

Export Sector-led Adjustment in Trouble? Unemployment, Fiscal Reconstruction and Welfare Reform in Germany and Japan

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Abstract

In the 1990s, Germany overloaded its social insurance system without reducing unemployment, whereas Japan accumulated unprecedented public debts without economic recovery. However, both countries maintained trade surpluses amid a severe depression. Furthermore, Germany restored budget balance and Japan enacted welfare retrenchment. This paper argues that the contrasting adjustment patterns of Germany and Japan can be coherently understood as cases in which two types of export sector-led employment adjustment in non-centralized coordinated wage regimes were aggravated. The German export sector's dependence on social insurance schemes for employment adjustment made it intolerant of other fiscal burdens even at the cost of unemployment, while the Japanese export sector's dependence on business expansion for employment adjustment made it intolerant of social insurance burdens compared to fiscal deficits.

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I. Introduction

The Puzzle: Structural Maladjustment or Reinforced Sectoral Adjustment

In the 1990s—with the fall of the Berlin Wall in Germany and the burst of the asset bubble in Japan—the two economic powerhouses of the 1980s turned into the economic laggards. The growth rates of Japan and Germany were less than a half of the US and were the lowest among the G7. In Germany and Japan, prolonged stagnation led to unprecedented levels of unemployment and the need to cope with unemployment put severe pressure on government finances. Facing fiscal pressure, Germany and Japan tried to restore fiscal balance *and* retrench social programs, especially public pensions. However, Germany was unable to enact effective employment policy and pension reform in 1996 (with pension reform being suspended in 1998) and Japan abandoned fiscal reconstruction in 1997 making it the only G7 nation that allowed the public debt to *increase* at this time, as shown in Figure 1.

Conventional wisdom regards Germany and Japan as cases that failed to adjust to changing economic circumstances.¹ Neither country seemed able to generate growth and employment because of heavy social security burdens or fiscal deficits. However, the picture seems less simple upon scrutiny. Two points warrant attention. First, despite low growth rates, Germany and Japan recorded the largest trade surpluses among the G7 (Figure 2). Second, such critical accounts neglect the fact that Germany reduced budget deficits (seen in Figure 1) while Japan carried out pension retrenchment in 1994 and 2000 with relatively little resistance.

Figure 1 & 2 about here

The puzzle that derives from the above is twofold. Why were Germany and Japan able to maintain export competitiveness in a recession and why did both countries only partly fulfill their objective of fiscal and welfare retrenchment? In need is a coherent explanation of why maintaining export competitiveness compelled Germany to delay social policy reform despite fiscal reconstruction, and Japan to enact pension retrenchment while abandoning fiscal reconstruction.

Existing approaches to fiscal and social policy reforms (or their failures) have problems addressing the above puzzle. Economic globalization, for instance, is commonly listed as the cause of fiscal and welfare retrenchment. The most plausible explanation of how economic globalization affects fiscal and social policy is the capital mobility theme, which argues that capital mobility imposes fiscal and welfare reform by constraining the government's ability to reflate the economy during hard times.² Actually, such an explanation makes retrenchment undertaken in Germany and Japan

more puzzling because these two countries were rare instances in which the governments were not compelled to enact tight monetary policy and fiscal retrenchment by exchange rate or balance of payments problems caused by inflation. Unlike the UK in the late 1970s, Canada and France in the early 1980s (for different reasons), or Italy, the UK, and Sweden in the early 1990s, Germany and Japan maintained low inflation, balance of payment (especially trade) surpluses, and a strong currency throughout the 1980s and 1990s. Neither the German nor the Japanese government had to tighten monetary policy and cut fiscal spending to curb inflation in order to maintain the value of the currency, preserve foreign reserves, and promote industrial competitiveness. Rather, Germany was the only major West European country that did not subject monetary policy to exchange rate stability because the D-mark *was* the anchor currency of Europe as a result of Germany's low inflation. Immunity to inflation also distinguishes Germany and Japan from the US, which was compelled to enact tight monetary policy in the early 1980s to curb inflation, although the US was unique in its large trade and budget deficits despite attempts in fiscal and welfare retrenchment.

Theories that explain why policy reforms are hard to come by have difficulties in explaining the differences in fiscal and pension reform within the same country, whether the cause of reform difficulties is policymaking structure or program resilience. Again, the similarity of Germany and Japan makes the two countries a suitable pair for comparison. The concerted nature of German or Japanese policymaking has often been mentioned as the cause of policy deadlock and therefore for slow or compromised reforms.³ Indeed, both Germany and Japan are generally regarded as consensus democracies as opposed to the Westminster-type adversary democracies.⁴ Similarly, although the recent literature emphasizes the path dependent nature of entrenched social programs,⁵ German and Japanese unemployment and pensions schemes are classified as Bismarck or conservative.⁶ Thus, neither the policymaking structure nor the program structure explains why Germany had more problems reforming the unemployment pension system than balancing the budget and why it was the opposite for Japan. Instead, one would expect fiscal reconstruction to be easier in the fiscally centralized Japanese unitary state than the fiscally decentralized German federal state.

More directly related to the above puzzle is the most recent debate on the impact of economic globalization on the welfare states of open economies. While those who focus on the path dependent nature of welfare programs are skeptical on the impact of economic globalization on such programs, others stress the new policy challenges confronting the welfare state. Thus, on the one hand, those who analyze the causes of welfare program change, like Pierson and Iversen, identify post-industrialization, demographic change, and fiscal restraints have a stronger impact on welfare programs than economic globalization.⁷ Since the interest here is the structural causes of welfare reform, there is less an interest in the processes of policy change. On the other hand, others like Scharpf argue that economic globalization creates new policy problems while

constraining the fiscal ability of the state and political resources of social groups to solve such problems.⁸ As a result, by examining the process of policy change, this school of thought focuses on the variety of adjustment patterns to the general constraint of economic globalization. The two schools, however, share a common recognition on serious impact of industrial change and fiscal austerity on the welfare state. They differ on whether such trends are constraints independent from the global economy or whether they are affected by the way in which countries adjust to economic globalization.

Although our framing of the puzzle and selection of cases aim to present a framework that will improve the adjustment literature on the impact of economic globalization, our results have suggestions on the structural constraints on the welfare state discussed at the end of this paper. We see two problems that need to be addressed with regard to the adjustment literature. First, the literature predominantly uses economic performance to evaluate the effectiveness of policy reform, making Germany and Japan as cases of policy maladjustment.⁹ Instead, we ask why attempted reforms are easier in some policy areas than others because we think that many variables other than institutions and program characteristics affect economic outcomes at a certain point in time. In other words, we think political and institutional factors are more suited to explain priorities on policy reform than economic performance. Second, the existing literature usually views the global economy as a common constraint on institutions that causes different policy outcomes. Such a view, however, cannot capture the true impact of global economy on policy changes because it does not explain how the adjustment to the global economy creates different domestic demands for (fiscal and welfare) policy change. To rectify this problem, we propose a two-step approach that explains first the consequences of international economic adjustment and then the impact of such domestic adjustment on fiscal and social policies. To implement a two-step approach we focus on the key *agents* of international economic adjustment—the trade-competitive industries (hereafter, export sector)—and select two countries that are similar in their international economic profile (i.e., low inflation and large trade surpluses) and the characteristics of the export sector.

This paper adopts such a two-step approach to explain how the export sector arrangements that facilitated trade competitiveness resulted in different government priorities over fiscal and welfare retrenchment. We stress the need to focus on export sector's employment adjustment problem as the link between export competitiveness and retrenchment policy. More concretely, we stress the following three points. First, it is the employer-union cooperation in the export sector that contributes to low inflation and reinforces competitiveness. Second, employment adjustment of the export sector generates broader social and fiscal policy demands shared by other sectors to cope with the problem of labor redundancy. And, finally, the export sector employer's opposition to increased tax and social contribution burdens shapes the government's priority in policy retrenchments, especially between social policy and fiscal retrenchment.

Seen in this perspective, the contrasting patterns of policy adjustment in Germany and Japan during the severe recession of the 1990s reflect the reinforcement of the different ways in which the export sector of the two countries utilized public policy to facilitate employment adjustment and cope with general unemployment. For both countries, low inflation and trade competitiveness has been the result of cooperative employer-union relations in the export sector, in which the unions moderated wage demands to maintain trade competitiveness and cooperated with employers in employment adjustment. The seeming paradox of Germany and Japan maintaining large trade surpluses amid economic stagnation can be explained as a result of the export sector's continuing ability to rationalize employment, especially during hard times, during which unemployment increased and demands for remedies were voiced by broad sectors of the economy. However, while employment adjustment in Germany depended heavily on unemployment benefits and pension schemes, in Japan it depended on labor market policies and public investment. When the burden on social insurance schemes in Germany and large public debts in Japan during periods of employment adjustment conflicted with the export sectors' opposition to higher social security and tax burdens, the export sector employers pressed for the retrenchment of programs other than those critical to employment adjustment. The reinforcement of the above adjustment patterns during the recession of the 1990s enabled Germany to recover fiscal balance at the cost of stalled unemployment insurance and pension reform and Japan to enact pension reform at the cost of increased public investment and public debt.

Section II is divided into two parts. In Part 1, we show that in both Germany and Japan non-centralized wage coordination led to low inflation and persistent trade surpluses. We also describe that it was export sector unions in Germany and large firms of the export sector in Japan that orchestrated wage coordination. Part 2 is divided into three. We begin by showing how different wage coordinators affect employment adjustment measures and how the interaction between export-sector employers and other actors shape the government's policy retrenchment priorities. That is followed by an examination of the policy dilemmas faced by the export sector in the Germany and Japan. The conclusion will summarize the general implications of our argument to the recent developments in the literature of employment adjustment, the welfare states, and coordinated market economies and reiterate the merits of our approach in understanding Germany and Japan.

II. The Cases: Germany and Japan

1. The Similarity: Non-centralized Wage Coordination

Recent developments in the comparative political economy literature ascribe trade competitiveness and low inflation to export sector-accommodating wage

coordination. Such claims revise the earlier neo-corporatism literature, which attributed low inflation and low unemployment to comprehensive unions and centralized collective bargaining.¹⁰ The Calmfors-Driffill model—which provides the theoretical foundation for the centralization theme—stipulates low inflation and low unemployment at the highly centralized and decentralized poles of labor market structures.¹¹ Where the unions are comprehensive and centralized they internalize the negative effects of high wage increases on their members' employment and therefore moderate wage demands, whereas fragmented unions are subject to competitive labor markets and cannot realize wages high enough to aggravate unemployment. This view, however, has difficulties accounting for trade competitiveness. Empirically, centralized wage bargaining broke down in typical neo-corporatist countries when the issue of trade competitiveness aggravated the conflict between the exposed and sheltered sectors.¹² As a result, views that look into sectoral interests have become persuasive in explaining wage coordination and industrial competitiveness.¹³

There are two complementary views that attribute wage coordination *without* centralized bargaining to low inflation and trade competitiveness. One view is that of David Soskice who ascribes the competitiveness of a certain type of market economies to the merits of long-term commitments in almost all aspects of corporate governance; i.e., wages, skill formation, corporate finance, research and development.¹⁴ According to Soskice, coordinated market economies, in contraposition to liberal market economies, facilitate long-term relations between employers and employees that is conducive to industrial competitiveness, including wage moderation in order to maintain competitiveness and employment security. However, for Soskice employer-union cooperation is only one of the micro (or corporate)-level factors that contribute to competitiveness, and he has yet to provide evidence on how corporate characteristics entail macroeconomic outcomes. The other view of Peter Swenson focuses on the export sector in support of the idea that wage coordination does not necessitate centralized wage bargaining. Swenson argues that a cross-class alliance of employers and unions of the export sector have an incentive to engage in wage moderation to maintain international competitiveness and to extend that wage standard nationwide by allying with other sectors of the economy in order to reduce wage competition and inflation.¹⁵ According to his view, neo-corporatist centralized bargaining represents one way in which the export sector can fasten its alliance with other sectors of the economy in order to impose its wage standards. Soskice and Swenson are complementary in that the former regards wage cooperation in the export sector necessary for sustained industrial competitiveness, while the latter stresses the necessity for the export sector to extend its wage settlement nationwide to result in low inflation. Both Soskice and Swenson seem to regard neo-corporatism as one variant of a larger class of regimes in which wage coordination led by the export sector results in and low inflation and industrial competitiveness.

