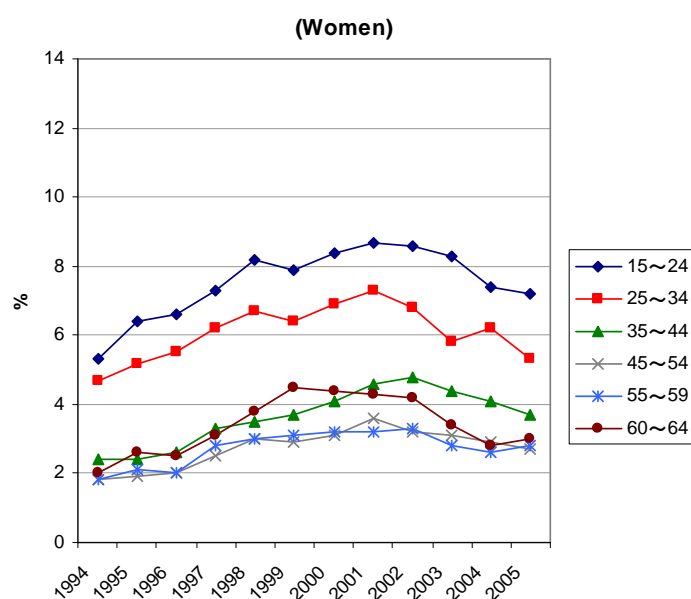
Note: Data between 1989 and 2001 are figures in February. 2003 thereafter, the data represent average figures of the first quarter.



**Figure 3 Unemployment rate by age category**



Source: Labour Force Survey 2006, Statistics Bureau



Source: Labour Force Survey 2006, Statistics Bureau

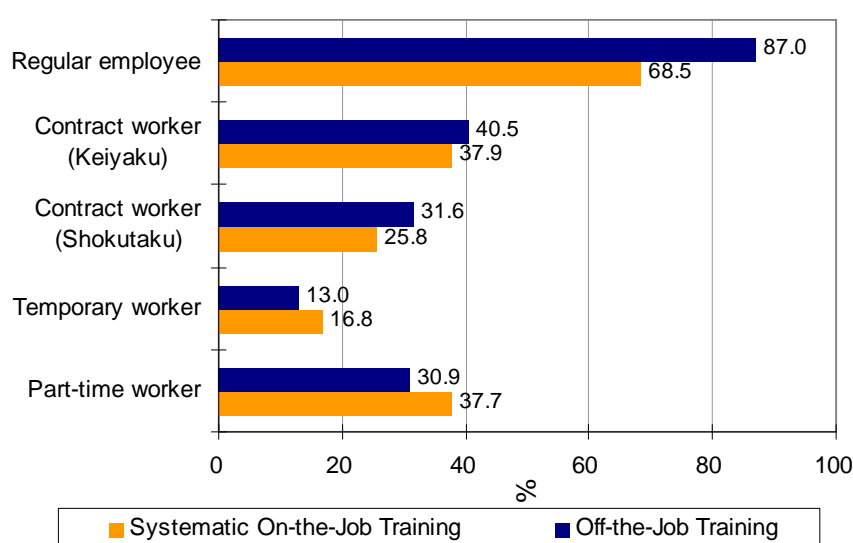
Among young non-regular workers, registered dispatched workers (those who are on the available staff list of an agency but not on the agency's payroll) are particularly vulnerable on the labour market. The number of registered dispatched workers was as high as 652 thousand (full-time equivalent) in 2006. This category of workers faces high income insecurity due to the fact that they are mostly offered short-term employment contracts (at times as short as one day of work) by their respective agencies. According to the MHLW, 81.8 per cent of contracts granted to registered dispatched workers were for employment of less than three months, and 94.2 per cent of contracts were for employment of less than six months in 2006. This precariousness of employment

combined with low wages gives birth to the increasing incidence of working poor in Japan (MHLW).<sup>57</sup>

### *Limited access to training*

Although the MHLW stated that it would be good for the system of human resources development (established under the long-term employment system) to be extended to cover non-regular workers (MHLW 2006: 241), non-regular workers tend to be excluded from training provisions. In Japan, it is the companies not the government that are the key providers of training. In the aftermath of the oil crisis public vocational training was linked to the employment security policy. Between 1978 and 1996, the MHLW supported company skill-development initiatives (Hamaguchi 2004: 178-180). The problem with the company-centred approach to learning and skill acquisition is the way companies choose the training beneficiaries. 70 per cent of part-time workers did not receive Off the Job-Training (Off-JT) and 62 per cent did not receive any On-the-Job Training (OJT) from the company they worked for (Figure 4) in 2006. Since the share of non-regular workers in the labour market has increased, the disproportional distribution of training opportunities may prove to be detrimental for skill enhancement in Japan.

**Figure 4 Job training by employment type (establishment survey)**



Source: JILPT, Survey on Human Resources Management Strategies and Worker's view under diversifying employment types 2006

### *Wage gap*

The limited access to skills development opportunities often leads to a weak wage progression and dismal career prospects. Table 6 demonstrates the distinctive age-wage profiles for regular workers and non-regular workers. The non-regular workers' wage stagnation makes a stark contrast with the regular workers' wage increases. In addition

<sup>57</sup> See: <http://www.mhlw.go.jp/houdou/2007/08/h0828-1.html> [24 March 2008].

to the difference in wage progression, large gaps in hourly wages exist between regular employees and part-time workers. Table 7 shows decomposed hourly wage gaps. The hourly scheduled cash earnings of part time workers are almost half (51.1 per cent) of those of regular employees. The gap widened when special cash earnings (e.g. a bonus) and overtime payments were included in the comparison. The hourly total cash earnings of part time workers fell to 40.3 per cent of those earned by regular employees. This data, however, does not allow for a fair comparison since the jobs occupied by regular employees and part-time workers are often different. Nonetheless, the OECD noted that the gap in hourly earnings between part-time workers and full-time workers in Japan “appears too large to be explained by productivity differences,” and raised concerns over equity in compensation (OECD 2006: 102). 63.0 per cent of part-time workers expressed dissatisfaction with their wages in a recent survey (JILPT 2006b: 102).

**Table 6 Annual cash earnings by age category, gender and employment type**

Age	Regular staff		Non-regular staff	
	Men	Women	Men	Women
<b>20-24</b>	320.8	287.2	255.6 (79.7)	218.9 (76.2)
<b>25-29</b>	414.8	351.5	294.0 (70.9)	238.3 (67.8)
<b>30-34</b>	495.9	385.8	325.3 (65.6)	243.2 (63.0)
<b>35-39</b>	592.5	425.6	336.4 (56.8)	233.2 (54.8)
<b>40-44</b>	670.5	439.1	347.3 (51.8)	223.0 (50.8)
<b>45-49</b>	701.4	428.4	361.1 (51.5)	222.5 (51.9)
<b>50-54</b>	709.0	413.5	328.9 (46.4)	218.3 (52.8)
<b>55-59</b>	662.8	396.4	336.8 (50.8)	214.1 (54.0)
<b>60-64</b>	478.9	342.9	353.8 (73.9)	215.6 (62.9)

Note: Annual cash earnings include contractual cash earnings and special cash earnings  
 Figures in brackets show the ratio of earnings between non-regular and regular workers of the same gender.

Source: Basic Survey on Wage Structure 2005, MHLW

**Table 7 Monthly working hours and wages (2004 average, 1,000 JPY)**

	Total hours worked (hrs)	Scheduled cash earnings	Overtime payment	Special cash earnings	Total cash earnings
<b>Regular employee</b>	170.0	308.6	24.4	80.3	413.3
(per hour worked)	-	1.82	-	0.47	2.43
<b>Part-time workers</b>	95.8	88.7	2.7	2.8	94.2
(per hour worked)	-	0.93	-	0.03	0.98

Source: Monthly Labour Survey, MHLW

Note: Establishments with five or more employees are surveyed

## Low social insurance coverage

Social insurance is intended to protect workers from the various risks in the labour market; however, many non-regular workers are excluded from social insurance (Table 8). The eligibility criteria to access this insurance generally excludes workers whose hours of work are shorter than those of full-time regular employees.<sup>58</sup> Even when they work the same hours as full-time regular workers, 23 to 55 per cent of part-time workers (*paato*, *arubaito*. See Part-time worker II in Table 7) were not covered by social insurance (Table 8). Some non-regular workers are covered by their employed spouse's insurance as long as their annual income is less than 1.3 million Japanese Yen (USD 11,818). However, workers in precarious employment who are covered neither under their own, nor under their spouse's social insurance find themselves in a very vulnerable position; even more so if they are parents. The growing divorce rate<sup>59</sup> implies that more non-regular workers may be left without social insurance, in addition to other difficulties they may be faced with such as finding regular employment.

