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Flexible Labour, Flexible Production and Innovation-by-Agreement: International Comparisons Contesting the Lindbeck-Snower Insider-Outsider Thesis and 'Structural Reforms' in the European Union

Teresa Carla Oliveira*, Stuart Holland**

Abstract

This paper critiques the case for flexibilisation of labour markets. It evidences that influential claims for this in terms of an insider-outsider thesis by former Nobel economics committee member Assar Lindbeck and the British economist Dennis Snower were purely theoretical without offering any evidence, or recognising contrary evidence. It cites a recent admission by the IMF that there is no basis for claiming that protection of employee rights inhibits economic efficiency and cites also a questioning of structural reforms and an obsession with competitiveness by Benoît Cœuré, an Executive Director of the ECB. It illustrates that the achievement of some of the most competitive companies in the world, in Japan, has been based on reinforcing insider rights through commitment to lifetime employment for core employees and how this has enabled high levels of efficiency and process innovation through continuous improvement. It relates this to theories of psychological and social contracts, and evidences the influence of this flexible production rather than flexible labour market model on the recommendation of innovation-by-agreement in the 2000 Lisbon Agenda of the European Council including the right to work-life balance which has not been integral to flexible production in Japan. It then summarises some implications.

JEL: D20, E24, J24, J41.

Keywords: Flexibility, Continuous Improvement, Psychological and Social Contracts, Innovation-by-Agreement, Work-Life Balance.

Introduction

Since the onset of the financial crisis of 2007-08, 'structural reforms' to achieve more flexible labour markets have been demanded by the 'Troikas' of the IMF, the European Central Bank and the European Commission of weaker and mainly peripheral EU member states. This paper submits that the case for them is unfounded. It does so first by citing rethinking by the IMF in a study that finds no link between employment protection and inefficiency. Also a questioning of structural reforms by Benoît Cœuré, a member of the executive board of the ECB.

It then critiques the insider-outsider theory forwarded by former Nobel economics committee member Assar Lindbeck and the British economist Denis Snower on the grounds that their flexible labour market case, though influencing claims for structural reforms, was entirely theoretical, with no supporting evidence. It contrasts this with the flexible production model in Japan, where failures in flexible labour markets in the early 20th century gave rise to lifetime employment for core workers, and illustrates how this enabled the *kaizen* of continuous improvement and achievement of some of the most competitive companies in the world. It relates this to western theories of psychological contract and social contract and. demonstrates that recommendation of

* Faculty of Economics University of Coimbra

** Faculty of Economics University of Coimbra and Institute for Advanced Studies Köszeg.

this flexible production model, with the principle of work-life balance, was made to and endorsed by the European Council in the Lisbon Agenda 2000. It also summarises some implications in relation to feasible policies to recover employment in Europe.

1. Deflation, Flexible Labour Markets and Structural Reforms,

Flexibilisation of labour markets has been integral to the case for 'structural reforms' which have been demanded of several EU member states since the onset of the financial crisis of 2007-08. Such reforms assume that increased economic efficiency, and innovation, depend on a reduction of social protection of labour. If business did not need to engage employees on the basis of long-term contracts, or any contracts, and could fire them easily, then new and innovative firms would be able to attract the new workers they need to expand their business (Janssen, 2015).

Yet recent research by the IMF has found there is no evidence that deregulation of labour markets increases economic efficiency. This is highlit in a text box in the IMF's World Economic Outlook of April 2015 recognising that productivity in terms of output per worker can be increased by using more highly skilled labour and information and communications technology, and by investing more in research and development. But, in a survey of OECD countries, does not find any statistically significant negative effects on productivity, and thus economic efficiency that result from defence of employee rights through protective labour market legislation (IMF, 2015a).

In addition, in November 2015, an IMF Staff Discussion Note published findings that 'beggar-thy-neighbour' wages policy through 'structural reforms' was not a condition for recovery through increased competitiveness but was deflationary (IMF, 2015b). Unlike the 'crowding out' hypothesis of Milton Friedman, the IMF also has found that there is no evidence that public spending drains rather than sustains the private sector (Abiad, Furceri and Topalova, 2015). In effect, EU 'structural reforms' are not working at a macroeconomic level. Rather they are imposing massive social and political costs in terms of high levels of unemployment which is encouraging political extremism (Holland, 2015b).

In parallel, in statements in 2014 and 2015, Benoît Cœuré, French Member of the Executive Committee of the ECB, questioned the case for structural reforms and the obsession with competitiveness at the cost of demand. As he put it

> 'I want to stress that we need to enhance our understanding of the supply side so we can better appreciate its interactions with demand. For instance, we know too little about which policies will extend the benefits of micro-level reforms to the macroeconomy… The empirical debate is also still raging over the short-term impact of such reforms on output... And the optimal pace of supply side reforms has not been established empirically…' Cœuré, 2015).

Adding also that

> 'Structural reform' is a term that policymakers like to utter, but it is often too vague to be meaningful. In particular, my hope is that work in this area can help policymaking escape the obsession of 'competitiveness' which, when narrowly defined, focuses on export market shares, real exchange rates and unit labour costs (Cœuré, 2014)'.

We suggest that the research on lifetime employment in Japan cited in this paper could help at least some policy makers challenge such obsessions. Not least in that it demonstrates precisely the link between micro level and macroeconomic and social outcomes that Cœuré laments has been missing in much of the presumption of the need for structural reforms in Europe.