Germany and Japan can be considered as a similar case of cooperative and coordinated but not centralized wage bargaining. Surveys by the OECD rank Germany and Japan among the top countries with coordinated wages.¹⁶ In both countries, wage coordination was led by the export sector, albeit in different ways. In Germany, the metal workers unions accepted coordinated wage moderation during the D-mark appreciation of 1976-1980, when exports contracted and balance of payments deteriorated. Facing high inflation after the first oil crisis, the metal workers union (IG Metall) assumed wage leadership when it recognized that double-digit wage packages realized under the leadership of the public sector union in 1974 might lead to massive layoffs. The moderate unions could not afford high wage increases, if they were to maintain social partnership. The Bundesbank was also willing to tighten monetary policy at the first signs of wage inflation. This wage system remained in effect during the rapid currency appreciation of 1985-1988 and the post-unification recession of the 1990s.

In Japan, coordinated wage moderation led by export sector was completed in 1975 immediately after the first oil crisis and continued thereafter despite changes in economic conditions. During the 1975 wage bargaining round, the export-industry unions led by the steel union called for wage moderation and agreed on wages increases within the guidelines set by the employers' association, only a year after the public-sector union led bargaining won a 30 percent wage increase. Thereafter, the annual wage increase for the major firms in the metal industries was extended to domestic sectors at rates close to the inflation rate, which was low among the advanced nations.¹⁷ Wage coordination in Japan, however, was the result of *employers* referring to the large export firms in their wage negotiations, and the wage leadership of the large export firms remained intact despite the replacement of steel by the automobiles and electronics firms in the mid-1980s.¹⁸ As a result, wage coordination in Japan leveled wage *increases*, thereby fixing *wage differentials according to firm size*, whereas in Germany it resulted in equalizing wage *differences* among industries. The different consequences of the German union-orchestrated and the Japanese employer-orchestrated wage coordination can be seen in Figures 3a & 3b.

Figures 3a & 3b about here

In both in Germany and Japan, the export sector-led wage coordination resulted in low inflation and trade surpluses since the later 1970s, despite the rapid appreciation of their currencies. The inflation rates of the G7 countries (as well as the OECD average) in Figure 4 shows that Japan and Germany maintained low inflation, except 1974-75 in Japan and 1992-93 in Germany. The average inflation rates of Japan and Germany between 1975-99 were significantly lower than the remaining G7 countries or the OECD average. Figure 2 has shown that, Germany and Japan are the only two

G7 countries that have been recording a significant trade surplus. It is noteworthy that both countries showed trade surpluses in the early 1990s despite prolonged economic stagnation. Interestingly enough, Germany and Japan recorded large trade surpluses despite the export sectors being continuously pressured by currency appreciations, except for the high dollar period of the early 1980s. The exchange rates between the D-mark and the yen against the dollar shows a rapid appreciation of the D-mark and the yen in the late 1970s and after the mid-1980s, with a period of high US interest rates and high dollar in between.

Figures 4 about here

2. The Difference: Employment Adjustment and its Effect on Public Policy *The Two Patterns of Employment Adjustment*

Intensified global competition aggravated by currency appreciation resulted in recessions caused by export contraction that spread to non-export sectors and put enormous pressure on the export sector to cut labor costs and rationalize employment in order to remain competitive. Facing a similar problem of labor redundancy, however, German and Japanese employers in the export sector pursued employment adjustment in different ways. Exiting elderly workers from the labor market was the major tool of employment adjustment in Germany, whereas Japanese employers preferred re-employment of elderly workers in lower-wage sectors of small businesses. Accordingly, the export-sectors in the two countries called for different public policies conducive to their patterns of employment adjustment. Why did the export sectors in Germany and Japan undertake contrasting employment adjustment measures in the first place?

We hypothesize that the roles played by the unions or the employers in coordinating wages nationwide affect the preference of the export sector with regard to employment adjustment policy. Where the employers and unions value cooperative employment security, the most effective way for employers to rationalize employment and cut labor costs to maintain competitiveness is to move elderly employees out of the firm, while unions pressure employers to retain and re-train employees. The way in which this conflict of the interest between employers and unions is solved differs depending on the agent of wage coordination.

In Germany where industrial unions orchestrated wage coordination, their demands for employment security are too costly even for employers of the export sector, and much more so for the non-export (i.e., less competitive or sheltered) sector employers. Furthermore, the unions of the non-export sector could side with their employers and break union solidarity in order to preserve employer-union cooperation in their industry. As a result, in order to maintain nationwide union solidarity, the export sector unions are likely to compromise with the non-export sector unions on employment adjustment, calling for less costly measures. Early retirement, dependent on

unemployment benefits and pension insurance, appears as a compromise, as the export sector cross-subsidizes the non-export sector in social insurance schemes. Thus, the interests of the unions and employers, driven by the unions' quest for unity, converge on the promotion of private and government measures to facilitate early retirement into the pension scheme. As a result, employment adjustment and unemployment reduction depended heavily on state policy. Although employers-union cooperation is by no means the only path that leads to early retirement into pension, this pattern is compatible with non-centralized wage coordination.¹⁹

By contrast, in Japan where employers of large export-sector firms orchestrate wage coordination, such employers can accommodate the union demands for retain employees by shifting elderly employees into lower-wage small-business sector. Small businesses are willing to hire released workers from the export sector at lower wages, especially if there is a monopolization of skilled employees by large firms. Since Japan's employer-orchestrated wage coordination does not level wage differences across sectors but instead maintain wage differences according to firm size, there exists a dynamic lower-wage small business sector that can absorb redundant workers. As a result, the interest of the large firm employers dominated by the export sector, and that of small firm employers converged on measures that assisted small businesses and kept elderly employees active in such lower-wage small business sector. The public policies preferred by all sectors included counter-cyclical public investment, active labor market measures, and industrial aid to depressed industries.

Available data clearly indicate that employment adjustment is achieved by exiting elderly workers from the market in Germany and by retaining them in the market in Japan. Figure 5 depicts differences between Germany and Japan in the labor participation rates of elderly male employees in three age cohorts (55-59, 60-64, and over 65). The differences are (1) in the same age cohort labor participation in Japan is much higher than Germany; (2) the difference between the employment rates of the same age cohort widens as the age bracket goes up; and (3) the labor participation rates have declined more steeply in Germany. Furthermore, in Germany elderly participation rates moves in sync with the unemployment rates, whereas, whereas in Japan the labor participation rates of those 55-59 and 60-64 have *increased* in the 1990s despite an increase in unemployment rates.

Figure 5 about here

Even though the agents that orchestrated wage coordination—export-sector industrial unions in Germany and export-sector large firms in Japan—called for public policies that facilitate employment adjustment, the employers of the export sector avert increases in tax or social policy burdens due to the negative effect on international competitiveness. Facing the dilemma of their need of public policies conducive to their

employment adjustment and their bearing of a large portion of their costs, export sector employers are likely to strongly oppose the expansion of government programs other than measures that are crucial to their employment adjustment. Thus, in the case of union-orchestrated adjustment, early retirement and pension schemes remain resilient, whereas the employers and unions become split over the expansion of employment schemes or counter-cyclical spending. The importance of maintaining competitiveness, usually compels the government (and to a lesser extent the unions) to accept the employers' policy demand to restrict government spending, diminishing the governments ability to control unemployment. In contrast, in the case of employer-orchestrated adjustment, export sector employers tolerate counter-cyclical spending that would expand business opportunities, while their demand to retrench social policy face resistance from the unions and small businesses. However, opposition to social policy retrenchment can be ameliorated if employment adjustment is geared towards keeping elderly employees active in the market, since elderly workers can be asked to contribute to welfare schemes while receiving less benefits.

Indeed, as seen in Figure 6, Germany's unemployment rates fluctuate wide in sync with economic cycles, whereas Japan's unemployment rates are flat. Likewise, Figure 1 depicts Germany's public finances to fluctuate conservatively with only short periods of low budget deficits, whereas large counter-cyclical budget deficits are seen in Japan.

Figure 6 about here

So far, the basic indicators on elderly employment and the cyclical trends in unemployment and deficit spending show that we can discern two different types of export sector-accommodating adjustment in Germany and Japan. In what follows, we provide further evidence that the wage coordinators promoted policies that helped employment adjustment and that the demand by export sector employers to curb tax and social insurance burdens led to fiscal or welfare retrenchment other than the core employment measures.

Germany: Social Policy Dependent Adjustment

From the above reasoning, we stress the following three points with regard to Germany. (1) Early retirement and heavy dependence on social policy for employment adjustment resulted from a compromise between the export sector unions and the non-export sector unions. (2) Employers are likely to prevail over the unions in favor of fiscal and employment program retrenchment other than those related to employment adjustment. And (3) the pattern of social policy dependent adjustment continued in the 1990s but was less effective as a remedy to the recession of the 1990s triggered by German unification. Furthermore, the relatively familiar German case of wage

coordination, employment adjustment, early retirement, and fiscal restraint provides a baseline for the less understood and more obscure case of Japan.