**Table 8 Social insurance enrolment rate**

	Employment Insurance				Employee Health Insurance			
	Men		Women		Men		Women	
	Married	Single	Married	Single	Married	Single	Married	Single
<b>Contract worker</b>	77	82	80	85	80	82	73	85
<b>Temporary worker</b>	31	17	42	20	26	14	41	19
<b>Part-time worker I*</b>	26	13	40	34	18	6	19	25
<b>Part-time worker II*</b>	69	45	77	72	67	51	67	66
<b>Workers on loan</b>	65	62	83	68	65	77	79	67
<b>Dispatched worker</b>	48	69	67	76	49	70	55	73
<b>Other</b>	78	47	53	61	77	46	47	51
<b>Employee Pension Scheme</b>								
	Men		Women					
	Married	Single	Married	Single				
<b>Contract worker</b>	76	80	72	84				
<b>Temporary worker</b>	19	15	8	17				
<b>Part-time worker I*</b>	9	7	19	24				
<b>Part-time worker II*</b>	60	49	66	65				
<b>Workers on loan</b>	65	76	79	65				
<b>Dispatched worker</b>	47	60	52	69				
<b>Other</b>	72	41	43	50				

\* 'Part-time worker I' refers to worker whose daily hours of work, or weekly days of work are less than those of regular employees. 'Part-timer II' refers to "part-time" workers whose hours of work and work days in a week are almost equivalent to those of regular employees but treated as part-time workers in terms of compensation, training, career opportunities, and so forth.

Source: General Survey on Diversified Types of Employment 1999, MHLW

<sup>58</sup> Workers whose prescribed working hours are less than three quarters of those of full-time regular employees are generally excluded from employees' pension insurance and employee health insurance schemes. Employment insurance does not apply to workers who work less than 20 hours a week, and workers in small enterprises with less than five employees in agriculture, forestry, or the fishing industry.

<sup>59</sup> According to the Japan Institute of Life Insurance, the divorce rate (the number of divorces over the number of marriages per year) reached 37.6 % in 2004. The rate was 18.3% in 1980 and 21.8 % in 1990. (data available online: [http://www.jili.or.jp/lifeplan/event\\_type/lifeevent/mariage/10.html](http://www.jili.or.jp/lifeplan/event_type/lifeevent/mariage/10.html) [13 July 2007].

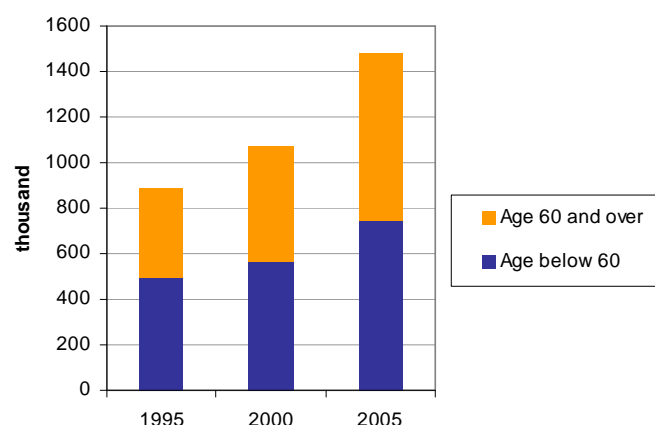
Persons who are not covered by employee's social insurance may be covered by other national insurance schemes (i.e. national pension and national health insurance). Under these insurance plans, workers are responsible for making the full contribution by themselves unlike the enterprise-based insurance scheme in which employers pay half the insurance premium. Making the premium payment in full may be a substantial financial burden for low-income non-regular workers. Besides, as indicated in section 1.7, the national pension alone does not provide a sufficient income to sustain one's livelihood in old age. Efforts to expand the coverage of social insurance schemes meet a strong opposition by the industry. In addressing this issue, however, policy-makers should consider the wider public interests, i.e. the need to prepare for meeting the challenges of a rapidly aging society by providing income security in old age. The incidence of poverty is growing, especially among senior citizens. 49.8 per cent of the livelihood protection beneficiaries registered with the authorities in 2005 were aged 60 and above (Figure 5).

**Table 9 Social insurance enrolment rate of non-regular workers by age category (%)**

Age category	With spouse			Without spouse		
	employment insurance	Health insurance	pension plan	employment insurance	Health insurance	pension plan
<b>Men</b>						
20-24	24	24	24	20	22	21
25-29	57	56	54	59	52	49
30-34	65	64	61	76	73	67
35-39	77	77	75	62	61	61
40-44	73	72	68	43	35	52
45-49	76	78	77	77	78	74
50-54	80	76	73	64	64	63
55-59	81	78	78	50	54	52
60-64	63	54	52	63	47	47
<b>Women</b>						
20-24	32	66	18	46	44	42
25-29	50	37	33	69	63	62
30-34	52	36	35	67	63	61
35-39	51	32	31	67	64	64
40-44	49	31	30	54	50	49
45-49	53	33	33	62	50	47
50-54	56	35	34	60	44	43
55-59	58	38	38	64	55	55
60-64	55	42	42	41	34	27

Source: Nagase, Chapter 7 of the JILPT research report No. 158

**Figure 5 The number of persons receiving livelihood protection**



Source: Basic survey on beneficiaries of livelihood protection, MHLW

### *Weak union representation*

Union representation provides security against the practice of undue dismissal and unreasonable changes to working conditions. It also augments the negotiation power of employees vis-à-vis the employer. Although the estimated unionization rate for part-time workers in Japan is constantly growing, union representation of non-regular workers remains low. In 2006, only 4.6 per cent of part-time workers were represented by a union. Miura points out that in their work unions have prioritized the protection of their regular members, which are most often the regular employees, or the “insiders”, which leaves the insider-outsider (atypical workers) cleavage deep (Miura 2001: 18).

**Table 10 Union representation rate**

Year	Employed (incl. part-time workers)		Part-time workers ( <i>paato, arubaito</i> )		
	The number of employed (incl. part-time workers)	Estimated unionization rate	The number of part-time workers	Of which union members (women)	Estimated unionization rate
	(10 thousand)	(%)	(10 thousand)	(10 thousand)	(%)
2001	5,413	20.7	1,087	28 (25)	<b>2.6</b>
2002	5,348	20.2	1,053	29 (26)	<b>2.8</b>
2003	5,373	19.6	1,089	33 (29)	<b>3.0</b>
2004	5,371	19.2	1,096	36 (32)	<b>3.3</b>
2005	5,416	18.7	1,120	39 (33)	<b>3.5</b>
2006	5,517	18.2	1,125	52 (43)	<b>4.6</b>

Source: Basic Survey on Labour Unions (as of June 30 each year), MHLW

Labour Force Survey, Statistics Bureau

Note: The number of part-time workers for 2001 is the average of February and August of the year

## Low upward mobility

It is ideal if non-regular employment serves as a stepping-stone to stable regular employment; however, evidence suggests that this is not the case in Japan. The limited mobility between non-regular and regular employment highlights the problem of labour market dualism in Japan. The non-regular employment seems to exercise a lock-in effect due to the limited access to training, the lack of established promotion paths and the biases in hiring. As noted earlier in this paper, Japanese employers have largely opted for saving costs by hiring non-regular workers. More than two thirds of the companies that hire non-regular workers have no formal scheme in place to promote non-regular workers to the ranks of regular employees, and the majority of them never promote non-regular workers to the rank of regular worker (Table 11). Although non-regular workers account for a third of the employed (excluding executives) in Japan, recruitment managers still perceive them, rather severely, as ‘second-class’ workers. In a survey<sup>60</sup> by Nippon Keidanren, 24.3 per cent of companies said that they would not consider hiring ‘freeters’ (young part-time workers that are between the ages of 15 and 34, excluding homemakers and students) as regular employees, and 64.0 per cent expressed reluctance about offering an open-ended contract to *freeters*. Another survey conducted by MHLW among hiring managers reported similar attitudes vis-à-vis *freeters*.

