German and Japanese labor markets and labor market policies between globalization and world economic crisis – Towards a comparison

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On the brink of a global employment crisis following the global financial and economic crisis, this paper looks back on the development of labor markets in two countries, which during the second half of the 20th century have been among the most successful ones in terms of economic growth and social inclusion. The recent history of labor markets and labor market policies in Germany and Japan can be divided into four phases: (1) a phase of strong institutional co-ordination of labor markets before the onset of globalization; (2) the emergence of an employment crisis related to both the challenges of globalization and to nation-specific factors, especially the burst of the real estate speculation bubble in Japan and re-unification in Germany; (3) since 2003 an attempt to solve the employment crisis by a market-optimistic approach; and (4) finally new challenges arising from the Global Financial and Economic Crisis of 2009. To predict the further development, this paper suggests three scenarios.

1 Labor markets prior to 1990

After the Second World War, both Japan and West-Germany had developed distinct economic institutions, which set these countries apart from other contemporary highly-industrialized economies: Whether “Japan, Inc.” (a term coined by American businessman John Lobb in 1971) or “Rhenish capitalism” (a term originating from French economist Michel Albert, 1991) – before the onset of globalization in the 1990s both countries showed features which were rightly interpreted as elements of

The pre-1990s West-German labor market was characterized by features including the following (for details see Ganßmann 1999, Blien/Walwei/Werner 2002, Blanchard 2005, Jacobi/Kluve 2006, Werner 2006, Deutsche Bundesbank 2007, Eichhorst / Marx 2009):

Labor and capital and their respective organizations considered each other as partners in a joint effort towards neutralizing distributitional conflicts by creating economic well-being (Sozialpartnerschaft) rather than opposing each other in class conflict. From the 1970s the German model even included worker participation in management decisions in large-scale private industry (Mitbestimmung). As one consequence, the incidence of industrial disputes in Germany was rare by international comparison. Furthermore, relatively long-term employment practices were common, another factor contributing to social stability. In a cross-country comparison with micro survey data (Couch 2003), it has been shown that in the 1980s returns to tenure were lower in Germany than in the US, but peak earning occurred later. A possible reason for the lower returns to tenure can be seen in Germany’s “dual system” of vocational education, i.e. vocational training is provided simultaneously on the job and in industry-specific supportive school courses. Apprentice education is therefore partly financed by the enterprise. Slow increases in wage with age can be interpreted as an attempt on the part of firms to recoup their investment while the late peak provides an incentive for German employees to remain longer with their employers and change jobs less frequently than in comparable economies. On the other hand, the regulations regarding dismissals – very strict by international comparison – made job change at the request of the employer a rare case. In addition to fairly unified qualification profiles, the practice of wage-setting predominantly by industry- and region-specific agreements (Flächentarifverträge) rather than on the enterprise-level contributed to moderate wage dispersion – another factor of social cohesion: The ratio of gross earnings of the 9th to the 1st earnings deciles in 1980 was situated halfway between the slightly more egalitarian Scandinavian and the much less egalitarian Anglo-American economies.

In the steadily growing West-German economy, excess demand rather than excess supply had been a labor market problem until the mid-1970s. A constant stream of
labor immigration (from East Germany, from Southern Europe, from Turkey, from Poland and the Soviet Union) filled the gaps – Turkish immigration especially in “3D” (dirty, dangerous, and demeaning) jobs (such as those reported in Günter Wallraff’s famous book of 1985 “Ganz unten”). This indicates that even in this golden era of Fordism – based on full employment, mass consumption, social partnership and factor and commodity markets strongly regulated by the state – “sub-proletarian” forms of employment existed.

From the mid-1970s, following the oil price shocks, the West-German labor markets underwent a substantial change, as unemployment became a continuously aggravating problem. In each of the subsequent business cycles, unemployment increased rapidly during slumps and only slowly declined during booms without returning to its previous levels, leaving behind an increasing stock of unemployed (see Figure 1).

*Fig. 1: Annual GDP growth rate and unemployment rate, Germany, 1970-2009*

This phenomenon can be partly explained by a microeconomic approach pointing to the fact that labor qualifications become obsolete during unemployment in times of rapid technical changes, ultimately resulting in mismatches between labor supply and labor demand. Also bureaucratic hurdles were blamed for the persistent high official unemployment rate, as some black market activities (estimated 4 to 15% of GDP) have been associated with unfavorable income tax and social security contributions and regulations of non-full time work forms.
In a macro-economic approach, the reason for the chronic unemployment has been seen in an insufficient growth of the production potential. The underlying causes, however, have been fairly contentious between a majority of German supply-side economists (arguing that incentives for economic activities were too low because wages were too high) and a few demand-side economists (arguing that mass income was too low to provide sufficient marketing opportunities which finally resulted in an insufficient growth of production and jobs) (see Sell 2007). With benefits being rather generous by international comparison, the increase in unemployment caused exploding public expenditures. On the other hand, unemployment reduced public income from taxes and social security contributions. Thus, by late 1980s the problem of chronic unemployment was increasingly becoming a problem of all areas of public finance, including health services and old age pensions.


