Myths about Japanese employment practices: An increasing insider–outsider conflict of interests

NAOHIRO YASHIRO*

Abstract

It appears that Japanese employment practices, once hailed as one of the secrets to Japan's "miracle" of rapid economic development after World War II, are not keeping up with important changes in Japan's economy and society under deceleration of economic growth and aging of the population. Nevertheless, the current regulations protect the practices of lifetime employment security and seniority-based wages as a desirable work style. However, these practices not only deter labor market flexibility, but also entail social costs by creating a "wall" that divides insiders and outsiders of firm-specific labor markets, and this leads to large wage disparities. Furthermore, these practices create an "implicit packaged contract" between firms and their employees, allowing the firm wide discretion over employees' work style, including working hours and job placement. As more women pursue full-time careers, they are being forced into the difficult position of having to choose between their careers outside the home or their children. The difficulty of this decision has resulted in a rapidly declining fertility rate. This paper argues that Japanese employment practices need to be revolutionized to allow better work–life balance and an alternative lifestyle for an increasing number of dual-income families.

Keywords: employment practices; insider–outsider conflicts; work–life balance.

日本的雇用慣行の神話－拡大する労・労対立

八代尚宏

戦後の日本経済の発展を支えた大きな柱としての日本的雇用慣行は、最近の経済の長期停滞と人口高齢化という環境変化に、十分に対応できなくなっている。それにもかかわらず、現行の法制度は、終身雇用や年功賃金を「望ましい働き方」として保護する考え方を変えていない。日本の雇用慣行は、労働市場の流動性を損ねるだけでなく、企業内の正規社員と企業外の非正規社員の間で、大幅な賃金格差等の「働き方の壁」を形成し、深刻な社会的コストを生む要因となっている。また、正規社員の内でも、雇用保障等の代償として、慢性的な長時間労働や頻繁な配置転換・転勤等、幅広い人事上の裁量性を受け入れるという「包括的な契約」がある。このため、フルタイムの女性社員が増えるほど、企業内のキャリア追求と家庭での子育てとの、いずれかの選択を迫られ、それが出生率の持続的な低下の大きな要因となっている。本論文は、共働き家族の増加に対応して、日本的雇用慣行が、仕事と子育てを両立させるワーク・ライフバランス等、多様な働き方を許容するためには、どのような改革が必要かを論じている。

1. Introduction

The Japanese work style has, since World War II, been mainly based on three pillars that are now considered traditional Japanese employment practices: (i) long-term employment security, (ii) seniority-based wages, and (iii) firm-based labor unions. Both blue-collar and white-collar workers come together in the same union membership and most of the executives of the company are selected from senior employees. On the basis of these employment practices, Japanese firms have long been associated with a harmonious, rather than confrontational, relationship with employees.

There is plenty of literature on these Japanese employment practices. The original interpretation by Abegglen (1958) was that they are based on employers' paternalism. But this view has gradually declined, and the general consensus is now that they are not specific to Japan but found in other nations as well (Dore 1973), although they are still more prevalent in Japan with respect to the male employees of large firms (Flath 2005). Furthermore, these practices are rational devices for human capital formation within a firm (Mincer and Higuchi 1988). For example, Shimada (1977) showed that the shape of the seniority-based pay scales differs widely by size of firm, level of education, and gender, all of which are closely related with a need for human capital formation. And Koike (1987) argued that on-the-job training is an important device to produce multi-skilled workers in firms honoring a long-term job commitment be-

tween the firm and its employees. Thus, Japanese employment practices were considered one of the secrets of successful economic development.

On the other hand, Cole (1972) suggested that, with a slowing down of economic growth, employers might not maintain Japanese employment practices because the commitment of long-term employment is not consistent with flexibly adjusting labor costs. Indeed, as GDP growth fell from on average 4% in the 1980s to 1% in the following two decades, the cost to firms of keeping excess employees has continuously increased. As a result, firms' profits have been squeezed and the recovery of investment delayed. Nevertheless, most employers have preferred to maintain these employment practices despite the adverse economic changes.

This results in a shrinkage of new employment opportunities for school graduates and a growing number of "non-regular employees" who are excluded from both employment guarantees and the seniority-based wages granted to regular employees. An increase in unemployed and nonregular workers has widened income disparity, a gap that has become a serious social issue in a society that was once considered egalitarian. Moreover, these employment practices, which are implicitly based on a clear division of labor – i.e., the husband at work and the wife at home – have caused more frictions in a society that sees an increasing labor market participation of women and more double-income employee households.

An insight of this paper is the need to focus more on the insider–outsider conflict of interests between workers with different work styles than on the traditional labor conflict between employers and employees. Employment practices that once functioned so well for economic development have today become obsolete, and even cause a variety of social problems. This is contrary to a general and more recent view in Japan that these traditional employment practices are still important devices for employment stability and, thus, they need to be defended against alternative work styles. Indeed, supported by labor unions, the current government is eager to regulate temporary work, which may well displace regular employment.

The structure of this paper is as follows: Section 2 reviews a basic mechanism of employment practices for skill formation. Although, as a whole, these practices consist of an efficient scheme for providing intensive on-the-job training, they are based on the assumption of a high rate of economic growth and a pyramid-like age structure of the population. This basic mechanism will then be closely related to a dual-structure labor market. Unlike the general perception of "equitable employment practices", these practices are not truly equitable, especially when considered from the viewpoint of the growing number of workers outside firm-specific labor markets. Section 3 will discuss the conflicts between

traditional employment practices and family life under the dramatically changing economic and social circumstances since the early 1990s. Under these constraints, the prospect for a new work style that provides a better work–life balance and the necessary institutional framework for supporting such a transformation is discussed in Section 4. Policy implications of the above will be presented in the concluding section.