**Table 11 Promotion of non-regular workers to regular employee status**

	Have formal system to promote non-regular workers to regular employee status (%)	Have actually promoted non-regular workers to regular employee status (%)
Contract Worker	34.6	30.6
Contract Worker ( <i>shokutaku, re-hired retiree</i> )	7.6	6.4
Part-time workers	19.5	13.2
Part-time workers (long hours of work)	26.5	25.2
Other	22.7	26.7

Source: Survey on fixed-contract work 2005, MHLW

Table 12 corroborates the extent of the above-described lock-in effect of non-regular employment. Only 400 thousand, or 2.3 per cent of non-regular workers, succeeded in switching from a non-regular job to a regular job in 2007. At the same time, 440,000 regular employees became non-regular workers in the same year. Per year, 380,000 (176,700 men and women 203,300) non-regular workers on average found a regular employment, and 465,000 (240,000 men and 225,000 women) regular workers became non-regular workers. The limited upward mobility and the net increase in the number of non-regular workers poses a critical challenge to job-matching since during the same year, 15.5 per cent of all non-regular workers (roughly 2.53 million) wanted to gain regular employment (author’s calculation based on JILPT 2006c: 22, table 17). The percentage is even higher among youth: over 60 per cent of male *freeters* in their

<sup>60</sup> Top-management survey on spring labour-management negotiation, 2006.

twenties and around 50 per cent of female *freeters* in the same age category aspired to obtain open-ended employment contracts<sup>61</sup> (MHLW 2006: appendix 60, table 2-(2)-35).

**Table 12 Labour mobility between non-regular and regular employment (thousand)**

Year		2002	2003	2004	2005	2006	2007
Men	From non-regular to regular	160	170	160	200	190	180
	From regular to non-regular	230	250	270	230	230	230
Women	From non-regular to regular	200	180	190	220	210	220
	From regular to non-regular	240	230	230	210	230	210

Note: Workers who left the former job within the past one year are counted in the table

Source: Labour Force Survey, Statistics Bureau

### 3.4 Socio-economic consequences of unbalanced flexibility and security

Labour market flexibility has been increasing since the mid-1990s while the traditional pattern of security provision has stayed largely constant. This discrepancy has engendered criticism towards the traditional corporate-centred approach to security since the growing number of non-regular workers has remained largely excluded from security provisions. As a result, Japan suffers the negative consequences of unbalanced labour market flexibility such as low consumption growth and wage deflation despite the fact that it is undergoing its longest period of economic expansion in its post-war history, a widening wage gap, and a low birth-rate.

#### *Export-led recovery and weak consumption growth*

The Japanese economy has been expanding moderately since 2002.<sup>62</sup> The rigorous growth in net exports has been the main driver of the long-lasting recovery from the economic stagnation in the 1990s<sup>63</sup> (Figure 6). Net exports recorded a six-fold increase between 2001 and 2006, owing largely to the favorable economic conditions in export destinations and the considerable depreciation of the Japanese yen.<sup>64</sup> During the economic recovery Japanese companies have amplified their ordinary profit.

<sup>61</sup> Those *freeters* who wish to continuously work on the same employment status apparently prefer leisure time (MHLW 2006: appendix 61, table 2-(2)-36). Low wages given to them may influence their hours-of-work decision.

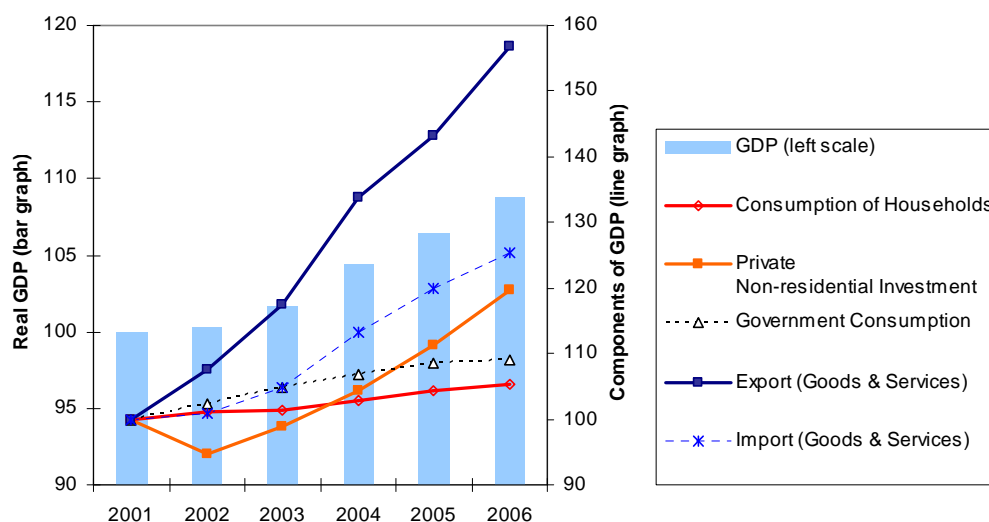
<sup>62</sup> January 2002 was the cyclical bottom. Thus, this paper uses the first quarter of 2002 (or 2001 for annual data) as the basis for economic and labour market performance comparison.

<sup>63</sup> As of March 2008, a threat to the sustainability of this export-led economic recovery emerges with the negative effects of the sub-prime loan crisis in the US on the World economy.

<sup>64</sup> Effective USD/JPY exchange rate of the currency has dropped 16.0 per cent. The rate in January 2007 was 32.4 per cent lower than seven years ago (Source: Bank of Japan).



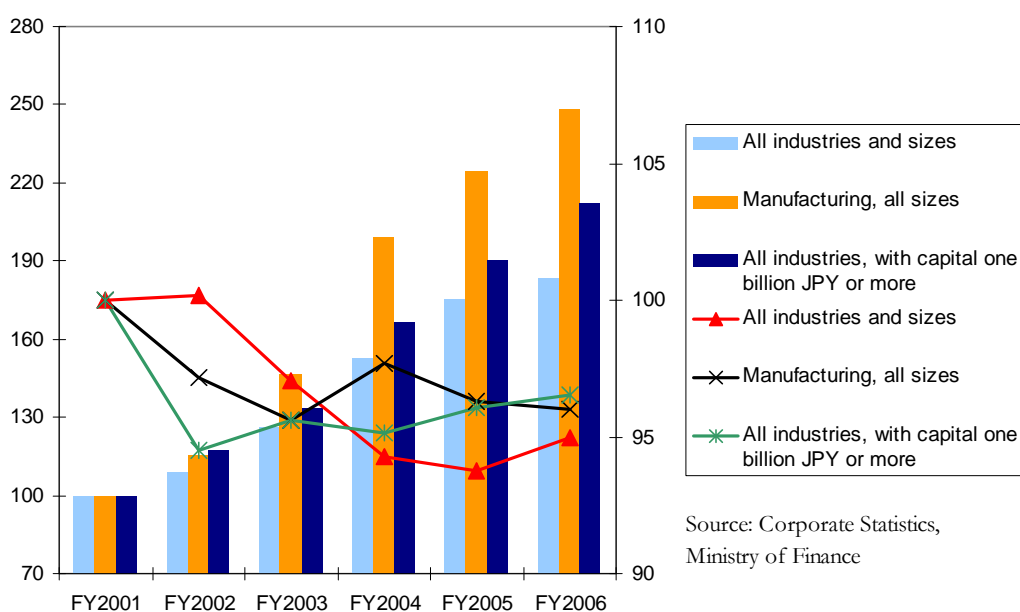
**Figure 6 Annual Real GDP (expenditure approach, Year 2001=100)**



Source: Economic and Social Research Institute, Cabinet Office

**Figure 7 Average ordinary profit and annual employee salary per head, FY 2001=100**

**Ordinary profit (bar graph, left scale) and employee salary (line graph, right scale)**



Source: Corporate Statistics,  
Ministry of Finance

The Bank of Japan projected that the Japanese economy would continue its “sustained economic expansion with a virtuous circle of production, income, and spending in place” for both FY 2007 and FY 2008, counting that the “strength in the corporate sector should filter into the household sector via various channels” (Bank of Japan 2007: 1-2). Diverse factors, however, have prevented the improvement of the household sector. The greatest impediment to the Bank’s scenario has been the clogged

channel between the corporate sector and the household sector (Figure 7). The robust increase in ordinary profit has not been reflected in the salaries of their employees between FY 2001 and FY2006. To the contrary, salaries recorded a negative growth during this time. The consequence of this was a registered decline in the disposable income of workers' households. Between the first quarter of 2002 (the last cyclical bottom) and the first quarter of 2007, disposable income of workers' household dropped by 3 per cent. As a result, consumption expenditure also shrank by 2.7 per cent (Table 13). The drop in disposable incomes is a direct consequence of the wage stagnation (or decline) and increase in the number of low-wage earners.<sup>65</sup> Although trends of real wage growth vary by industry and by company size, the average real total cash earnings (for establishments with five or more employees in all industries) decreased by about two per cent between 2002 and 2005, despite a registered strong labour productivity gain (Table 14). This drop in the share of real labour income (Table 14) signifies income transfer from the household to the corporate sector, largely at the expense of the former (Nomura securities 2007: 4) - the exact opposite of what the Bank of Japan has predicted. The low-wages offered to non-regular workers seem to have offset the positive effects that employment growth was expected to have on the generation of disposable income and household consumption. Workers' households appear to have coped with the decline in disposable income by reaching into their savings. Between the first quarter of 2002 and the first quarter of 2007, the savings of workers' household decreased by 3.2 per cent on average (Table 15). As could be expected, the young workers' households were among those most severely hit by the negative wage growth and their savings reduced substantially.