Various paths of exit from the labor market into the public programs were institutionalized after the late 1970s as employers sought ways to release employees and rationalize employment. In exchange for wage moderation the export-sector unions negotiated employment security with employers. As a result, for instance, workers in electronics and automobiles pressed management to avoid layoffs by relying on transfers and retraining, while the works councils of steel industry agreed on layoffs in exchange for generous early retirement plans.²⁰

Promoting early retirement was an issue on which both the militant metal unions and the more moderate union could agree. Actually, IG Metall preferred to pursue issues of codetermination expansion and workweek reduction in order to prevent firm-level cooperation from eroding the combative role of industry unions. By contrast, the moderate unions opposed the 35-hour workweek and instead stressed the utility of early-retirement plans to cope with unemployment. Because of union disagreement and, more importantly, strong opposition from the employers, the Social-Liberal government was able only to pass a compromising expansion of codetermination in 1976, and IG Metall was unable to win a 35-hour workweek in 1978-79 despite a six-week strike.²¹

Instead of workweek reduction, early retirement became the major means for employers to reduce employment and cut labor costs. There were three major paths of early retirement, (a) disability pensions, (b) pensions after long-term unemployment at sixty, and (c) flexible retirement at age sixty-three. The disability pension became a "disability-unemployment pension," strongly contributing to early exit for the age cohort of 55-59, when a Federal Social Court ruled in 1976 (following a 1969 precedent) that an employee can receive a full disability pension even if the person is partially disabled and can work part-term. Most firms, however, used the popular path of long-term unemployment pension by urging workers at 59 or younger (the 59er rule) to leave by offering to top up their unemployment benefits to the level of their last net earning until the employee can draw a pension at sixty. The companies started to make systematic use of this pathway during the economic problems of the late 1970s to reduce their work force and replace older workers with qualified and less costly younger ones. Indeed, the users of unemployment pensions among male employees tripled to 6-7 percent in the late 1970s and then increased to 10-12 percent in the 1980s. By the early 1980s almost every union had signed collective bargaining agreements that offered for elderly members early retirement and other flexible work models. Finally, flexible retirement at age sixty-three, introduced in 1973 (requiring 35 insurance years with a contribution period of at least 15 years), failed to become popular because of the availability of other retirement paths.²²

Since the wake of the oil crisis, German government maintained a generally

restrictive fiscal policy regardless of partisan affiliation and despite increasing unemployment against the backdrop of tight monetary policy. The dominant view in the Social-Liberal and then the Christian-Liberal governments and the industrial circles was that fiscal austerity and reduction of corporate burdens was necessary for economic recovery. Thus, austerity packages immediately followed sporadic spurts of domestic stimulus, which put pressure on unemployment and pension schemes by reducing government subsidies. Fiscal austerity first targeted employment programs other than early retirement, such as vocational education and training, before it eventually tightened the eligibility of early retirement programs, despite the increased use of the programs and its importance for industrial adjustment. Thus, fiscal restraint exacerbated the dilemma of insurance schemes and rendered them insufficient to counter cyclical unemployment.²³

For instance, the Budget Structure Law of 1975 severely cut educational and training programs despite high unemployment shortly after the reflationary package of 1974 increased spending to address structural depression and cut income tax. Similarly, the first signs of inflation and deteriorating trade balances in 1981, as a result of the 1978-79 stimulus package, compelled the Bundesbank to tighten monetary policy and the Social-Liberal government to enact cuts in social and employment programs, in spite of rising unemployment shortly. The 1981 amendment to the Employment Promotion Act scaled down active labor market measures, while the 1982 Consolidation of Work Promotion Law tightened the eligibility for and the allowances of government-sponsored training and retraining programs. However, the government's attempt to force firms to pay back unemployment benefits that the FLO paid to long-term unemployed workers dismissed at the age of 59 was challenged in the courts before it took effect.²⁴

Efforts in fiscal reconstruction continued under the Christian-Liberal government after 1982 by way of tightening benefits and increasing indirect taxes and social insurance contributions. The Budget Reform Acts of 1983 and 84 increased the VAT and social insurance contributions, imposed a forced loan on the better off, postponed the annual increases in pensions and income support programs, and cut family allowances and educational grants. More importantly, in 1983 unemployment benefits were reduced and in 1984 the eligibility for disability pension (three years of employment within the last five years) was tightened, which affected mostly housewives without recent work experience. The government was unable to cut back on spending for early retirement. The Pre-retirement Act of 1984 to provide an alternative to the costly unemployment benefits of the 59er rule and government policy to force firms to reimburse social benefits received by dismissed workers before they reached the age for flexible retirement were both ineffective.²⁵

Furthermore, as soon as the economy recovered in 1985 the government enacted large corporate tax cuts, reversed earlier cuts in training programs, and implemented

pension retrenchment, accommodating the interests of the export sector. The 1986 tax reform concentrated on corporate tax cuts and in 1987 a 20 percent corporate tax cut, funded by social security cuts and increases in VAT was proposed [CHECK]. Between 1985-87 the government rapidly extended the maximum period of unemployment benefits.²⁶ Finally, in 1989 the German government passed the Pension Reform '92, which gradually raised the pension age until 2001, making 62 the earliest pension age and a reduced pensions for early retirees, and planned a 65 retirement age. Other elements of pension reform included the raising the contribution rates, lowering of benefits (calculated from net instead of gross earnings), and increasing the state's contribution out of general taxation. The Social Democrats and the unions resisted a concrete schedule for extending the retirement ages, arguing that a significantly lower unemployment would be necessary to extend work life.²⁷

Shortly after unification, the German economy sank into recession when the Bundesbank acted against inflation and high wage increases during the immediate post-unification boom. The adjustment pattern characteristic of Germany remained resilient during such hard times mostly because the western export sector extended their organizations to former East German and transplanted familiar institutions of economic adjustment. The unions accepted wage moderation and insurance schemes were used to facilitate employment adjustment and curb unemployment, and the government restored budget balances by increasing indirect taxes and social insurance contributions.

Social partnership based on firm-level codetermination and wage coordination established a solid presence at eastern Germany within a short period. As a result of institutional expansion, in 1993, the works councils of large automobile firms traded-off pay and benefit concessions for new investment and job guarantees, and similar agreements had spread to major electronics firms. Amid such institutional developments, the employers tried to back away from phased-in wage parity between the former West and East and launched a new offensive to hold down labor costs. Employers, especially of small and medium sized firms, felt that the unions had made too many gains in wages and workweek reduction during the boom of the late 1980s. However, when the metal workers threatened to strike during the 1994 bargaining round, the metal industry employers backed off and negotiated a compromise. While employers secured a real wage restraint, they agreed to work-hour reduction and employment security (following the so-called VW model). The metal agreement had an impact on other bargaining sessions. Wage settlements of all industries were fixed below inflation even in thriving industries such as construction and banking.²⁸

After unification early retirement and part-time employment became widely used to cope with unemployment despite the metal unions' demand for comprehensive employment and industrial policy to halt de-industrialization and rebuild the eastern economy. The integration of the pension and unemployment schemes of the former east to the western system assisted and shaped the pattern of employment adjustment.

Furthermore, active labor market policy, used to improve public infrastructure, was expanded to an extent unseen in former West Germany. By late 1991, 700,000 had taken early retirement, an equal number held temporary position in job creation schemes. 4,000,000 people in eastern Germany were participating in government-subsidized training programs, and another one million had their jobs subsidized by the government through "short-time" work allowances. In 1994, 40 percent of the outflow from unemployment was in active labor market programs. To fund the programs the government in 1991 increased unemployment insurance contribution by 2.5 percent. West German pension contributions now covered deficit in the east deriving them of a surplus and compelled the government in 1992 to raise the employee insurance contributions by 3 percentage points. Between 1990-98 the total of social security contributions rose from 36 to 42 percent.²⁹

To finance the unification, therefore, the bulk of the adjustment costs were burdened by the insurance schemes, although the government did increase taxes to avoid deficit spending. Indeed, the government abandoned its "no tax-raise" commitment and pass the Solidarity Law and the Tax Amendment Act of 1991, which introduced a temporary 7.5 percent surcharge on personal and corporate income taxes, increased excises, and proved the new *Länder* with temporary tax expenditures. To provide additional funds while cutting the public debt the government reached a set of understandings with the *Länder* states, the unions, and the opposition known as the Solidarity Pact. In the Pact, the federal government renewed its commitment to massive spending in the East for infrastructure development (roads, railroads, government offices, etc.), active labor market policy, and new investment incentives to protect eastern businesses. The states accorded to a raise of the VAT and to fund the eastern states in exchange for a revision of the financial equalization scheme, which increased the state's portion of the funds vis-à-vis the federal government. The unions indicated their willingness to hold down wage demand in both East and West. Finally, in 1995 the Social Democrats in opposition agreed to deficit reduction and a tax surcharge in exchange for no welfare cuts.³⁰

With the heavy reliance on employment and pension schemes for economic adjustment, the possibility of the unions would agree on their retrenchment during high unemployment was slim. When the government presented its proposals on welfare retrenchment in which included a general benefit freeze and gradual extension of the retirement age, the unions left the negotiations in protest and organized a campaign against welfare cuts. The 1996 pension reform including phasing-in of benefits and increased age limits was unilaterally enacted by the government only to be suspended by the new Red-Green government in 1998. Also, the government's decision in 1996 to change pre-retirement for employees over 55 from a full to a partial retirement plan was in effect undermined by employers who had used the system extensively, especially in the eastern states.³¹

Compared to the relative success of the former western export-sector employers and unions in expanding their organizations and transplanting the institutions for economic adjustment, inaction in employment and pension reform amid high unemployment seems like a policy failure. However, this pattern of economic adjustment as well as efforts to reduce budget deficits can be regarded as being in accord with the pattern of union-orchestrated adjustment explained earlier and seen in West Germany until unification. Thus, Germany after unification indicates the continuity of its characteristic adjustment pattern of rather than sudden policy paralysis or maladjustment. The same continuity can also be seen in the Japanese case.

Japan: Market Expansion Dependent Adjustment

In contrast to the above German case, the following three points can be seen in Japan. (1) Deficit spending due to public investment resulted from a converging interest of the export sector and low-wage sectors (i.e., small businesses and sheltered sectors). (2) Employers are likely to demand fiscal reconstruction without increasing their burdens as soon as the *exports* showed signs of recovery and they prevail over the unions in favor of social policy retrenchment. And, (3) the pattern of market expansion dependent adjustment continued even during the recession of the 1990s triggered by the bust of the asset bubble aggravating Japan's public debt.

The export sector-led employment adjustment was reinforced during the high-yen and export sector-led slumps of the late 1980s and the early 1990s, and the government enacted pension reforms in 1985, 1989, 1994, and 2000, and tax reforms in 1989 and 1997 to accommodate its demands for lesser social burdens. Since pension retrenchment after the mid-1980s did not conflict with the government's employment policy of keeping the elderly active, the government was able to pass pension reform despite a stagnant economy and rising unemployment.

The export sectors engaged in employment rationalization, especially during periods of rapid yen appreciation, export contraction, and economic slowdown of the late 1970s, late 1980s, and early 1990s. In large firms, the employers cut labor costs by implementing measures in the following order: reduction of overtime, cutting the number of new recruits, firing temporary or part-time workers, deploying personnel to different positions or firms, and offering severance allowances and early retirement plans, as confirmed by numerous surveys.³² Figure 7a shows how these measures were used in manufacturing during periods of employment adjustment, with the late 1970s being the first peak. Figure 7b shows employment adjustment concentrated on manufacturing. When it became necessary to relocate employees outside the firm, large companies used corporate ties between subsidiaries or subcontractors and even created new subsidiaries by diversifying and spinning-off.³³

Figure 7a & Figure 7b about here

The export sector also aligned with other sectors of the economy and the unions lobbying for policies to assist creating employment opportunities. As a result, by 1977-78, the government had enacted extensive measures for troubled firms and their employees, which consisted of subsidies to retain, retrain, and rehire (especially elderly) employees *and* policies to assist firms in depressed industries diversify and small firms convert business. For depressed industries, the government provided incentives to cooperatively reduce production capacity and to diversify business. The application of such measures was contingent on the employers' submitting employment adjustment plans that obtained the consent of the unions. For smaller firms the government offered low-interest emergency loans, special loans for business conversion and equipment modernization, and tax breaks for new investment. In order to help firms absorb released employees, the government expanded subsidies to employers who relocated, retrained or recruited released workers with addition premiums in the case of elderly workers. To help the already unemployed, the government extended the period of employment insurance benefits (with additional assistance for the elderly), increased training subsidies, and put priority on depressed areas for allocating public investments. Thereafter, these policies have been revised and renewed every five years and remains in effect until June 2001.³⁴ In short, private and public policies for employment and industry focused on maintaining workers in the market and expanding employment opportunities by developing the small business sector.³⁵

Increased appropriation for such policies were usually part of large deficit spending packages the bulk of which being public investment programs. The government enacted large stimulus packages in 1978-79, 1987-89, 1992-93, immediately after rapid yen appreciation, and in 1998-99 under strong pressure from the US.³⁶ The export sector could coalesce with other economic sectors in support of US demands provided that the domestic stimulus concentrated on counter-cyclical public investment expenditures and adjustment assistance. To understand why public investment expenditures were preferred, instead of permanent tax cuts or new social programs, it is necessary to understand the unappreciated role of the Japanese construction industry as a major absorbent of small firms and workers released from manufacturing. In fact, the Japanese construction industry is the largest among the G7 that employs 10 percent of the work force and produces 10 percent of the GDP and is composed of overwhelmingly small firms with less than three employees. The industry has been steadily expanding and between 1974 and 1997 and added 2.2 million employees and 200 thousand companies, enough to absorb cyclical contractions of the manufacturing sector. Indeed, surveys of steel and shipbuilding towns in recession record a large number of small firms and workers moving from export-oriented manufacturing into construction-related businesses. The industry is notorious for colluding on public works bids so that business is distributed to the smallest firms.³⁷ In

short, public investment facilitated export-sector adjustment by supporting (until private investment picked up) the construction industry that had absorbed firms and employees released from the export sector.