2. Efficiency aspects of the Japanese employment practices

The three pillars of Japanese employment practices in the postwar period are mutually interacted for efficient skill formation in the firm. The first pillar is long-term employment security, which means that a regular employee usually enjoys guaranteed job security until the age of mandatory retirement (mostly at age 60). This was originally not a formal right of employees, but those who appeal to the court are likely to be protected by case law. Employees with a guarantee of long-term employment are more prominent in larger firms and the public sector, but those who work in small-scale firms also enjoy a measure of guarantee, albeit to a lesser extent. For example, in 2009, in the 55–59 age cohort just before retirement, 75.4% of male employees in large firms had more than 20 years' seniority (working experience in the same firm), and of these, 66.3% had more than 30 years' seniority. Table 1 reveals that the proportion of employees with longer seniority declines with size of firm, yet even in small firms, over one-third of employees had more than 20 years' seniority.

The second pillar is seniority-based wages. This is the practice of determining average wages based upon the years of service in a particular firm. The wage of a typical employee who continues to work in the same firm increases until retirement age, and then falls by shifting to a yearly employment contract. The slope of the age–wage profile has gradually become less steep, partly reflecting the changing age composition of employees (Figure 1). Though seniority-based wages are not unique to Japan, the wage gap between senior and junior workers is still larger than in other OECD countries. For example, Japanese male manufacturing

Table 1. *Proportion of employees with more than 20 years' seniority by size of firm.*

Years of working in the same firm: Firm size by number of employees	20~24 years	25~29 years	30 and above	Total
1000 persons and more	4.0	5.1	66.3	75.4
100–999 persons	6.0	6.9	40.0	52.9
10–99 persons	8.9	7.9	21.0	37.8
5–9 persons	10.3	9.8	22.9	43.0

Source: MHLW (2009a).

Figure 1. *Changing age–wage profiles of a typical employee who works in the same firm until retirement.*

Source: MHLW (2009a).

workers with 20–29 years' experience in the same firm had 72 % higher wages than new entrants – significantly higher than the difference of 41 % observed in Germany, or 29 % in France and the United Kingdom (JILPT 2010).

The third pillar is firm-specific labor unions. In Japan, both blue-collar and white-collar employees belong to the same union in a firm, unlike occupation-based unions in Europe. The proportion of labor union membership, however, has continuously declined from 45 % in 1950 to 18.5 % in 2009 (MHLW 2009b), partly reflecting an increasing proportion of nonregular employees.

A major role of these employment practices is to support smooth on-the-job training provided at the firms' initiative, producing multi-skilled workers who are more productive than single-skilled workers, as described in the following:

First, long-term employment security is part of the implicit contract to entice workers to accept intensive on-the-job training, which may require long working hours, frequent job rotations, and even relocation to undesirable locations throughout one's lifetime. Most employees are recruited immediately after graduation from high schools or colleges. Although they are unskilled – at least in firm-specific skills – when they enter the firm, these new company entrants eventually become multi-skilled workers thanks to intensive and continuous on-the-job training (Koike 1987). As part of this on-the-job training, employees are expected to accept wide-ranging job rotation, made possible by the single labor union in the firm. These job rotations are organized systematically and are not necessarily limited to posts in the same office or factory, but may include posts in rural areas and even overseas. While a wide range of job rotation is necessary for multi-skilled workers, it imposes a heavy burden on employees and their families. In return for job security, employees are

Figure 2. An image of the “entrapment mechanism”.

expected to accept their new posts unquestioningly. Often they are informed of new assignments with very little notice,¹ and purely at the discretion of the personnel office.²

Second, job security alone is not enough to keep these highly trained, multi-skilled workers within the firm unless combined with seniority-based wages. A rising wage profile, highly correlated with the number of years of service to a particular firm, partly reflects workers’ on-the-job training resulting in higher productivity. But Japan’s seniority-based wages usually set the slope of the wage profile to be steeper than that of labor productivity. This implies that the young workers are paid wages that are less than their marginal contribution to the firm. But if these young workers stay with the firm until retirement, they are eventually compensated through higher wages in their middle age, combined with a large lump-sum retirement benefit (Figure 2).³ Under the seniority-based wage scheme, employees cannot leave the firm without sacrificing the high opportunity costs of expected returns equivalent to the accumulated gap between actual wages and market wages based on productivity – a gap that will be positive for most employees past middle age. This “entrapment effect” on skilled workers within a firm prevents employees from resigning with skills they have gained through on-the-job training in any particular firm. In this sense, lifetime employment security and seniority-based wages are complementary.

Third, there is the role of firm-based labor unions, a characteristic of Japanese labor markets that is often misunderstood. Because labor union strikes are rare, Japanese labor unions are sometimes called “unions tamed by the employer”. Actually, when viewed from a long-term perspective, Japanese labor unions do an excellent job of protecting employee interests. The gap between actual wages and the workers’ marginal contribution to the company can also be interpreted as accumulated “implicit investments” by employees in the firm. Harmonious labor

relations between a firm and its employees are a byproduct of the “entrapment effect” described above.

In this sense, most employees in Japanese firms are *de facto* shareholders, but without any documents staking their claim in the firm (Yashiro 1997). And without a secondary market for trading, their commitment to the firm is even larger than ordinary shareholders, who can easily sell their shares. A major role of firm-specific labor unions is to protect the implicit assets of employees, which grow with the firm’s profits. Thus, some of the remarkably cooperative behavior that Japanese labor unions show toward company management – such as restraining wage increases during recessions or welcoming the introduction of new labor-saving technologies – is no mystery. Japanese labor unions are generally cooperative with the company management, because the major interest of employees is the sustainability and growth of the firm. That is the only way to reap the returns of their lifetime implicit investment in the firm. In return, the firms share any extra profits with employees through an annual or semi-annual bonus, accounting for over 20% on average of annual earnings in large firms, while usually fixing dividends to shareholders at a minimum level. This profit-sharing mechanism was in the past one source of high productivity and economic growth in Japan, and it is premised upon a long-term relationship between employees and firms.