**Table 13 Workers' household disposable income and consumption expenditure**

(Seasonally adjusted real value per person, Japanese Yen)

	Disposable income	Consumption expenditure
<b>The first quarter of 2002</b>	147,057	103,301
<b>The first quarter of 2007</b>	142,676	101,551
<b>Changes (%)</b>	<b>-3.0 %</b>	<b>-2.7 %</b>

Source: Household survey, Statistics Bureau

**Table 14 Labour productivity and labour income share**

	GDP per hour worked, total economy (constant 1990 US\$ at PPP) (2001=100)					Labour income share (real unit labour costs)				
Year	2001	2002	2003	2004	2005	2001	2002	2003	2004	2005
<b>France</b>	100.0	103.1	104.5	104.9	106.8	67.4%	67.6%	67.5%	67.3%	67.4%
<b>Germany</b>	100.0	101.5	102.7	103.4	104.8	69.5%	68.9%	68.8%	67.6%	66.7%
<b>Japan</b>	<b>100.0</b>	<b>102.2</b>	<b>103.8</b>	<b>107.2</b>	<b>109.4</b>	<b>61.6%</b>	<b>60.2%</b>	<b>59.2%</b>	<b>58.0%</b>	<b>57.9%</b>
<b>UK</b>	100.0	102.6	105.5	108.6	109.8	70.0%	68.9%	68.7%	68.1%	68.9%
<b>US</b>	100.0	103.0	106.1	108.9	110.8	68.2%	67.8%	67.3%	66.3%	65.5%
Source: KILM 5 <sup>th</sup> edition, ILO						Source: OECD online database				

<sup>65</sup> Though favourable economic conditions during the economic recovery increased employment, the employment gain was largely attributable to a significant growth in non-regular employment, which by far outweighed the drop in regular employment. Between 2001 and 2007 regular employment shrank by about 2 million and the number of non-regular employment grew by 3.7 million.

**Table 15 Savings held per household by age group of household head (JPY 10,000)**

Year / age	Average	-29	30-39	40-49	50-59	60-69
2002 Q1	1'313	342	762	1'093	1'705	2'288
2007 Q1	1'271	270	685	1'092	1'597	2'318
Change (%)	-3.2 %	-21.1 %	-10.1 %	0.0 %	-6.3 %	+1.3 %

Note: Savings include deposits, life insurance, and securities. Source: Household survey, Statistics Bureau

### *Increased poverty, social cohesion at risk*

The stagnation in income growth and the increase in the number of low-wage employees seem to have affected the foundations of social development and social cohesion. Recent survey results indicate a widening income inequality and an increasing incidence of poverty<sup>66</sup> (relative poverty). A clear increase is also registered for the inequalities in income distribution as measured by the Gini coefficient.<sup>67</sup> The OECD reported that the relative poverty rate<sup>68</sup> of Japan, which was 15.3 per cent in 2000, by far exceeded the OECD average, 10.6 per cent. A survey<sup>69</sup> by the Tokyo Metropolitan Government revealed a significant increase in the proportion of low-income households in 2006. More than a quarter (27.2 per cent) of households had an annual income of less than three million Japanese Yen (USD 27,273). The increase in relative poverty and the number of low-income households are partly attributable to the increasing share of senior households and atypical workers (OECD 2006: 100, MHLW 2006: 245-246).

The increased incidence of low-wage and unstable jobs among the young generation will most likely have grave implications for the future of the Japanese society. Figure 8 shows that while 59.2 per cent of male regular workers between the ages of 30-34 had a spouse in 2002, the rate was as low as 18.6 per cent for male part-time workers (*paato, arubaito*) in the same age category (MHLW 2006: Appendix 86). As a reason for remaining single, 44.4 per cent of male part-time workers (*paato, arubaito*) cited that they were not financially ready for marriage.<sup>70</sup> This trend is particularly worrying because it accelerates the decline in birth rates and the aging of the Japanese population, further undermining the basis for economic growth and let alone pension schemes. Another concern is that the current income gap may most likely be reproduced in the coming generations via difference in the extent to which parents today are able to invest in their children's education.<sup>71</sup> High income households have increased their educational expenditure over the last decade, widening the gap in educational

<sup>66</sup> An increasing number of people have been receiving livelihood protection, reaching to 1,476 thousands in 2005 almost half of which (49.8 per cent) were aged 60 and above. The figure increased by 404 thousands between 2000 and 2005, despite the economic recovery.

<sup>67</sup> There are four government surveys (Survey on the Redistribution of Income, National Survey of Family Income and Expenditure, Family Income and Expenditure Survey, and Comprehensive Survey of Living Conditions) that measure income disparity and all indicate increasing income gap. See figure 4.A1.1. For details (OECD 2006: 122).

<sup>68</sup> The relative poverty rate is defined as the proportion of the entire population that live on less than a half of median income.

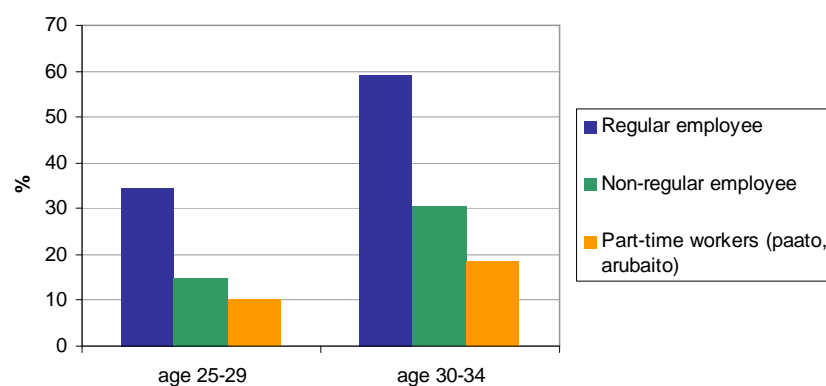
<sup>69</sup> Basic Survey on Welfare and Health, 2006.

<sup>70</sup> Source: White paper on the National lifestyle 2003

<sup>71</sup> The Coleman Report ("Equality of Educational Opportunity") released in 1966 showed that social class and family backgrounds affected students' academic achievements.

investment between high income households and households of middle- and low-income (MHLW 2007: 69). The increase in non-regular employment and its socio-economic consequences calls for an urgent intervention by the Japanese policy-makers.

**Figure 8 Marriage ratio of male workers by employment types**



Source:  
Calculated by MHLW, based on Basic Survey on Employment Structure 2002, Statistics Bureau

## 4. Steps toward Japanese “flexicurity”

In the previous two sections this paper discussed the rise and fall of the corporate-centred security on the Japanese labour market. Japanese companies used to demonstrate a tacit but strong commitment to long-term employment for (male) regular employees. Indeed, security on the labour market was concomitant to the continuous practice of stable employment relationships. Stable employment, however, came under increasing market pressure. The increase in the share of non-regular workers has engendered tensions in the traditional corporate-centred approach to security as it left a large proportion of workers relatively unprotected. This in itself led to the further problems in economic growth and social cohesion. The question is how labour market policies can address these issues and be used to bring about a new flexibility–cum–security balance. This section intends to provide insights into these issues via a cross-country comparison. Achieving an optimal balance between flexibility and security (flexicurity) could be the key to decent work and social justice.

### 4.1 Balancing security and flexibility

The balance between labour market security and flexibility has sparked debates since the 1994 publication of the *OECD Job Study*. Some experts contended that labour market rigidity resulted in higher unemployment and thus deteriorated overall economic performance. The research findings in the IMF’s *World Economic Outlook 2003*<sup>72</sup> serve as an example of this line of argument. However, the findings of a recent OECD study disprove this neo-liberalistic view by pointing out that the employment protection legislation (EPL) had little or no impact on the overall unemployment rate in 1999 and 2002 (OECD 1999, 2002). Auer, Berg, and Coulibaly revealed up to a certain point, there exists a positive tenure-productivity relationship, suggesting that the stable employment has beneficial effects on economic performance (Auer, Berg, and Coulibaly 2005: 327-329). It is a growing consensus that an optimal policy is to provide an adequate level of labour market flexibility and combine this with security supported by active labour market policies (Auer 2007, OECD 2004, European Commission 2006 and 2007).

