

A Nordic mirror for Japan, part 2

'Japanizing' the Nordic Model

Ever since the famous Iwakura mission of 1871, Japan has been noted for its ability to import foreign techniques, adapt them for Japanese usage, and sometimes go on to lead the world in that arena. Can this skill now be applied to adapting parts of the "Flexicurity" philosophy that has propelled structural reform and growth in the Nordic countries (see February *TOE*, pg. 5)? The Nordic model combines growth-enhancing market flexibility with income equality and security. The trick is that, instead of protecting redundant jobs at weak firms, the Nordics let firms rise and fall, but workers are aided in their transition from job to job.

Can Japan import key parts of the model, we asked Danish Employment Minister Claus Hjort Frederiksen. "I don't believe in the 'one size fits all' approach," he replied, "You can't copy us, but it is possible to learn from our experience."

Not a Chinese menu

The first lesson is that the Nordic model is not like a "combination platter" menu at a Chinese restaurant: one choice from column A; two choices from Column B. Many parts of the model only work well because they are linked to other parts. Neither flexibility nor security works well without the other. As former Swedish Social Democratic Finance Par Nuder put it, "You can't have strong capitalism without a strong social safety net."

"I have had many visits at this table in the past five years from ministers and politicians from France, Spain and Germany," explained Frederiksen, a member of Denmark's centrist Liberal party. "They are all very interested in our flexibility, i.e. the easier rules for hiring and firing people. However, when it comes to the crux of the system, the security part, then their interest drops. That's because it means they have to spend a lot of money to pay these high allowances and run these active labor market policies [retraining and other programs to help unemployed workers get new jobs.]"

That's a lesson for Keidanren and some

economists who hail the alleged flexibility of Japan's explosion of low-paid part-time and temporary jobs.

Institutions matter

Even the best policies don't work unless they have supportive institutions. People behave very differently depending on the institutional context. One example is the difference in Danish and British company responses to retraining programs. Professors Cathie Jo Martin and Duane Swank found that, because Danish employers are organized into a highly centralized federation, they have a sense of their collective interests as employers. They see training as a "public good" from which they will benefit as skills diffuse in the labor force. Hence, Danish companies are more willing than British firms to pay taxes for active labor market programs and participate in on the job training programs.

In Britain, where employers are less centrally organized, companies hold back on training. They fear that the money they spent on training might be lost as the upgraded worker went to another firm.

Big Japanese firms deal with this dilemma by practicing "internal flexibility," i.e. on the job training and job shifting within the firm. But this causes Japan to lose "external flexibility" and makes the worker too dependent on the fortunes of his own firm. It doesn't work as well for firms with shrinking markets and an aging labor force, or for the vast majority of Japanese who work for small and medium firms.

The good news is that Japan has, in the past, deliberately changed its labor market system via a cooperative effort of firms and the government. That is, after all, how the lifetime employment system was created in the first place in the 20th century. What people created, people can change.

Trust

After a while, institutions create attitudes that reinforce both the institutions and the policies. The ability of these policies to work

well depends on these attitudes, which cannot be created overnight.

Trust is one of the most important attitudes, emphasized Soren Andersen of the University of Copenhagen. "Scandinavian workers are willing to provide firms with flexibility because they really trust that they will get security in return." Trust is not easily or quickly built. "The other day, I had a visit from French unions. They liked the security part. But, they felt, that, even if they offered employers more flexibility, they wouldn't get society-wide security in return. They'd just get 'Flexploitation'."

Another important attitude is that social benefits are designed to enhance the feeling of all citizens that "we're all in this together." Benefits like free health care or free child care are 'universalistic,' i.e. they are provided to everyone, not just to the 'deserving poor.' As a result, most everyone feels that, "We pay high taxes, but we're also the ones who get the benefits. We all get sick. We all need education. We all risk losing our job. We all get old."

Nuder underlined that the universality of the benefits generated both efficiency and trust in the system. "A universal system can be cost-effective. To see that, just compare our health system to that in the US [the US spends more on healthcare as a share of GDP than any other rich country, but doesn't reap proportional benefits—TOE]. Secondly, there is no doubt that the universality of the system is critical to maintaining political support for it. Even the wealthiest Swedes can take benefits from the system. We don't want a system where you have to pinpoint those who are in need for others' charity. In the long run, that would lead to a situation where the rich and the middle class start to question why they should pay high taxes if they don't get the benefits."

In other words, voters support the programs of the Scandinavian welfare state because they see them as a kind of social insurance, like unemployment compensation or social security, rather than as charity.

By contrast, in countries like the US and Japan where, among non-retirees, many government-paid economic benefits are reserved for just the poor, many citizens feel: "We pay the taxes, but *they* get the benefits." Hence, voter support for such programs is low. Similarly, as more American and Japanese parents, dissatisfied with the public schools, send their children to private schools, they are less willing to pay taxes to support the

public schools.

Without trust and universality, governments can be immobilized. When Scandinavian governments were forced to dispense harsh medicine in the 1980s and 1990s to get out of crisis—and at later points as well—voters swallowed it because they were convinced it would be done fairly. Professors Junko Kato and Bo Rothstein contrast this with Japan, where, “a minimal welfare state and previous policies of directing government funds to special interests (e.g., in the form of construction projects and rice subsidies) meant that the majority of citizens did not consider public expenditures to be particularly useful or legitimate.”

