

# Structural Reform and Employment in Japan

## – Preparing for the Future –

By Seike Atsushi

### Japan's Work Force Faces Uncertain Times

Japan's unemployment rate rose above the 5% mark in July 2001, according to the Labor Force Survey, conducted by the Statistics Bureau of the Ministry of Public Management, Home Affairs, Posts and Telecommunications. The latest statistics show an even grimmer situation, with a jobless rate of 5.3% in September. (Figure 1) This is the worst level Japan has experienced since the government began compiling unemployment statistics using the current data-collection methods. Japan is now becoming a high unemployment society like many other industrialized countries.

Viewed from a long-term perspective of the past 40 years, when the Japanese economy was expanding briskly, from the 1960s until the first oil crisis near the end of 1973, unemployment remained very low – barely more than 1%. During this period, the former

West Germany and some other industrialized countries enjoyed equally low unemployment rates. The first oil crisis set Japan's unemployment rate climbing, and it reached the 2% level in 1975. It remained at this relatively low level for about 20 years, until 1994, after the economic "bubble" had burst. Incidentally, the latter part of the 1970s and the 1980s were less kind to other industrialized countries, where unemployment levels hovered much higher, at close to 10%.

But Japanese unemployment then started to climb rapidly again – to more than 3% at the end of 1994, more than 4% in the spring of 1998, and more than 5% in the summer of 2001. In one year, between the summer of 1997 and the summer of 1998, the rate soared an entire percentage point, a noteworthy increase considering that it had previously taken 20 years, from 1975 to 1994, for the rate to rise by the same amount.

Two factors behind these deteriorat-

ing employment figures are prevalent. One is an increase in frictional unemployment, caused by a "mismatch" between job applications and offers. In this frictional unemployment, companies are looking for workers, but the job seekers do not satisfy the work offers because of a mismatch in conditions – for example, their qualifications, wage expectations, age or desired location of work do not match company conditions.

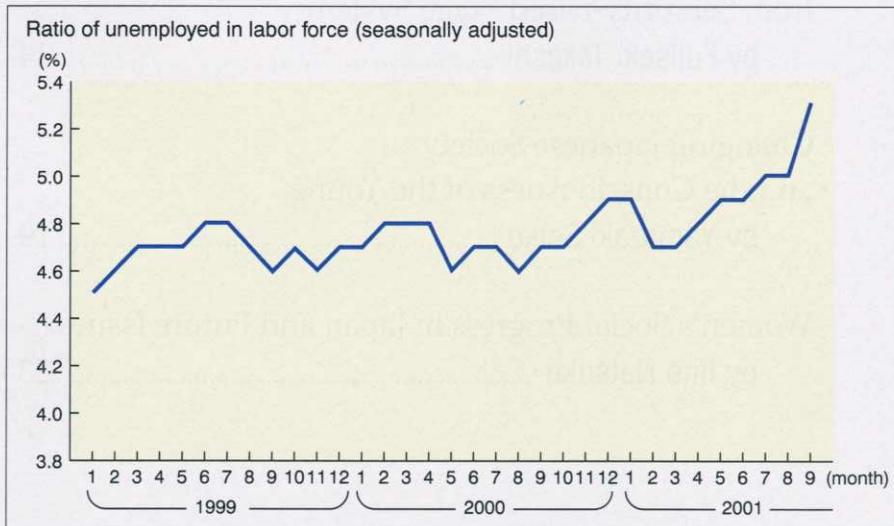
The second factor is that unemployment has resulted from a lack of demand for workers during the economic contraction. Companies hire workers in order to produce goods and services, and when the economy contracts, production declines and demand for workers also declines.

Frictional unemployment is rising because of various mismatches – for instance, demand for younger workers at a time when the labor force is aging; and differing qualification demands at a time when the change of technological and industrial structures is accelerating. The situation is worsened by the fact that companies are lowering employment levels during an economic downturn. Moreover, Japanese companies are changing the way they adjust employment. In the past, large Japanese companies were willing to maintain a surplus work force on a temporary basis, but now they try hard to cut the number of excess workers, offering them so-called voluntary quits. This new trend reflects the fact that companies now anticipate that the growth rate of the economy will not increase over the long term.