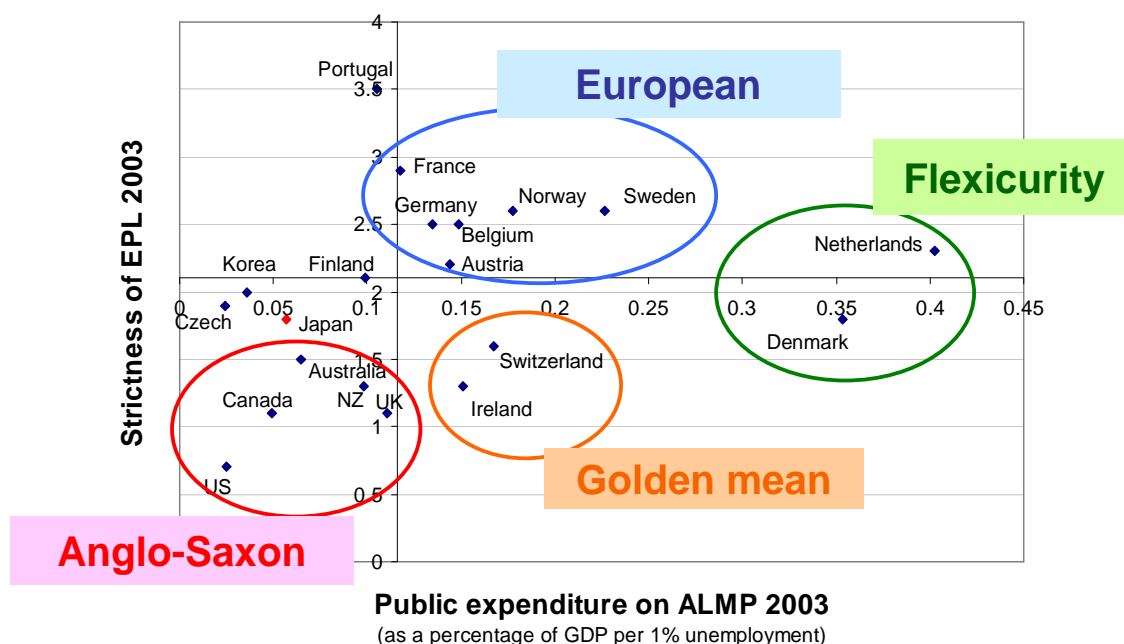
If an optimal balance between the two extremes (flexibility and security) is the desired goal, how can Japanese policy-makers achieve this? What policy directions should Japan take to strike the optimal combination between the two? Figure 9 plots 20 OECD member countries according to public expenditure on active labour market policies (ALMPs) as a percentage of GDP per 1% unemployment rate (a proxy for labour market security) and strictness of EPL (a proxy for flexibility/rigidity). The Anglo-Saxon countries (Australia, Canada, New Zealand, United Kingdom, and United States) cluster together at the lower left hand side (low employment protection and low spending on ALMPs). A number of European states (Austria, Belgium, France, Germany, Norway, and Sweden) that combine higher employment protection with higher expenditure on ALMPs (as compared to that of Anglo-Saxon countries) are plotted at the upper middle on the chart. Denmark and the Netherlands are the countries known to epitomize the “flexicurity” model by combining a moderate level of

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<sup>72</sup> In the report, the IMF argued that if euro area labour markets adopted US-style labour market, GDP in the area would be pushed up by 5.6 per cent in the long run (IMF 2003: 143-144).

employment protection (among the 20 countries compared) and a greater commitment to ALMPs. Switzerland and Ireland are found in the middle of the three clusters (Anglo-Saxon, Europe, and Flexicurity), thus their cluster is named “Golden mean.” Japan<sup>73</sup> is just above the Anglo-Saxon cluster.

**Figure 9 Flexicurity mapping of 20 selected OECD countries**



If the unemployment rate and the employment-to-population ratio are taken as indicators for labour market performance, then it could be concluded that the European cluster suffers from a relatively low labour market performance (Table 16. For figures of each country, see Annex IV). The Flexicurity cluster performs better than other clusters in terms of labour market performance, confirming Auer’s findings that moderate employment protection and stronger active labour market policies succeed in creating a dynamic and inclusive labour market (Auer 2005, 2007).

**Table 16 Labour market performance of each cluster (2003), weighted average by total employment**

	Unemployment rate (%)			Employment-to-population ratio (%)		
	Total	Youth (age 15-24)	Long-term (1 year or longer)	Men and women	Men	Women
<b>Anglo-Saxon</b>	6.0	12.3	0.8	61.3	67.9	55.0
<b>Europe</b>	8.5	14.6	3.9	51.9	59.0	45.3
<b>Golden mean</b>	4.4	8.2	1.3	62.6	71.8	54.0
<b>Flexicurity</b>	4.1	8.3	1.0	61.2	69.1	53.5
<b>Japan</b>	5.3	10.1	1.7	57.9	70.4	46.2

Source: ILO

<sup>73</sup> Japan’s relatively low expenditure on ALMPs reflects the fact that companies are the key providers of training in Japan.

As for labour productivity measured by GDP per hours worked (constant 1990 US\$ at PPP, total economy), all clusters show similar results,<sup>74</sup> with somewhat low figure for the Golden mean cluster (Table 17 and Annex IV). Japan's labour productivity is particularly low partly because of Japan's long working hours. Workers in the Anglo-Saxon countries and Japan work considerably longer than workers in the European and Flexicurity cluster. The difference in annual working hours between the Anglo-Saxon cluster and the Flexicurity cluster is over 360 hours. Inequality in income distribution (after tax and income re-distribution) measured by the Gini coefficient indicates that the European cluster and the Flexicurity cluster distribute income more equitably, whereas the Anglo-Saxon cluster, the Golden mean cluster and Japan show intensified disparities in income distribution. The level of equality in income distribution depends to a great extent on the taxation schemes and social policies in place, making it harder to determine the effects of active labour market policies and employment protection on income distribution. Nonetheless, theoretically, one could contend that a greater public commitment to career counselling, training, and servicing for employment placement, would enable people to get better jobs and move upward in the labour market, narrowing the income gap from the bottom.

**Table 17 Labour market and social indicators of each cluster**, weighted average by total employment

	<b>Labour productivity</b>	<b>Annual hours worked</b>	<b>Inequality in income distribution</b>
<b>Anglo-Saxon</b>	31.9	1777.8	0.345
<b>Europe</b>	30.8	1492.1	0.277
<b>Golden mean</b>	27.6	1649.2	0.327
<b>Flexicurity</b>	30.6	1411.5	0.244
<b>Japan</b>	23.6	1798.6	0.314

Labour productivity: GDP per hour worked (constant 1990 US\$ at PPP) total economy, year 2003, Source: KILM 5<sup>th</sup> ed., ILO  
Annual hours worked: Annual number of hours worked per person, Source: KILM 5<sup>th</sup> ed., ILO  
Inequality in income distribution: Gini coefficient (after tax and income re-distribution, total population) Year 2000, Source Forster and Mira d'Ercole, For Belgium and Switzerland, data is taken from WDI.

Overall, it appears that the Flexicurity cluster performs better than other clusters. It possesses dynamic and inclusive labour markets with high labour productivity and shorter annual working hours, and egalitarian income distribution (see Auer 2007). It is not surprising that the European Commission adopted 'common principles of flexicurity' and guides its member states to combine flexicurity and security in working arrangements (European Commission 2007)

<sup>74</sup> The U.S. boasts the highest GDP per person employed in 2003 (constant 1990 US\$ at PPP). Labour productivity per capita: the Anglo-Saxon cluster USD 27,027; the European cluster USD 20,424; the Golden mean cluster USD 23,008; the Flexicurity cluster USD 22,453; and Japan USD 21,021.

## 4.2 Policy directions

Following from the above, Japan should be aiming for an enhanced labour market security backed by a greater government commitment to active labour market policies. Indeed, market liberalization and the pro-flexibility labour market reform have exposed the Japanese employment system to market pressures with the share of workers generally left out of security surpassing one third of the employed. It is high time that Japan reviewed the balance between security and flexibility in the labour market<sup>75</sup> and redressed labour market segmentation.

