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## Pursuing Solutions for Japan's Employment Problems

Shinichi Nagasawa

### Abstract

When German laws were introduced into Japan after Meiji restoration, corporation system came down from Germany as Gesellschaft (kabushiki kaisha), as opposed to Gemeinshaft (kyodotai). However, Japanese gradually transformed Gesellschaft (kabushiki kaisha) to Japanese style, where everybody makes efforts together for the same goal. This resulted in the creation of life time employment, seniority based wage system and in house labor union, which were 3 items peculiar to Japanese management.

As Japanese had overly well adapted themselves, it was difficult to make necessary adjustments in the new era, "the lost two decades". The two decades brought awareness of the organizational inflexibilities imposed upon Japanese style corporations. In the period of economic decline, Japanese CEOs had no other choice, but to choose temporary staff with low wages, resulting in big wage differentials between the full time employed and temporary staff. In addition, life time employment made it difficult for the mid-career recruitment market to develop in Japan. As a consequence, when female employees left their jobs to give birth to their children, they find it difficult to find re-employment, when employment once again was possible. Having needs for urgent changes to Japan's employment system in mind, necessary measures for improvement were studied. Comparison of Japanese labor market with that of Europe and the United States was made. From the results of the study, the following conclusions are drawn. The Japanese labor market is still bureaucratically led, and lacks market mechanisms. The shift to the job based pay of Japanese employers and review of labor laws concerning the dismissal of employees are needed.

### INTRODUCTION

#### 1. The purpose and background for the research

Through the ages, Japanese have been said to be good at assimilating things introduced from outside, transforming them into matters or things that are Japanese specific.

An example is the invention of Japanese hiragana characters based on Chinese characters. After Meiji restoration, and its introduction of German laws, corporation system (kabushiki kaisha) came down from Germany as Gesellschaft, as opposed to the concept Gemeinschaft (kyodotai, with the meaning of communities).

It was accepted positively as "Japanese spirits combined with Western learning (WakonYosai)", however, it could also mean inventing things Japanese, but without deep insight into why such things came into being in Germany.

Yukio Noguchi, an economist, maintains that the current Japanese economic system was established during the wartime, after "National General Mobilization Law" was issued in 1938. According to Noguchi, in prewar days, Japanese corporations used to be purely capitalistic Gesellschaft, managed by CEOs who at the same time were major shareholders, with mobility of their employees. In the high economic growth period, after the war, Japanese CEOs started providing their employees with the job security, in order to avoid outflow of their employees. In 1958, J.C. Abegglen wrote in his "Japanese Management" that Japanese management was characterized by three items which were lifetime employment, seniority based wage system and in house labor union. In other words, Japanese transformed Gesellschaft into Japanese style kabushiki kaisha, overly adapting themselves to the new economic environments. In this regard, Kazuhiko Toyama, ex COO of Industrial Revitalization Corporation of Japan said that Japanese succeeded in changing Japanese corporations to organizations where everybody makes efforts

together for the same goal. Toyama added that as Japanese had overly well adapted themselves, it was difficult to make necessary adjustments in the new era, which brought about “the lost two decades (economic difficulties of Japan, starting from early 90’s)”.

The two lost decades brought awareness of the organizational inflexibilities imposed upon organizations internally in Japan. In the period of economic slow-down, as Japanese CEOs lost their confidence in the future, when they were forced to choose between the full time employed and temporary staff, they had no other choice but to choose temporary staff with low wages. As a result, big wage differentials between the full time employed and temporary staff became one of the gravest Japanese social problems society was facing. In addition, life time employment made it difficult for the mid- career recruitment market to develop in Japan. When female employees left their jobs to give birth to and/ or raise their children, they find it difficult to find re-employment, when employment was once again possible.

Having needs for urgent changes to the Japanese employment system in mind, necessary measures for improvement need to be reviewed.

**2. The method of research**

Applying the utmost emphasis on market mechanisms, we now make comparison of the Japanese labor market with that of Europe and the United States. Based on the comparison, if we identify peculiarities of Japanese market, we will do the research on wage system. Koshi Endoh, a labor economist, maintains that the wage system and practices on labor markets are very closely related. We often hear non-Japanese CEOs working in Japan saying that firing employees is extremely difficult in the Japanese market. Considering that this could lead CEOs to depend more on new temporary staff instead of the new full time employed, the international comparison of labor laws concerning the dismissal of employees must also be made.