This has had a big impact on government’s credibility and ability to implement policy. Social Democrats in Sweden were able to convince the public that increased taxes and cuts in benefits were plausible measures to eliminate huge deficits and so guarantee the long-term viability of the Swedish welfare state. In Japan, by contrast, the public is skeptical when the government says it needs to raise the consumption tax to finance the growing ranks of aged.

A real two-party system

Genuinely contested elections where parties (or coalitions) alternate in power are a critical buffer to reform. Any system, no matter how good, eventually becomes obsolete. The true test of a political system is whether it has the capacity to adjust as conditions change. Without truly contested elections, such adjustments are very hard to achieve. A party that is always in power becomes aloof, rigid, and unresponsive. On the other hand, a party that is never in power becomes irresponsible. The experience of victory and defeat causes parties to change.

Like Japan, Scandinavia suffered from decades of one-party dominance, in this case the Social Democrats. Just as Japan’s LDP became too protective of weak sectors and firms, so the Social Democrats became too “socialistic,” causing the economy to underperform and eventually lapse into economic crisis in the early 1990s.

The initial solutions proposed by Scandinavia’s center and conservative parties didn’t work either. In the effort to curb Social Democratic excesses, these parties proposed a “neoliberal” solution modeled on those of Ronald Reagan and Margaret Thatcher. Back in 1993, the current Danish Prime Minister, Anders Fogh Rasmussen of

the Liberal Party, wrote a book, *From the Social State to the Minimal State* pushing a neoliberal approach. The current Swedish Prime Minister, Fredrik Reinfeldt of the Moderate Party, took the same line during the same year in a book called, *The Sleeping People*. They argued that the problem was not this or that particular excess, but the entire Scandinavian welfare state model.

However, when these parties eventually got a chance to rule and tried out these policies during the crisis of the early 1990s, their responses turned out to be economic disasters that quickly led to political defeat. As a result, both the Moderates in Sweden and the Liberals in Denmark abandoned neoliberalism. This is not just a matter of changing their rhetoric to gain votes, but a genuine change in their view of what kind of policies actually work in Scandinavia. In our opinion, neoliberalism is just as unsuitable for Japan as LDP protectionism.

Today, neither Sweden nor Denmark is a one-party state. In both countries, the Social Democrats and center-right coalitions regularly alternate in power. That has made all the difference for their successful reform from the crisis of the 1990s. Just as the Swedish Moderates and Danish Liberals have abandoned neoliberalism, the Social Democrats have become less ‘socialistic.’

Harnessing globalization

Rather than fearing globalization, the Scandinavians have harnessed its power to break down anti-competitive practices at home. Some reformers in the Ministry of Economy, Trade and Industry (METI) would like to see Free Trade Agreements perform the same function for Japan.

Like Japan, Scandinavia found its economies hobbled by formal and informal cartels. Stefan Folster, chief economist, Confederation of Swedish Enterprise, explained, “Cartels were legal. They would divide up the country and companies would have monopolies in their region. They were quite common.” McKinsey Global Institute contends that “toothless” competition laws in the past de facto allowed firms to fix prices across entire industries. Just as in Japan, Sweden and Denmark imposed regulations—from limits on large-scale stores to regulations concerning hours—aimed at protecting mom and pop shops. Not surprisingly, productivity growth began to sag.

One of the chief weapons in overcoming this problem was joining the European

Union’s unified market, which Sweden, Norway and Finland did in 1995; Denmark had already joined the EU’s predecessor, the European Community, in 1973. “In joining the EU,” explained Folster, “Sweden had to introduce competition law, which didn’t really exist before that. Deregulation of restrictions on large stores has caused high food prices to drop toward EU levels.”

However, the real competitive impact came not from EU rules, but from the increase in globalization on the ground. The ratio of trade to GDP (in current prices) in Denmark and Sweden rose from about half of GDP in the 1960s to around 90% today. The cumulative stock of inward Foreign Direct Investment (FDI) soared from 5-7% in 1990 to around half in 2006. The increased competition forced domestic firms to either improve or stand aside. “Having a domestic monopoly doesn’t give you that much power when imports are half of the market,” said Folster.

At the same time, these countries spent a lot of money upgrading the skills of their people so that workers were able switch to more skill-intensive sectors. At any given time, nearly a third of Danes engage in adult education and retraining.

The overall result was a technological transformation of the country, bringing leaps in both productivity and real wages.

Where to start

Like Rome, the Nordic model was not built in a day. It took decades. How then can a country like Japan switch from a system of job security, i.e. protecting a person at his current job, to the income/employment security embodied in Scandinavia’s Flexicurity philosophy. “You could start,” Frederiksen replied, “with making sure that certain benefits are not tied to a single employer. In southern Europe, to get a pension you have to work at the same company until you retire. Otherwise you lose all the money you have put into your pension plan. To our mind, this binds people to a single company in a bad way. You have to rethink the concept that it is the company that provides everything from child care to the pension. If that system exists, you cannot create flexibility.”

Japan does not need to remold itself into either the American model or the Scandinavian model. However, in forging a revitalized Japanese model, Japan can learn from others in the spirit of the Iwakura mission.