2. Insider-Outsider Theory

The case for more flexible labour markets and for structural reforms was influenced by the 'insider-outsider' thesis of former Nobel economic committee member Assar Lindbeck and the British economist Dennis Snower who claimed that Europe only can be competitive by reducing the right of strongly unionised 'insider' employees to defend high wages and benefits against outsiders who would be prepared to work for less. Their claim was powerfully influential in Germany where it was held to justify the Hartz employment reforms reducing insider rights (Holland, 2015b).

Lindbeck and Snower's (1988) analysis is replete with algebra, *a priori* reasoning and generalisation but entirely lacking in any empirical support for the claim that insiders necessarily are less efficient that outsiders would be if they took their jobs. There is no evidence for such a claim (OECD, 1999, Esping-Andersen and Regini, 2000; Kelly, 2005; IMF 2015b).

Recent evidence from the Bundesbank and from the German statistical office also shows that the argument that a minimum wage will destroy jobs and create unemployed 'outsiders' has not been supported since the introduction in 2014 of a minimum wage of €8.50 an hour in Germany - 50% of the median German wage. This refutes pessimistic predictions in a spring 2014 forecast from the Ifo research institute in Munich which warned of 200.000 jobs being destroyed and predicted an immediate increase in unemployment from January 2015 onwards. Whereas, from January to July 2015, unemployment in Germany fell by 250.000. The outcome was higher wages in general, substantially higher wages for the lowest paid and many temporary jobs being replaced by regular ones (Bundesbank, 2015; Janssen 2015).

Implicit within the Lindbeck-Snower insider-outsider case are differences in how western mainstream economics conceptualise 'the firm and industry' and how Japanese economists and management do not. A foundation of western microeconomics is a Cobb-Douglas (1928) production function, which assumes that production is a function of combining capital and labour, plus some other residual factors such as technical progress. The premise of this is that capital is a fixed cost and labour is a variable cost and therefore disposable in the event of an economic downturn.

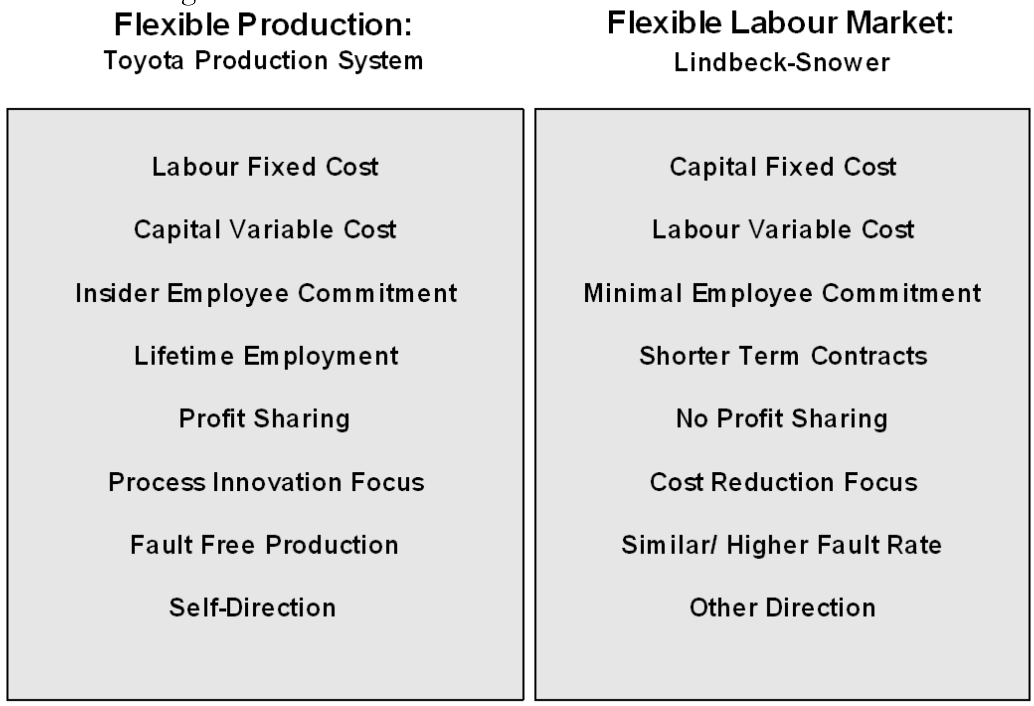
3. Japanese Lifetime Employment

With lifetime employment in Japan since the early 20th century this logic was reversed. With a commitment to long term employment, labour became a fixed factor of production, meaning that Japanese manufacturers had to gain continually better use of it. In leading Japanese firms flexible production and innovation are integral to the labour process through continuous improvements in work methods – *kaizen* (Yamaguchi, 2004; Moriguchi & Ono, 2004). Western microeconomics assumes that firms cannot grow beyond at a point at which their marginal costs will rise to meet price. Japanese producers have constantly been reducing marginal costs through continuous improvement (Womack & Jones, 1996; Colenso, 2000).

It was because of 'insider' commitment to lifetime employment that Japanese producers had to find more efficient methods of work operation to increase and sustain their competitiveness. For Toyota, and what then became known as The Toyota

Production System, economies of scope or doing more with the same, rather than more of the same, was vital for its survival after WW2, since there was insufficient demand for vehicles for it to achieve economies of scale.

Figure 1: Flexible Production and Flexible Labour Markets



Source: Own formulation, and Lindbeck, A., & Snower, D. J. (1988), The Insider-Outsider Theory of Employment and Unemployment, Cambridge, MA: MIT.

Kaizen style 'continuous improvement', with the need to cut costs after the impact of the 1973 oil shock, was the driving force behind high efficiency lean production that, by 1982, had enabled both Toyota and Honda to double output per worker whereas US auto producers hardly increased it at all (Ohmae, 1982). These differences between flexible production and flexible labour markets are contrasted in Figure 1.