Although the export sector acquiesced deficit spending packages, it became the main supporter of government plans to reduce public debts as soon as business showed signs of recovery. Thus, the export sector employers led the charge for cuts in corporate taxes and social security burdens in the early 1980s, late 1980s, and mid 1990s. However, the only way the government could accommodate such demands without aggravating the budget deficit was by curbing future benefits and broadly distributing payment increases in social security and by packaging indirect tax increase with income tax cuts. To make social insurance (pension and health care) retrenchment less objectionable, the government further promoted elderly employment and thereby made social security retrenchment compatible with economic and employment adjustment.

Efforts led by peak business associations dominated by the export sector, to reduce the budget deficit in the early 1980s after its increase in the late 1970s were atypical in two ways. The government failed to introduce a new sales tax in 1979 and therefore the export sector insisted on future social insurance cuts. The government's blueprint of the social security reform developed in tandem with its reports on the need to strengthen corporate welfare and to provide incentives for employers to keep employees in the market.³⁸ Based on such suggestions, social partners in large corporations agreed on measures to keep the elderly active by extending retirement, reducing retirement payments, providing recruitment services for retirees, and expanding employee health-care services to retirees. The government's welfare reforms of the early 1980s—the 1982, 1984, 1986 health care and the 1985 pension reforms—had in common (a) benefits cuts and payment increases, (b) government subsidization reduction, and (c) the redistribution of costs from the small firms and the self-employed to the large corporations. While the large corporations could accept (a) and (b), especially since they had installed programs that paid the employees' social security payments, they had to compromise on (c). For instance, the 1985 pension reform integrated the two major pension schemes (for employees and the self-employed) into a two-tier system of flat-basic and income-related supplementary pensions (only to employees), raised contribution rates, curbed future pensions, and reduced government subsidies by concentrating them to basic pensions. Here, large corporations, which had provided retirement payment for their employees, curbed future contribution and government subsidization to public pension, whereas the self-employed obtained concentration of state resources to their basic pension.

The politics of fiscal reconstruction in the 1989 and 1996 (passed in 1994) had a similar feature. The export sector and the government, on the one hand, introduced and raised the consumption tax in exchange for a large income tax cut. The 1989 tax

reform introduced a new 3 percent consumption tax in exchange for a reduction in the number of tax brackets, the lowering of tax rates, and large temporary income tax cuts.³⁹ The 1996 tax reform raised the consumption tax rate to 5 percent in exchange for special and additional income tax cuts. On the other hand, the government, with the support of business groups, reinforced measures to promote elderly employment while incrementally extended the retirement age. In the aforementioned 1985 pension reform, extending the pension age from sixty to sixty-five had to be compromised because of strong opposition from small businesses and the unions that argued the retirement age at most companies was still sixty and that further employment was not guaranteed.⁴⁰ The government had to suffice with stipulating that pension scheme for those over sixty was a “partial” one subject to further review and that a review will be carried out every five years. Meanwhile, the government promoted the extension of statutory retirement age, and expanded programs that encouraged employees to retain, retrain, or recruit employees over sixty. In 1986 the government made the legal retirement age sixty to which firms were to voluntarily abide.⁴¹ By the 1990s, employer opposition to retirement extension waned considerably and the demands shifted towards measures to facilitate elderly employment.⁴² Thus, in the 1994 pension review, the government raised to sixty-five the pension age for basic pensions (by 2013) and expanded the taxable income to net annual income. In addition, the government introduced a program to compensate for severe wage loss for re-employed or relocated employees over sixty, reduced the pension for those employed, and made it obligatory, but not compulsory, for employers to retain employees until sixty-five.

The above adjustment pattern continued in the late 1990s. Once the export sector started to recover, the government embarked on a tax hike and other fiscal reconstruction efforts in 1996-97, however such policies resulted in plunging the economy into a recession, accompanying with the collapse of asset prices and the holder of such assets, namely the banking and construction industry. For the first time in postwar years major banks collapsed and the construction industry contracted significantly. As a result, the domestic economy remained depressed amid growing trade surpluses. However, while the recession compelled the government to abandon the 1997 Budget Reconstruction Law, that mandated it to balance the budget and reduce public debt, in favor of domestic stimulus measures, the government enacted pension reform. The stimulus measures were aimed to expand businesses and keep the elderly in the market, and, as a result, the government was able to rise the pension age for supplementary pensions to sixty-five (by 2025) and index pensions to inflation (instead of wages) without much resistance in 2000. In addition, to keep those between sixty and sixty-five active their pension (to supplement income) was reduced and they were asked to pay pension contributions.⁴³

The above account of Japanese economic and policy adjustments since the mid-1970s show that export-sector employers in adjusting to recurring yen appreciations

avored moving the elderly in the labor market and expanding business opportunities there. To facilitate this pattern of adjustment this export sector concurred to counter-cyclical budget deficits, although it was the first to commit the government to reducing its tax and social security burdens and to restore balanced budgets. The government's policy was to encourage elderly employment did not contradict with retrenching pensions by extending the pension age enacted as a means for fiscal reconstruction. Thus, although Japan in times of economic adjustment did not have face the German dilemma between fiscal reconstruction and pension reform, the cost was the increase of public debt and the neglect of other reforms that might help stimulate the domestic economy. Having established that the contrast between Germany and Japan fits the contrast between union- and employer-orchestrated adjustments, we will now turn to the implications of this comparison.

III. Concluding Remarks

In this paper we argued that the pattern of policy adjustment seen in Germany and Japan in the 1990s is a result of the different ways in which the export sector had depended on social and fiscal policies to facilitate employment adjustment, which they had to protect even when demanding a reduction in tax and social insurance burdens. We employed a two-step framework that examines first how the export sector's wage coordination shapes the fiscal and social policy used for employment adjustment and then how patterns of employment adjustment interact with the export sector employer's demand for fiscal and social burden reduction. The result was different government priorities in fiscal and social policy retrenchment even in countries where the export sector's adjustment to the changing global economy—currency appreciation and trade competition—resulted in similar international economic profiles—low inflation and large trade surpluses.

We claim that this two-step approach provides a coherent account on differences in wage moderation, employment adjustment, and policy dilemma. The framework has stressed the importance of the adjusting agent (i.e., the export sector) and employment adjustment on issues that had traditionally been analyzed from the viewpoint of organized labor. These two points have implications for the recent developments in the literature of employment adjustment, the welfare states, and coordinated market economies respectively.

Since the earlier work of Manfred Schmidt and Gøsta Esping-Andersen, three basic ways to cope with unemployment; i.e., market exit, public employment, and private employment, have been widely recognized.⁴⁴ It has been established that decentralized labor markets are conducive to private employment expansion and centralized labor markets to public employment expansion. However, the impact of economic globalization on such employment adjustment patterns have not been

systematically researched, although recent studies argue that economic globalization tends to constrain the expansion of public sector employment. It remains to be explained in a world of economic globalization why some governments can still expand private employment through Keynesian spending and why some governments chose labor exit. We have shown that as long as trade competitiveness is maintained, existing employment adjustment policies remain resilient despite an economic slump or an increase in unemployment. Our point is, in order to reach this conclusion and understand why policies related to unemployment can be very resilient, it is necessary to carefully examine the agents adjusting to the global economy.

Our focus on adjusting agents also serves to complement most recent studies, which stress structural constraints—such as aging population, post-industrialization (expansion of the service sector), and restrained fiscal capacity—on welfare states to explain welfare policy change.⁴⁵ Our analysis of Germany and Japan suggests that the degree of fiscal constraint, industrial change, and preparedness for an aging society may differ according to how the countries adjust to the global economy. In Germany and Japan the export sector employers demand fiscal restraint in order to remain competitive, which in effect helped maintain a robust manufacturing sector, and that employment adjustment in Japan in prepared for an elderly society by promoting elderly employment. Indeed, among the G7 countries, Germany and Japan have the largest manufacturing sector, in terms of employment (as proportion of total employment) and output (as proportion of GDP), and the smallest service sector in terms of employment. Thus, it seems some of the structural constraints on welfare states can be regarded as a result of economic adjustment, even if economic globalization cannot be considered as a structural constraint.

Finally, by examining particular countries where social partnership in the export sector generated trade surpluses, instead of low unemployment or high growth, we can clarify not only the problems of the Soskice's dichotomy of coordinated and liberal market economies but also his criticism of neo-corporatism. Because Soskice lists numerous corporate-level characteristics as definitive of coordinated market economies, he tends to increase the variants of coordinated market economies while failing to provide evidence on how corporate characteristics entail macroeconomic outcomes.⁴⁶ We have argued that the strongest determinant of industrial competitiveness is employer-union cooperation at export industries and that there are at least two ways—union orchestrated and employer-orchestrated—to link such cooperation with different patterns of employment adjustment and different priorities on fiscal and welfare retrenchment. This means that there is an employer-centered way of adjustment as an alternative to the union-centered view of neo-corporatism, in accord with Soskice's criticism of the literature. Moreover, both union-centered and employer-centered analysis can relate micro-level cooperation to broader policy choices and outcomes, a point that has not been fully developed by Soskice.

Hopefully, a focused comparison Japan and Germany presented in this article has provides a framework that improves our understanding of the link between economic adjustment and retrenchment reforms.

Notes

¹ Observations that regard Germany a policy reform failure in the 1990s include Fritz W. Sharpf “Economic Changes, Vulnerabilities, and Institutional Capacities,” in Fritz W. Sharpf & Vivien Schmidt eds., *Welfare and Work in the Open Economy. Vol. 1: From Vulnerability to Competitiveness* (Oxford: Oxford University Press, 2000), 21-124; Anton C. Hermerijack & Martin Schuldi, “Sequences of Policy Failures and Effective Policy Responses,” in Sharpf & Schmidt, *Welfare and Work, Vol. 1*, 125-228; Philip Manow & Eric Seils, “Adjusting Badly: The German Welfare State, Structural Change, and the Open Economy,” in Fritz W. Sharpf & Vivien Schmidt eds., *Welfare and Work in the Open Economy. Vol. 2: Diverse Responses to Common Challenges* (Oxford: Oxford University Press, 2000), 264-307.