The long-term commitment between a firm and its employees is based on an “implicit packaged contract”. A firm has wide-ranging control over employees in terms of job allocations – that is, the types of jobs and location of work – which are necessary for the systematic creation of well-trained employees with important firm-specific skills. In return, employees are granted stability in the form of implicitly guaranteed lifetime employment and seniority-based wages. The long working hours of Japanese employees are a side effect of this system, and they partly reflect higher capacity utilization of the firm’s investment in human capital development. But long working hours also leave room for reducing “man-hour labor inputs” in times of recession without actually laying off workers.

For employers, this packaged contract worked especially well during Japan’s sustained period of high economic growth. Guaranteeing lifetime employment to employees was not very costly to firms, given Japan’s strong economic growth interrupted by only brief recessionary periods up to the 1980s. Seniority-based wages were also preferable for firms, given the large proportion of young employees and the scarcity of senior employees.

But what about employees? If employment is guaranteed and wages go up every year regardless of performance, what incentive do employees have to work hard for the company? The answer lies in the severe

competition for the better posts in a firm. A better post can lead to significantly higher wages in the long run, including executive posts in the current or subsidiary firms beyond retirement age.⁴ This “job competition” model (Thurow 1975) applies not only to private companies, but also to government, where wages are rigidly fixed. A “good” post in a company or ministry is usually one that allows the employee to acquire qualified on-the-job training and precious experience, which result in better promotional chances and thus lead to higher lifetime earnings. Conversely, a “bad” post is generally a routine job that does not provide “useful” skill training. The gap in skills between workers who, with similar backgrounds, entered a given firm is largely based on the difference in the quality of their on-the-job training. This competition for useful on-the-job training results in an internal “rat race” among employees, even though they are guaranteed lifetime employment.

The work/lifestyle of long working hours and frequent job postings in rural areas or even overseas is required in the process of on-the-job training, and is implicitly based on a traditional division of labor at home, with a full-time homemaker raising the children running the home. The high rates of economic growth up to the end of the 1980s made it possible for even an average family to realize a lifestyle which, in the prewar period, only the rich could afford: a full-time housewife raising two or three children with the help of various labor-saving home appliances and a car. It was the realization of the “Japanese dream” of catching up with American living standards, almost a “national target” since the collapse of the economy in World War II. Japan’s economic success had been so impressive that many leaders in business, the labor unions, politics, and academia were persuaded that these (now termed “traditional”) Japanese employment practices were superior and needed to be protected from erosion by new trends such as temporary or agency work, regardless of changes of economic and social circumstances.

3. Changing economic and social circumstances surrounding the labor markets

Japan’s economic conditions have changed drastically in the 1990s, and they are putting considerable strain on those “traditional” Japanese employment practices that were established in the postwar period of strong economic growth.

3.1. Increasing costs of labor hoarding

The first factor is the bursting of the asset bubble in 1990/1991 and the subsequent long-term economic stagnation. After persistent increases in

Figure 3. *Fluctuations in the labor share of national income in Japan and the United States.*

Source: Cabinet Office (2009).

the postwar period, land prices began to fall such that the urban land price index in 2009 was less than 30 % of the peak attained in 1991 – that is, back to nearly the same level it had been in 1981 (JREI 2010). As a result, both firms and households suffered substantial capital losses, discouraging investment in equipment and housing. This “balance-sheet effect” had a substantial impact on economic growth: GDP growth declined from 4 % on average in the 1980s to 1.5 % in the 1990s, followed by 0.8 % in the first decade of 2000 (Cabinet Office 2009). The decline further deflated land prices based on the discounted value of future rents.

A direct impact of a decline in the trend economic growth has been an increase in costs associated with hoarding excess workers due to employment guarantees, despite falling production. Before the 1990s, the costs of labor hoarding in times of recession were compensated for by full utilization of skilled human resources in the following long periods of boom. However, since the early 1990s, sluggish GDP growth under persistent deflation has largely changed the picture. This is indicated by a sharp rise in the aggregated labor share of national income to a historically high level from 1995 to 2003 and in 2008. A major driving force behind this phenomenon is a large fall in national income while employees’ compensation remained stable even during recessions (Figure 3).

Another factor is a persistent deflation: the GDP deflator declined continuously from the peak in 1994 to 2009 by 13 %. The continuous fall in prices has pushed up real wage costs even with stagnant nominal wages. This is in contrast to past periods in which modest inflation allowed real wage costs to be reduced smoothly by restraining nominal wage in-

creases. The rigidity of both real wages and employment in Japan results in a widely fluctuating labor share of income, a situation that is in sharp contrast to the stability of the labor share of income over the business cycle in the United States, where employment is smoothly adjusted with fluctuations in production. The resulting loss in the profit share of Japanese firms in recession has negative impacts on the firm's financing for investment and delays the upturn in production and associated employment in the economy's recovery phase. Traditional long-term employment security has been effective at keeping unemployment rates low,⁵ but is offset by dampening demand for labor during times of economic expansion until the excess labor in firms has been eliminated.