### Structural Reform – No Time To Lose

The Japanese government is pushing ahead with structural reform against this backdrop of worsening unemploy-

Figure 1



Sources: Labor Force Survey, Monthly Results (September 2001), Statistics Bureau, Ministry of Public Management, Home Affairs, Posts and Telecommunications

ment. Structural reform involves reducing government expenses to get the nation's finances in order, and weeding out bankrupt companies to dispose of bad debt. Both of these pressures will push unemployment levels even higher in the short term.

But the government must push forward with structural reform. Japan's socioeconomic conditions are changing, and the economy will end up in even worse straits over the medium and long term unless the government gets its finances in order and tackles structural reforms in other areas as well, such as the disposal of bad debt. Two significant socioeconomic changes taking place in Japan are: (1) the population structure as fewer children are born and the population ages; and (2) companies recognize a growing need to add value to products and services in order to remain competitive.

Japan's population structure is changing to an extent seen nowhere else in the world. By 2015, more than one-quarter of the population will be 65 or older, a higher percentage than in any other country. On the other hand, the number of Japanese between 20 and 29 will drop by more than 4 million between 2001 and 2010. In other words, a rapidly decreasing numbers of young and middle-aged workers will have to support a growing number of elderly. (Figure 2)

As the population ages, much more money will be needed to finance pension plans and provide medical treatment and nursing care. This burden will grow even heavier, unless steps are taken now to reduce Japan's accumulated debt. We now know for sure that Japan will have fewer young and more elderly in the future, and we also know that government debt must be repaid, so the debt – which is the people's debt – has to be reduced as much as possible, as soon as possible.

All industrialized countries are experiencing a similar trend toward a lower birthrate and an aging population, but Japan is in a less favorable position because its government debt is higher than in European countries and the United States. Worse, Japan's popula-

tion is aging even faster, and this means that reducing the current government debt is even more important for Japan than it is for countries in Europe and the United States.

The combined debt of the national and local governments in Japan now exceeds ¥700 trillion, 1.4 times more than the annual gross domestic product, and the debt will continue to grow if we ignore it. With our population continuing to age and the birthrate dropping even more, we are at a crossroads: will we tackle the debt, or will we head toward national bankruptcy? The only choice is for the government to waste no time getting its finances in order.

We have another urgent challenge in the changing competition structures surrounding Japanese companies. In U.S. dollar terms, Japanese workers now earn the highest hourly wage in the world. This is not a new phenomenon – the 1985 Plaza Accord opened the way for the yen to rise over a period of several years from around ¥240 to the U.S. dollar to around ¥120, a 200% jump in value. The rise reflected Japan's improved standard of living, of course, but for companies in Japan who are employing the world's most highly paid work force, it is almost impossible to do business here unless they keep producing value-added goods and services in order to earn a profit.

Meanwhile, rapid industrialization in China and other developing countries is enticing Japanese manufacturers to transfer some of their production there. If they hope to survive, however, they must offer superior products and specialized services. The only other option would be to compete by paying Japanese workers no more than their counterparts in developing countries.

To avoid this scenario, Japan's industrial structure must be reformed to facilitate the production of value-added goods. For example, economic resources, mainly capital resources, are needed for higher-end industrial sectors and new growth sectors. Capital should not be used to prop up sectors that are actually bankrupt. Rather, the bad debt should be disposed of as soon as possible.

## The Need for an Adequate Social Safety Net

We have seen how the structural changes that will occur in Japan over the medium to long term make it essential that the government move forward with structural reform now. The problem is that, in the short term, structural reform will create more unemployment. Accordingly, the necessary policy for the government is how to deal with the emerging employment problems resulted from the structural reforms.