² Duane Swank, “Political Institutions and Welfare State Restructuring: The Impact of Institutions on Social Policy Change in Developed Democracies,” in Person ed., *The New Politics*, 197-237. The Theoretical underpinning of this argument is the Mundell-Fleming model, which stipulates that under conditions of capital mobility a country faces a trade off between exchange rate stability and monetary policy autonomy. If a country tries to stimulate its economy be cutting interest rates below neighboring large economies that would cause an outflow of capital, a depreciating currency, and possibly depleting foreign reserves. If the government is committed to stabilize its currency against an international currency under such conditions, a run on its currency is likely to entail. Cf. David M. Andrews, “Capital Mobility and State Autonomy,” *International Studies Quarterly* 38-2 (1994), 193-218.

³ Specialists of German politics stress the problematic pattern of governments having to accommodate the social partners (“corporatism”), the opposition (“cooperative opposition”), and the states (“cooperative federalism”) as the cause of policy inaction. Cf. Razeen Sally and Douglas Webber, “The German Solidarity Pact: A Case Study in the Politics of the Unified Germany,” *German Politics* 3-1 (April 1994), 18-46. Bernhard Ebbinghaus & Anke Hassel, “Striking Deals: Concertation in the Reform of Continental European Welfare States,” *Journal of European Public Policy*, 7-1 (2000), 44-62. Observers of Japanese politics stress vested interests as the cause of policy deadlock.

⁴ See ArendtLijphart, *Patterns of Democracy: Government Forms and Performance in Thirty-six Countries* (New Haven: Yale University Press, 1999).

⁵ Cf. John Myles & Paul Pierson, “The Comparative Political Economy of Pension Reform” in Paul Pierson ed., *The New Politics of the Welfare State* (Oxford: Oxford University Press, 2001), 107-145; Stewart Wood, “Labour Market Regimes under Threat? Sources of Continuity in Germany, Britain, and Sweden, in Person ed. *The New Politics*, 368-409.

⁶ The unemployment and the pension schemes of Germany and Japan are based on Bismarkian social insurance principles like Germany with a marginal role for means-tested programs or private programs.

⁷ Paul Pierson, "Irresistible Forces, Immovable Objects: Post-Industrial Welfare States Confront Permanent Austerity," *Journal of European Public Policy*, 48-2 (1999), 539-560, Toben Iversen & Thomas R. Cusack, "The Causes of Welfare State Expansion: Deindustrialization or Globalization?" *World Politics*, 52-* (2000), 313-349.

⁸ See ft. 1.

⁹ Sharpf & Schmidt eds., *Welfare and Work in the Open Economy. Vols. 1-2*.

¹⁰ On neo-corporatism see David R. Cameron, "Social Democracy, Corporatism, Labor Quiescence and the Representation of Economic Interests in Advanced Capital Society," in John Goldthorpe (ed.), *Order and Conflict in Contemporary Capitalism* (Oxford: Clarendon Press, 1984), 143-178.

¹¹ Lars Calmfors & John Driffill, "Bargaining Structure, Corporatism, and Macroeconomic Performance," *Economic Policy*, 3(1988), 13-61.

¹² On the challenges to Swedish model centralized wage bargaining by the export-sector employer's quest for labor flexibility and the conflict between exposed and sheltered sectors over wage moderation and the costs of employment adjustment, see Jonas Pontusson & Peter Swenson, "Labor Markets, Production Strategies, and Wage Bargaining Institutions: The Swedish Employer Offensive in Comparative Perspective," *Comparative Political Studies*, 29-2 (1996), 223-250; Torben Iversen, "Power, Flexibility, and the Breakdown of Centralized Wage Bargaining," *Comparative Politics*, 27-4 (1996), 399-436.

¹³ For instance, Geoffrey Garrett & Christopher Way, "The Sectoral Composition of Trade Unions, Corporatism, and Economic Performance," in B. Eichengreen, J. Frieden & J. von Hagen (eds.), *Monetary and Fiscal Policy in an Integrated Europe* (Berlin: Springer, 1995), 38-61; idem "Public Sector Unions, Corporatism, and Macroeconomic Performance," *Comparative Political Studies* 32-4 (1999), 411-434, assumes in their argument an open economy with a cleavage between exposed and sheltered sectors despite claiming to adhere to the Calmors-Driffill model.

¹⁴ David Soskice, "Reinterpreting Corporatism and Explaining Unemployment: Co-ordinated and Non Co-ordinated Market Economies," in Renato Brunetta and Carlo Dell'Aringa (eds.), *Labour Relations and Economic Performance* (New York: New York University Press, 1990), 170-211; Idem, "Divergent Production Regimes: Coordinated and Uncoordinated Market Economies in the 1980s and 1990s," in Herbert Kitschelt, Peter Lange, Gary Marks, John Stevens (ed.), *Continuity and Change in Contemporary Capitalism* (Cambridge: Cambridge University Press, 1999), 101-134.

¹⁵ Peter Swenson, "Bringing Capital Back In, or Social Democracy Reconsidered: Employer Power, Cross-Class

Alliances, and Centralization of Industrial Relations in Denmark and Sweden,” *World Politics*, 43-4 (1991), 512-544.

¹⁶ Cf. OECD, “Economic Performance and the Structure of Collective Bargaining,” *Employment Outlook* (Paris: Author, 1997); Soskice, “Divergent Production Regimes” in Kitchelt, at al. eds., *Continuity and Change*.

¹⁷ Several calculations have been carried out to explain the wage standards. For instance, Tsujinaka says the union demanded wages close to the rate of nominal economic growth and settled for about 70 percent of their demands. Yutaka Tujinaka, “Kyu'chi ni tatsu 'rodo' seiseku katei,” in Nakano Minoru ed., *Nihon-gata seidaku kettei no henyô* (Tokyo: Toyo Keizai-shipo-sha, 1986), 278-288.

¹⁸ Mari Sako, “Shunto: The Role of Employer and Union Coordination at the Industry and Inter-Sectoral Levels,” in Mari Sako and Hiroki Sato, eds., *Japanese Labor and Management in Transition* (London: Routledge, 1997), 236-263.

¹⁹ It is noteworthy that heavy reliance on early retirement and public pension schemes to ease the cost of employment adjustment and curb unemployment is a familiar pattern of the so-called “conservative” (as opposed to “liberal” or “social democratic”) adjustment typical of the Continental West European states. Gøsta Esping-Andersen, *Three Worlds of Welfare Capitalism* (Princeton: Princeton University Press, 1990), chap 6: Idem, *Welfare States without Work: the Impasse of Labour Shedding and Familialism in Continental European Social Policy*,” in idem ed. *Welfare States in Transition: National Adaptations in Global Economies* (London, Sage, 1996), 66-87; Toben Iversen & Anne Wren, “Equality, Employment, and Budgetary Restraint: The Trilemma of the Service Economy,” *World Politics*, 50-4 (1998), 507-546. However, we expect early retirement schemes to be challenges by different constellation of interests and thus subject to different political processes depending on whether employer-union cooperation exists.

²⁰ Andrei S. Markovits & Christopher S. Allen, “Trade Unions and the Economic Crisis: The West German Case,” in Peter Gourevitch et al. *Unions and Economic Crisis: Britain, West Germany, and Sweden* (London: George Allen & Unwin, 1984), 147-167; Andrei S. Markovits, *The Politics of the West German Trade Unions: Strategies of Class and Interest Representation in Growth and Crisis* (Cambridge: Cambridge University Press, 1986), 126-146

²¹ IG Metall continued to demand a shorter workweek in the 1984, 1987, and 1990 bargaining rounds and incrementally realized their demands in exchange for further flexibility in working hours.

²² Edgar Grande, “West Germany: From Reform Policy to Crisis Management,” in Damgaard, Gerlich and Richardson eds., *The Politics of Economic Crisis*: Kathleen A. Thelen, *Union of Parts: Labor Politics in Postwar Germany* (Ithaca: Cornell University Press, 1991) 112-146

²³ Philip Manow & Eric Seils, “The Employment Crisis of the German Welfare State,” in Ferrera & Rhodes, eds.,

Recasting European Welfare States, 137-160; Manow & Seils, "Adjusting Badly".

²⁴ Sharpf, "Economic and Institutional Constraints"; Elke Thiel, "Macroeconomic Policy Preference and Coordination: A View From Germany," in Paolo Guerrieri and Pier Carlo Padoan, eds., *The Political Economy of European Integration* (New York: Harvester Wheatsheaf, 1989), 202-230

²⁵ The 1984 Act set up a framework for collective agreements in which the government partially subsidized early retirement for those over 58. However, the scheme however did not apply to the public workers and metal workers unions that did not have collective agreements, and was not renewed in 1988 because of disinterest of its beneficiaries, especially the chemicals union. In addition, the reimbursement clause was suspended in practice.

²⁶ In 1985 the benefits for the unemployed aged 49 was extended from 12 to 18 months. In 1986 the benefit periods were 16 months for those aged 44-48, 20 months for those aged 49-53, and at 24 months for those aged 54 and over. In 1987, the eligibility age was lowered to 42 and the coverage extended to 32 months for those aged 54 and over.

²⁷ Klaus Jacobs, Martin Kohli & Martin Rein, "Germany: The Diversity of Pathways," in Martin Kohli, Martin Rein, Anne-Marie Guillemard & Harman van Gunstern, eds., *Time for Retirement: Comparative Studies of Early Exit from the Labor Force* (Cambridge: Cambridge University Press, 1991), 181-221; Manow & Seils, "The Employment Crisis"; Idem, "Adjusting Badly," Josef Esser, "State, Business and Trade Unions in West Germany after the 'Political Wende,'" *West European Politics* 9-2 (April 1986): 198-214; Douglas Webber, "Kohl's *Wendepolitik* After a Decade," *German Politics* 1-2 (August 1992): 149-180; Winifried Schmäl, "The '1992 Reform' of Public Pensions in Germany: Main Elements and Some Effects," *Journal of European Social Policy*, 3-1 (1993), 39-51.

²⁸ Dieter Sadowski, Martin Schneider and Karin Wagner, "The Impact of European Integration and German Unification on Industrial Relation in Germany," *British Journal of Industrial Relations* 32-4 (December 1994): 523-537; Anke Hassel & Thorsten Schulten, "Globalization and the Future of Central Collective Bargaining: The Example of the German Metal Industry," *Economy and Society*, 27-4 (November 1998), 486-522; Lowell Turner, *Fighting for Partnership: Labor and Politics in Unified Germany* (Ithaca: Cornell University Press, 1998), chapters 1-5.

²⁹ Roger Lawson, "Germany: Maintaining the Middle Way," in Giuliano Bonoli, Vic George & Peter Taylor Gooby, *European Welfare States: Towards a Theory of Retrenchment* (Cambridge: Polity Press, 2000, eds., 31-50; Anton Hemerijck, Philp Manrow & Kees van Kersbergen, "Welfare without Work? Divergent Experiences of Reform in Germany and the Netherlands," in Stein Kuhnle (ed.), *Survival of the Welfare State* (London: Routledge, 2000), 106-126; Manow & Seils, "Adjusting Badly."