There has been a widespread presumption that lifetime employment in Japan relates to a Confucian group culture and is not translatable to other societies (e.g. Sparrow & Marchington, 1998). Yet this misses that it was the outcome of the *failure* of flexible labour markets in Japan in the early 20th century. Japanese industrial firms had been training engineers, at considerable cost, but then found that they quit to accept higher pay offers from others. As a result most of them introduced annual wage increases or 'seniority pay' to retain them as insiders as well as 'lifetime employment' to the age of at least 55 for 'core' workers (Yamaguchi, 2004; Moriguchi & Oo, 2004).

Lindbeck and Snower (1988) not only did not consider how the loss of trained labour with flexible labour markets caused Japanese employers to offer 'insider' lifetime employment. They neither refer to it, nor to Japan, nor to any actual labour market. When this was put by one of us to Dennis Snower on the launch in London of his and Lindbeck's insider-outsider thesis, he replied: 'I don't know about Japan. It may be different'.

None of which implies that all Japanese companies replicate the features of the Toyota model of Figure 1. Though some do, many have stayed within a combination of both Fordist standardised mass production and some of features of the Toyota Production System such as just-in-time *kanban* component supply to reduce inventories. For instance, when a company such as Sony gained impact in the games market by its PlayStation this was because it was an innovative product rather than a process innovation. It depended also on a brilliant designer and engineer Ken Kuturagi (Lewis, 2006). But once it had made the transition from concept through to development it was standardised rather than customised to individual demand, as the TPS was, and its production in terms of scale economies, classically Fordist.

Besides which, less than a seventh of the Japanese economy ever has been 'lean' in the in the sense of flexible production and economies of scope (Ohmae, 1982; Womack & Jones, 1996). The leading companies which achieved this were mainly in the *keiretsu* conglomerate groups, each of which was linked to a major bank. While many of them succeeded with lean production, the banks did not, while few of the holding companies were lean organisations. Most of them embodied what Ronald Dore (1973, 1986) has recognised as 'flexible rigidities' by which the operational logic of their subsidiaries was flexible but their own organisational logic was not. There were exceptions. Honda never had an inflexible system. It had a flexible promotion structure in which a promising individual was not dependent on his immediate boss or supervisor. It also took flexible production to the point at which its design engineers could suggest changes even on the production line. But Honda was not an outcome of the *keiretsu* bank related system rather than an entirely new start-up by a classic Schumpeterian owner-entrepreneur (Ohmae, 1982).

Nor is this to suggest that Toyota got everything right all the time, or that its organisational logic consistently matched its operational logic in terms either of efficiency or innovation. Its overall success is not in question. In 1948 it was making only as many vehicles in a year as General Motors was making in a day. By 2006 it had overtaken GM as the world's leading vehicles producer (Nakamoto and Reed, 2006). But this was not a once-off big leap rather than many small steps of operational and organisational learning.

For example, in design and marketing strategy Toyota made big mistakes both in Western markets and in China. One of the reasons for its long term success was its reputation for fault-free production, stemming in part from workers being able to stop an assembly line to prevent a fault going through, which had been anathema to Ford. But in its first European production foray, based in the UK, it found that consumers did not want 'bland boxes', even if they were fault-free. As Thierry Dombreval, head of European sales for Toyota, later put it:

> 'We didn't have a product that really appealed to European customer in terms of exterior or interior design, powertrain or driving dynamics, which was pretty well everything that counted'.

As an outcome, the breakeven point of 200,000 vehicles a year at its Derbyshire plant in the UK, and only after introducing entirely new models, took five years more than planned' (Dombreval , cit.; Mackintosh, 2006).

But the commitment to a culture of continuous improvement meant that Toyota learned up within those five years, whereas the US auto majors failed to do so for decades, producing models that, other than 4x4 station wagons, consumers did not want.

Nor did Toyota for a long time know how to market in the US or Europe. In Japan its reliance on door-to-door sales and customer loyalty meant it had little experience of how to manage western dealer outlets. It was only by bringing in American managers to run most of its key sales and distribution in the States that it managed the breakthrough which resulted in the US market coming to provide nearly half of its total operating profit.

Its initial but late start with investment in China in 2002 also was matched by a dismal performance, ranking ninth in sales and tenth in production by 2006, not least through an incoherent marketing strategy, such as taking advertising space in metropolitan city centres to high light the mountain terrain capabilities of its 4x4 sports utilities. Again, it was only when it brought in US managers to China that it began to make the breakthrough there to gain it a million vehicles a year or the equivalent of Nissan's peak global production (Shirouzu, 2006).

Gaining both *kaizen* and *kanban* practice in all Toyota's suppliers also took time. By the mid 60's Toyota had achieved this for its own production facilities. But on *kanban*, it was only in the later 60's that it discovered that many of its suppliers were stockpiling finished goods in warehouses on a just-in-case rather than just-in-time basis. These were stacked with parts assembled far in advance of their shipments since the suppliers had no idea how to produce in small lots to replenish the amounts withdrawn from stocks several times a day by Toyota (Womack & Jones, 1996).

After 1973, when demand for vehicles stalled, and then was low, Toyota kept demanding price reductions for parts from its suppliers which mean that they needed to gain continuous cost reductions. Its first tier suppliers realised that they would have to teach the second tier the principles of the Toyota Production System, which only took effect from the end of the 1970's. Reducing the lead times for delivery of cars to only a few days only was achieved when the company re-merged with Toyota Motor Sales, which had been split from it under pressure from its banks in 1950. It was only in 1991 that Toyota reorganised its production into three platform groups for front drive cars, rear driven cars and trucks. (Womack & Jones, ibid). It was only a decade later (Nakamoto & Reed, 2007) that its organisational logic in integrating platforms and common parts matched its sustained operational success in process innovation.