In a very similar way to Germany, industrial relations were dominated by cooperation between capital and labor rather than by confrontation. Incidents of industrial dispute were rare in spite of ritualized conflicts in the spring wage offensive (shuntō, which counters the tendency towards disparate wage settlements at the enterprise level). As a possible consequence of the enterprise-based primary wage setting, dispersion tended to be a little higher in Japan than in Germany but was still far below the US figures. In large-scale enterprises, and, to a lesser degree, in the medium and small-scale enterprises, ultra-long-term employment was the norm (see Figure 2 for a comparison between long-term tenure in Japan, Germany, and the USA). A reason for this can be seen in Japan’s extremely rapidly changing industry structure, which called for most job-specific skills to be acquired in continuous in-house trainings rather than in schools. This led to a highly selective screening of new entrants to the labor force. Given the problem of asymmetric information, to minimize risks for employers the process was heavily based on the reputation of schools. Payments steeply rising with years of tenure discouraged movement to the next best job opportunity so that there was a high probability that an enterprise’s investment in labor force training could be recouped in the long run. This feature of the Japanese labor market can possibly be better explained by the efficiency wage model. According to this model workers respond to above-average payment by
being less prone to job change and thus by increased productivity. In the Japanese case, young workers were paid less and older workers have been paid more than their marginal contribution to value adding, whereby young workers were plausibly induced to make an effort in order to stay knowing that their wages would increase with tenure, while older workers worked harder in order to continue being paid more than their contribution to the value added. In any case, a strong negative correlation between tenure and job change is plausible in this employment system.

Fig. 2: Share of long-term tenure (＞10 years), male labor force, various countries, 1970s/80s


From what has been said before it becomes clear that in Japan’s Fordist era the requirement of qualitative flexibility of labor use, ubiquitous in a rapidly changing industrial structure, was met by enterprise-internal labor markets rather than by external labor markets. The requirement of quantitative flexibility in the use of labor in boom phases was met by a relatively high amount of overtime work by regular workers as well as some temporary work (around 5% of total employees in the 1970s and around 7% in the 1980s according to the Ministry of Internal Affairs’ Labor Force Survey data), while labor immigration was extremely low by interna-

2 A seniority-based wage system as described above had been in force in most Japanese companies until the 1970s. It gradually changed to a less automatic “merit-based” and/or “skill development oriented” grade system from the 1970s to the early 1990s.
tional comparison. In bust phases, the burden of numerical flexibility was determined by the position of the enterprise in the industrial system: lowest risk for regular workers in core enterprises, highest risk for non-regular workers in second-tier suppliers. In spite of Japan’s labor force generally being rather homogenous in social respect and well-secured, precarious employment was thus not completely absent in the pre-globalization phase – albeit small in overall size and graded in the extent of risk. From the labor supply side the scheme as described above was supported first by the fact that the norm of ultra-long term employment made employees prepared to work overtime even if not immediately adequately compensated for. Secondly, as unemployment benefits were very meager (90 to 300 days, depending on insurance duration and age – in general no further social security beyond this point except in cases of illness), those becoming unemployed in bust times were willing to accept even the smallest jobs. This fact has obviously contributed to an underestimation of unemployment in Japan vis-à-vis countries with a higher social protection of the unemployed.

A synopsis of stylized facts of the German and the Japanese labor market institutions and employment situation prior to the 1990s is provided below.

Synopsis 1: Labor market characteristics in Japan and Germany, pre-1990

<table>
<thead>
<tr>
<th>Japan</th>
<th>Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td>vocational training heavily concentrated on the job; fierce screening procedures of new entrants to the labor force</td>
<td>in many trades dual vocational training system; on-the-job training with simultaneous supportive courses</td>
</tr>
<tr>
<td>ultra-long term employment as a norm, long term-employment as a rule for regular workers in core enterprises</td>
<td>long term-employment as a rule</td>
</tr>
<tr>
<td>industrial relations cooperative rather than conflict-oriented</td>
<td>industrial relations cooperative rather than conflict-oriented</td>
</tr>
<tr>
<td>low labor immigration</td>
<td>high labor immigration</td>
</tr>
<tr>
<td>wage setting on the enterprise level but partly harmonized by nation-wide wage-setting process, moderate wage dispersion depending on the position of enterprise in the industrial structure</td>
<td>wage-setting industry/regional-specific, very low wage dispersion with negotiated standard wage rate and low positive/negative enterprise-specific wage drift in booms / busts</td>
</tr>
<tr>
<td>until 1991 low rates of unemployment as measured by national standards</td>
<td>since mid-1970s rapidly increasing and increasingly persistent unemployment both national and ILO standard</td>
</tr>
<tr>
<td>very meager unemployment benefit schemes; dismissed workers tend to take up odd jobs</td>
<td>very generous unemployment benefit schemes; unemployed tend to live on social welfare</td>
</tr>
</tbody>
</table>
Starting around 1990, for nearly two decades globalization has interfered with labor markets of high-income countries in many ways (for a general perspective on winners and losers of globalization see Wohlmuth 2004). International trade in commodities and services has been liberalized across the world. However, in the case of Germany the fall of economic borders to Eastern Europe and in the case of Japan the emergence of China as a powerhouse of international commodity production deserve particular mention, implying not only increasing opportunities for exports but also increased import competition. The quantitative net effect of external trade on employment seems to have been negative, as in both Japan and Germany exports have been capital-intensive, while imports have been labor intensive. For Japan, the negative net effect on employment was estimated to have been one million jobs (Higuchi 2006). In Germany, it has been argued that the employment effect of the huge export volume is much smaller than usually assumed due to its high import content (“bazaar effect”, Sinn 2005).