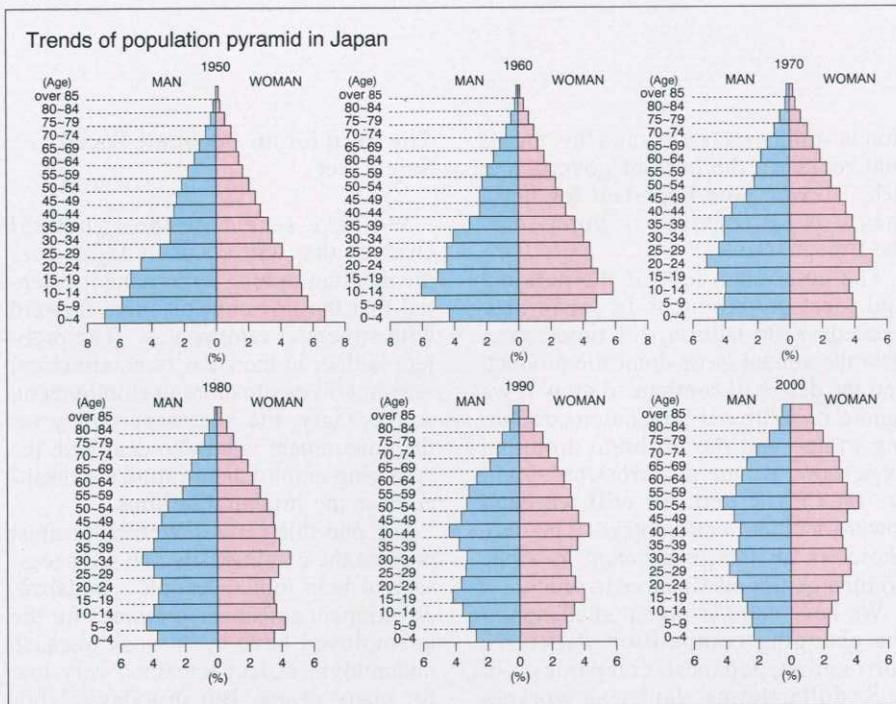
For one thing, the government must prepare the conditions which are necessary to help jobless people. In Japan, government assistance measures for the unemployed have been weak because unemployment had remained very low for many years. But in today's labor pool, one out of 20 people is unemployed. This means that nobody should be surprised if he/she is the next to lose his/her job. Japan needs a stronger social safety net to protect the livelihood of the unemployed and make it easier for them to find new jobs.

The social safety net should be strengthened in a number of ways, especially:

(1) Unemployment benefits should obviously be enhanced. The first concern for the unemployed is how to pay for life's necessities until they return to work. Unemployment benefits are the most important safety net during this period. Under Japan's current Employment Insurance System, the unemployed are entitled to 60-80% of the pay they received just before losing their job, for a maximum period of 330 days. However, this option is only available to people between the ages of 45 and 59 who have contributed to the employment insurance plan for at least 20 years, and who left their work because of corporate downsizing. All others receive benefits for a shorter period of time.

The problem here is that more than one-quarter of the people presently unemployed have been out of a job for over a year. In other words, at least one-quarter of the unemployed, even

Figure 2



Source: Statistics Bureau, Ministry of Public Management, Home Affairs, Posts and Telecommunications

those who are entitled to receive benefits for the maximum period, are not protected by the government's employment insurance plan. The government should at least increase the entitlement period to more than a year.

(2) The government should prepare easier conditions for the unemployed to find new work. The most important conditions for finding new jobs are ample information about employment and proper matching of the requirements of employers and workers. The information should be as complete as possible, to help employers and job seekers match needs: what jobs are offered in which locations, and what qualified people are available in which communities? These objectives can be achieved by strengthening the role of the "Hello Work" Public Employment Security Office, and through further deregulatory measures to facilitate the use of private-sector placement services.

Of course, simply knowing which companies have openings is not enough if the job seeker is not qualified for the position. Over the years, Japanese companies developed worker skills mainly through on-the-job training, and this is why little thought was given to establishing programs for the unem-

ployed, to help them develop new skills outside the workplace. Expanded programs are now urgently needed, including loans for comprehensive skill development for the unemployed.

(3) A third important measure is to prohibit age discrimination in the job market. Middle-aged and older unemployed people find it very difficult to re-enter the work force because of age restrictions that are clearly stated by companies in their job advertisements and during the hiring process. The door to re-employment is shut for older workers when companies stipulate that applicants should be, for example, "45" or "under 45." This is a very serious issue for middle-aged and older job seekers, a barrier that cannot be removed simply by offering more job information or excellent retraining programs. Job seekers who cannot find work because their wage expectations are too high can learn to reduce their expectations, and those who lack the required qualifications can retrain. In both cases, they can adapt and find work. But in the case of an age barrier, older job seekers have no recourse, no matter how willing they are to adapt.

If this problem is not addressed, it will become even more severe in time,

as Japan's population continues to age and the ratio of older adults to the total number of unemployed becomes higher. We urgently require a social consensus in favor of prohibiting age ceilings in corporate job offers and hiring practices. In October 2001, the government made it obligatory for companies to make an effort not to mention age restrictions in advertisements and when hiring, but even stronger regulations are needed.