A major consequence of the higher costs of labor hoarding has been the increasing number of temporary or part-time workers, which by 2009 accounted for one-third of total employees. These non-regular workers have fixed-term employment contracts with no guarantees for renewal. Manufacturing industry in particular, facing large fluctuations in demand, needs these nonregular workers, who can be shed easily when demand falls. Thus, stability of employment for regular workers is based on the instability of employment for nonregular workers. Employment adjustments during recession are common to many OECD economies, but this "wall" between insiders and outsiders of the firm-specific labor market is a characteristic unique to Japan. In contrast to the seniority rule of "last in, first out" in layoffs in the United States, in Japan a nonregular worker who has worked for several years may well be laid off to ensure job security for a regular worker who is a new hire.⁶

3.2. Aging of the workforce

A second factor accounting for the increasing costs of labor hoarding is the aging of the population and the labor force. The Japanese population likely peaked in 2007 and is projected to decline from 127 million to less than 100 million by 2050. Furthermore, the proportion of people aged 65 and above has risen rapidly, from 7% in 1970 to 23% in 2010, and is expected to be 40% in 2050 (NIPSSR 2010). While population aging is a common phenomenon in developed economies, Japan's population is aging faster than most. For a society in which employment practices are implicitly based on an abundant supply of young labor and a pyramid-like age structure of the population, this change will be dramatic. The proportion of workers aged 40 and above increased by 7.8 million between 1975 and 2009, while the number aged under 40 fell by 2.7 million. During the same period, the number of senior workers between the ages of 55 and 64 increased by 4.3 million, accounting for 83% of the increase in total population (NIPSSR 2010).

Although average life expectancy in Japan has risen to the highest level in the world,⁷ mandatory retirement at age 60 is still prevalent. This practice is not appropriate given the rapid aging of the population, and skilled human resources are not put to use. In the United States, mandatory retirement ages have been judged illegal, constituting age discrimination, and European countries are moving in the same direction. One reason why mandatory retirement ages have not been challenged as age discrimination in Japan is that it is offset by the age-related practice of seniority-based wages. As earnings rise to exceed the marginal productivity of older employees, there has to be a certain age at which employment is terminated, otherwise firm profits will be squeezed.

Although most employees subject to mandatory retirement rules are quickly re-employed by the same firm, they are normally hired under very different conditions, generally renewable one-year fixed-term contracts at about half the wages they were earning just before retirement. Furthermore, mandatory retirement practices are closely related to the labor laws, which are very protective in Japan. For example, dismissal of employees due to a lack of job capability is not admitted, in principle, by Japanese courts. The logic of the court is that the firm plays a crucial role in the skill formation of its employees and has to share responsibility for the alleged incapability. Thus, mandatory retirement rules are the only chance for firms to reshuffle employees.

3.3. Increase in female workers and double-income employee families

The third factor is a continuous increase in female management-track employment.⁸ This is mainly due to women's higher enrollment ratio in college education and a growing service sector, providing better employment opportunities. Women as a proportion of total employees increased from 32% in 1975 to 42.3% in 2009 (MIAC 2010). This trend partly reflects increasing numbers of women enrolled in higher education. The college (excluding junior colleges) enrollment ratio of women increased from 12.3% in 1980 to 45.2% in 2010, rapidly catching up to the level of men (56.4%) (MEXT 2010). Highly educated women in the labor market naturally seek employment opportunities similar to their male counterparts, and – unlike previous generations of female workers – are not quick to leave the labor force after marriage. This increase in working married women is reflected in the higher proportion of dual-income households, which rose from 35% in 1980 to 55% of total employee households in 2008 (MIAC 2010).

Nevertheless, Japan's tax and social security systems implicitly favor traditional households based on the gender roles of men at work and women at home. There are strong financial benefits to families with a de-

pendent spouse who either does not work or earns less than a certain annual salary.⁹ This penalizes married women who continue to work with substantial opportunity costs.¹⁰ The traditional work style, in which the husband concentrates on work while leaving household duties and child-care to his wife, is unsustainable when most women continue to work even after marriage.

4. Negative aspects of employment practices

If the premise is accepted that traditional Japanese employment practices are not based on some sort of cultural paternalism, but rather on the rational economic behavior of Japanese firms, then it is natural that there will be both pros and cons to the practices. While Japanese employment practices are useful for producing skilled workers through intensive on-the-job training, they also impose a heavy burden on employees in the form of long working hours and forced job placements. Of course, even in Japan, disgruntled employees can quit their jobs, but with such an inflexible labor market, the possibility of finding another job with similar conditions is low. Thus, in Japan, the opportunity costs of leaving a firm are especially high. This makes it difficult for many employees to seriously consider changing jobs mid-career. A survey comparing employee job satisfaction in Los Angeles and Tokyo reflects this situation, with the Americans reporting significantly higher job satisfaction than their Japanese counterparts, who have to stay on in unsatisfactory jobs.¹¹

4.1. Long working hours

Japanese firms are notorious for their long working hours, and hard data support this popular image. According to the International Labour Organization, the proportion of employees working over 50 hours a week was 28.1 % in Japan compared with 20.0 % in the United States, 5.7 % in France, and 5.3 % in Germany (ILO 2004). More recent data from 2007 indicate that Japanese employees who work more than 60 hours a week were concentrated in the peak child-raising age bracket of 25–44 (MHLW 2007). Employees with young families face a serious dilemma in trying to balance their child-rearing responsibilities with their jobs. Working conditions in most Japanese firms are premised upon the existence of a supportive spouse who does *not* work.

These long working hours can be attributed to traditional employment practices. First, teamwork, rather than individual responsibility for a specific job, is common in most Japanese offices. Working together with senior employees is a wonderful learning opportunity for junior colleagues, but it is time consuming and often requires many long meetings. Second,

job manuals are usually scarce and the boundary of an individual's job with others is ambiguous. Employees who want recognition from their supervisor often expand their own vague job description by invading the territory of others. Third, under the job competition model mentioned above, the most easily measured indicator of superior work is the length of time one spends at the office. Employees can get recognition from their supervisors and overtime pay at the same time. However, these time-intensive management practices are frustrating for dual-income families who have to divide their limited time between work and home responsibilities.