Structural changes in industry induced by the increasing cross-border flows of long-term investment have also been important for employment. Competitive pressure on the domestic labor force was fiercest in industries producing “Heckscher-Ohlin”-commodities (i.e. where comparative advantage is based on factor abundance): Reduced transport costs, especially due to containerization, and an emerging production capacity in countries with low unit labor costs have not only increased import competition but also triggered the relocation of production sites with Japanese FDI targeting especially China / South-East Asia, while East- and South-East Europe have been most relevant host regions for cost-cutting German FDI. The quantitative employment effect of tariff-hopping or market-seeking FDI, often targeting other high-income countries, but also China and Eastern Europe, is more ambiguous. In most cases the employment effect for the home country is probably positive, as successful enterprises safeguard or even increase domestic employment by investment abroad. This employment, however, is of a different type – in R&D rather than in assembling, for university graduates rather than for blue-collar workers – in Japan also: in urban areas rather than in rural areas (Higuchi 2006), in Germany: for people speaking German rather than for second-generation migrants with an only rudimentary command of the German language.

The increased pressure on enterprises to produce more efficient meant, firstly, reducing labor costs. In Germany during the 1990s an increasing dissolution of regional
wage agreements and thus lowering wage rates was possible following a continuous weakening of trade unions due to a variety of reasons, including structural changes of the workplace. Labor disputes in Germany became rare and virtually disappeared in Japan (see Figures 3 and 4).

**Fig. 3: Trade Union density (organized employees in per cent of total), Japan and Germany, 1960-2007**

Data Source: OECD Employment Data Base.

**Fig. 4: Loss of working days by strikes and lockouts, various countries, 1970-2007**


Secondly, the pressure to reduce labor costs resulted in the creation of a pool of low-wage labor and especially of labor being flexible enough to be used in production at less than full-time and long-term units, such as subcontracted employment, part-time employment, and old-age employment. In Japan, around 1990 overseas-born Japanese, e.g. from Brazil, increasingly entered the labor force, mainly in “3D”-jobs.
During this period, wage differences increased. In Japan, male part-timers’ hourly earnings in per cent of regular staff declined from around 58% in 1990 to less than 50% in 2002. In Japan, the conventional systems of seniority or merit-based payments were increasingly followed by a performance-oriented employee assessment and compensation system (seikashugi). Also in Germany, earned income inequality increased, even if still moderately in the 1990s. In other words: Globalization has enforced a (previously only rudimentary visible) bipolarization of the labor market.

In addition to globalization, pressures for the German and for the Japanese labor market resulted from two specific factors: the burst of the Japanese bubble economy and Germany’s reunification. In East Germany around 8,000 state-owned enterprises with a productivity lag of in some cases more than two decades were either privatized (which usually meant that labor-saving production technologies were introduced) or completely closed. This led to mismatches between labor supply and labor demand in spite of a considerable East-West migration and re-qualification efforts. In Japan, after the burst of the bubble economy in 1990, a decade-long recession and increasing unemployment followed (see Figure 5).

Fig. 5: Annual GDP growth rate and unemployment rate, Japan, 1980-2009


Both in Germany and in Japan, the resulting financial burdens further limited the scope for demand-strengthening measures to solve the unemployment problem. Government debts started to exceed any previously known limits (in Germany mitigated by the 60 %-limit of the Maastricht Treaty) – see Figure 6.
Fig. 6: Ratio of government net debt to GDP, various countries, 1980-2005

Data Source: IMF, WEO database.

Synopsis 2: Labor markets in Japan and Germany during the 1990s

<table>
<thead>
<tr>
<th>Japan</th>
<th>Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐ capital-intensive exports, labor-intensive imports: net effect is negative even in spite of huge current account surplus.</td>
<td>☐ capital-intensive exports, labor-intensive imports: net effect is negative even in spite of huge current account surplus.</td>
</tr>
<tr>
<td>☐ outward flows of FDI much larger than inward flows of FDI: negative net effect on domestic employment assumed, changes in labor demand</td>
<td>☐ outward flows of FDI much larger than inward flows of FDI: net effect on domestic employment contentious, changes in labor demand</td>
</tr>
<tr>
<td>☐ structural changes of labor demand: low qualified workers (esp. new entrants to labor force) in shorter demand</td>
<td>☐ structural changes of labor demand: low qualified workers in shorter demand</td>
</tr>
<tr>
<td>☐ huge government debts piling up due to unsuccessful deficit spending in a decade-long recession</td>
<td>☐ job destruction in East Germany due to technology gap and reunification under non-competitive exchange rate</td>
</tr>
<tr>
<td>☐ bipolarization of labor market access: long-term contracts continue, hiring ice age for new entrants (living on odd jobs)</td>
<td>☐ huge government debts piling up due to the integration of East Germany, finally mitigated by Maastricht treaty</td>
</tr>
<tr>
<td>☐ bipolarization of earned incomes: widening gap between payment for regular and for non-regular employees, generally increasing wage differences due to new payment systems being introduced</td>
<td>☐ bipolarization of labor market access: protected high-wages receiving insiders unemployed outsiders, however: lowest youth unemployment in all OECD</td>
</tr>
<tr>
<td></td>
<td>☐ increasing wage differences</td>
</tr>
</tbody>
</table>
Market-optimistic responses to labor market pressures