### *Flexibility*

Labour market policies ideally facilitate the economy's adaptation to changes in the business environment and the technology as they take place. Quick adaptation to these changes requires a new set of skills and a reallocation of available resources. Companies alone may not be able to bear the burden of adjustment, let alone individual workers. Thus, adequate state policies need to be in place in order to allow for the society and business to cope better with the changing business environment and incessant technological innovations. Policies should be tailored to assist resource reallocation and to mitigate negative developments associated with the changes. The MHLW has already initiated a reform of the employment insurance scheme (since 2004) that shifts the focus: 1) from supporting employment maintenance to supporting labour movement, 2) from subsidizing hiring to resolving the mismatch between labour supply and demand, and 3) from livelihood support to supporting re-integration into the labour market. Dialogue with social partners and their cooperation seems an essential element conducive to the successful implementation of this new set of policies.

It should be stressed that coping with changes does not necessarily mean reducing employment protection or encouraging employment turnover. It should be kept in mind that hiring/firing is not the only adjustment method available. This paper demonstrated that Japan has excelled in the exercise of internal/functional flexibility. Stable employment–cum-investment in employees' human capital has been a key for Japanese companies to master new skills and to implement modern production technologies (Becker 1993: 24). Indeed, the European Commission promotes internal adjustment (the adjustment of work organization and working hours within the company to the business cycle) among EU member states. Reducing employment protection and realizing a flexible labour market (as seen in the discussed Anglo-Saxon countries) may not be the optimal solution for Japan. It should be emphasized that external flexibility alone might not lead to high labour market and socio-economic performance.

It is a common misconception that regular employees in Japan enjoy a level of employment protection so high that it introduces rigidity in the labour market. In contrast with this conviction, the OECD has ranked Japan among the average in terms of strictness of employment protection legislation for regular employment. It is rather the social norms that respect a trade-off between functional, internal, and wage flexibility and employment security that restrict dismissal from employment. In fact, regular employees contribute to higher functional/internal flexibility<sup>76</sup> in exchange for

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<sup>75</sup> Wilthagen mapped out practical pathways to realize an optimal balance of flexibility and security in the labour market (see Wilthagen 2008).

<sup>76</sup> Regular employees accept long overtime work, job re-assignment, and geographical relocation. Wage flexibility is also high in Japan. Internal flexibility results in excessively long working hours for certain



employment security (Passet 2003: 159), and employers respect this subtle transaction balance. The observation that the high employment protection enjoyed by regular employees forces employers to rely increasingly on non-regular workers to earn numerical/external flexibility (OECD 2006: 116) is also not accurate. Again, the principle reason for hiring non-regular workers is to save costs, both wage and non-wage. Downward cost pressure from the market, combined with a weak anti-discrimination legislation and ineffective union opposition in Japan, has allowed the expansion of atypical employment not covered by security schemes. Ensuring equity in treatment among all types of workers and expanding social security coverage would more effectively reduce the incentive for hiring non-regular workers as well as redressing inequalities and relative poverty.

## Security

As increased pressures for cost efficiency and workforce adjustment have a perceivable impact on employment relationships, workers, and especially vulnerable non-regular workers, should be provided with reinforced labour market security. Such measures can include the provision of access to training, social security, and protection against discrimination. As discussed in the introduction of this paper, the described labour market security is different from job/employment security as it combines employment security with social protection.

The current labour market institutions in Japan, however, seem not to be very well equipped to provide an effective response to the market influences on employment. Non-regular workers tend not to benefit from training and social insurance because of the specificity of the labour market structure and employment practices that sharply divide open-end contract holders and other workers. Besides, the emphasis on active labour market policies (ALMPs) in terms of resource allocation remains feeble in Japan as compared to other countries. The government expenditure on labour market policies ranked among the lowest (Table 18) among OECD countries in 2005. A similar conclusion can be obtained when one compares the government expenditure on public training as percentage of GDP per one per cent of unemployment (Table 19). It appears that the public employment service office in Japan is understaffed since the average number of jobseekers handled by a PES staff member is larger than the average number of comparable countries for which data is available (Table 20).

A recent reform initiative has re-affirmed the state's role in public employment services. The Council for Regulatory Reform and its successor body proposed the partial privatization of the public employment security office with the aim of improving the quality of its services while cutting costs. An evaluation provided by an appointed committee<sup>77</sup> revealed that private companies perform below state agencies and cost more (Evaluation committee of market tests: 2007 and 2008). The findings of the evaluation re-affirmed that the state plays a key role in the provision of vocational training and employment placement services. Indeed, as stipulated in the ILO Employment Service

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categories of regular workers. According to the Labour Force Survey, 25.1 per cent of Japanese employees (men and women) and 34.9 per cent of male workers in non-agricultural sectors worked over 49 hours a week. 21.7 per cent of male employees in their 30s and 20.2 per cent of those in their 40s worked more than 60 hours per week.

<sup>77</sup> Reports of evaluation committee of market tests are downloadable at <http://www.mhlw.go.jp/houdou/2007/11/h1126-2.html>, and <http://www.mhlw.go.jp/houdou/2008/03/h0325-1.html> [13 March 2008]

Convention the principal responsibility for providing free public employment services rests with the government (C88, 1948 - ratified by Japan in 1953). The Government of Japan is required under this Convention to ensure effective recruitment and placement for job seekers, especially those belonging to particularly disadvantaged groups. The number of staff and the budget for ALMPs need to be sufficient in order to fulfil the functions and roles demanded under the Convention.

**Table 18 Public expenditure on labour market policies, as a percentage of GDP, 2005**

Country	Active measures	Passive measures	Country	Active measures	Passive measures
<b>Denmark</b>	1.74	2.51	<b>Italy</b>	0.54	0.82
<b>Belgium</b>	1.08	2.37	<b>Australia</b>	0.45	0.61
<b>Netherlands</b>	1.33	2.02	<b>Canada</b>	0.32	0.62
<b>Germany</b>	0.97	2.35	<b>New Zealand</b>	0.39	0.44
<b>France</b>	0.9	1.62	<b>Japan</b>	0.25	0.43
<b>Sweden</b>	1.32	1.2	<b>UK</b>	0.49	0.19
<b>Spain</b>	0.78	1.45	<b>US</b>	0.13	0.24
<b>Switzerland</b>	0.76	0.93	<b>Korea</b>	0.13	0.22
<b>Ireland</b>	0.63	0.83	<b>OECD average</b>	0.64	0.97

Source: OECD

**Table 19 Public expenditure in training (as a percentage of GDP per 1% unemployment)**

<b>Denmark</b>	1.00
<b>The Netherlands</b>	0.78
<b>Sweden</b>	0.55
<b>Germany</b>	0.38
<b>France</b>	0.32
<b>UK</b>	0.28
<b>Spain</b>	0.15
<b>US</b>	0.09
<b>Japan</b>	0.09

Source: OECD Employment Outlook 2006

**Table 20 Public employment services (PES), 2003**

	Number of PES staff working directly with job seekers and employers	labour force per PES staff	Unemployed per PES staff
<b>Denmark</b>	1'500	1'906	103
<b>Finland</b>	2'600	999	90
<b>Germany</b>	12'500	3'160	293
<b>Japan</b>	15,000*	4'428	209
<b>Portugal</b>	2'100	2'576	164
<b>Switzerland</b>	1'516		113
<b>United Kingdom**</b>	16'300		87
<b>Average (excl. Japan)</b>			142

\* Of which around 9,000 were on non-regular contract. Data as of March 2005 (Source: Cabinet Office).

\*\* Data as of March 2007. The number of personal advisors, financial advisors, contact centre staff, and floor managers of Jobcentre Plus is counted as PES staffers in this table.

Source: World Association of Public Employment Services (WAPES) and KILM 5th ed., ILO.

If the government alone cannot meet the increasing demand for a new type of labour market security, then it seems vital that the government, together with social partners, discusses, re-designs and implements the new labour market security, by mobilizing the instruments and resources of the society. As for training, social partners and other bodies such as the chamber of commerce, municipal offices, universities and civil society organizations may provide training<sup>78</sup> at sectoral, regional and/or community level, reflecting the skill in demand. It is, of course, desirable that companies commit to the provision of training. As for income security, it is necessary that a greater number of workers are covered by social insurance. If non-regular workers are to be left without social insurance, other means of income security may be desirable. The compensation for unstable employment provided in France (*Indemnités de fin de mission* and *indemnités compensatrice de congés payés*) may serve as an example.

At the same time, the Japanese government could consider reinforcing its efforts to fight discrimination and to overcome labour market segmentation between regular employees and non-regular workers. Policy interventions seem to be an appropriate means of promoting and ensuring equality of treatment in dealing with persons employed under different job types; as well as resolving the 'lock-in effect' of non-regular employment. The OECD pointed out that the difference in productivity would not explain the gap in earnings per hour between full-time and part-time workers in Japan (OECD 2006: 102). If this cannot be negated, social partners are also expected to take action to correct such practices of discrimination in the labour market. To this end, the government has already amended (in 2007) the Part-time Work Law<sup>79</sup> in order to encourage the equitable treatment of part-time workers.<sup>80</sup> JTUC-RENGO, the largest Japanese trade union confederation, has set up a non-regular work centre that exclusively addresses various treatment issues confronting non-regular workers. Some companies have already begun upgrading non-regular workers to the rank of regular employees in order to retain an able work force. Social partners and the government need to continue these positive steps towards bridging the gap in treatment between non-regular workers and regular employees.