There then was a major challenge to Toyota's reputation for fault-free production. In August 2009, a veteran California Highway Patrol officer was driving family members in a Lexus ES350 near San Diego when the accelerator of the car stuck, it increased speed before hitting another vehicle, rolling over, and bursting into flames. All four occupants died. The ES350 crash focused media attention on Toyota, and sudden acceleration complaints grew quickly.

But an investigation discovered that the car that crashed near San Diego had been retro-fitted with all-weather floor mats designed for a Lexus RX, which were too long for the ES350, thus trapping the accelerator pedal and causing the crash. A 10-month investigation then found that Toyota engineering was not to blame for several of the runaway cases but also people pressing the wrong pedals. The study, by the National Highway Traffic Safety Administration and NASA scientists examined 280,000 lines of Toyota software and 3,054 complaints of sudden acceleration. Reporting in 2011 it concluded that the causes were wrongly retro-fitted floor mats and driver error (NHTSA, 2011).

4. Cooperating to Compete: *Kaizen* as Mutual Advantage

When most management texts refer to *kaizen* they style it as 'continuous improvement'. Yet *kaizen* in Japanese combines two words and two concepts - *kai* meaning change for the better or improvement and *zen* signifying something that is to mutual advantage. The gain for core workers in leading Japanese companies after WW2, was not only 'lifetime employment' until at least the age of 55, and a seniority wage system with annual increments, but also twice annual profit sharing.

Lifetime employment in Japan, and the seniority wage system, is a norm, not a rule. It has been implicit in practice, rather than explicit in the sense of a formal employment contract. It differs between firms and sectors and within them, and also has changed significantly over time such as an 'early' model dating from 1910, a dynamic 'growth' model thereafter, a 'stationary' model during cyclical recession, and a 'reduction' model including early retirement with compensation in the face of longer term structural changes in demand, as with declining demand for heavy engineering, steel and super-tankers after the first OPEC oil prices in 1973. New recruits to any Japanese company rarely were granted permanent employment status until their early thirties. Such 'half-way' workers also buffered some fluctuations in demand (Yamaguchi, 1995; Moriguchi & Ono, 2004).

While Sparrow and Marchington (1998) recognised that bonuses for lifetime employees were profit related they opted to describe these as 'employee dependence on high and virtually guaranteed twice yearly annual bonuses'. Yet these could be as much as a quarter of total pay, while the right to profit sharing made a reality of the concept of stakeholding which, in the West, frequently has been little more than rhetoric. It meant that core employees had a vested interest in the success of the firm.

Multi-skilling and multi-tasking and job variation also has made it possible for Japanese producers to overcome the alienation of Taylorist single tasking which was so great for Ford that although offering $5 a day, which was unprecedented at the time, and also profit sharing if workers would stay for 6 months, the pressure of such single tasking, well parodied by Charlie Chaplin in his *Modern Times,* was such that the turnover during its first year at his Highland Park plant for the Model T was equivalent to its total initial labour force. Next to no one wanted such a high performance but also highly pressured job (Lacey, 1987).

Job variation in leading Japanese firms has meant that workers can spend some years with an assembly plant, then some in marketing, or direct door-to-door sales, some in cost control or accounts, and some in relations with supplier companies. Ohmae (1982) has stressed that this internal redeployment and job variation ranges widely beyond the auto industry and relates also to explicit strategies for corporate product and market diversification. In his contributing to a Special Report on lifetime employment for The Japanese Times, drawing on several Japanese studies as well as his own experience of retraining Japanese engineers as sales managers, Braser (2014) found to his surprise that such job rotation was not a loss of their identity as engineers, which they retained, and would return to engineering, but gained what in HRM terms was enhanced organisation-fit.

Core employees or work groups also had the right to be directly paid for suggestions leading to continuous improvement. Yet this often is cited, such as by Sparrow and Marchington (1998), without recognising the central relation between continuous improvement and lifetime employment. Companies such as Toyota and Nissan did not gain phenomenal rates of continuous improvement such as doubling productivity in the decade after the 1973 oil price increases just because workers were paid to suggest them, not least when the rate in itself was not high (Ohmae , 1982; Kaplinsky and Posthuma, 1994), but because the commitment to lifetime employment meant that employees proposing innovative methods of work operation knew they would not thereby be innovating themselves or colleagues out of a job.

The combination of lifetime employment with profit related pay amounted to 'equity' not in the sense of shareholding, but in terms of both procedural and distributive justice. Distributive equity obtained in that workers knew that their making a new proposal to raise efficiency meant mutual advantage both for the company and themselves. But was the procedural '*zen*' of mutual advantage, rather than only *kai* as a management technique, that made possible sustained continuous improvement.

Where *kaizen* has worked well it also has been because of synergies at operational rather than only at organisational levels. Thus Colenso (2000) reports that: (1) the primary unit of *kaizen* is a team; (2) teams can learn better and faster than organisations; (3) autonomous units therefore can be more productive; (4) such teams can focus on the sequence and flow of production in a self-directed manner rather than constantly needing Taylorist monitoring; (5) feeding up on what can be done better is more effective than whether a top down Taylorist operational design has been fulfilled (Taylor, 2011).

Kaizen style continuous improvement not only has its critics assuming that it is dependent on a Confucian culture, even if it is aided by it, but others who in prominent cases have proved as underinformed as Lindbeck and Snower. Thus Porter (1998) has claimed that US managers have had *kaizen* 'coming out of their ears', and that it failed them. Yet on which he offered no evidence, other than a passing observation that multiple die changes within one shift in pressing body parts for autos had been tried and failed in the US. Missing thereby that the achievement of this by Toyota meant that it could shift from economies of scale – more of the same - to economies of scope – more with the same.