**RESEARCH CONTENTS**

**1. Wage system**

On the basis of what wages are paid for, wage system is generally classified into two types, as the table below,

	Job Based Pay	Merit(Seniority) Based Pay
Wage Standards	Job	Abilities
Characteristics	Clear job description with easier response to globalism	Flexible personnel changes within corporations
Area	Europe and the U.S.	Japan

As has been mentioned, as in Europe and the U.S., there are a lot of people from different backgrounds(religion, culture, races, etc.) working in corporations, wages are received in exchange for their jobs. In contrast, among all advanced countries, Japan is the only country where wages are paid for employees’ abilities. Keiichiro Hamaguchi, a labor economist, wrote in his work “Youngsters and labor”, that Japanese labor relations are membership type, as opposed to job type of other advanced countries. In the opinion of Hamaguchi, the membership type has two distinctive features: regular pay raise and hiring all new graduates as of April.

First, in the understanding of non-Japanese, the regular pay raises are one of the most strange practices in Japanese market. In other advanced countries, pay raises are implemented only when labor efficiencies are improved or the difficulty of work is increased. In advanced countries it is not understandable that the pay raise is implemented for every employee on regular basis. In Japan, as a pay raise is implemented, while every employee continues to do the same job, corporate management has difficulty with financial planning and resources. Hiring new graduates at a time is another labor practice which is unfamiliar to non-Japanese. The labor practice in Europe and in the U.S.A is year-round recruitment. In principle, new employees are hired to fill vacancies due to retirements or expansion of businesses. According to Hamaguchi, when National General Mobilization Law was enacted in 1938, restrictions on hiring new employees were issued. After the war, restrictions were transformed into labor management orders, which en-

able only governmental organizations (currently called “Hello Work” ) to be engaged in job introductions. When it comes to new graduates, organizations work in cooperation with schools, which is the origin of hiring new graduates as of April 1<sup>st</sup>, immediately after their graduation. However, the practice of hiring new graduates at a time has become one of the major causes of employment problems in Japan.

New graduates are provided with major opportunities for finding employment upon graduation. As a consequence, they are likely to only be employed temporarily, if the opportunities presented are missed, resulting in a gap in wages among young employees. However, new graduates employed by major corporations of their choice, being aware that the longer they stay, the higher their pay will be, never leave for even better opportunities. This makes it difficult for the mid-career recruitment market to develop in Japan.

Why then is the seniority based pay prevalent in Japan? As the post war economic recovery started from the devastation, the security of life for employees used to be given top priority. Paying the middle aged who supported their families higher than young employees was the policy widely accepted. Whenever CEOs tried to introduce job based pay, they encountered strong oppositions from labor unions.

## 2. Laws concerning the dismissal of employees

Shinya Ouchi, a labor laws expert, argues that the basic principle of labor laws in the U.S.A. is “employment at will”, which means that the maintenance of employment relations depends entirely on the will of all the parties concerned. In other words, if one of the parties so wishes, the cancellation of employment is legally feasible. On the other hand, after the war, new labor laws were introduced to Japan from other countries where job based labor relations are dominant. As a result, a gap between job based labor laws and Japanese realities (life time employment) has been filled by judicial precedents. In this connection, the ruling passed by the High Court of Tokyo in 1979 provided the fundamental conditions needed for the dismissal. They are,

- 1) Necessities for personnel cuts
- 2) Efforts to avoid the dismissal
- 3) Appropriateness of dismissal standards and selection of the person dismissed
- 4) Appropriateness of dismissal procedures

As described above, with larger Japanese corporations where the labor unions are strong enough, it is difficult to dismiss employees who are redundant.

## THE CONSIDERATION OF RESEARCH CONTENTS

### 1. Advantages and disadvantages of wage system

As discussed in RESEARCH CONTENTS, one of the advantages of job based pay is more closely linked to market mechanisms. As the wage market for a specific job is developed, if people find their pay level below the market, they will move to employers who pay the market level, which promotes the mobility of employees. Employers will pay more attention to the wage market, while employees will do their best to develop their professional skills, as the development of their skills is the principle access to higher wages. In contrast, one of the disadvantages of Japanese seniority based pay is the pay level not being linked to the market. Generally speaking, middle or small sized Japanese corporations pay lower wages than large corporations, regardless of the job to which an employee is assigned. To make matters more difficult, should the employees’ capabilities not decline, the pay structure will tend to be seniority based. It may sound ironical to say that the retirement age could be Japanese management invention, in order to put the upper limit on the increase of employees who are soaked in care free life? In the U.S., the retirement age is considered as the age discrimination. There, employees are dismissed not due to their age, but due to the fact that their job efficiencies declined. Naohiro Yashiro, a labor economist maintains that the abolition of the retirement age is the general trend in Europe, too.

## 2. The shift to the job based pay of Japanese employers

In early 90's, after the burst of Japanese bubble economy, Japanese large corporations started introducing “pay for performance”, where the evaluation criterion is the performance of employees' job. However, according to “the White Paper on Labor Economy of 2013”, the number of Japanese employers, introducing pay for performance had kept on increasing until the year 2004, while, since the year 2007, the number of employers newly introducing pay for performance has been on the decline. It is believed to be attributable to the fact that the basis of pay for performance is job based pay, which Japanese are not accustomed to.

