

Japan's "Flexicurity" Approach:

Reforming labor market institutions with a focus on security, training, and flexibility



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Profile

Dr. Tsuru joined RIETI in 2001 and serves as Senior Fellow. His expertise covers Japan's corporate governance, financial system, bank behavior, employment system and political economics. Prior to his current post at RIETI, he was Research Economist at the Institute of Monetary and Economic Studies, Bank of Japan (2000-'01); Staff Economist, Economics Department, OECD, Paris (1995-2000); and Government Economist, Economic Planning Agency of Japan (1984-'95). He received a Ph.D. in Economics from the University of Oxford. His major publications include *Fiscal Reforms of Japan: Redesigning the Frame of the State* (written and edited with Masahiko Aoki, published from Toyo Keizai Inc. in 2004, in Japanese), *Labor Market Institutions Reform in Japan: Changing the Way People Work* (written and edited with Yoshio Higuchi and Yuichiro Mizumachi, published from Nihon Hyoronsha in 2009, in Japanese).

The Japanese economy has been falling at a far greater rate since last fall than ever imagined amid the spreading impact of the global financial crisis. Japan's gross domestic product (GDP) contracted at an annualized rate of 12.7% during the third quarter (October-December) of fiscal 2008, which was the sharpest drop recorded among developed countries. Employment conditions have been worsening just as rapidly. The initial rounds of job cuts preyed on non-regular workers, resulting in growing job losses among dispatched factory workers and fixed-term workers in export-oriented industries, and are now emerging as a major social problem. If the real GDP for fiscal 2009 (April 2009 through March 2010) declines by 3% or more as forecast by private-sector research institutes, the unemployment rate could rise to above 5.5% (see note).

A hurried and poorly thought-out policy response under such conditions could do more harm than good. For instance, assigning blame for the job turmoil to the dispatch services responsible for placing factory workers, and attempting to protect workers by banning such services could aggravate the unemployment situation even further by narrowing the scope of available job opportunities. In order to properly respond to the current situation, the government needs to develop both a short-term and long-term vision, i.e., it needs to implement emergency stop-gap measures in the short term while redesigning and reforming relevant institutional mechanisms over the long term. As one specific step toward achieving these goals, I would like to propose a Japanese version of the "flexicurity" approach that revolves around the following three words: security,

training, and flexibility. These three policies complement each other like the proverbial three arrows that work together to strengthen one another.

Flexicurity, a term coined by combining the words "flexibility" and "security," refers to an employment and labor policy approach under which a government seeks to achieve greater labor mobility by weakening employment protection and enhancing unemployment insurance, thus facilitating displaced workers' reentry into the workforce through proactive measures such as job training. Denmark's flexicurity model is one of the most well-known cases.

» Is flexicurity necessary?

Why do we need to pursue the flexicurity approach now? Because growing job uncertainty amid rapidly worsening employment conditions have dampened household consumption and investment spending to the point where it is now contributing significantly to the economy's downward spiral. This negative cycle must be stopped. And to achieve that end, it is imperative for the government to make a strong commitment to ensuring social security so as to provide people with security.

Security in this context means taking immediate action to boldly expand and upgrade the safety nets protecting non-regular employees, who have been the hardest hit by the sharp downturn of the economy. The government has announced plans to lower the eligibility threshold, from a minimum scheduled employment period of one year to six months, for participating in the unemployment insurance program. But this change is not enough. Scheduled employment periods are problematic because they are subject to the judgment of employers. There is an incentive for employers to underestimate such periods to the point where they fall below the threshold, thus releasing employers from the obligation to pay out unemployment insurance premiums.

Unemployment insurance should be available to all employees in the same manner as workers' accident compensation insurance, irrespective of their scheduled employment period. At the same time, the government needs to review and alter the eligibility requirements for

other social security programs—including employee pensions and medical insurance—that effectively restrict the participation of part-time, fixed-term workers. Indeed, it should design an institutional framework that enables the integrated administration of all these social security programs, including unemployment insurance.