For while General Motors or the other US auto majors could indulge the luxury of changing new body part dies during a three week summer annual break for employees other than those directly concerned with changing the dies, and stick with the die for this for a year, Toyota and other Japanes companies following it could produce one, two or three different auto body parts even within an eight hour shift, combining this with *kanban* just-in-time delivery of components for assembly of two to three different vehicles on a bi-daily or tri-daily basis. A further irony of which is that it was US retailers that had learned such just-in-time principles in terms of automatic re-stocking from current indications of depletion of stocks in sales. Yet from which, within a classic 'silo' mentality, the US auto majors failed to 'learn up' (Oliveira, 2007).

Porter also neglected that, as Colenso (2000) has stressed, 'at the heart of *kaizen* lies a set of values' including a mutual commitment to valuing the work of others, rather than management treating labour as only a disposable factor of production and therefore endorsing temporary contracts. As Kaplinsky and Posthuma (1994) have put it, the answer to why *kaizen* has not 'delivered' for so many firms outside Japan:

> 'lies in the social rather than the technical domain, for the essential principles of these Japanese techniques - their *technics* - are easily comprehended and not technologically complex. But their successful adoption overturns many of the social relations of domination which were so important in the evolution of Taylorist forms of production management and control' (Kaplinsky & Posthuma, ibid, p. 285).

There also has been a tendency since the economic recession in Japan following its banking crisis of the early 1990s and low growth thereafter to presume that 'soft'

HRM and lifetime employment in Japan have failed and that there is nothing to be 'learned up from them' for western models of management. Thus Sparrow and Marchington (1998) have claimed the demise of 'Japan' as business model and that:

> 'Disillusionment knows no national boundaries. Japan too has changed from being a role model for HRM policies and practices to becoming a major target for those who argue for a break-up of national business systems… pay pressure has seen divergence from (the) uniform agreements, with profitable firms such as Toyota offering well above the average, but Nissan and Honda falling well behind. Financial markets have dropped harmonious practices and share prices of internationally competitive exporters have increased while several organisations face bankruptcy' (Sparrow & Marchington, ibid., p. 8).

But the 1990s recession in Japan stemmed not from the production sphere, or the failure of lifetime employment, but from the banking sector where the presumption of continued high growth and tolerance of non-performing loans had become endemic, while mortgage lending was for property whose values bore scant relation to reality, which was a prequel of what was to happen in the following decade in the US and in Europe.

The retrenchment from this 1990s failed 'trust in banks', with parallels in the West, was severe. It profoundly affected both household net wealth as property equity went negative and, with it, consumer disposable income and confidence. It also thereby reduced the growth of internal demand, corporate revenues, performance and profits.

Moreover the recession and low to nil growth in Japan since the 1990s was not only due to a banking crisis. A key reason was the 1985 Plaza accords by which Japan, responding to US pressure, agreed to a major revaluation of the yen. Another was the degree to which, with globalisation, Japanese manufacturers had been undertaking foreign direct investment elsewhere such as in the US and Europe and also, increasingly, in Asia. In the US, this had been in part to avoid protection, such as was perenially being demanded by the American auto majors and steel producers. In Europe, it either was by joint ventures such as between Renault and Nissan or Honda and Rover, or by entirely new plant (Holland, 2015a).

Elsewhere, in Asia, such investment increasingly was in China both because of lower labour costs and the need to be present in a market which was achieving unprecedented double digit growth for more than three decades. But such investment and production abroad replaced direct exports from Japan and thereby compromised the export-led growth model which earlier had been crucial to Japan's postwar 'economic miracle' (Holland, 2015a). Thus the slowdown of the Japanese economy was not due to the commitment of leading Japanese firms in manufacturing to lifetime employment rather than other factors. In a long-term survey of this in Japan, Moriguchi and Ono (2004) recognised that:

> 'Despite pessimistic predictions, however, empirical studies have found no major changes to the practice pertaining to core employees' (Moriguchi and Ono, ibid, p.1).

Moreover several studies had routinely but wrongly predicted the demise of Japanese lifetime employment not only from the 1990s, but from decades earlier. Cole (1971, 1979) argued that it was not sustainable even under high economic growth, as chronic labour shortages would raise 'outsider' employees' options and encourage them to move from one job to another.

But it was precisely this from the 1910's which encouraged leading Japanese employers to introduce such a wide range of incentives to employees to stay with them, rather than move for a wage rise offered by another firm, and led to the introduction of annual pay increases and assurance of lump sum retirement benefits. Beck and Beck (1994) and others predicted that the economic slowdown in the 1990s coupled by the globalisation of financial markets would promote American-style personnel practices, such as layoffs, performance pay, and mid-career job changes.

Thus the claims for how lifetime employment would fail shifted from how it would not survive high growth to how it would fail in recession. Economic stagnation since the 1990s in Japan certainly has posed a serious challenge. Many firms stopped recruiting at earlier rates or stopped it altogether. But despite increasing pressures to let workers go, management continued to uphold lifetime employment (Genda and Rebick 2000; Rebick 2001; Sako 1997; Sako and Hiroki 1997; Kato, 2001, Braser, 2014). Employment for core workers remained stable in the 1990s. Job retention rates and employment durations remained virtually unchanged in comparison to the 1980s, including for medium firms with only 30 employees or more rather than only the giant *keiretsu* combines. In the *keiretsu* groups management held onto core employees by lateral transfers whether intra-firm or to other subsidiaries within the conglomerate group rather than 'letting them go' (Sako and Hiroki 1997; Genda and Rebick 2000).