Overall, labour market institutions need to evolve as the labour market environment changes. Globalization, the advancement of technology and shareholder capitalism have intensified market pressure on employment in Japan. The labour market policy response to this development should be two-fold: facilitating resource reallocation and enhancing labour market security for all workers, especially for vulnerable groups. To this end, scaling up ALMPs appears to be the correct policy approach. The idea of flexicurity, striking an optimal balance between labour market flexibility and security with fairer distribution of security among all categories of workers (European Commission: 2006), may serve as a model for policy discussion. Another dimension of changes that requires adjustment of labour market institutions is the greater labour participation of women. Human resource management practices and social insurance schemes can no longer assume a male bread-winner-model as the norm. They should be gender-neutral and accommodate workers' needs to balance professional and family responsibilities.

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<sup>78</sup> Training outside companies cannot foster firm-specific skills. Thus effects of the public training on firm's productivity need to be moderately estimated (Fujikazu Suzuki: remarks in a meeting on 28 September 2007)

<sup>79</sup> The Part-time Work Law came into effect on 1 April 2008.

<sup>80</sup> The Law defines part-time workers as workers whose prescribed hours of work are shorter than regular employees in the same establishment. Thus the law applies to all workers other than part-time workers (i.e. contract workers).

## 5. Conclusion

The paper analyzed the Japanese labour market in terms of its flexibility and security distribution. In the first two sections it discussed the rise and the fall of the corporate-centred approach to security in the Japanese labour market. Indirect finance, stable and non-intervening shareholders, employment policy and judicial precedents that encouraged employment maintenance by companies have shaped the Japanese employment system in a way that protected regular employees from market pressure in the past. Indeed, Japanese companies used to demonstrate a tacit but strong commitment to long-term employment for (male) regular employees. Conditions, however, changed employment relations in order to reflect the increasing influence of market pressures as employers shift part of the burden of overcoming market challenges onto their employees. The emphasis on employability, the changing pattern of profit distribution to the favour of shareholders, the shift from defined-benefit to defined-contribution pension plans, the trend towards performance pay and the increasing use of cost-saving non-regular workers imply the extent to which the market exercises an influence on employment in Japan. With the changes in corporate finance and governance as well as the greater use of ICT technology, employers have started to combine various types of employment in order to become more cost-efficient and adaptable to an ever-changing business environment. The labour market reforms that increased flexibility in employment have been conducive to this transition. Today, more than a third of Japanese employees work on non-regular contracts and are largely excluded from the traditional corporate-centred security. Labour market segmentation is severe in Japan since the treatment gap between the two groups of workers remains large and mobility between the two is very low. Clearly, this undermines the consumption growth potential, which in itself limits the economic growth. The ‘lock-in’ effect of non-regular employment affects not only the income distribution, but also the career prospects of youth and population growth. These negative socio-economic consequences call for redressing the unbalanced distribution of flexibility and security in the labour market.

The increasing number of studies and the cross-country comparison presented in section 3 indicate that through the optimal combination of labour market security and flexibility a higher labour market performance and better socio-economic outcomes can be achieved. From these findings it follows that, in order to achieve decent work and social justice, one policy direction that Japan could take is to enhance labour market security, especially for non-regular workers. Policy-makers could consider shifting the focus of policies from supporting employment maintenance to providing employment security and social protection to all workers. This policy change would both counterbalance the increasing market pressure in the sphere of employment and facilitate the necessary adjustment and resource reallocation. This policy proposal does not advocate the creation of a flexible labour market with high employment turnover. Japan combines an average level of employment protection legislation to regular employees (in comparison with other OECD members) with a unique but effective set of employment adjustment methods. The resulting high internal/functional flexibility and employment protection must, of course, remain at the core of the system. A greater public commitment to active labour market policies (ALMPs), however, is required in order to enhance labour market security to cover those categories of workers that do not enjoy its provision at present. Nevertheless, it appears that Japan’s current resource allocation to ALMPs stands at a suboptimal level from the analysis provided in section 3.2. Social dialogue and social partner’s cooperation may be helpful in filling the gap. In addition, labour market segmentation between regular employees and non-regular workers calls for further policy interventions and social partners’ action in order to redress discrimination in the labour market.

In conclusion, the general policy recommendation for Japan yielded through this analysis is to engage in building labour market institutions for the greater provision of labour market security, in order to respond to both the business environment of today and to the urgent need to redress labour market segmentation. Since market mechanisms alone cannot strike a desirable balance between security and flexibility, a ‘visible hand’, shaped by the well-coordinated efforts of the government and social partners, is required.

## Annex I: Employment types in Japan

Employment types have diversified in recent years as flexible forms of employment have increased. Definitions for each employment type listed below are the ones used by the Ministry of Health, Labour, and Welfare (MHLW). The paper follows the definition unless otherwise specified.

Employment Type (Japanese)	Definition
Regular worker ( <i>Seishain</i> )	Employee whose term of employment is not fixed, excluding part-timers, workers on loan, etc.
Non-regular worker ( <i>Hi-Seishain</i> )	Employee/worker other than regular employees
Contract workers ( <i>Keiyaku Shain</i> )	Employee with a fixed contract. Contract employees usually are engaged for their special skills for a fixed amount of time.
Contract workers ( <i>Shokutaku Shain</i> )	Employee re-employed after retirement by a fixed contract.
Workers on loan from other companies ( <i>Shukkou Shain</i> )	Employee sent to another company based on a temporary transfer contract from a parent company.
Dispatched workers ( <i>Haken Roudousha</i> )	Temporary staff dispatched by employment agency permitted by the Worker Dispatch Law. “Registered dispatched workers” are enrolled on a job agency’s available staff list but not on the agency’s payroll “Hired dispatched workers” are employed by a job agency and are dispatched into other companies.
Temporary workers ( <i>Rinjiteki Koyousha</i> )	Worker with a contract less than one month or worker hired on a daily basis.
Part-time workers ( <i>Paato, Arubaito</i> *)	Worker whose daily hours of work, or weekly days of work are less than those of regular employees. Terms of employment exceed one month, or have no limitation.
Other	Workers other than above

The definition of a part-time worker, however, requires caution since appellation sometimes defies actual employment status and working conditions. In fact, 27 per cent of workers called ‘part-time workers’ (*paato* or *arubaito* in Japanese) at their workplaces work more than 35 hours a week (Statistic Bureau, Basic Survey on Employment Structure 2002). Though it sounds contradictory, there exist quasi-full-time part-time workers and they are compensated in many cases less favourably than regular workers. Some 1,087 thousand workers called *paato* or *arubaito* worked more than 35 hours a week and more than 250 days a year, which is equivalent to full-time regular work. Therefore, a threshold of working hours (e.g. 35 hours per week) may not clearly distinguish part-time workers from regular workers. Surveys carried out by the Statistics Bureau (Labour Force Survey and Basic Survey on Employment Structure) define part-time workers (*paato* or *arubaito*) as those who are called as such at their workplaces. Surveys by MHLW (e.g. Employment Trend Survey, Monthly Labour Survey) classify part-time workers as listed in the table above.

## Annex II: Employment insurance

The replacement rate of basic allowance ranges from 45 to 80 per cent. A cap is imposed upon daily basic allowance by age category (i.e. those below age 30: JPY 6,395, age 30-44: JPY 7,100, age 45-64: JPY 7,810, age 60-64: JPY 6,808). The maximum duration of the allowance is longer for those who have difficulties in finding a new job (e.g. disabled people), and those who lost their job due to involuntary separation (e.g. bankruptcy, dismissal for company's economic reasons). The basic allowance is not payable during the initial seven days of unemployment. Those who voluntarily quit a job have a waiting period of one to six months before they start to receive the allowance.