³⁰ Martin Hellwig and Manfred J. M. Neumann, "Economic Policy in Germany: Was there a Turnaround?" *Economic Policy* 5 (October 1987): 103-145; Razeen Sally and Douglas Webber, "The German Solidarity Pact: A

Case Study in the Politics of the Unified Germany,” *German Politics* 3-1 (April 1994): 18-46; Werner W. Pommerehne and Lars P. Feld, “Fiscal Evolution in the Federal Republic of Germany, 1980-1992: Recent Developments and Room for Consolidation,” *European Economy, Reports and Studies*, No.3. (1994); Reimut Zohlh ofer, “Institutions, the CDU and Policy Change: Explaining German Economic Policy in the 1980s,” *German Politics* 8-3 (December 1999): 141-160.

³¹ Wood, “Labour Market Regimes”; Ebbinghaus & Hassel, “Striking Deals.”

³² See Nariaki Akita, “Koy  kank  to haichi tenkan, shukko,” in Idem, ed., *Nihon no koy  kanko no henka to h * (Tokyo: Hosei daigaku shuppan-bu, 1993), 7-91, Taka’aki Ogata, “Koy  seisaku no genjitsu,” in Kikuo Ando *et.al.* eds., *Nihon-teki keiei no tenki* (Tokyo: Yuhikaku, 1980), 227-239.

³³ For instance, of the 8,923 workers who left Mitsubishi Heavy Industries in 1976-77, 53 percent was dispatched to related firms, 31 percent left voluntarily to seek new employment, and 16 percent retired. The number of newly created subsidiaries to place the elderly employees increased rapidly after the late 1970s. The shipbuilding industry eliminated 40 percent of its employees between 1974 and 1979 with the firms usually finding new positions for the former employees.

³⁴ Sueo Sekiguchi, “An Overview of Adjustment Assistance in Japan,” in Hong W. Tan and Haruo Shimada, *Troubled Industries in the United States and Japan* (London: Macmillan Press, 1994)

³⁵ Yoshio Yuasa, “Kozo fuky  chi’iki ni okeru rishokusha no d k  to koy  mondai,” *Ritsumeikan keizaigaku*, 30-6 (1982), 202-208; Tosho Aida, “Nohon z sengy  no d k  to koy  mondai,” *Shakaiseisaku gakkai Hokokushu*, 27 (1983), 51-53; Kiyoshi Yamamoto, “Zosengy  ni okeru sh gy sha no kis ,” *Shakaikagaku kenkyu*, 41-3 (1989), 231-267; Hisayoshi Serizawa, “Tekko-gy  ni okeru r shi-kankei no shin-kyokumen,” *Kochi daigaku shakai kagaku ronshuu*, 54 (1987), 171-193; Heihachiro Kawabe, “Tekko sangyo,” in Tomio Makino, ed., *Nihon-teki r shi-kankei no henb * (Tokyo:  tsuki Shoten, 1991), 34-41; Seigo Mizota, “Tekko-gy  no kozo-kaikaiku,” in Yoshiro Miwa (ed.), *Gendai nihon no sangyo-k z * (Tokyo: Nihon Hy ron-sha, 1991), 183-203; Robert M. Uriu, *Troubled Industries* (Ithaca: Cornell University Press, 1996), chapters 5-7.

³⁶ The US government orchestrated every rapid yen appreciation since the late 1970s as a means to rectify the large bilateral trade imbalance and the US made Japanese domestic stimulation a *quid quo pro* for supporting the dollar, fearing that Japanese industries’ might import its way out of a high-yen recession. C. Randall Henning, *Currencies and Politics in the United States, Germany and Japan* (Washington D. C.: Institute for International Economics, 1994), chaps 4-6.

³⁷ Nikkan kensetu tsushin, *kensetsugy  wa ima* (Tokyo Author, 1980), 73-81; Ichir  Saito, *Kensetugy * (Tokyo: Ky ikusha, 1987), 26-45; Nihon doboku k gy kai, ed., *Doboku-kyo 40-nen no ayumi* (Tokyo: Author, 1989), 46-48

³⁸ For the government's welfare reform, see John Creighton Campbell, *How Policy Changes: The Japanese Government and the Aging Society* (Princeton: Princeton University Press, 1992), 260-267.

³⁹ Nobuhiro Hiwatari, "Explaining the End of the Postwar Party System," in Junji Banno, ed., *The Political Economy of Japanese Society* (Oxford: Oxford University Press, 1998); and idem., "Adjustment to Stagflation and Neoliberal Reforms in Japan, the United Kingdom, and the United States," *Comparative Political Studies* 31-5 (October 1998): 602-632.

⁴⁰ The unions favored a fixed amount basic pension with an incomes-proportional superannuation, both of which were to be paid from the age of 60 and indexed to wage increases (instead of cost-of-living). Kiyoshi Murakami & Yasuhiko Yamazaki, *Kôreika shakai to nenkin* (Tokyo: Chuô Hoki Shuppan, 1981); Ikuo Soneda, *Nihon no kigyo nenkin, Showa 60 nendo-ban* (Tokyo: Tôyô keizai shinpo-sha, 1985); Shakaihoshô-undo-shi Henshu-iinkai, ed., 467-471

⁴¹ Even then, the government was only able to make sixty an indicative clause in the Law to Stabilize Elderly Employment.

⁴² On the 1990s, I have heavily depended on daily newspapers (*Asahi shiubun* and *Nihon keizai shinbun*) as well as Ôhara Shakai Mondai Kenkyujo ed., *Nihon rôdô nenkan* (Tokyo: Rôdô Jyunpô-sha, annual).

⁴³ Yokoyama & Tada eds., *Nihon shakai hoshô*, 294-296, 317-321; Hidehiko Shimizu, "1980 nen-dai ikou no waga kuni no nenkin seido kaikaku," *Waseda seiji-keizai-gaku zasshi*, 333 (1998), 187-214; Special Feature: nenkin kaikaku: sono rinen go genjitu, *Kikan nenkin to koyô*, 18-3 (1999), 4-43.

⁴⁴ See Manfred G. Schmidt, "The Politics of Labor Market Policy," in F. G. Castles, F. Lehner & M. G. Schmidt, *Managing Mixed Economies* (Berlin: Water de Gruyter, 1988), 4-53; Gøsta Esping-Andersen, *Three Worlds of Welfare Capitalism* (Princeton: Princeton University Press, 1990), Chapter 6; Toben Iversen & Anne Wren, "Equality, Employment, and Budgetary Restraint: The Trilemma of the Service Economy," *World Politics*, 50-4 (1998), 507-546.