Government policies in Japan from the 1990s also helped sustain the lifetime employment principle. First, a programme was established in 1997 to provide special subsidies for job creation and skill formation in fifteen new growth areas. Second, the government paid employers direct subsidies to retain or employ older workers (Genda and Rebick, ibid.). Third, it undertook a range of social investment programmes including urban renewal and enhancement of the urban environment which, like the New Deal policies in the US, were designed especially to create jobs for men who were not being recruited into firms, or did not make it into 'core employment'.

Enterprise unions mainly negotiated wage increases that were in line with productivity gains, and their willingness to accept virtually no real wage increases kept unemployment rates low in the 1990s (Genda and Rebick, ibid). Unlike earlier periods, there were no major labour disputes in the 1990's, suggesting realism in the sense that Japan herself was facing competitive challenges with the major 1985 revaluation of the yen, and emerging lower cost competition from China.

Since the 1990's, there have been redundancies, especially with senior staff being prematurely retired, as they did with the 'stationary' or 'sectoral 'decline' qualifications of lifetime employment in the 1970's, even if this was matched by a higher early retirement bonus. There has been significant down-sizing, much of which has been by non-replacement of temporary employees (Rowley and Tashiro, 2009).

But lifetime employment still remains central to the 'implicit equity' and mutual advantage of leading Japanese firms which is crucial to their competitive advantage. Braser (2014) found that the principle of seniority pay until retirement had been near to universally maintained. The commitment to lifetime employment in Japan therefore has survived the 1990's banking crisis and recession into the 21st century, as it survived the earlier crisis of the 1970's. It also did so by both self-interest and mutual advantage. Business realised the self-interest of retaining core employees and their skills and experience, while the government saw mutual advantage in terms of economic and social cohesion in helping them do so.

As Pilling earlier put it, Japanese companies 'have managed to reinvent themselves without aping the Anglo-Saxon model' (Pilling, 2006). As Sako (1997) also has claimed, the principle of lifetime employment continued to be upheld by management because, without it, motivation and workers' cooperation would falter. Canon, which for a time appeared to be considering shorter term performance related contracts, then reconfirmed the lifetime employment principle for the central reason of keeping workers' tacit knowledge, implicit skills and experience 'in house'. As Fujio Mitarai, President of Canon, stressed, the company thereby gains a workforce which is constantly relearning while Canon also keeps the secrets of its process innovation inside the company (Pilling, 2004).

5. Psychological and Social Contracts and Lifetime Employment

A psychological contract is not written but implicit, depending both on the presumption of mutual respect and of shared values. The concept of a social contract is long standing in western political theory since both Locke (1690, 1988) and Jean-Jacques Rousseau (1762, 1960). Both have precedents in terms of Western Europe since the Middle Ages, even if neither of them was conceptualised at the time. Thus Bloch (1939, 1994) evidenced the degree to which loyalty, and mutual advantage, was typified from the early medieval period when literacy, even among the aristocracy, was limited, by the simple gesture of a lord and liege joining hands – the liege putting his hands between those of the lord - making a symbolic mutual commitment of the lord to protect the liege and of the liege to serve the lord. While, in the much more recent context of Japan since the early 20th century, the commitment to lifetime employment for core employees was not written, but symbolised in a handshake. Underlying which, in both cases, was both mutual trust and mutual advantage.

Similarly, although Argyris (1960) was among the first to coin the term psychological contract, and it was developed also by Schein (1965, 1980). Coyle-Shapiro and Parzefall (2008) have submitted that the principles behind it as a concept can be traced to Bernard (1938) who had submitted that employee commitment needs to be balanced by reciprocal concern for employees by the organization.

In the context of stable Fordist or Weberian organisations much of this was feasible and evidence based. But from the 1980's, with globalisation, down-sizing, outsourcing and shorter-term contracts, it was thrown into question. Hiltrop (1996) then suggested that a new psychological contract emerged in which, despite less job security, and while no one could expect to be employed for longer than he or she added value for an employer, the implication was that an employee still had the right to expect interesting and rewarding work, and get the training and experience to be able to be employable elsewhere. But, as Armstrong comments, 'this could hardly be called a balanced contract since 'employers still call the shots except when dealing with the special cases of people who are much in demand and in short supply' (Armstrong, 2002, p. 50).

According to Herriot and Pemberton (1995, 1997) employee voice thereafter was drowned out by managerial rhetoric which sought to persuade employees 'that reality is the opposite of what they knew from their own experience to be true' (Herriot and Pemberton, 1995, p. 32). Conway and Briner (2005) have drawn attention to the increased interest in the concept of psychological contract since publication of the work of Denise Rousseau (1989, 1998; Rousseau and Parks, 1993;) but which involved several 'shifts' in assumptions and focus. These included:

- a shift from assumption of mutual needs or mutual advantage to an individual's perception of what such a contract might mean;
- an increasing perception by employees that their presumption of such a psychological contract had been breached (Rousseau, 1989, 1998; Conway and Briner, 2005).

Herriot and Pemberton (1997) have criticised Denise Rousseau's one-sided perception of psychological contract on the grounds that it 'has little to say about the contracting process' (Herriot and Pemberton, 1997, p. 45). Guest (1998) also has submitted that a one-sided contract is inherently contradictory. If a contract, whether explicit or implicit, is concerned with reciprocal obligations, how each of the parties regard this reciprocal process is relevant. Nonetheless, her claim, mainly from US evidence, that perceptions of its breach were becoming typical had force in an era in which delayering, down-sizing and shorter term contracts were becoming common.