4.2. Frequent job placements

Frequent job rotations at the direction of the firm are required under traditional lifetime employment contracts. This allows firms to shift employees to busy sections and better allocate human resources. According to a government survey on working conditions, 90% of large firms (i.e., firms with over 1,000 employees) indicated that they were dependent on job placements to local or overseas offices (MHLW 2004). Furthermore, job rotations are necessary to give employees varied experience in the firm or in related companies within the group. A firm's most important on-the-job training is that of administration or management. Usually, a firm promotes new employees by one rank in a rural office before using their newly developed skills at the headquarters. Job postings in rural areas are an important step in climbing up the promotion ladder of a large firm.

Both employees and labor unions usually accept these job placements in return for job security. When it is difficult for the entire family to move together, it is not unusual for husbands to relocate alone, leaving their families behind at home. A survey showed that there were 300,000 family separations due to job relocations in 2003 (MHLW 2004). The cost of relocation to rural offices is probably higher for dual-income families where both partners are working full time and sharing childcare than for traditional family types.

4.3. Declining fertility ratios

Since traditional Japanese employment practices are premised upon long working hours and frequent job rotations, they require employees to put in greater than full-time work, something that is difficult without the support of a full-time homemaker. Thus, there is a *de facto* trade-off for employees with young families between raising their children and continuing to work full time. Most often, this choice falls to the woman, who faces an "either/or" choice between raising children and continuing to

Figure 4. Increasing female labor force participation and declining fertility rates (1984–2009).

Source: JILPT (2010), MIAC (2010).

work full time. Statistics indicate that most women choose their children. Over 60% of women who have a baby leave full-time employment without taking maternity leave, although there are officially entitled to do so (MHLW 2007). However, long-term job security and the resulting lack of job mobility in Japan make it quite difficult for women who leave full-time jobs to re-enter the job market later when their children have grown up. This dilemma introduces substantial opportunity costs to child rearing, opportunity costs that are increasing in line with the average wage of women.

The high opportunity cost of raising children is a major factor behind Japan's declining fertility rates, and the negative correlation between female labor force participation rates and fertility rates is evident (Figure 4). However, this negative correlation is not necessarily observed in all OECD countries; Scandinavian countries, for example, have higher fertility ratios and female labor force participation rates than Japan. The stark trade-off faced by Japanese women is embedded in Japan's inadequate social support system, and in labor market practices that make working full time difficult for women with small children (Tachibanaki 2010).

4.4. Increase in nonregular workers and wage disparity issues

The increasing proportion of nonregular workers has been a serious social issue in the last decade, defying the myth of the "Egalitarian Japanese Society". Although the insider–outsider theory of employment is not new (Lindbeck and Snower 2001), the effect is more pronounced in Japan, where firm-specific labor markets play a significant role. The large wage difference between regular and nonregular work at middle age is

Figure 5. Age-wage profiles of regular, placement, and part-time workers (2005). Source: MHLW (2007).

mainly because the wages of regular workers are based on seniority rules, while those of nonregular workers are determined in the occupation-based labor market. Thus, the wage gap becomes larger as the age of workers increases (Figure 5). Certainly, this is partly due to skill differences, but the principle of “equal pay for equal work” does not apply in Japanese labor markets.

The divergence in employment conditions between regular and non-regular workers is mainly attributable to traditional employment practices, which divide workers between insiders and outsiders of the firm-specific labor market. This insider–outsider difference has existed throughout Japan’s postwar economic development, but it became a serious social issue when Japan’s economic growth stagnated in the early 1990s and the number of nonregular workers steadily increased. As economic stagnation continued, Japanese firms gradually shifted their demand for employment toward “non-regular workers” to allow themselves greater flexibility to adjust employment. The proportion of employees granted employment security by becoming regular workers has fallen from 80 % in 1990 to 66 % in 2009 (MIAC 2010).

4.5. Conflict of interests between generations

The burden of employment adjustment is also borne by new school graduates. Especially in a stagnant economy, entry to firm-specific labor markets is limited to new high school or college graduates. Thus, the timing of graduation greatly affects one’s lifetime earnings in Japan. Protecting the employment of senior workers who – due to the seniority-based wage system – earn high salaries requires firms to curtail recruitment of

young people. Those unfortunate enough to graduate in times of recession have fewer opportunities for regular work; and once that port of entry is missed, it often does not reappear later in life. This leads to increasing income disparity between youths who have regular employment and receive on-the-job training and those who have only temporary jobs.

Because labor mobility across firms is limited, the ports of entry to large firms are usually crowded with many college or high school students looking for good job opportunities. Thus, the job search period is getting longer, and many college students have started writing job applications and going to interviews even in their junior year. Getting an official offer can take one year or more, and studies are sacrificed. This once-and-for-all recruitment practice is inherent in the system of regular job rotations within the firm. In many large firms, graduates of certain well-known universities have a clear advantage, because they are considered to be potentially better at absorbing the firms' on-the-job training. This "screening" process is more important in Japanese firms that provide intensive on-the-job-training and solid job security.

The importance of a screening process by large firms is a major cause of severe competition among high school students aiming to enter the better universities. With this competition, household expenditure on supplementary training for the specific skills needed to pass college entrance examinations has increased over time. This "rat race" among high school students and even elementary school students puts a heavy burden on the average family and creates disparities in the children's educational attainment, disparities that reflect the gaps in family income levels.