From what has been said before, it becomes clear that in both Germany and Japan macro-economic employment policies had been exhausted by around the turn of the century. In the German case, the “Reconstruction of the East” (Aufbau Ost) programs had been among the largest fiscal stimulus packages ever. Every year 75 billion Euros, i.e. 4% of the German GDP, had been transferred to East Germany, mainly to consumers via social security funds. In addition, private investment has been subsidized contributing to a capital-intensive rather than an employment creating production structure in East Germany. Especially in construction, overcapacities were created by subsidies (Donges 2008). In Japan, public work spending as a percentage of GDP was the highest of all industrialized nations – more than 6% during the 1990s. Given the huge overcapacities from the bubble era, these efforts were more or less in vain if not counter-productive, as private investment was crowded out from the capital market. Further steps in this direction were not possible. In addition, governments became increasingly aware of the general limits to national fiscal policies in an open economy, where demand created by government deficit spending cannot be kept inside its own economy due to internationally concluded rules and transnational company behavior. Finally, monetary policies had also reached their limits. Real interest rates were already low in Germany, even if not near zero as in Japan – and anyway beyond national control since the implementation of the European Central Bank. In Japan, increasing exports by exchange rate policy would have been equally strange given the country’s huge current account surplus (nevertheless there was devaluation of the Japanese currency in the mid-1990s which contributed to triggering the Asian Financial Crisis of 1997).

What therefore appeared on the agenda between the 1990s and 2008 was a policy of systemic reforms to ease market adjustment. Labor markets were but one of various playing fields – much in line with the dominant theories promoting deregulation as a panacea against all economic ills in the 1990s (for an overview see Sell 2007). Regarding labor markets, the OECD consensus around the turn of the century consisted of the expectation that less regulation would allow a faster equalization of supply and demand of labor. The subsequent extension of the use of labor was expected to enhance growth and economic well-being, especially as both Germany and Japan were not able to reach their potential growth rates (see Figure 7).
Subareas of labor market reforms included:
- “active” labor market policies, such as intensive career counseling or retraining of workers to reduce mismatch unemployment
- A reduction of taxes on labor income and a reduction of social security contributions to increase incentives to work by reducing reservation wage rates
- A relaxation of employment protection legislation to increase the willingness of employers to hire staff by increasing the possibility to fire in the case of economic slowdown or individuals not meeting the employer’s expectations in terms of work performance
- A reduction of unemployment benefits to increase incentives to work as this reduces reservation wage rates
- A decentralization of wage formation to increase job offers also at below-regulation wage rates as this takes into account the offers of below-average productivity enterprises;
- Reduced legal constraints on working time-flexibility and part-time work to increase demand for labor and minimize working-time related mismatches of supply and demand of labor
- Relaxed regulations on early retirement and old-age pension schemes to increase labor supply at below-regulation wage levels and in less-than full-time portions.

Specific measures taken between the mid-1990s and 2005 in Japan and Germany comprised those shown in Synopsis 3.
### Synopsis 3: Labor Market Reforms in Japan and Germany around 2000

<table>
<thead>
<tr>
<th>Japan</th>
<th>Germany</th>
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</thead>
<tbody>
<tr>
<td>labor standard law reformed to establish clear rules governing dismissals for economic reasons (2003)</td>
<td>liberalizing employment protection legislation, i.e. company size limit for dismissal protection raised from 5 to 10 employees (introduced 1996, reversed 1999, re-introduced 2004): easier firing is expected to trigger easier hiring maximum duration for contracts through temporary work agencies extended to three years (2003)</td>
</tr>
<tr>
<td>benefit duration increased for those who become involuntarily unemployed after bankruptcy or dismissal (2001)</td>
<td>benefit duration for contracts through temporary work agencies increased (four times since 1994) unemployment assistance merged with social assistance forming a new benefit type (2004)</td>
</tr>
<tr>
<td>incentives to find a job quickly increased through a change in calculation methods of re-employment allowances for those finding a job quickly and by raising subsidies for educational training (2001)</td>
<td>benefit duration reduced for all age groups under 55 to 12 months, cutting entitlement periods by more than half for many old age groups (2004)</td>
</tr>
<tr>
<td>public job creation programs by central and local governments introduced along with new employment subsidies (1999) introduction of “career counselors” (2000)</td>
<td>more scope for benefit sanctions (2002), rejection of any job offer entails benefit sanctions for recipients of the new unemployment assistance benefit</td>
</tr>
<tr>
<td>introduction of subsidies for employers to hire middle-aged or elderly workers in regions of high employment (1999), existing employment subsidies extended to the unemployed under the age of 30</td>
<td>active labor market policies: design of individual action plans become mandatory (2005)</td>
</tr>
<tr>
<td>during the 1990s: wage determination increasingly on company level; since 2000: stagnation of average real wages</td>
<td></td>
</tr>
</tbody>
</table>


For comparative analysis, compliance with the OECD-Job Strategy can be used as a benchmark for these policies (even if there are some methodological shortcomings in this procedure, see Brandt / Burniaux / Duval 2005, p. 56). For the period of 1994 to 2004 an indicator has been calculated to assess the degree to which reforms followed the OECD-suggestions, i.e. not an indicator showing the degree of already
complying with the suggestions but an indicator of the comprehensiveness of reforms in this direction (rather a vector showing the development than an assessment of a particular position).

