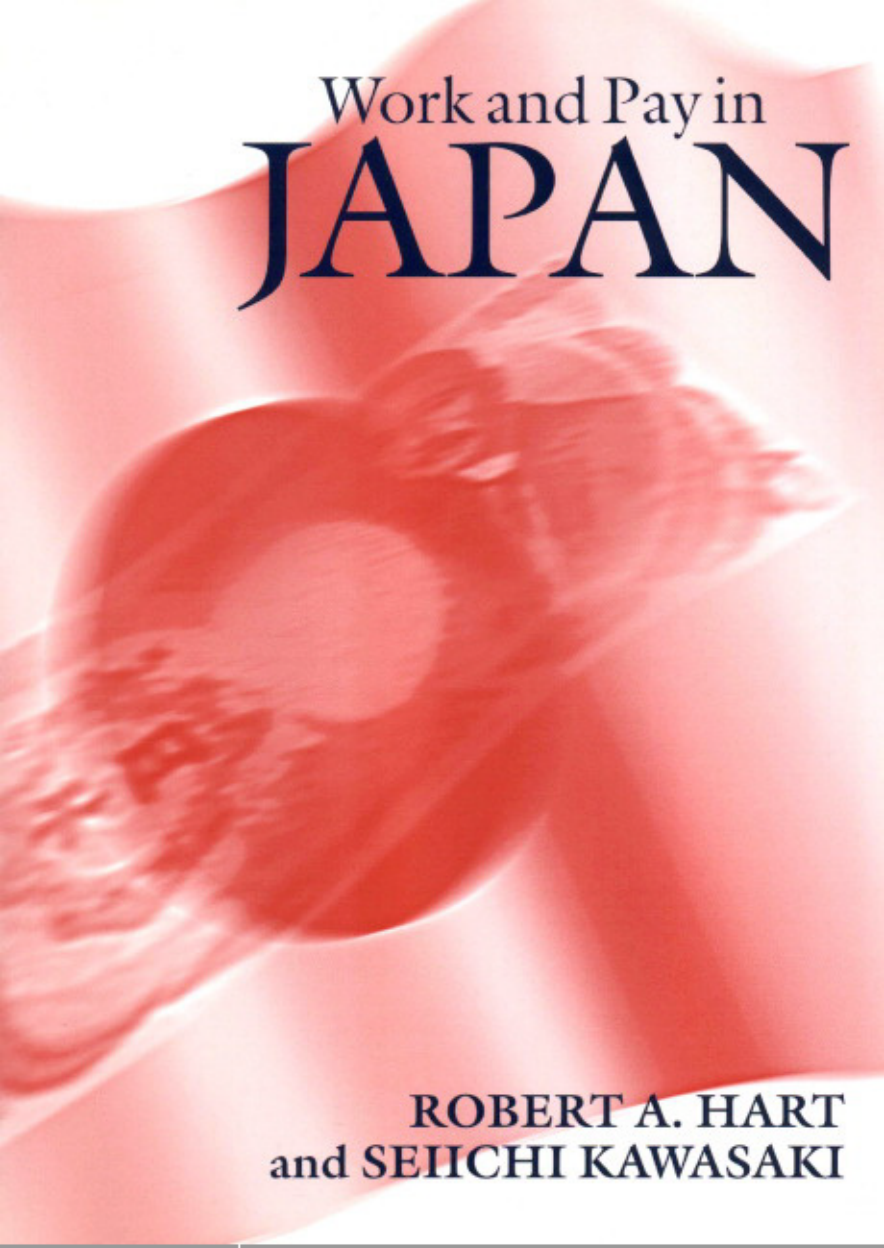
Work and Pay in JAPAN



ROBERT A. HART
and SEIICHI KAWASAKI

CAMBRIDGE

more information - www.cambridge.org/0521571375

This page intentionally left blank

WORK AND PAY IN JAPAN

Provides a comprehensive overview of Japanese labour market institutions and practices with respect to employment issues and labour payments. It contains extensive discussion of the effects of industrial relations, small business activity, business cycles and schooling on work and pay. An early chapter is devoted to presenting, in an accessible manner, essential labour market ideas and concepts that recur throughout the text.

Important topics covered include unions and wage determination, the breakdown of total labour costs, the Japanese bonus system, the employment life-cycle, small businesses and subcontracting, and pay and productivity over the business cycle.

A key feature is that subject areas and themes are examined within a comparative United States/European framework. This allows assessments of whether or not the structure and performance of the Japanese labour market have differed from experience elsewhere.