5. New work styles for balancing work and family life

The increasing number of married women with young children and of older workers in the labor market requires a better work–life balance and, in particular, reasonable working hours and less-frequent job relocation. Currently, these conditions are available only to nonregular workers, who gain them at the sacrifice of relatively low earnings, non-permanent employment contracts, and often lower levels of responsibility. The divergence in these two types of employment conditions has resulted in approximately two-thirds of workers "voluntarily" opting for nonregular jobs (MHLW 2007). This does not necessarily imply that these nonregular workers are satisfied with their lower wages and working conditions, but that they have no alternatives. However, the divergence in these two types of employment conditions in the current labor market may well be improved by providing an alternative concept of work style.

5.1. Three principles of an alternative work style

A new work style that is more realistic, given the current economic and social circumstances, would incorporate the following three principles:

“Age-free”: Under the current practice of seniority-based promotion, one’s age or years of service to a particular firm are the most important determinant of earnings. This makes life planning easier for employees, but imposes a heavy burden on firms with an increasing share of senior workers. However, this practice, which seems at first sight favorable to older workers, actually works against them since it forces many firms to maintain a mandatory retirement age of around 60. If wages were set more in line with the employees’ contributions to the firm regardless of their age, even in their middle age, then many senior workers could probably continue to work after the current retirement age, perhaps even with more flexible working arrangements. This trade-off between lower wages and longer employment would benefit the majority of employees. Moreover, increasing the labor force participation of older workers would likely have a positive effect on the trend of the household savings ratio declining with aging (Yashiro and Oishi 1997; Yashiro 2003). Age-free is a key concept in coping with an aging society.

“Equal pay for equal work”: This principle is not well established in Japanese labor markets, as opposed to the occupation-based principle in European labor markets. Japan’s labor laws require equality of hourly wages between full-time and part-time workers only if both are regular workers.¹² This leaves a significant wage gap between most regular and nonregular workers. Implementing the principle of equal pay for equal work is difficult because it is challenging to clearly define “equality” over various kinds of jobs. Even in cases where regular and nonregular workers perform similar jobs, the regular workers may well have more responsibility, particularly in urgent matters, in return for higher earnings. Introducing the principle of equal pay for equal work would require employers to create job manuals that clearly explain the wage differences across different jobs. Management may consider it costly in the beginning, but would eventually find it important as a basis for shifting from the current seniority-based system to a market-based wage scale, a shift that is required in aging societies.

“Double-income employee family model”: The current social system is implicitly based on a single-earner family. For traditional households, with a busy household head focused on his career and a nonworking spouse running the home, employment stability is a top priority. On the other hand, double-income employee families are less vulnerable to the risks associated with one partner being laid off. They may be more concerned about working conditions such as shorter working hours or fewer

job relocations. An alternate contract with more flexible working hours or limited job relocations cannot be achieved without employees sacrificing job security to some extent. It will be necessary to establish clear rules for laying off employees, with fair compensation in times of recession and with the consent of labor unions for individual lay-offs. The alternate contract has to be optional, rather than a replacement for traditional contracts, otherwise the conflicts between employees will be aggravated.

A better balance between work and nonwork would be beneficial for the majority of employees. It is not only attractive for married women who continue to work while raising children, but young men and women who want to have more time for personal development, social activities, and volunteer work, for example, would also benefit. The shift would also be good for older workers who may find it hard to work grueling hours but have no difficulty in managing a normal working week. The one exception would be middle-age men with a full-time homemaker spouse, men who enjoy the current work style, including chronically long overtime hours, and are resistant to change.

Despite the potential benefits of a change in work–life balance through more flexible employment practices, the Japanese government has recently submitted the bill to the Diet in the opposite direction by trying to prohibit in principle temporary workers, rather than improve their working conditions.¹³ The logic behind this proposal is that stable employment and seniority-based wages alone represent a “good work style”. But the regulation may well reduce employment opportunities for both regular and temporary workers, as terminating the contract of unregulated temporary workers have made employment protection of regular workers possible in times of recession.

5.2. *Reform of the labor laws*

A major obstacle preventing the change of employment practices is the current labor law. According to an OECD study on the strength of protection of permanent workers against dismissal, Japan’s position is average (OECD 2004). However, the most salient feature of Japan’s regulation is not necessarily its strength, but its ambiguity. In Article 16 of the current Employment Contract Law (*Rōdō Keiyaku-hō*), which was established in 2008, it is stated that the dismissal of employees for reasons that are either irrational or socially unacceptable is not allowed. A major problem with this law is that the criteria of “irrational” or “socially unacceptable” are not spelled out, so interpretation is left up to the courts, and the judgments differ widely by area (Ohtake 2002). This leads to uncertainty among employers, who do not know the true costs of lay-offs or downsizing. And this uncertainty discourages firms from employing

regular workers or establishing new employment practices that would better meet the needs of employees in double-income employee families. In reality, the law tends to favor employees of large firms, who, supported by affluent labor unions, can afford to appeal to the courts. Employees of smaller firms, on the other hand, often cannot afford to take their claims to court and are therefore not in practice protected by the law.

One way to improve the current Employment Contract Law would be to clearly specify the conditions and procedures necessary for the dismissal of regular workers. For example, a certain amount of pecuniary compensation with consent from labor unions could be one criterion for “socially acceptable dismissal”. Thus, even employees of small firms would benefit, contrary to the current practice of dismissal without reasonable compensation. If such a rule could be applied to both regular and nonregular workers, it would lower the “walls” dividing them, significantly affecting current employment practices. It would provide a variety of employment options, ranging from current regular jobs with compulsory overtime to nonregular jobs with less job security, with some attractive options in between the two extremes.