Among the 30 OECD countries, in the sub-area of “active labor market policies”, the average share of adopting what had been suggested was 33% of the complete measures (see Figure 8). Germany was the top-reformer in this area (considered to be an equally important element in the “Fordern and Foerdern” concept) with 58% of the maximum score, while Japan was below average with 23%. With regard to the flexibilization of working time such as the administrative assistance in the implementation of increased part-time work opportunities, Japan was a top-reformer with 33%, well above the average of 15%, while Germany was around average.

Other areas where German labor market flexibilization was more intensive than the OECD-average included the reduction of employment protection, cuts in the unemployment benefit system, the decentralization of wage setting procedures, and the liberalization of retirement regulations. It should be emphasized that huge moral pressure is exerted on the unemployed, who after a twelve month period of receiving insurance-based unemployment benefits, are transferred to a category of benefits which is considered the ultimate social net (“Arbeitslosengeld II”, often referred to as “Hartz IV” after the creator of these labor laws). Many recipients perceive this category to be inadequate to their status (apart from being lower in monetary terms).

The wide scope of the deregulations made Germany the fourth-strongest labor market reforming country of the 1994/2004 period (after Denmark, The Netherlands, and Finland). Although the strongest reformer in terms of a flexibilization of working time (including part-time work), Japan only moderately deregulated its labor markets in an OECD-comparison (overall reform score 25 out of 30).

However, this does not mean that the present position of Japan indicates less state intervention in the labor markets than in Germany, as Japan started from a lower level of regulation. For instance unemployment benefits in Japan had been very low even in the pre-1990s, so that meeting only 4% of the OECD’s suggestions in this field does not mean that Japanese unemployed are not worse off than German unemployed, where the changes complied with the OECD’s suggestions to an extent of 19%. Only the velocity of change was higher in Germany. In fact, the velocity and radicalism of these changes shocked many (and even contributed to the Social Democrats / Ecologists (Red-Green) government’s loss of power in 2005).
Fig. 8: Intensity of labor market reforms (benchmark: OECD average), various countries, 1994-2004


The reform results can be assessed on various levels. First and foremost, has overall unemployment been systematically reduced as expected? Due to the short time period, it is not yet possible to provide a statistically valid answer. However, research both in the framework of the NAIRU (non-accelerating inflation rate of unemployment) approach and in the framework of the Okun / Verdoorn approach do not contradict the assumption that the new institutional framework contributes to more employment generation (for the NAIRU concept see Layard / Nickell / Jackman 2005, see also: Phelps / Zoega 1998, Espinosa-Vega / Russell 1997, Landmann / Jerger 1999, Franz 2000, Turner et al. 2001, SVR 2005, Fujii 2008; for the Okun / Verdoorn approach see Schmidt 2000, Pusse 2002, Schäfer 2005). The NAIRU-estimation attempts to separate the structural component of unemployment from the business cycle component. A simpler Okun / Verdoorn-type approach attempts to find the threshold level of economic growth necessary to reduce unemployment. An estimation of this threshold level is provided in Figures 9 and 10. Both in Germany and in Japan, the threshold values have been lower after the reforms, indicating that labor markets in fact have become more susceptible to economic growth. In Germany, the slow decrease of unemployment in the upturn of the business cycle had been reversed: Since the implementation of the “Agenda 2010” labor market reforms in 2003/2004, overall unemployment had been rapidly reduced to a 16-year low in 2008.
Figure 9: Responsiveness of unemployment reduction (in percentage points) to GDP-growth (in per cent), Germany, 1980-2008

\[
\begin{align*}
y &= -0.2594x + 0.8294 \\
R^2 &= 0.2717 \\
y &= -0.505x + 0.4854 \\
R^2 &= 0.3376 \\
\end{align*}
\]


Figure 10: Responsiveness of unemployment reduction (in percentage points) to GDP-growth (in per cent), Japan, 1980-2007

\[
\begin{align*}
y &= -0.1076x + 0.3897 \\
R^2 &= 0.7428 \\
y &= -0.1344x - 0.0127 \\
R^2 &= 0.6017 \\
\end{align*}
\]

The unemployment rate is calculated according to the ILO-definition from labor force survey data. Own computation. Data Source: IMF, WEO Database 2009.

However, this is only half the story. The other half is that the reforms contributed firstly to an increasing bi-polarization of labor markets in both countries (for a general overview see Fujiki et al. 2001, Schettkat 2003, Walwei 2003, Leschke et al.)
2006, Jones 2008, Eichhorst / Marx 2009), and secondly to an increasing incidence of poverty, especially the creation of a social segment of working poor, as can be shown by data from both Japan (Jones 2007, Sekine 2008, Tachibana / Urakawa 2008) and from Germany (Headey / Holst 2008).

The increased responsiveness of employment to GDP-growth – starting in the 1990s under the impact of globalization and enforced by the labor market reforms of 2003/04 – was based on the enlargement of the labor market segment of precarious employment (see Figure 11).