Robert A. Hart is Professor of Economics at the University of Stirling. He is Editor of the *Scottish Journal of Political Economy*. He has published widely in journals including *Economica*, *European Economic Review*, *Economic Journal* and *Oxford Economic Papers*. His previous books include *Human Capital, Employment and Bargaining* (1995), co-authored with Thomas Moutos.

Seiichi Kawasaki is Professor of Economics at the School of Informatics and Sciences, Nagoya University. He has published widely in journals including *American Economic Review*, *Econometrica*, *Demography*, *Applied Economics* and *Journal of the Japanese and International Economies*.

WORK AND PAY IN JAPAN

Robert A. Hart
and Seiichi Kawasaki

CAMBRIDGE
UNIVERSITY PRESS

PUBLISHED BY THE PRESS SYNDICATE OF THE UNIVERSITY OF CAMBRIDGE
The Pitt Building, Trumpington Street, Cambridge, United Kingdom

CAMBRIDGE UNIVERSITY PRESS
The Edinburgh Building, Cambridge CB2 2RU, UK
40 West 20th Street, New York, NY 10011-4211, USA
477 Williamstown Road, Port Melbourne, VIC 3207, Australia
Ruiz de Alarcón 13, 28014 Madrid, Spain
Dock House, The Waterfront, Cape Town 8001, South Africa

http://www.cambridge.org

First published in printed format 1999

ISBN 0-511-03841-0 eBook (Adobe Reader)
ISBN 0-521-57137-5 hardback
ISBN 0-521-57772-1 paperback

To our children Jennifer, Linsey, Nobuya,
Rosalind and Tetsuya

Contents

Figures

Tables

Preface

Work and pay in Japan have been subjects of considerable interest among students of comparative international labour markets. There are two main interrelated explanations of this. First, important aspects of the Japanese labour market appear to differ significantly from experience elsewhere. Examples include the structure of the union system, the size and coverage of bonus payments, lengths of wage and employment contracts, the age of official retirement and the importance of subcontracting. Secondly, the Japanese labour market has appeared to perform somewhat differently from those of its main competitor economies during the post-war period. Among other features, it has generally experienced more employment stability, lower unemployment and greater wage flexibility.

We have attempted in this book to provide a more comprehensive coverage of these and related issues than has hitherto been available under a single cover. Further, for most topics, we provide considerably more depth of empirical and analytical coverage than can be found in existing texts. Not only do we examine the main features of employment and payment systems in Japan but, throughout the book, we also provide background details of related European and United States evidence and experience. Moreover, we extend the definition of 'pay' to include non-wage labour costs that do not constitute direct remuneration but, nevertheless, are necessarily incurred by the employment of labour.

We have purposely written the book in a non-technical way so as to appeal to a readership whose interests stretch well beyond the confines of labour market economics. Inevitably, some of the issues and problems we discuss have been examined by researchers who have adopted labour market models and concepts that are not immediately familiar to non-specialists. Rather than ignore a vital body of work, we go to some lengths to explain conceptual details in an accessible way.

In chapter 1, we set the scene by introducing the key areas of interest. Issues directly relating to work and pay are merely highlighted at this stage before being dealt with in

far greater depth at later stages. However, less direct topics – involving job tenure, worker participation and unemployment – are covered in more detail. Chapter 2 is also introductory in nature in that it is designed to explain, in a non-technical way, a number of important labour market theoretical and empirical models that are referred to at various later stages. Particularly strong emphasis is given to human capital models and the use of wage–experience profiles.

The industrial relations context of work and pay decisions forms the subject area of chapter 3. Inevitably, the enterprise union system and its relationships to wage determination and human capital formation make up the main thrust of analysis in this chapter. Comparisons are also made with industrial relations structures in Europe and the United States. Special attention is given to union density, the 'spring offensive', industrial wage equalisation, joint consultation, quality control circles and comparative international assessment.

Wage and non-wage labour costs are concentrated on in chapters 4 and 5. In chapter 4, we provide a complete breakdown of direct and indirect labour costs not only in Japan but also in a comparative international setting. Important differences in cost structures between Japan and elsewhere are established. Chief among the latter is the unique importance of bonuses in Japan, and chapter 5 is completely devoted to a discussion of such payments. We provide a full analysis of the main competing hypotheses advanced to explain the relative importance of bonus payments in Japan and a critical appraisal of the available empirical evidence.

Chapter 6 deals with the main phases of employment over the working life-cycle – that is from recruitment to retirement via training and promotion. Our evidence on recruitment expenditures by firms is based on detailed data that are uniquely available in Japan. In an international comparative setting, we provide empirical evidence on promotion systems and on the changing age structure of retirement. Only in the case of training expenditures do we find that, as in all other countries, a complete evaluation is prevented by the very partial coverage of related cost statistics.