⁴⁵ See ft. 7

⁴⁶ See ft. 14

Figure1: General Government Financial Balance / Nominal GDP

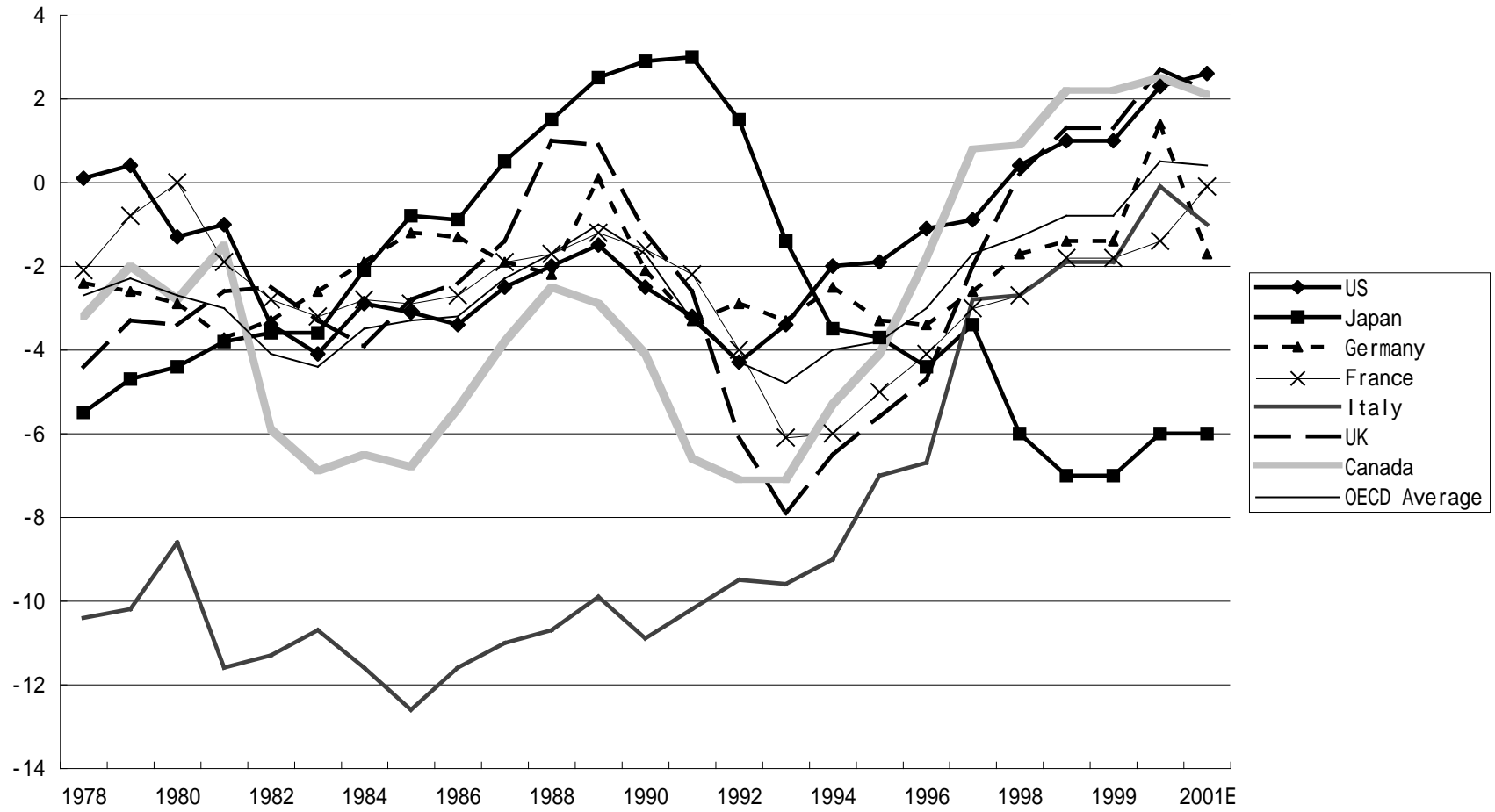


Figure2: Trade Balance of G7 countries

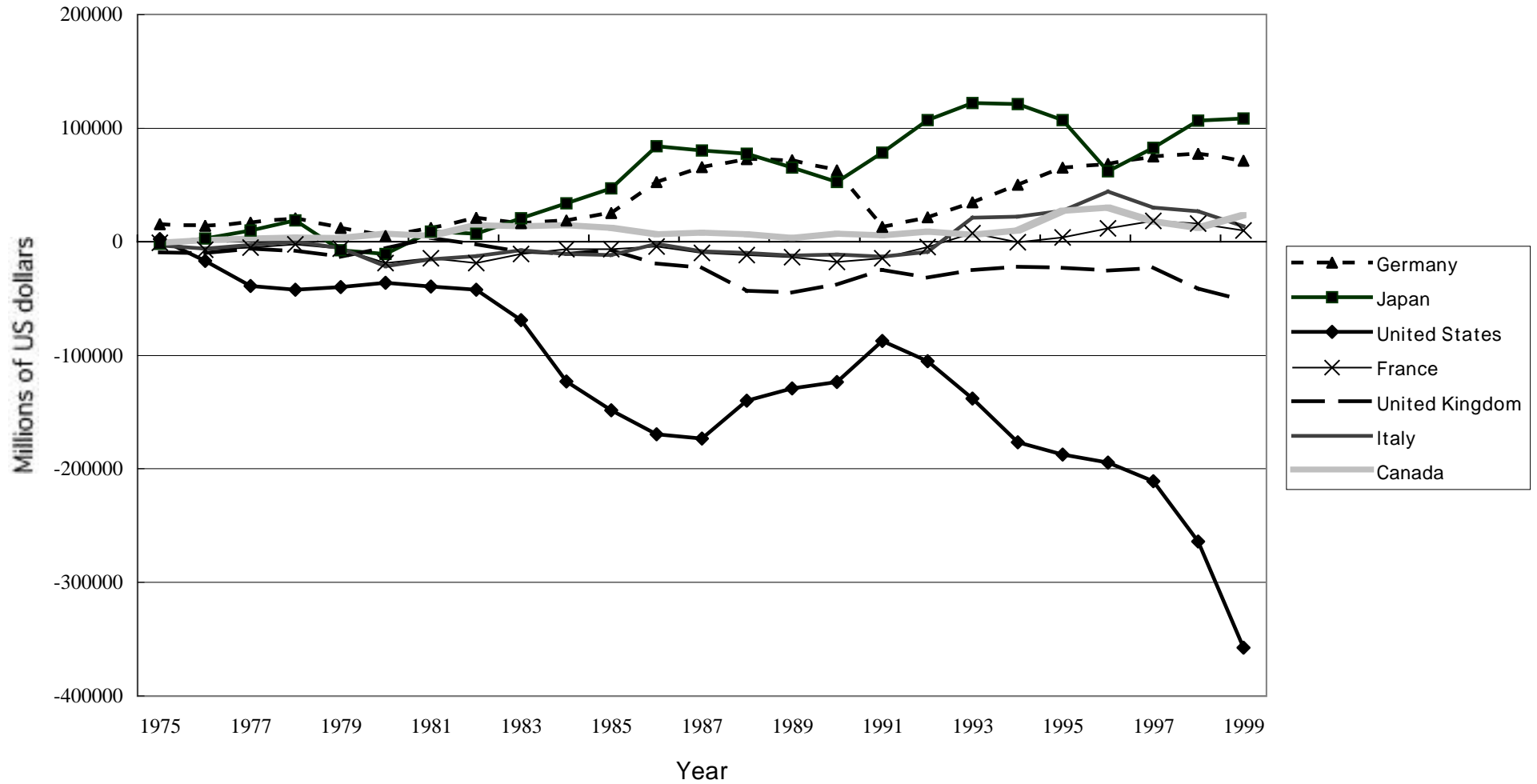


Figure3a: Monthly Salary in Manufacturing

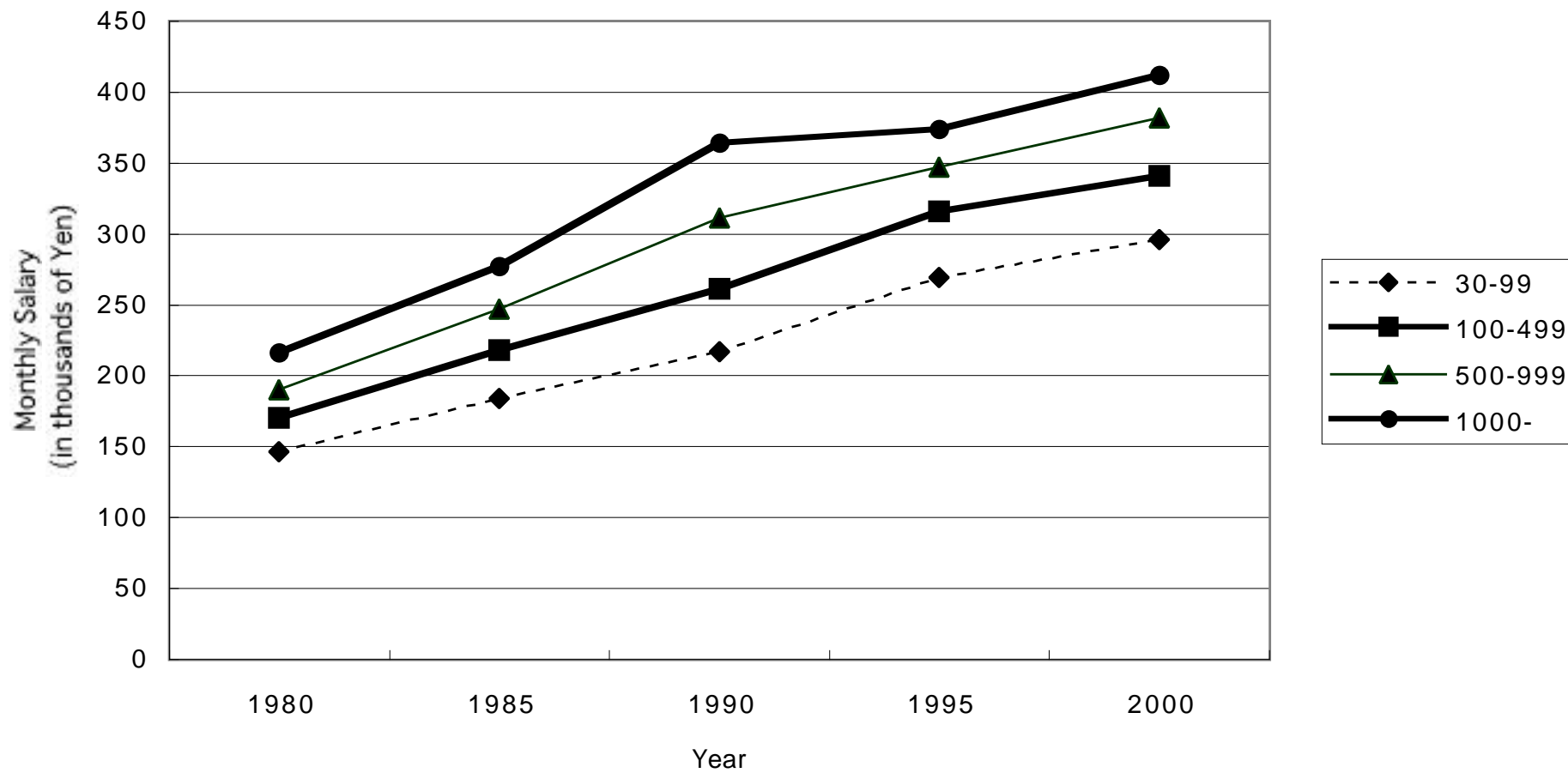


Figure 4: Inflation

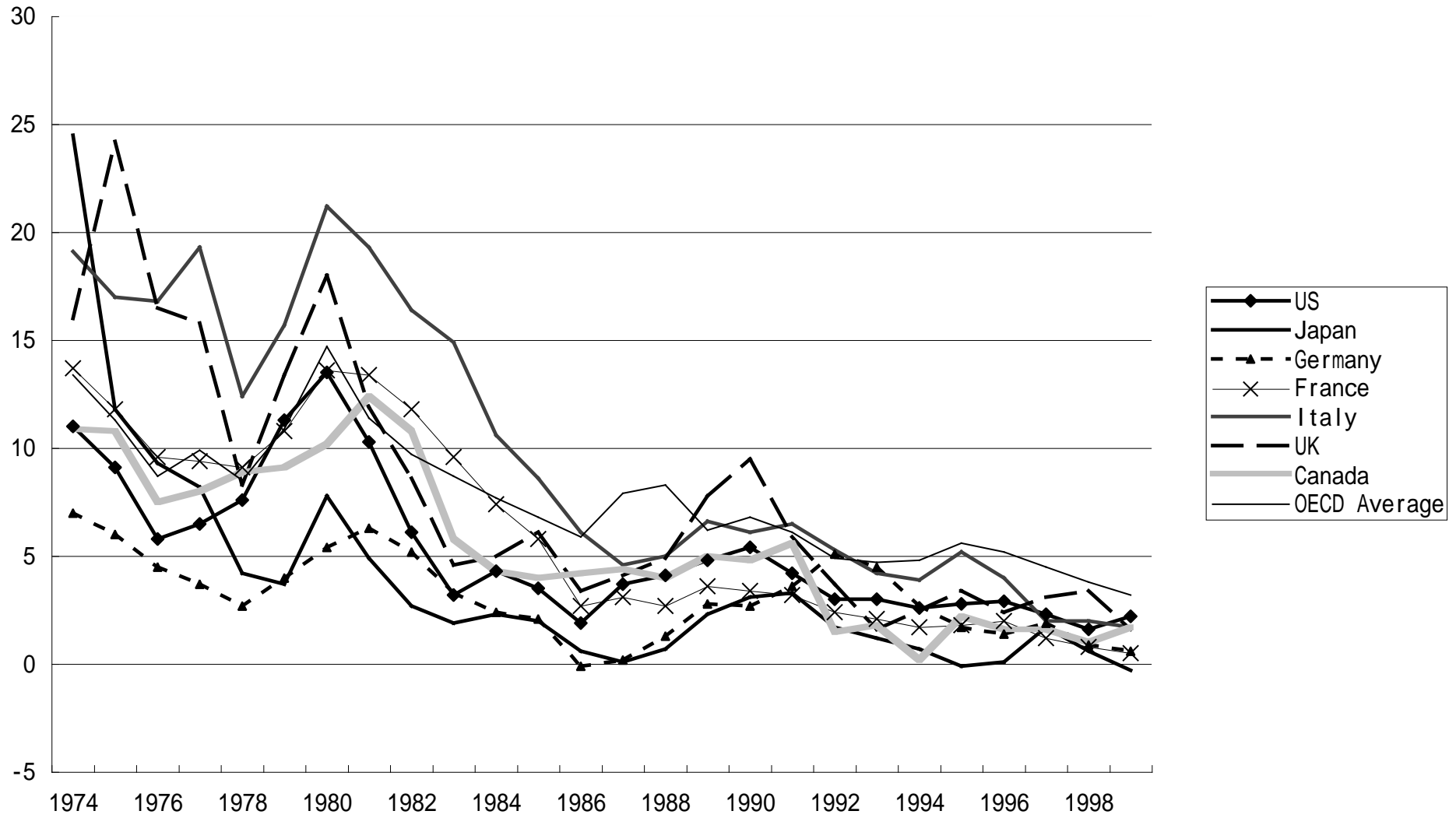


Figure5: Labor Participation Rate of Three Age Cohorts
(Germany & Japan, Male)