Figure 11: Ratio of subcontracted employment to total, Japan and Germany, 1974-2009

![Graph showing ratio of subcontracted employment to total, Japan and Germany, 1974-2009.](image)


On the other hand, neo-corporatist features of the labor markets continued, such as the considerable degree of protection of workers in the core of the workforce (see Figure 12). For Japan, Shimizutani/Yokoyama (2006) found that average years of tenure for permanent male workers had even extended after 1990.³

³ There are no comprehensive data sets available before 1992, and the OECD data starting in this year do to date neither cover Japan nor the US. Japanese data can be retrieved, however, from micro survey (Ministry of Labor, Basic Survey on Wage structure) which could be matched by German data from the German Socioeconomic Panel.
Another result of the bipolarization of labor markets can be seen in the fact that the inequality of gross earnings increased considerably, although in Japan less than in Germany. A common feature in the first half of the first decade of our century was that wage dispersion in OECD countries converged. Generally, while the Anglo-American wage system tended to decrease inequality, the other OECD countries increased inequality. No country, however, matched Germany in the increase of inequality (see Figure 13).

In both countries there are in principle three sources of precarious employment: new entrants, previously regularly employed, and unemployed. These three sources are, however, differently involved in the two countries. The situation of new entrants is especially worth mentioning. In Japan new entrants to the labor force have been increasingly marginalized. Many of the “lost generation”, graduating from college and high school around 1995 to 2005 were unable to find permanent jobs (the period therefore being called the “hiring ice age”) and became “freeter”.

As a social science terminology, in Japan (usually young) part-time workers with frequently changing menial jobs have been called freeters, a neo-logic out of English: “free” and German “arbeit”. The White Paper on the Labour Economy 2007 by the Ministry of Health, Labour and Welfare defines “freeters” as those aged between 15 and 34, graduate in the case of male, graduate and single in the case of female and, (1) for those currently employed, who are treated as part-time or arbeit worker by their employers, (2) for those currently unemployed, who seek the part-time or arbeit jobs and (3) for those not currently employed, who

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\[^4\] As a social science terminology, in Japan (usually young) part-time workers with frequently changing menial jobs have been called freeters, a neo-logic out of English: “free” and German “arbeit”. The White Paper on the Labour Economy 2007 by the Ministry of Health, Labour and Welfare defines “freeters” as those aged between 15 and 34, graduate in the case of male, graduate and single in the case of female and, (1) for those currently employed, who are treated as part-time or arbeit worker by their employers, (2) for those currently unemployed, who seek the part-time or arbeit jobs and (3) for those not currently employed, who
Japanese companies still place disproportionate emphasis on recruitment of new graduates, if a new graduate cannot find a job as a regular employee on graduation, chances of good employment increasingly deteriorate. In contrast, in Germany youth unemployment has been very low by OECD comparison due to the strong commitment of German enterprises to apprenticeship education.

In both countries precarious employment is much less protected in any sense of working environment. Unionization, although generally declining in both countries (see above), is still strong in large-scale enterprises, while it is nearly absent in smaller and medium ones with less than 100 workers. Dispatched workers are hardly organized at all.

Figure 13: Gross earnings inequality, various countries, 1980-2005.

![Graph](image)

The exhibit provides the ratio of the best-paid decile of employees to the lowest-paid decile. Data Sources: Osberg, L. / Sharpe, A. (2004), An Index of Labour Market Well-being for OECD Countries, Centre for the study of Living Standards; OECD STAT Database.

An estimation of the new labor market dynamics

In Germany, employment statistics differentiate between gainfully employed who pay (in the case of midi-jobs: reduced) social security contributions and employment without social security contributions. The reported figures partly overlap, however, with employment which has rightly been termed precarious, including people working in government-subsidized employment and subcontracted employment (Zeit-

are neither engaged in household duties, attending educational institutions nor waiting to start a new job, and wish to find part-time or arbeit jobs. In Germany, a recent similar neo-logism was built from “precarious” and “proletariat”: the Prekariat.
arbeit) as well as working poor receiving social benefits in addition to a full time job (Aufstocker). In addition there are those exclusively in marginal jobs below a threshold value of 400 Euros per month or with short term contracts (less than 50 days per year). We have classed all these employment forms as “precarious employment” in Germany. This may be overestimated as a considerable share of people in marginal jobs (nearly 5 million) are students, housewives etc. On the other hand we did not consider the 2 million employees who worked in a marginal job in addition to their full-time job – pointing in many cases to a low income in their principal job. Both errors can be assumed to compensate each other. From micro-survey data it can be estimated that 75 % of the regular employment is full time and 25 % (mostly voluntarily) part time. In our estimation we did not consider these part-time employees as precarious, as working part time in Germany mostly seems a voluntary decision on the part of the employee. From these considerations we estimated the amount of precarious employment in Germany to add up to 16 per cent of the total labor force, with regular employment accounting for 72 per cent and unemployment including unemployed under work obligation or in government organized training (i.e. a wider definition than used by the Government’s Labor Agency) to total 12 per cent (all estimations for 2008).