The issues of labor market regulatory reform are often interpreted as a conflict of interests between employers and labor unions, or the confrontation between neo-liberalism and social democracy. However, this is not necessarily the case for Japan’s current labor market. The harmonious relationship between employers and employees is still maintained, reflecting effective employment protection and a low incidence of the traditional type of labor disputes. What has become more prominent recently is a conflict of interests between workers, such as between regular and nonregular workers, between employees in large firms and those in small firms, and between traditional single-earner employee families and double-income employee families. Unfortunately, Japan’s labor unions represent the interests of regular employees of large firms, and therefore tend to be major supporters of the current system.

These conflicts between workers may well indicate that the current government is not moving toward a more Scandinavian-style system, with greater labor market flexibility but also greater security and protection for workers. The expansion in 2009 of coverage for unemployed persons who had worked for a shorter period was a desirable policy direction. But prohibiting the majority of temporary jobs as advocated would have the negative effect by reducing their employment opportunities. More protection of existing temporary workers, combined with less regulation of their work-style, is consistent with Article 181 of the International Labour Organization treaty, which Japan enacted in 1999 – well before the so-called Koizumi era of neo-liberalism.

6. Conclusion

Japanese lifestyles are heavily influenced by current employment practices. In what has become a typical scenario, young new-hires are recruited straight out of college or high school. Male employees continue to work their way up the promotion ladder until the mandatory retirement age, while most female workers leave their jobs upon marriage or the birth of their first child. This system worked fairly well in the era of high economic growth, when Japan's labor force was young and the economy grew steadily, prompting firms to continually expand employment. It was an efficient scheme for creating multi-skilled workers within the firm, and played an important role in providing a safety net for employees over the business cycle.

However, these same traditional employment practices have gradually become obsolete as Japan's economy has stagnated and the labor force has aged. In fact, the proportion of workers that enjoy this traditional form of employment protection has fallen and, today, the wall dividing the insiders of firm-specific labor markets and outsiders is a major cause of wage disparity. This has become an important social issue since the late 1990s, and it is now hard to argue that traditional Japanese employment practices are more "equitable". As the economy has stagnated, nonregular workers and new graduates have borne the costs of maintaining the *status quo*.

These traditional employment practices are implicitly based on the division of gender roles at home, with the husband focused on his career and the wife a devoted, full-time homemaker. Men who enjoy the benefits of this system are expected to make the firm their priority in return for the promise of job and wage security. However, this implicit contract is not as attractive to the increasing number of double-income employee families in which both husband and wife work full time. The difficult trade-off between work and child-raising for these families is reflected in the clear correlation between declining fertility rates and increasing participation of women in the workforce. The time has come for a new lifestyle, based on more flexible employment and a better work-life balance, with fewer working hours and relocations of workplace. In its protection of traditional employment practices, the government would seem to be behind the times.

This new Japanese lifestyle will be more diverse. Though a certain proportion of families will certainly maintain the traditional roles described above, they will be far from typical; being a full-time homemaker will likely become a "status symbol" advertising the unusual success of her husband. Dual-career households will become the norm, and the majority of those families will gladly trade a lifetime employment guarantee for more flexible working conditions and a better work-life balance.

Naohiro Yashiro (yashiro@icu.ac.jp) is Professor of Economics at the International Christian University in Tokyo. He earned his Ph.D. at the University of Maryland, was president of the Japan Center for Economic Research, and a member of the Regulatory Reform Committee and the Council of Economic and Fiscal Policy in the Japanese government. His main research interests are aging of the population, social security, and labor market issues. Recent publications include *Health Care Issues in the United States and Japan* (co-editor, 2006) and *Reforming the Japanese Labor Markets* (in Japanese, 2009).

Notes

- * The author appreciates the valuable comments by two anonymous referees and Prof. Heather Montgomery, International Christian University.
- 1. The once-and-for-all recruitment of new workers is done on 1 April of each year (the beginning of the fiscal year in Japan).
- 2. The administrative function of recruiting and allocating employees in Japanese firms or firm groups is usually concentrated in the personnel office.
- 3. Young workers who move to another firm are likely to secure higher wages, while older workers who change job are likely to have to settle for lower wages. This is cited as indirect evidence for the gap between wages and productivity.
- 4. In a large firm, senior posts in subsidiary firms are usually offered to those employees who have made major contributions to the parent firm just before the retirement age.
- 5. From 2008 to 2009, Japan's unemployment rate rose by 1.1%, a modest increase when compared with the decline in GDP of 5.3%. In the United States, the equivalent figures were 3.4% and 2.5%, while in the euro zone it was 1.9% and 4%.
- 6. In 2006, the average length of employment of part-time workers working in the same firm was 5.4 years; those who had worked for more than 10 years in the same firm accounted for 17% of all part-time workers (MHLW 2006).
- 7. In 2008, life expectancy in Japan was 79.3 years for males and 86.1 years for females, compared with 77.1 and 82.4 years, respectively, in Germany.
- 8. While the labor force participation of women used to be higher in the 1950–1960 period, most of these women were either self-employed or family workers. Compared to women who work for an outside firm, these women experienced fewer personal conflicts between work and family life.
- 9. Definition of “dependent spouse” in employee household is that the spouse earns an annual wage of less than 1.03 million yen for income tax allowance, while it is less than 1.3 million yen for being a beneficiary for the basic pension and health insurance without own contribution. If she earns more than the threshold income, she is not covered by her husband's social security, and has to pay the social security contribution by herself.
- 10. Nonworking spouses benefit from a certain allowance of the income tax of the household head, as well as basic pension and healthcare benefits with no individual contributions.
- 11. According to Watanabe (1999), the ratio of those who are satisfied with their current job is 82% in Los Angeles and 60% in Tokyo, but the ratios of those who want to change jobs are 46% and 27%, respectively.