The issues of human capital formation in particular and employment and wage systems in general, have strong implications for the expected reactions of employment, labour productivity and labour costs over the business cycle. Such concerns are analysed in chapter 7. Most of the empirical studies discussed present international comparative evidence and so provide very useful yardsticks on which to base judgements of differences and similarities in Japanese cyclical labour market performance.

Chapters 8 and 9 deal with two special topics of work and pay in Japan that have been given particular Japan-related attention in the labour market and industrial literature. After establishing the quantitative importance of its subject matter, chapter 8 deals with small business aspects of work and pay. Inevitably, the chapter devotes considerable attention to the role and quantitative importance of the Japanese subcontracting system. The link between pre-work education and the subsequent path of wage growth forms the basis of chapter 9.

Finally, in chapter 10, we attempt succinctly to summarise the importance of work and pay in Japan within a broader international setting.

1 Setting the scene

We begin by highlighting a number of key Japanese work and pay issues. Several topics – such as wage and bonus payments, employment and working time – are dealt with in some depth in later chapters and so we merely draw attention to a number of salient features at this stage. Other areas – such as the length of jobs, unemployment and labour force participation – are discussed in detail here in order to serve as a useful backdrop to related points of interest at later stages. In common with most of the ensuing text, we discuss topics in a comparative international setting.

From an international perspective, interest in Japanese employment, remuneration and labour costs has stemmed, primarily, from perceived differences in organisation and performance compared to other major industrial economies. One theme of the book is to question the extent to which Japanese differences are real or apparent. Four examples are as follows. First, in chapter 3, we question the degree to which the Japanese enterprise union system is unique. Second, in chapter 5, we examine the cases for and against the claim that the bonus system constitutes a unique form of remuneration. Third, we consider in the present chapter whether Japanese post-war unemployment experience has been significantly different from elsewhere. Fourth, in the present chapter and elsewhere, we investigate whether job tenure and labour turnover and their relationships to wage growth have played a distinct role in Japan.

1.1 Economic growth and labour productivity

By OECD standards, Japan's economic growth performance taken over the whole of the post-war era has been remarkable. While the pattern of growth has not been even, the economy has experienced significantly longer periods of above-OECD-average compared to below-OECD-average real growth. The 'miracle' years occurred during the period from the early 1950s to 1973 when annual real GNP growth often exceeded 10 per cent and averaged about 9 per cent, well in excess of other OECD member countries.

Recovery from the first OPEC supply shock in 1973/4 marked the beginning of a more modest era of real growth up to the late 1980s, yet it remained above the OECD average. More recently, the 1990s have witnessed a significant worsening of relative growth performance. The bubble of asset price inflation, that built from 1986, burst in 1989 with accompanying problems of dampened consumer spending, low investment in a high-risk environment, falling land prices and lack of confidence in financial markets. Argy and Stein (1997) present a useful discussion of these phases of economic activity.

During the 1950s and 1960s Japan's average growth rate of around 9 per cent compared to a rate of around 4 per cent in the United States. One way of determining the absolute and relative contributions of different productive factors to overall growth is the supply-side approach of decomposing production functions into each of the separate inputs.[1] At the aggregate level, the three important factor inputs are labour, capital and technological progress. These can each be further subdivided into: (i) *labour*: employment, hours, sex/age composition, education; (ii) *capital*: inventories, non-residential structures and equipment, dwellings, international assets; (iii) *technological progress*: knowledge, improved resource allocation, scale economies.

Compared to the United States in the 1950s and 1960s, Japan experienced a higher absolute contribution to its growth rate from each of the three aggregated factors as well as from most of their component parts (Denison and Chung, 1976). In relative terms, about 55 per cent of growth performance within Japan was attributable to technological progress, about 24 per cent to capital and about 21 per cent to labour. Respective relative contributions to growth in the United States were 48 per cent, 20 per cent and 32 per cent. Interestingly, the *absolute* contribution of employment within the labour factor was the same in each country although, given differences in national economic growth, it accounted for 13 per cent of Japan's and 29 per cent of the United States' growth. A key labour difference was hours of work which contributed to around 2 per cent of Japanese growth but had a *negative* 5 per cent effect on growth in the United States.

During the 1970s, Japan's average growth fell substantially, to around an average of about 4.8 per cent. Shinohara (1986) analyses factor contributions for this later period. The contribution of technological progress to growth fell substantially in absolute terms, though it was still over 50 per cent in relative terms. Labour's absolute contribution also fell but it also held up in relative terms. However, while the hours component of labour made a modest contribution in the earlier period, it had a slightly negative impact in the second period. Both the absolute and relative contributions of capital diminished in the later period.