The new dynamics of the labor market after the reforms especially reduced unemployment by increasing precarious employment and only to a much lesser extent by transferring unemployed into regular employment. Precarious employment may include waiting to be offered work, poorer pay (even compared to regular workers doing the same sort of jobs), fewer fringe benefits (such as cheap meals in factory canteens), and less security in terms of old age pensions etc. When compared with the alternative of being unemployed, however, a different perspective has to be applied.

In Japan, non-regular employment is differentiated between those working on short-term contracts, those on temporary transfers from other companies or dispatched from temping agencies, temporary staff, and part-timers. Japanese statistics report a decreasing number of regular staff: the share sank from 80 % in 1994 to 67 % in 2006 (JILPT 2009, p. 74), and those working in non-regular employment do so increasingly against there will. According to micro surveys, their share rose from 19% in 1994 to 30 % in 2003 (JILPT 2009, p. 87). From these figures we estimate, that 66 % of the Japanese labor force is in full-time, regular employment, while 20 % are voluntarily in non-regular forms of employment, and around 10 % are involuntarily
in non-regular employment, with a narrowly defined 4% of the labor force being unemployed. The proportions are recapitulated in Figure 14, a formal model is provided in Figure 15.

*Figure 14: The new labor market dynamics after globalization and de-regulation – Japan and Germany*

In the model of Figure 15, the first sector is assumed to be highly regulated. Real wage rates ($w_r$) are set above market clearing wages by negotiations between employers and trade unions, resulting in the wage setting curve. In the second sector, no trade unions exist. Here, supply of labor is fairly unlimited. Apart from accepting
high unemployment, policy options to reduce unemployment include: (1) reducing the power of trade unions in the first sector to approximate the wage setting curve to the labor supply curve, (2) to reduce reservation wages in the non-regulated sector, for instance by reducing welfare benefits, (3) to increase labor demand in the low-wage sector, or (4) to increase demand in the high-income sector – or combinations. Obviously, labor market reforms both in Germany and Japan have so far predominantly used the second and fourth approach (lowering reservation wage levels and increasing demand in the low-income sector), i.e. by increasing precarious employment. The first approach (the weakening of the wage setting power of trade unions) seems to have happened without government intervention – but only to a limit extent, thus from this side contributing to the dualistic nature of the present labor market in both countries.

Figure 15: A formal model of policy options in dualistic labor markets

4 Will the reformed labor markets stand the challenges of the Global Economic Crisis?

While the Koizumi reforms in Japan as well as the Schroeder reforms in Germany helped to adjust the respective labor markets to the demands of a globalized economy and partly remedy unemployment, this has been a “second best solution” only, as much of the successes have to be attributed to the increased use of “irregular” or “precarious” employment. Especially these jobs, however, show a high responsiveness to business cycles and these workers, already poverty-threatened if not already impoverished, do not have anything to fall back on apart from welfare benefits. Given the high dependency of both Germany and Japan on exports, it has already become clear that these two countries will feel the global contraction most of all OECD economies. Due to this combination, the global financial and economic crisis may turn into a social crisis in both Japan and Germany by 2010. How can this be best prevented? Three scenarios emerge.

Scenario 1: The “Short term rescue – In the long run we are all dead” – approach

In this scenario, the economic recession will rapidly be overcome by the joint action of the G20-governments. Governments will continue to create budget-deficit financed demand (especially in the US, China, and Japan). In this scenario, governments not only successfully forget the negative experiences with fiscal stimulus packages made by their own predecessors, both in Germany in the 1970s (leading to stagflation) and in Japan in the 1990s (during the decade-long recession), but are also able to give the lie to most empirical research which can be summarized as: “fiscal multipliers are overwhelmingly positive but small” (Hemming/Kell/Mahfouz 2002).5

In this scenario the advanced economies and China create markets for each other in a Nurksean-type “big push” – co-ordination being a conditio sine qua non for any government-deficit based strategy in the era of liberalized commodity and capital markets. What is equally important for this scenario is the ability of governments to successfully conceal the fact that deficits today translate into the crowding out of

5 By the way: the idea of a negative fiscal multiplier – i.e. the theoretical ground for a huge tax reduction to overcome the crisis – as demanded by the German liberal party (now in government), is also not substantially supported by empirical research (Hemming/Kell/Mahfouz 2002).
risk-taking private investors and into tax increases tomorrow (Ricardo’s equivalence principle – fortunately, not all of the taxpayers will be dead in the long run!) – and that fiscal multipliers tend to be negative in the medium term! In this scenario, due to the asymmetries of lobbying (“losers lobby harder”\footnote{In sunset industries (shrinking total profits) no newcomers will be expected, therefore the individual firm’s rent from lobbying will be constant or will even increase over time (if other firms withdraw from the market). In sunrise industries, however, newcomers will absorb the rents accrued by the lobbies, see Baldwin / Nicoud 2005.}) – sunset industries, owners and unions alike, such as the automotive industries in high-income countries, will continue to shift substantial factions of the stimulus packages to their rescue. But not only necessary structural changes to the economy will be retarded for a while. As most fiscal stimulus packages overwhelmingly aim at private consumption, there is no scope for redirecting the economic development of the post-industrial economies.