### Replacement rate of basic allowance (as of 1 July 2007)

Daily wage	Replacement rate	Daily basic allowance
1) Age below 60		
JPY 2,080 – 4,100	80%	JPY 1,664 – 3,280
JPY 4,100 – 11,870	50 – 80%	JPY 3,280 – 5,935
JPY 11,870 – 15,620	50%	JPY 5,935 – 7,810
2) Age 60 - 64		
JPY 2,080 – 4,100	80%	JPY 1,664 – 3,280
JPY 4,100 – 10,640	45 – 80%	JPY 3,280 – 4,788
JPY 10,640 – 15,130	45%	JPY 4,788 – 6,808

Source: MHLW

### Duration of basic allowance payment (days, as of 1 July 2007)

Age / Years insured	less than 1	1-4	5-9	10-19	Over 20
a) Separation due to bankruptcy, dismissal, etc.					
Less than 30	90	90	120	180	-
30-34	90	90	180	210	240
35-44	90	90	180	240	270
45-59	90	180	240	270	330
60-64	90	150	180	210	240
b) Voluntary separation					
All age categories	90	90	90	120	150
c) Those who have difficulties in finding employment (i.e. disabled people)					
Less than 45	150	300	300	300	300
45 - 64	150	360	360	360	360

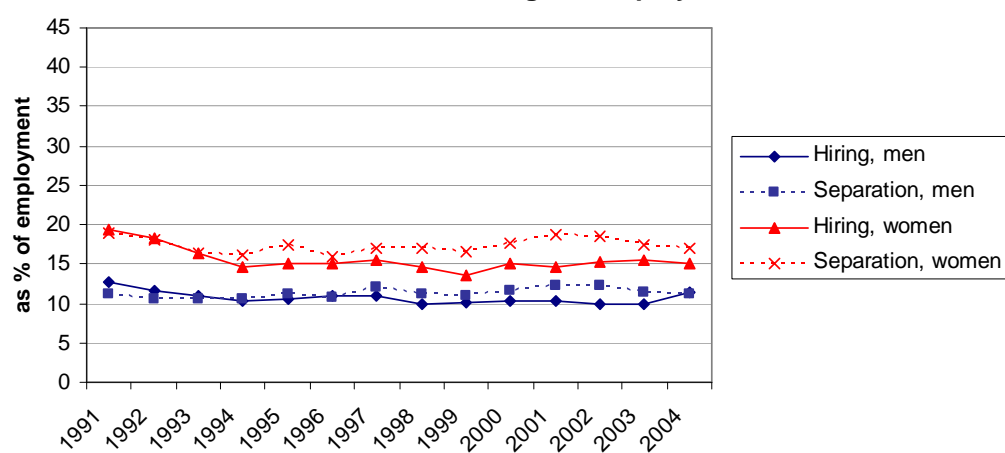
Source: MHLW

## Annex III: Average employment tenure and labour turnover

Age / Year	Men				Women			
	1995	2000	2005	Changes 95-005	1995	2000	2005	Changes 95-05
20~24	2.7	2.7	2.3	-0.4	2.7	2.4	2.1	-0.6
25~29	5.1	5.2	4.8	-0.3	5.2	5.3	4.5	-0.7
30~34	8.5	8.4	8.2	-0.3	7.7	8.1	7.3	-0.4
35~39	11.9	12.0	11.7	-0.2	9.3	9.8	9.4	0.1
40~44	15.8	15.3	15.2	-0.6	10.5	11.0	10.5	0.0
45~49	19.3	19.2	18.6	-0.7	11.2	12.7	11.9	0.7
50~54	22.1	22.1	21.7	-0.4	13.0	14.1	13.7	0.7
55~59	21.8	22.5	22.6	0.8	14.4	15.6	15.5	1.1
60~64	13.4	13.7	14.5	1.1	13.3	14.4	14.3	1.0

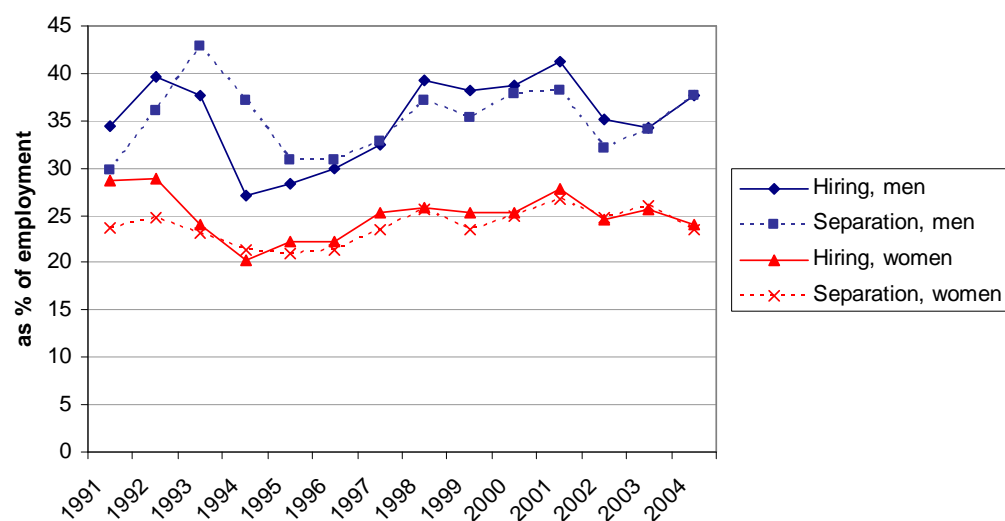
Source: Basic wage structure survey, MHLW

Labour turnover: regular employees



Source: Employment trend survey, MHLW

Labour turnover: non-regular employees



Source: Employment trend survey, MHLW



## Annex IV: Labour market and socio-economic performances of each cluster (cluster average: weighted average by total employment)

	ALMP	EPL*	Unemployment rate (%)			Employment-to-population ratio			Annual number of hours worked per person	GDP per hour worked (constant 1990 US\$ at PPP) Total economy	Gini coefficient (multiplied by 100), Total population
	Public expenditure on ALMP as a percentage of GDP per 1% unemployment	Strictness of EPL (v2) All jobs	Total	Youth (age 15-24)	Long-term (1 year or longer)	Total	Men	Women			
ANGLO-SAXON											
Australia	0.064	1.5	5.9	12.2	1.3	59.0	66.5	51.7	1729.5	27.5	30.5
Canada	0.049	1.1	7.6	13.6	0.7	61.8	67.4	56.5	1734.0	27.0	30.1
New Zealand	0.098	1.3	4.6	10.2	0.5	63.0	70.5	55.9	1812.6	20.2	33.7
United Kingdom	0.110	1.1	4.9	11.5	1.1	59.3	66.6	52.5	1676.8	28.6	32.6
United States	0.025	0.7	6.0	12.4	0.7	61.8	68.3	55.5	1806.0	33.6	35.7
cluster average	0.042	0.8	6.0	12.3	0.8	61.3	67.9	55.0	1777.8	31.9	34.5
EUROPE											
Austria	0.144	2.2	4.3	6.5	1.1	56.7	65.5	48.5	1641.5	30.2	25.2
Belgium	0.149	2.5	8.2	19.0	3.5	47.2	55.6	39.4	1575.0	32.6	33.0
France	0.118	2.9	9.0	21.5	3.8	49.3	56.3	42.9	1529.8	34.1	27.3
Germany	0.134	2.5	9.3	10.6	4.9	52.0	59.4	45.1	1439.0	28.3	27.5
Norway	0.178	2.6	4.5	11.7	0.3	63.8	68.3	59.4	1398.6	36.4	36.1
Sweden	0.227	2.6	5.6	13.8	1.0	60.0	63.5	56.6	1562.3	28.4	24.3
cluster average	0.137	2.6	8.5	14.6	3.9	51.9	59.0	45.3	1492.1	30.8	27.7
GOLDEN MEAN											
Ireland	0.151	1.3	4.7	7.6	1.6	57.0	67.1	47.2	1671.0	32.6	30.4
Switzerland	0.167	1.6	4.3	8.5	1.1	65.2	73.9	57.1	1639.3	25.4	33.7
cluster average	0.162	1.5	4.4	8.2	1.3	62.6	71.8	54.0	1649.2	27.6	32.7
FLEXICURITY											
Denmark	0.354	1.8	5.4	9.8	1.1	62.1	68.1	56.3	1552.4	29.2	22.5
Netherlands	0.403	2.3	3.7	7.8	1.0	60.9	69.5	52.6	1363.0	31.1	25.1
cluster average	0.390	2.2	4.1	8.3	1.0	61.2	69.1	53.5	1411.5	30.6	24.4
Japan											
	0.057	1.8	5.3	10.1	1.7	57.9	70.4	46.2	1798.6	23.6	31.4
Data source	OECD	OECD	OECD	ILO	ILO	ILO	ILO	ILO	OECD	ILO	OECD
Year	2003	2003	2003	2003	2003	2003	2003	2003	2003	2003	2000

EPL: Employment Protection Legislation  
WDI: World Development Indicator, World Bank

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