By contrast, lifetime employment in Japan was not only transactional in the sense of 'stay with us rather than move and we will guarantee you a job'. Drawing on a meta-analysis of studies of it for a century in Japan, Moriguchi and Ono (2004) have analysed it as: 'a set of interdependent human resource management (HRM) practices surrounding an implicit and long-term employment contract. They also have done so in terms consistent with what Benoît Cœuré of the ECB has called for in Europe, in examining 'firm-level practices within the context of an employment system in which micro-level practices interact with macro-level institutions' (Moriguchi and Ono, ibid, p. 1).

In their meta-analysis Moriguchi and Ono have identified lifetime employment as a social as well as an economic institution, representing an implicit contract and reciprocal exchange of trust, goodwill, and commitment between employers and workers which emerged as an equilibrium outcome of the dynamic interactions among management, labour, and government and became an integral part of the nation's employment system reinforced by complementary institutions such as state welfare policies, labour laws, corporate governance, social norms, family values, and its public education system. Also that, while originally driven by the need to gain economic efficiency by retaining trained labour and their skills, as the system evolved the social benefits of employment security proved to be far greater than its direct economic benefits.

Moriguchi and Ono do not relate their findings to either theories of psychological or social contract. Yet, as represented in Figure 2, some twenty 'sets of meaning' that they ascribe to 'lifetime employment' are relevant to both. Not least since the implicit social contract in Japan has been that while hyper-efficient manufacturing firms have achieved vast productivity gains, a share of these then are transferred through taxation to the rest of the economy.

Figure 2: Psychological and Social Contracts in Japan

Source: Derived from Moriguchi, C. and Ono, H. (2004) Japanese Lifetime Employment: A Century's Perspective. Stockholm: European Institute of Japanese Studies, Working Paper 205. May.

Not that all features of the Toyota Production System should be idealised. As stressed by Fincham and Rhodes (1999), it involved varying degrees of constraint. In return for job security, core workers knew that their responsibility was to accept and respect the authority of their seniors. Sanctions could not include dismissal without breaching the principle of lifetime employment. But they were deployed in foreclosing the chance of promotion within the company for those who did not cooperate. Since pay was seniority based, this could mean the loss of a future income stream. But, non-promotion also meant loss of face and respect, of more significance in a Confucian culture than in the 'stop the boss' oppositional culture of some postwar Anglo-American industrial relations.

Where the Toyota production system also has been open to challenge is in lack of work-life balance. For decades leading Japanese companies paid limited attention to this, tending to demand that workers commit themselves to their flexible production schedules. This became notorious in the Japanese word *karoshi*, or 'working to death'. According to a 2008 report from the Japan Productivity Center for Social-Economic Development, nearly 90% of workers said that they did not even know what 'work-life balance' means. The Japanese Trade Union Confederation also reported that two-thirds of men put in more than 20 hours of unpaid overtime monthly. One in 25 admitted to working 80 extra hours, a level that risked *karoshi* (Rowley 2009).

According to Rowley and Tashiro (2009), nonetheless, in a report for *Business Week,* some companies including Toyota have been making a 'genuine effort' to find a better balance between work and leisure for their employees. Toyota, for example, now generally limits overtime to 360 hours a year, even if at a monthly average of 30 hours this could surprise rather than impress. Nissan offers telecommuting for office workers to make it easier to care for children or elderly parents. And dozens of big corporations have introduced 'no overtime' days when staff must leave promptly at 5:30 p.m.

Resistance to better work-life balance in Japan appears to be cultural. Few workers feel they can take advantage of the encouragement of this by management. Even before the slowdown of the Japanese economy following the government's agreement to the 1985 Plaza Accords which massively revalued the yen, and before the near nil growth of the economy after the early 1990s property and banking crisis, many workers simply took their work home with them, earning the epithet *furoshiki*, or 'cloaked overtime' rather than achieving better work-life balance. In 2007 Mitsubishi UFJ Trust & Banking, a division of Japan's largest banking group, allowed employees to go home up to three hours early to care for children or elderly relatives. Yet by 2009 only 34 of the company's 7,000 employees had signed up for the plan (Rowley and Tashiro, 2009).

Whereas greater attention to work-life balance is where western companies may be able to compensate for lack of lifetime employment as an incentive to commit to continuous improvement, especially if linked to profit sharing, and to concepts such as flexibility-by-consent and innovation-by-agreement on which one of us succeeded, through the then Portuguese prime minister Antonio Guterres, in gaining an endorsement from the European Council in the Lisbon Agenda 2000.

6. Innovation-by-Agreement

A common and in large part justified perception of the Lisbon Agenda 2000 is that it has failed, not least in its claim that within ten years Europe should be the most competitive economy in the world (EC, 2000).

But one of the reasons why it did not succeed is that governments failed to endorse that its recommendation for innovation-by-agreement between social partners should be part of the *acquis communautaire*, i.e. a citizenship right for all members of the EU, and thus part of a European Social Model.

The proposal to the European Council for innovation-by-agreement (Holland, 2000; Lisbon Agenda, 2000) included:

- achieving better work-life balance by allowing negotiation of the incidence of individual working time to non-work time to suit family or other personal needs;
- recognising a share of overtime working as 'time credits' which employees later can draw on as paid 'under-time';
- enabling individual proposals for new methods of work operation to be individually recognised and credited, as in Japan;
- combining flexible methods of work operation with job variation including horizontal mobility to offset alienation from routine, as also in Japan;
- 'enhanced competence profiling' to extend and diversify the application of skills;
- skills path planning for both lower line managers and workers rather than only career paths for middle or higher levels of management;
- the right to lifelong learning.