The contribution of employment and hours, especially up to the early 1970s, would suggest that Japan's post-war hourly labour productivity has grown relatively strongly. This is certainly the case in relation to Europe, for example. Figure 1.1 compares the quarterly measure of hourly productivity in Japan with those of the Federal Republic of Germany (FRG) and the UK between 1960 and 1989 (FRG) and 1996 (UK). The period of rapid growth up until the early 1970s witnessed Japan's rate of productivity rise from roughly half those of the two European countries in 1960 to virtual parity by the late

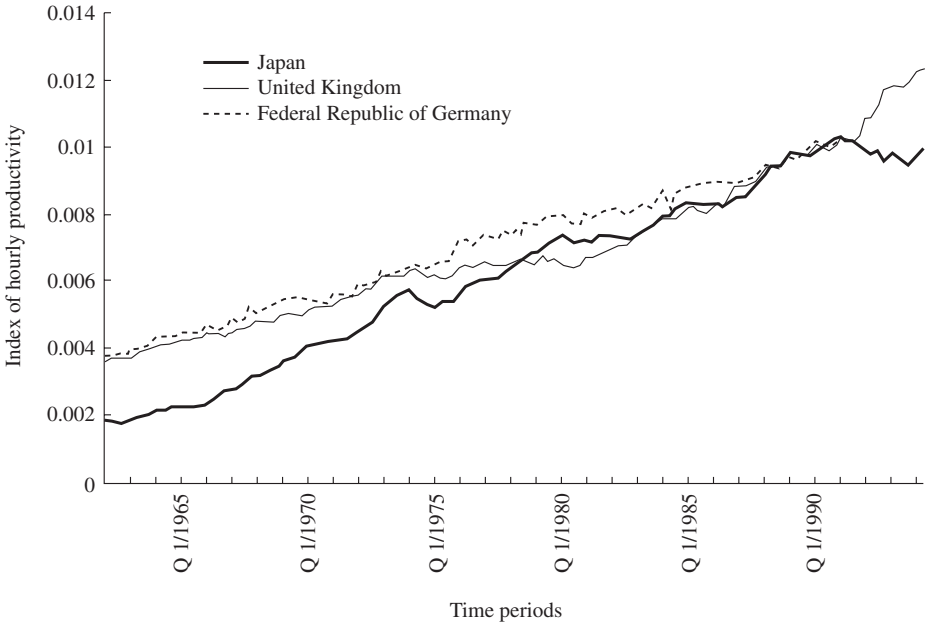


Fig. 1.1. Hourly labour productivity in Japan, the Federal Republic of Germany and the United Kingdom, 1960–96. Data for Germany on a comparable basis are not available after 1989. (*Source:* OECD labour force statistics.)

1980s. Noticeably, however, Japan's productive performance has fallen back somewhat during its 1990s economic crisis.

At least with respect to major economic shocks, it would appear from figure 1.1 that Japanese labour productivity varies directly with the business cycle. For example, it dips quite noticeably after the 1973/4 OPEC supply shock and again after the burst bubble in the early 1990s. What accounts for this direction of reaction? This question is associated with two important and interrelated areas of comparative international labour market research involving Japan. The first of these involves an explanation of the observed productivity cycle. This concerns the view that Japan is *less* likely than other major economies to buffer against recessionary events by allowing its employment stock to vary in size. In this event, pro-cyclical hourly productivity may be associated with the fact that, during economic downturns and upturns, employment fluctuates less than proportionately to output because firms show high propensities respectively to hoard and dis-hoard labour. The second area of research is closely linked to cyclical productivity and is central to neoclassical labour and macro-economics. A central tenet of neoclassicists is that the optimising firm equates the ratios of marginal productivities of labour and capital to their respective marginal costs. In a short-run context, a propensity to hoard labour, for example, may prevent the realisation of such a goal on the employment front. This and other short-run influences may in turn induce systematic cyclical patterns in

price–cost mark-ups. Both these avenues of interest are investigated in some detail in chapter 7.

1.2 Wages, bonuses and non-wage costs

Most Japanese workers receive the major part of their direct remuneration via two channels. First, and familiar to many workers in other countries, they are paid in the form of regular (usually monthly) wages. Secondly, they receive bonus payments which, typically, are paid twice a year. The bonus constitutes around one-fifth to one-quarter of total cash earnings. As we show in chapter 4, bonus payments in most other countries are very small by comparison. A few countries do have significant per-worker bonuses and other premiums. However, such payments (even the highest of these, such as in France and Germany) are less than half of Japanese bonuses when expressed as proportions of total labour costs.