To be sure: After having overcome the recession, globalization will accelerate again. Global competition will be fiercer than ever, as world-wide only the strongest enterprises will have survived. Also new industries and new enterprises will have emerged. Having supported private consumption rather than future-oriented industries, countries such as Japan and Germany will again fall behind. Extrapolating from what we see today, “living deads” will have survived with government subsidies but the increased world-wide competition will force them to continue to cut expenses, especially labor costs – which means that not only the prospects for labor in general will deteriorate, but also the share of precarious employment will continue to grow. Given the stronger protection of core workers, the losers of globalization – low qualified marginal workers – will have experienced the anti-capitalist rhetoric of the 2009-GFC\footnote{“I believe social market economy is a good model which can show the way forward. [...] One could perhaps call this the “third way”, which I feel we need worldwide, a system which contrasts with unbridled capitalism involving great financial and other risks but has nothing to do with socialist command economy experiments.” (Speech by Federal Chancellor Angela Merkel at the World Economic Forum, 30/01/2009)} as but a short intermezzo in their continually worsening position on the labor markets in capitalist economies under the ever increasing pressure of global competition.

Obviously, this is a probable scenario at least as far as the short-term oriented attempts to rescue sunset enterprises by (conventionally called “Keynesian”) deficit-financed spending and winning votes by consumer subsidies is concerned, given the underrepresentation of the interests of future voters in elections and the intention of politicians to maximize actual votes. “We have to re-think, even thoroughly Keynes-
“Keynes euphoria” as Dr. Schäuble, Germany new Minister of Finance (Christian Democrat) demanded (27/11/2008), industrial nations are seen in a “Keynes euphoria” (German business daily, Handelsblatt 28/04/2009), and the Japan Times reported: “The politicians, bureaucrats, businessmen and journalists during the administration of former Prime Minister Junichiro Koizumi were slaves of Milton Friedman. Today, however, these same people have become slaves of Keynes.” (13/05/2009). The crucial question, however, will be, whether the fiscal stimulus packages will actually take effect. If not – and chances are – the second scenario may be realized.

**Scenario 2: Long term depression and immiserization**

In this scenario, stimulus packages will not be sufficient enough to prevent the economic crisis from triggering mass unemployment already in 2009. It is even possible that the stimulus packages will increase over-capacities in the medium term. This might result in a long-lasting depression, such as the Japanese recession of the 1990s.

In this case, governments increasingly run out of policy options (fiscal policies cannot be expanded unlimitedly because of the danger of stagflation, monetary policies have already nearly reached the bottom line). In consequence, the immiserization of workers already in precarious employment will become inevitable. In Japan, sometimes dismissal of irregular workers already means homelessness to them because houses are owned by the companies. Increasingly, governments will try to shift the burdens to the most vulnerable worker groups. In Japan, some indications of this strategy can already be seen, such as sending back migrant workers of Japanese origin to Latin America.

Obviously, this seems to be the worst scenario. Due to the coordination of fiscal stimulus packages it seems to be less likely than the first scenario, but it cannot be ruled out on the basis of the research quoted above regarding the limited nature of the effects of this policy.

**Scenario 3: The “orderly Retreat, orderly advance”-approach**

In this scenario, policy makers show consciousness of history – not only with regard to past experiences, but also understanding the responsibility of our own time for the future. In this scenario, politicians acknowledge that crises are nothing alien to capitalism. On the contrary, they understand that capitalism develops its potentials not only in boom phases but, probably even more so, in bust phases and that capitalist development is discontinuous by its mere nature. In this scenario, policy makers are
aware of the fact that the history of capitalism shows that the more workers, enterprises, and governments tried to stop inevitable structural changes by increased exploitation or self-exploitation, the longer recessions continued, but that after each crisis an even stronger economy, strengthened by the disappearance of less efficient producers, emerged. Governments in this scenario will safeguard workers, rather than enterprises. In this scenario, governments will assist new industries, representing the opportunities of the 6th Kondratieff cycle (see Tilly 2002, Siemon 2007), and tackle the inheritance of the industrial era such as climate change by investing especially in education and research and adjust their educational systems to these challenges: “There is certainly no point in trying to conserve obsolescent industries indefinitely; but there is point in trying to avoid their coming down with a crash and in attempting to turn a rout, which may become a center of cumulative depressive effects, into orderly retreat. Correspondingly there is, in the case of industries that have sown their wild oats but are still gaining and not losing ground, such a thing as orderly advance.” (Schumpeter 1942, p. 90)

In this scenario, policy makers know that by strategic decisions, supported by investment in public goods and by protecting the most vulnerable groups by social policies, the bipolarization of labor markets could be increasingly overcome, as greater demand for highly-qualified jobs provides incentives for workers to gain further qualifications. This also reduces the supply of low qualified workers contributing to an increase in their pay and also more social security in this sector.

Is this scenario probable? There are some indications that some politicians (from very diverse backgrounds!) such as former Japanese Prime Minister Mr. Aso (Liberal Democrat) in his “Strategy for the Future” (Aso 2009) or former candidate for chancellor, Mr. Steinmeier (Social Democrat), in his “Deutschlandplan” (Steinmeier 2009) are aware of this opportunity. By doing this, Japan and Germany would link their future strategies to past experiences in the acceleration of a socially inclusive rapid structural change of the economy in the past century, albeit under different economic conditions of the world economy. In the present author’s opinion, however, this strategic turn seems to be the least probable of the three scenarios.
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