12. Regular status is rare for part-time employees and, in 2006, only 5% of all part-time workers had monthly wages equivalent to those of regular employees (MHLW 2006).
13. In 2008, the then-opposition Democratic Party of Japan (which came to power in 2009) submitted a bill to the Diet to prohibit, in principle, fixed employment contracts. The bill proposed that workers working jobs that were required permanently by the firm should have employment guarantees (Yashiro 2009).

References

- Aegglen, James C. 1958. *The Japanese factory*. New York: Free Press.
- Cabinet Office. 2009. The system of national accounts. <http://www.esri.cao.go.jp/jp/sna/menu.html> (accessed 12 November 2010).
- Cole, Robert E. 1972. Permanent employment in Japan: Facts and fantasies. *Industrial and Labor Relations Review* 26 (1). 615–630.
- Dore, Donald. 1973. *British factory – Japanese factory*. Berkeley: University of California Press.
- Flath, David. 2005. *The Japanese economy*, 2nd edn. Oxford: Oxford University Press.
- ILO (International Labour Organization). 2004. *Working time and workers' preferences in industrial countries: Finding the balance*. Geneva: ILO.
- JILPT (Japan Institute for Labor Policy and Training). 2010. *Databook of international labour statistics*. Tokyo: JILPT.
- JREI (Japan Real Estate Institute). 2010. *Shigaichi kakakushisu* [Urban land price index]. <http://www.stat.go.jp/data/nenkan/zuhyou/y1712000.xls> (last accessed 31 October 2010).
- Koike, Kazuo. 1987. Human resource development and labor–management relations. In Kozo Yamanura & Yasukichi Yasuba (eds.), *The political economy of Japan. Vol. I: The domestic transformation*, 289–330. Stanford, CA: Stanford University Press.
- Lindbeck, Assar & Dennis Snower. 2001. Insiders versus outsiders. *Journal of Economic Perspectives* 15 (1). 165–188.
- MEXT (Ministry of Education, Culture, Sports, Science and Technology). 2010. *Gakkō kihon chōsa* [A basic survey on schools]. http://www.mext.go.jp/b_menu/toukei/chousa01/kihon/1267995.htm (accessed 24 August 2010).
- Mincer, Jacob & Yoshio Higuchi. 1988. Wage structure and labor turnover in the United States and Japan. *Journal of the Japanese and International Economics* 2. 97–133.
- MHLW (Ministry of Health, Labor, and Welfare). 2004. *Koyōkanri chōsa* [Survey on working conditions]. <http://www.mhlw.go.jp/toukei/list/39-16.html> (accessed 24 August 2010).
- MHLW (Ministry of Health, Labor, and Welfare). 2006. *Pātotaimu rōdōsha no sōgō jittai chōsa* [Survey on part-time workers]. <http://www.mhlw.go.jp/toukei/list/132-18.html> (accessed 24 August 2010).
- MHLW (Ministry of Health, Labor, and Welfare). 2007. *Shūgyō keitai no tayōka ni kansuru sōgō jittai chōsa* [Survey on the diversification of work styles]. <http://www.mhlw.go.jp/toukei/list/5-19.html> (accessed 31 October 2010).
- MHLW (Ministry of Health, Labor, and Welfare). 2009a. *Ueiji sensasu* [Wage census]. <http://www.mhlw.go.jp/toukei/list/52-21.html> (accessed 24 August 2010).
- MHLW (Ministry of Health, Labor, and Welfare). 2009b. *Rōdōkumiai kiso chōsa* [A basic survey on labor unions]. <http://www.mhlw.go.jp/toukei/list/13-21.html> (last accessed 31 October 2010).

- MIAC (Ministry of Internal Affairs and Communications). 2010. *Rōdōryoku chōsa* [Labor force survey]. <http://www.stat.go.jp/data/roudou/index.htm> (accessed 31 October 2010).
- NIPSSI (National Institute of Population and Social Security Research). 2010. *Jinko tokeishiryō* [Statistical data on population]. <http://www.ipss.go.jp/> (accessed 24 August 2010).
- OECD. 2004. *OECD employment outlook*. Paris: OECD.
- OECD. 2010. *OECD economic outlook 87*. Paris: OECD.
- Ohtake, Fumio. 2002. *Seirikaiko no jishō bunseki* [An empirical analysis of dismissals due to business fluctuation]. In Fumio Otake, Nobuya Ouchi & Yuichi Yamakawa (eds.), *Kaikohōsei o kangaeru* [Legal system on dismissals]. Tokyo: Keiso Shobo.
- Shimada, Haruo. 1977. *Rōdōkeizaigaku no furontia* [The frontier of labor economics]. Tokyo: Sogo Rodo Kenkyusho.
- Tachibanaki, Toshiaki. 2010. *The new paradox for Japanese women: Greater choice, greater inequality*. Tokyo: I-House Press.
- Thurow, Lester. 1975. *Generating inequality*. New York: Basic Books.
- Watanabe, Shin. 1999. *Tenshoku no susume* [Encouragement for changing jobs]. Tokyo: Kodansha.
- Yashiro, Naohiro. 1997. *Nihonteki koyōkankō no keizaigaku* [Economics of the Japanese employment practices]. Tokyo: Nihon Keizai Shinbunsha.
- Yashiro, Naohiro. 2003. Demographic changes and their implications for Japanese household savings. In Robert M. Stern (ed.), *Japan's economic recovery*, 375–395. Northampton: Edward Elgar.
- Yashiro, Naohiro. 2009. *Rōdōshijyō kaikaku no keizaigaku* [Reforming the Japanese labor markets]. Tokyo: Nihon Keizai Shinbunsha.
- Yashiro, Naohiro & Akiko S. Oishi. 1997. Population aging and the savings-investment balance in Japan. In Michael Hurd & Naohiro Yashiro (eds.), *The economic effects of aging in the United States and Japan*, 59–87. Chicago: University of Chicago Press.