Interest in the Japanese bonus system stems not merely from its uniqueness but also from the possibility that it may somehow be linked to the relatively strong Japanese economic performance in the post-war era. Bonuses in Japan have been variously argued to serve a number of economic roles. They may simply be regarded by the firm and its workforce as a component of total compensation that behaves in a largely indistinguishable manner from regular wages. Thus, the market forces of demand and supply for labour services may largely determine both forms of compensation. Bonuses alternatively may represent a form of efficiency wage by providing a reward for greater effort. By contrast, and at a general level, wages may reflect more systematic and structural elements of remuneration, such as seniority-based pay scales (the Nenko system), while bonuses are used to adjust total compensation to fluctuations in firms' economic experiences. In this event, we might expect that the bonus should display more flexibility than the wage. One school of thought in this respect regards bonuses as a form of profit-sharing between the firm and its workforce. Another holds that bonuses reflect shared returns to investments in firm-specific skills and know-how.

Beyond direct remuneration in the form of wages and bonuses, firms incur labour costs associated with statutory and private welfare provision, recruitment and training, severance compensation, and other forms of non-wage labour costs. There are a number of interesting differences between Japan and elsewhere in several items of these costs and these are highlighted and discussed in chapter 4.

1.3 Enterprise tenure and labour turnover[2]

The length of stay by workers in given jobs is a crucial labour market subject area. Theoretical and empirical developments centred on this variable have important Japanese links. Relative to most major economies, higher proportions of Japanese male workers, at least up to the age of 55, enjoy long-tenure jobs. The contrast is particularly stark when length of tenure is compared with that in the United States, as in the following comparison of the period 1979–89 in Japan with 1983–91 in the United States.

[A]lmost 40 per cent of American men in the 37–40 age range had 0–4 years of tenure in 1983 and only about one in three of them is estimated to last another eight years with the firm. By contrast, only 17 per cent of Japanese men aged 35–39 had under 5 years of tenure in 1979, and almost half will go on with the firm for at least another ten years.

[A]lmost regardless of age or tenure, Japanese men are significantly more likely to be with the same employer ten years later. For example, among American men in their mid twenties just starting work in 1983, fewer than 25 per cent were still employed with the same firm eight years later. In contrast, over 50 per cent of Japanese men in their mid-twenties were still with their original employer ten years later. (*OECD Employment Outlook*, 1993)

A possible, although partial, explanation of the above differences, especially among younger workers, is that Japanese employers devote more effort and expenditure towards finding appropriate new recruits directly from schools and universities. This may result in good job matches being established at an early, formative, stage. In contrast, the United States may rely more on workers themselves sampling jobs in the early work years before finding good job matches through a process of trial and error (Topel and Ward, 1992). We deal with links between schooling, tenure and wage growth in chapter 9.

Another line of reasoning focuses on investments in firm-specific human capital skills and organisational know-how. Where significant investments take place, premature separations – due to quits or layoffs – may result in large turnover costs. Accordingly, bargaining parties may expend considerable effort in attempting to preserve the returns accruing to specific investments by minimising costly separations. Job tenure and specific investments would be expected, therefore, to be positively associated. Ideas in this area are developed in some detail in chapter 2 and examined empirically in several later chapters.

While hard facts on comparative international levels of per-worker human capital investment are lacking, circumstantial evidence would appear to support the case that Japan is high in the league table. Most comparative work has featured Japan and the United States. One type of supporting evidence is based on the incidence of formal enterprise training and tenure. Table 1.1 reveals that, for a range of enterprise sizes, the Japanese labour force enjoys (i) longer tenure, (ii) higher incidences of formal training, and (iii) lower percentages of workers with less than one year of tenure.[3] As we will see in chapters 2 and 5 and elsewhere, length of tenure is associated in the human capital literature with firm-specific investments in worker skills and know-how and, in turn, such investments impact on wage growth. Therefore, the comparative longevity of job tenure in Japan has much wider ramifications than purely employment-related questions.

The general picture portrayed in table 1.1 is confirmed in a wider context in table 1.2 which presents comparative European and United States data. These data reveal that, relative to the other countries, (i) a lower proportion of Japanese workers have tenure of one year or less, (ii) median tenure for Japanese men is relatively long, and (iii) average tenure for men and women is relatively long (the OECD unweighted average is 8.7 years).

At least from a human capital perspective, we might expect specific investments – and, therefore, length of tenure – to be greater in large than in small firms. At given pay levels,