

# Human Capital Investment & Raising Labor Mobility in Japan

By Naoyuki Haraoka

The aging of the population and a lower fertility rate are phenomena observed in many OECD nations, not only in Japan. These two demographic developments will lead to a declining labor force. Assuming that economic growth depends on labor growth and capital growth, as well as technological progress, the decline in the labor force must be offset by productivity in order to maintain economic growth.

Among the possible policy measures to achieve this, raising labor mobility is one that is attracting more attention today. There are two significant merits of this policy. With a mobile labor force, structural economic reform can be achieved more easily, as labor can be smoothly transferred from less competitive sectors to more competitive ones, thereby boosting overall productivity. The other merit is for individual workers. With more freedom to choose a job in a mobile labor market, they could increase their own happiness by changing jobs more easily and finding work that is suitable for them. Enhanced individual happiness will raise labor productivity as well.

In the case of Japan, what has prevented these merits from emerging to raise productivity has been the lifetime employment system and

seniority-based wages and promotion – the essence of the traditional Japanese management system. It is necessary for us to understand that this system is becoming obsolete today in a zero-growth era. The Japanese management system worked well only in the high-growth era, when people were wealthier and could happily expect higher salaries as they worked longer. In a zero-growth economy, workers cannot get higher salaries, no matter how long they work for the same company. Their promotion opportunities are limited as well. Thus, in Japan in particular, we need a drastic change of mindset to take account of individual happiness rather than loyalty to a company.

It would be better to eliminate this lifetime employment system and the seniority-based wage and promotion system. We will then need to build a new labor market based on individual capacities. Workers must be paid and promoted in accordance with their competencies, and they would change jobs easily if they are not happy with their current one and find new jobs better suited to their skills. In this way it would be possible to achieve high labor productivity and individual worker's happiness simultaneously. Most importantly, to achieve this new labor market, we would need consolidated



human capital investment for re-educating and reskilling the labor force. With enhanced skills, an individual worker could find a better job more easily and an employer could find a more competent worker.

Our Roundtable, the leading article in the issue, summarizes the issues and challenges faced by Japanese business and workers today under zero growth, in particular, how irrelevant the Japanese labor management system has become under the new economic circumstances.

Consolidated human capital investment and improved labor market mobility could create a better working environment for immigrants as well. To offset the negative impact on economic growth of a declining labor force, we would need skilled immigrant labor as well.

Following our Roundtable, we have an interview focusing on reskilling among OECD economies with Stefano Scarpetta, director of Employment, Labour and Social Affairs at the OECD, and then an interview with a Finnish government official, Saara Ikkela, about best practices in education in terms of human capital investment and Finland's efforts to achieve individual well-being and economic growth at the same time.

The last two articles in our cover story are related to the issue of immigration. The first is on Japan's immigration policy written by Toshihiro Menju, managing director of the Japan Center for International Exchange, who notes that Japan has already been taking a relatively open policy toward immigrants. The second one is an interview with Prof. Gi-Wook Shin, a sociology professor at Stanford University, in which he talks about an interesting research project on the potential benefits of talent flows into the Asia-Pacific region. This is a timely topic in light of the increased cooperation among Asia-Pacific nations.

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