» Greater security must come with training and flexibility

However, if safety-net related measures become too generous in an isolated way, they may trigger a moral hazard for workers and produce an unintended side effect by increasing the rigidity of the labor market. We must not forget the long-term structural unemployment experienced by European nations in the 1970s when they pushed themselves toward the goal of becoming welfare states following the oil crisis. Long after their economies had recovered from the oil crisis, European countries continued to suffer from high jobless rates due to the prolonged unemployment of young, unskilled workers. When providing greater security, the government needs to design and implement an institutional framework that is sustainable over the long term and that incorporates the elements of training and flexibility that are described below.

Training involves the implementation of active labor market policies, such as re-training to facilitate reemployment for individuals who have lost their jobs, providing employment subsidies, and establishing public job-placement services. By looking at the relationship between unemployment benefits and government expenditures on active labor market policies (both measured as a percentage of GDP), we can see that countries providing greater unemployment benefits spend more on active labor market policies in order to prevent the occurrence of moral hazards.

Japan has a lot of room to maneuver in raising expenditures on unemployment benefits and active labor market policies, which are substantially lower than those in European countries. However, we must keep a cautious distance from those who are advocating active labor market policies as if they were a panacea. While acknowledging the potential positive effects of such policies, the Organization for Economic Cooperation and Development (OECD) has

noted that many that have already been implemented have proven to be unsuccessful. According to the OECD, in order to improve the efficiency of job matching and enhance the work experience and capabilities of individuals, it is imperative to identify and implement an appropriate combination of policies.

Meanwhile, an empirical study from Sweden has shown that the most effective means of facilitating the reemployment of displaced workers is by providing subsidies to companies that hire such workers as regular employees. The Swedish study also found that the rate of success in terms of reentry into the workforce was actually lower for people who either had been working in the public sector on a fixed-term contract or had received training not related to a specific company, than it was for those who had not taken advantage of any such programs. These findings indicate that actual work experience with a private-sector company has the greatest appeal to potential employers. Thus, generally speaking, high expectations should not be placed on government intervention in education and training.

One noteworthy segment of active labor market policies encompasses those focused on activation, which entail policies designed to increase incentives for displaced workers to find new jobs. In implementing their activation programs, European countries such as the Netherlands and Switzerland have undertaken a carrot-and-stick approach by providing job-finding support through periodic interviews with job counselors on one hand, while at the same time restricting unemployment insurance benefits for those who do not attend job training or other participatory programs. These can serve as useful reference points for Japan.

Lastly, flexibility refers to measures for increasing the versatility and mobility of the aggregate labor force with respect to both the labor market and individual work styles. One way to explain the prolonged structural unemployment in Europe from the 1980s onward is the “insider-outsider” theory. According to this theory, “insiders”—incumbent regular employees whose jobs are protected by membership in labor unions—have strong bargaining power and therefore their wage rates do not decrease even in bad times, whereas “outsiders” are unemployed workers who cannot find jobs even when they are willing to work

for lower pay. Under this situation, unemployment tends to last for prolonged periods and the human capital of displaced workers deteriorates, which further mitigates the influence of outsiders on the labor market. In other words, unemployment becomes structurally self-reinforcing as displaced workers find it increasingly difficult to make their way out of the unemployment pool.

» How to prevent a rise in structural unemployment

When non-regular workers, particularly fixed-term workers, lose their jobs in Japan, it weakens outsiders’ influence on the labor market. There are concerns that this situation may lead to greater polarization between regular and non-regular workers, between the employed and unemployed, and aggravate the rigidities of the labor market. In order to suppress rising structural unemployment, we must begin by preventing real wage increases that are attributable to insiders’ bargaining power. For instance, work-sharing results in higher hourly wages if the aggregate amount received by employees remains unchanged despite a reduced number of hours worked. It should be noted that this policy has the effect of prolonging unemployment for outsiders.

Given the seriousness of the problem of disparities between regular and non-regular workers, the need to review and overhaul the treatment of regular workers, including not only wage systems but also social security and other fringe benefits, is inevitable. To start with, the preferential treatment of fringe benefits should be corrected. Reversing the polarization of the labor market is eventually going to require the entire institutional system, including the job security system, to be overhauled so that new measures can be implemented to equalize the benefits available to both regular and non-regular employees.

Note: According to a recent analysis in which Okun’s law was applied to the Japanese economy (Takao Komine, “Keizai Kyoshitsu,” *Nihon Keizai Shimbun*, February 11, 2009), a 1 percentage point decrease in the real GDP growth rate translates into a 0.3 percentage point rise in the unemployment rate.