The proposal for Innovation Agreements in the Lisbon Agenda therefore had the potential to combine economic efficiency for an organisation through Japanese models of continuous improvement with what most Japanese firms had *not* achieved - both economic efficiency *and* social efficiency in the sense of more effectively meeting the personal needs of employees, especially through the right to work-life balance.

This case was reflected in the text of the Lisbon Presidency Conclusions for:

> 'restoring the European Social Model [by] agreements between social partners on innovation and lifelong learning, by exploiting complementarity between lifelong learning and adaptability through flexible management of working time and job rotation,... reducing

occupational segregation, and making it easier to reconcile working life and family life' (EC, 2000).

This then was followed through by two Commission reports from the Directorate General for Employment and Social Affairs (COM, 2002; COM 2004) stressing that The European social dialogue as a force for innovation and partnership for change in an enlarged Europe should enhance the contribution of European social dialogue.

The Lisbon Agenda, therefore, was less a call for flexibility-by-constraint or 'structural reforms' under threat of closure or down-sizing, than for flexibility-by-consent between management and labour at plant, branch or other local levels to gain and sustain both economic and social efficiency.

Yet within two years of the second Commission paper endorsing social dialogue at enterprise level, the Directorate General for Employment and Social Affairs published another report (COM 2006) endorsing the case for 'Flexicurity' as allegedly reconciling greater flexibility and economic efficiency. But this was not based on the combination of insider security and flexible production as in Japan, but on flexible labour market principles. Further, while such a model had worked well in Denmark, in an economy mainly composed of small to very small firms, it had been through extensive retraining possibilities for unemployed workers, as well as directly helping them gain new job placements, at a cost of nearly 3% of GDP (Holland, 2015b), whereas the EU commitment to funding such retraining was near to nil, and a policy to help secure replacements non-existent.

7. Summary

What this paper has shown is that there is no evidence to support either insider-outsider theory or the case for 'structural reforms'. There has been increasing concern, notably in the UK with the rate at which temporary or 'zero hours' contracts are increasing (Fleming, 2015). Raising minimum wages in Germany in 2014 did not lead in 2015 to the fifth of a million job loss predicted by employers' institutes but, by July that year to an increase of a quarter of a million jobs (Janssen, 2015).

It should be recognised in terms of the greater research and evidence for which Benoit Cœuré has called that labour market flexibility in Japan in the early 20th century failed. It resulted in workers who had been trained in one company leaving for higher pay in another, and encouraged the introduction of 'lifetime' employment for core workers, with annual wage increments and profit sharing. Labour mobility was within companies through job variation, rather than between firms. Multi-tasking and multi-skilling was aided by both formal retraining and on-the-job informal learning.

The *zen* of mutual advantage from retaining core workers in Japan enabled the *kai* of continuous improvement in work methods such as a doubling in productivity for Toyota and Honda in the decade after the 1973 OPEC oil price increases. The recession in Japan from the 1990s was not caused by 'insider privileges' but by a banking crisis combined with the effects of a revalued yen in 1985 and increased foreign direct investment substituting for exports.

Lifetime employment in Japan has combined both psychological and social contracts, even if Japanese theorists have not been much concerned with the conceptual framework of either. Its example, combining both economic and social efficiency, influenced the recommendation by one of us of innovation agreements which were endorsed in the Lisbon Agenda, but with the difference of stressing the right to work-life balance. The failure of the Lisbon Agenda was not in its aspiration that this should be a European citizenship right, but the resistance of Germany to accepting innovation agreements as an EU citizenship right for workers in the public and bigger business sectors.

High levels of youth unemployment in key member states of the EU since the onset of the Eurozone crisis tend to confirm Guy Standing's (2011) case that there is a new 'precariat' of workers without assurance of a stable job. Standing has claimed that this is a new 'dangerous' class for vested interests and mainstream political parties. And which may have been the case with their demise in the French presidential and legislative elections in 2017 and the negative Brexit vote of 2016 in the UK. As also with more extreme forms of rejection of a neoliberal European model and reversions to nationalism. It has long been the case that that when those who are economically and socially excluded face a crisis of individual and social identity to which mainstream parties, or trades unions, may have no immediate or longer term response, alienation, insecurity and unemployment spawn political extremism.

Moreover, contrary to myth, it was not inflation in the mid 1920's that caused the rise of Hitler, but the deflation imposed after the financial crash of 1929 by Brüning as chancellor who, like the EU Troika recently with 'structural reforms', resorted to government by decree rather than debate and lost popular consent (Holland, 2015b). This relates to political failure of EU governments to adopt policies to recover the European economy which are feasible without new institutions, or treaty revisions, or fiscal transfers between member states, as submitted in *A Modest Proposal to Resolve the Eurozone Crisis* by one of us with Yanis Varoufakis since 2010 and with James Galbraith in 2014, and also in the *Pavia Declaration* of 2015.

Which relates also to more general issues of both economic and social efficiency. The words efficiency and economy are constantly juxtaposed. This is less so for efficiency and societies. Yet a society is not efficient if it allows banks to speculate with people's savings and destroy them. Nor is it efficient if it tolerates persistently high levels of unemployment. Nor if it offers only temporary employment contracts to young people rather than is concerned with more deeply embedded employee rights. Nor if it only serves markets rather than ensures that they also serve people. What is needed is 'back to the future' in terms of learning up from the degree to which Europe, postwar, and Japan since the early 20th century, learned in that it is better to cooperate to achieve social efficiency in terms of both functional economies and functional societies than compete down on both costs and social wellbeing.

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