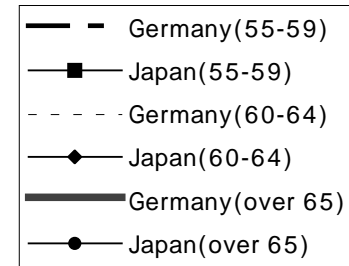
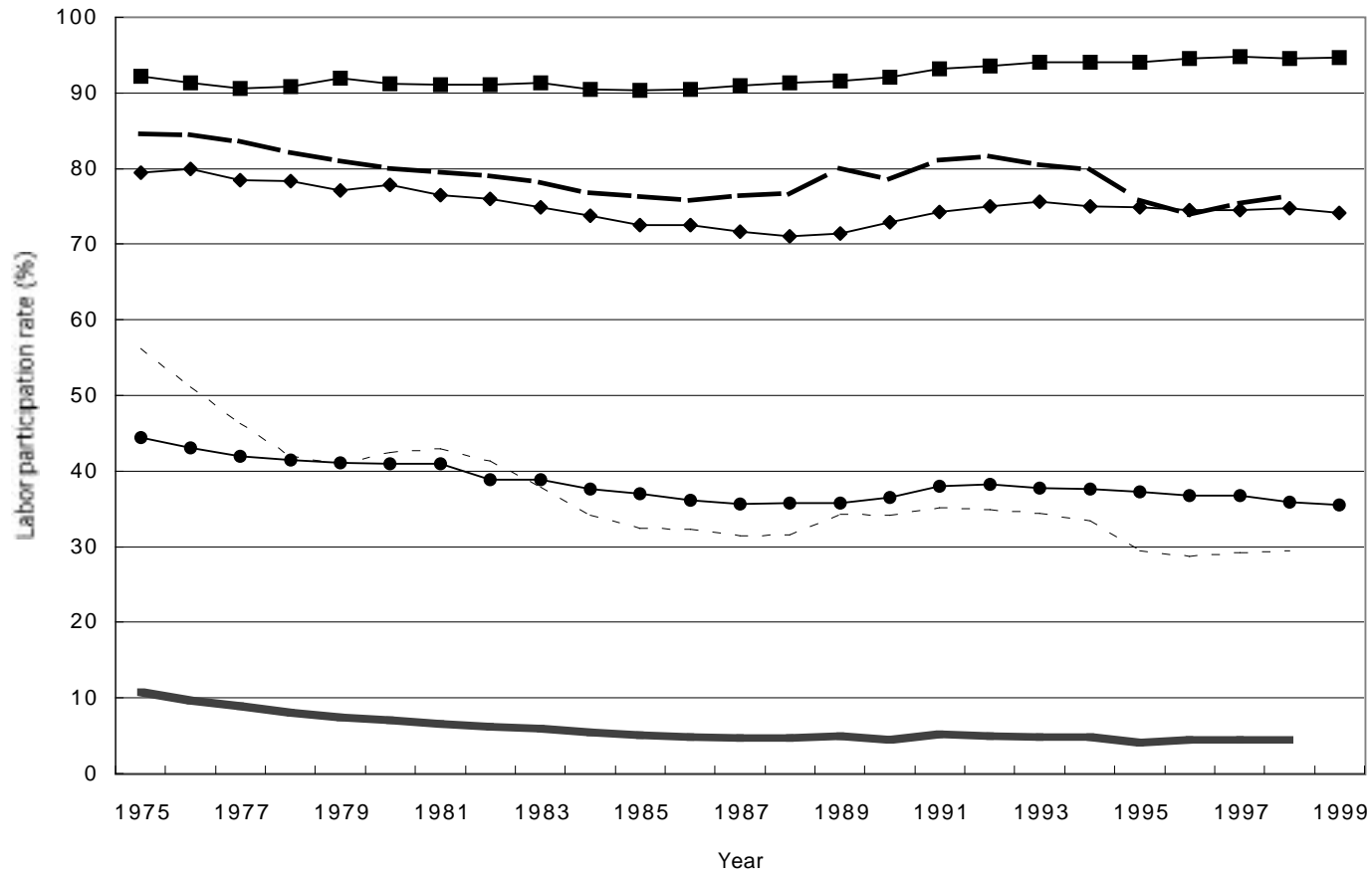


Figure 6: Unemployment

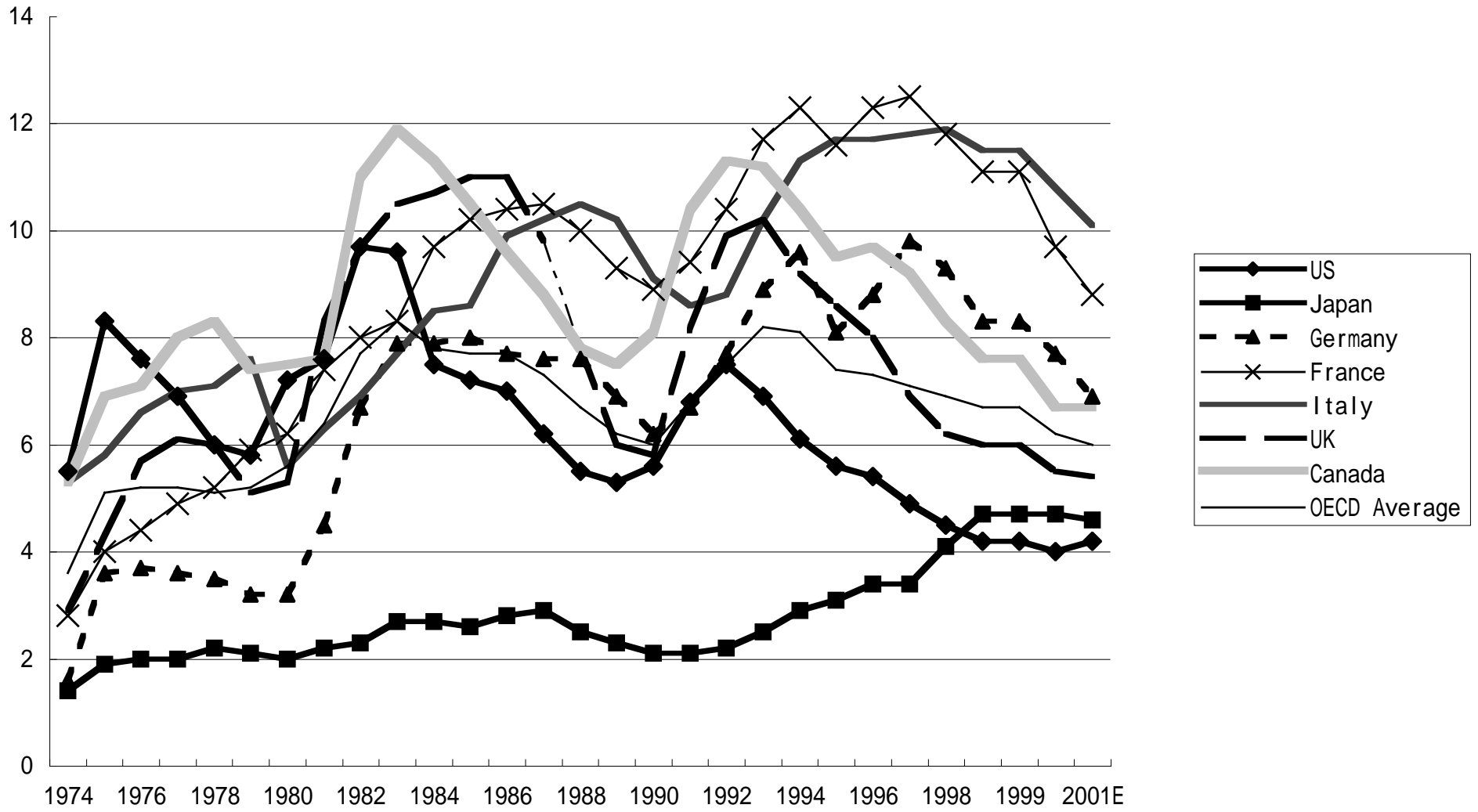


Figure 7a: Employment Adjustment in Manufacturing

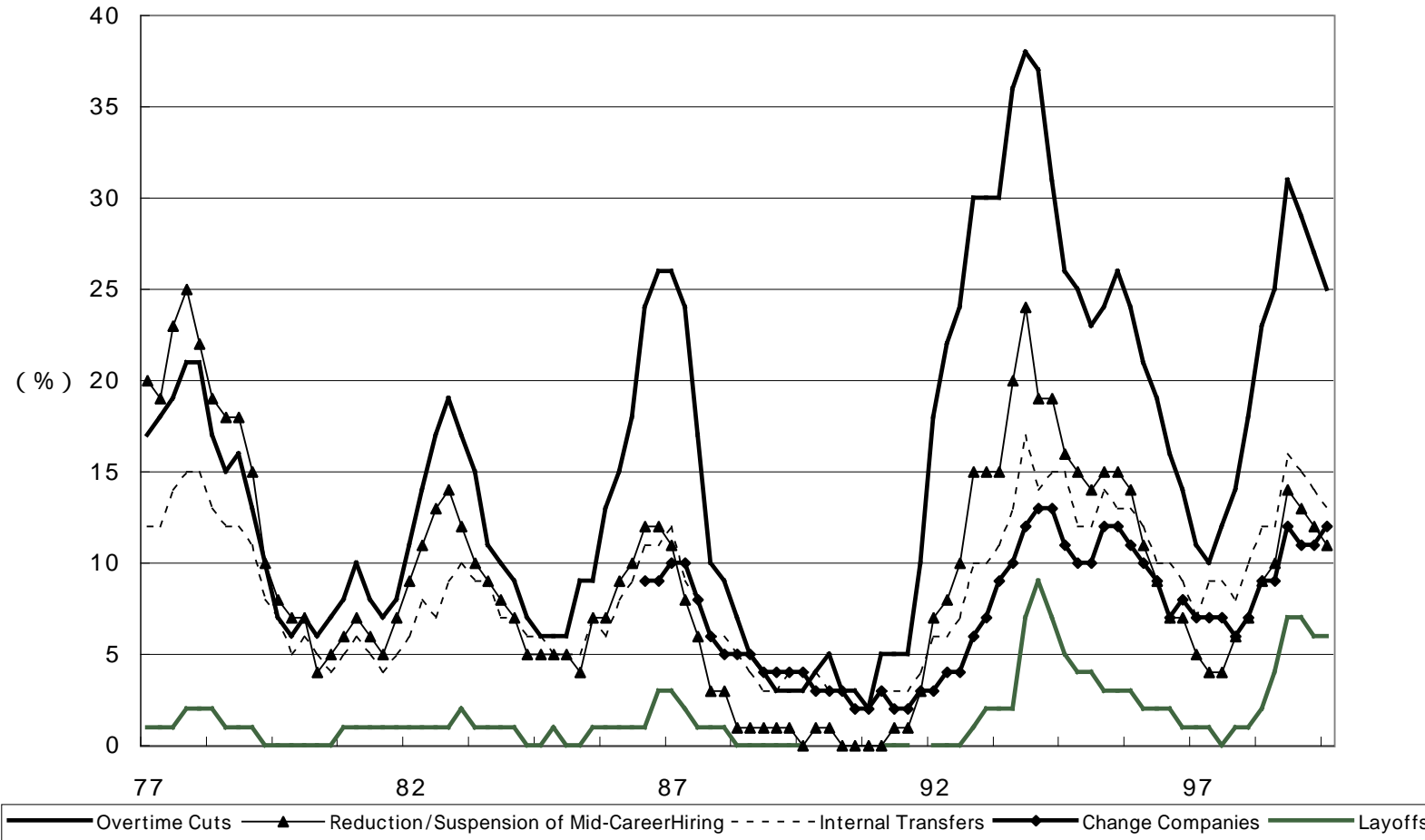


Figure 7b: Employment Adjustment by Industry