For this matter, Yoshio Sasajima, a labor economist, gave the following summary of pay for performance of the United States and Japan.

	Pay for performance of the U.S.	Pay for performance of Japan
The clarity of job contents	Clearly defined in job descriptions	In general, no job descriptions
Hiring method	Hired for a specific job	Not hired for a specific Job
Personnel changes	In general, by opportunity announcement	Appointment from within corporations
Performance appraisal	Fair evaluation and transparency required	Low transparency

Recently, even on Japanese market, the non-existence of job descriptions is severely criticized. As the scope of job for each employee is not clear, the performance appraisal tends to be subjective. If working hard until midnight is positively evaluated, all employees are forced to work overtime, which makes it difficult for married Japanese women to continue to work. Currently Japanese economy is suffering from a shortage of workers, and hence, in terms of the full utilization of manpower of women, working long hours should be avoided.

Notwithstanding the fact that the introduction of “pay for performance” is no longer fashionable, based on the research conducted by Japan Productivity Center in 2014, the permeation of job based pay is pro-

ceeding gradually among Japanese employers. Canon, for example, introduced job based pay for every employee, starting from the year 2005. A year ago, Sony also introduced job based pay, in order to save labor costs. The following items could be noted as the background of the gradual shift to job based pay.

### 1) A principle of determining wages “equal labor, equal pay”

As discussed in RESEARCH CONTENTS, a widening gap of wages between the full time employed and temporary staff, is one of the most serious problems facing Japanese. The majority of economists believe this has caused the stagnant personal consumption, which, in turn, leads to decline of Japanese economy. Job based pay is based on a principle, “equal labor, equal pay”. As a result, if the principle penetrates itself into Japanese management, a gap of wages will be narrowed.

### 2) The development of mid-career recruitment market

As discussed earlier, the lack of mid-career recruitment market in Japan is the reason for difficulties finding re-employment, for married women who leave their jobs to have or raise the children, or for new graduates who missed opportunities of finding full time employment upon graduation. As job based pay is linked to labor market, it will promote the mobility of employees and development of mid-career recruitment market.

### 3) The globalization of Japanese economy

With globalization advancing ahead, Japanese will work with non-Japanese colleagues. Having non-Japanese workers within the organizations will make it necessary to introduce job based pay, which is more prevalent outside this country.

### 4) The necessity for strengthening corporate governance

The latest window-dressing of Toshiba exposed the weakness of Japanese corporate governance to the outside world. It is believed that three

ex CEOs of Toshiba ordered their subordinates to be engaged in the window-dressing.

Under the life time employment system, ex CEO appoints new CEO. The new CEO, in gratitude for the appointment, will not be in a position to deny what his predecessor did, which is how Japanese large corporations brought about corporate scandals in the past. A few years ago, the window-dressing of Olympus, one of major endoscope manufacturers was brought to light. Ex CEOs of Olympus hid the window-dressing for 10 years, which, in the end, was disclosed, by a non-Japanese executive, who was employed by their London, England subsidiary.

### 3. The review of labor laws concerning the dismissal of employees

In the past, Japanese court's decisions used to be in favor of strict restrictions on the dismissal of employees, and the reasons they gave for their decisions presented difficulties finding re-employment. If, thanks to the shift to job based pay, the mid-career recruitment market is developed in Japan, restrictions on the dismissal will have to be lifted. As a matter of fact, OECD's examination report on Japanese labor market pointed out in 2006 that there existed a wide gap of wages due to the over protection of the full time employed. They added "Japan could do more to help young people find stable jobs".

## CONCLUSION

As previously discussed, Japanese economy is now at a turning point. I believe it is time we made a new step forward to build a new system in response to the new rapidly changing environments, while being fully aware that the present system is the result of accumulated wisdom of our predecessors. It is my observation that although Japan has been successful catching up with other advanced countries in economic growth, the Japanese labor market is still bureaucratically led, and lacks market mechanisms. This is where reform is needed. Review of wage system and labor laws concerning the dismissal of employees is a key to the success of the reform.

## MEASURES PROPOSED FOR IMPROVEMENT

Granted that in Japan slow progress is made in terms of the shift to the job based pay, we have to speed up the process. Centralization of authorities to manage personnel affairs may as well be a Pandora's box. With many of the major Japanese corporations, the personnel departments currently hold authorities to hire, train, and place employees in addition to the policies for promotion and pay raise. The authorities should be transferred down to business sites and senior level staff, with professional skills on the business sites should hire employees for their professional field in accordance with their hiring policies. Pay should certainly be job based, and pay raises and promotions should be recommended by them. Among major Japanese banks, Resona Bank started human resource system reforms in this way, and so far has reportedly been successful.

## KEY WORDS

Life time employment, job based, seniority based, wage gap, dismissal of employees,

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