### Necessity of the Reform of the Employment System to Adapt to Economic Structural Change

I have indicated the need to quickly enhance Japan's social safety net, in order to deal effectively with the employment insecurity that will arise from structural reform. But even more essential is the need to change the employment system itself, to bring it in line with socioeconomic changes that make structural reform necessary in the first place.

First, because Japan has a low birthrate and an aging population, the employment system should be changed so that, as much as possible, age is not a factor in employment. Money for pensions, medical treatment and other expenditures for the elderly comes mainly from the active work force in the form of social insurance premiums. But raising these premiums much higher would reduce spendable income and lower workers' living standards. On the other hand, if the government reduces this burden on workers by substantially cutting seniors' pensions and the quality of their medical and nursing care, it would go against the ideal of an affluent society for all, and the question would remain: what was the benefit of having achieved economic growth?

Therefore, it would also be important to permit seniors who wish to work, and are able to do so, to continue working for as long as possible. If they worked, they would continue to pay taxes and contribute to social insurance programs, and this would reduce the per-capita burden. And because they would retire later, they would receive

pensions for a shorter period of time, meaning that pensions would not have to be cut drastically. Fortunately, seniors in Japan are eager to continue working, perhaps more eager than in any other industrialized country. If we can satisfy their strong desire to participate in the work force, we would help them to achieve their goal of active, life-long participation in society.

The greatest barrier older adults face in achieving this goal is the current employment system, especially the practice of mandatory retirement. Workers are forced to retire at a certain age, regardless of their desire to keep working, and regardless of their skills. The ideal of life-long participation in society is negated more by the practice of mandatory retirement than any other element in Japan's employment system. The Ministry of Health, Labor and Welfare has reported that about 90% of all companies having at least 30 workers have the practice of mandatory retirement, and that about 90% of these force their workers to retire at 60, the lowest age limit permitted by law.

As such, it would be difficult to realize the life-long participation in society unless we review the practice of mandatory retirement. At the very least, the compulsory retirement age should be raised to 65 – the age at which pension entitlement begins.

Of course, there are reasons why companies enforce the practice of mandatory retirement and set age limits when advertising jobs and hiring personnel. Two important reasons are: 1) the seniority wage system, under which compensation rises with age and length of service, and 2) the age-based promotion system, under which some older employees are promoted to managerial or supervisory positions. Under these systems, unless the higher-paid, older workers retire, a company's wage costs would spiral ever upward and younger workers would not be promoted. When companies have openings they would choose young people so that they can pay them less, and when they hire workers for non-managerial positions they would choose those who are younger than middle-aged managers. If

companies agree to eliminate age-based personnel management systems including the practice of mandatory retirement and age-related hiring restrictions, they must also eliminate the existing seniority wage and promotion systems. What is needed is a new compensation system under which workers are paid not according to their age but according to their specialized skills and their contribution to the company. The result would be that companies would no longer assume that they had to pay older workers more, or that they could not offer younger workers better conditions before the older ones retired.

Second, as the competition in the area of added value becomes more and more important in the changing business structures among companies, they need to offer wages and working conditions that reward workers who add value to company products. In the competition in the area of added value, some workers will create marketable value in products and services, and then job opportunities would be obtained for those who produce and sell those products and services. In this competitive environment, it is extremely important for companies to attract workers capable of creating added value and to offer them working conditions that are satisfactory enough to ensure dedication to the job. This implies an employment system that permits considerable differences in wages and working conditions, with fairly high compensation being given to workers who are able to create added value.

Until now, Japanese companies have awarded higher wages and better working conditions to personnel promoted into managerial positions, but the differences in wages and working conditions mentioned above would not be determined by this old custom. The most important task that managers had in the past was to get people to work as a large group. But this was at a time when being competitive meant producing many common goods and offering many common services as cheaply as possible. In today's competitive world, where added value is so important, the best workers are professionals who

have the creativity and specialized skills needed to create added value. Until now, workers have been evaluated on their capability to become excellent managers, but in the new competitive age of added value, many levels of job evaluations will be needed – for instance, if there are 100 types of added-value, 100 evaluation standards would be possible.

We have seen how Japan's population pyramid is changing, with fewer children and a growing number of elderly, and how important added value is to remaining competitive. From both these perspectives, it is obvious that wages and work conditions, which are presently based on seniority, should be based instead on ability and contributions to the company. This new approach will only succeed if the company is able to accurately evaluate a worker's abilities and level of contribution. And workers will only accept the new system with satisfaction if they have the opportunity to improve their abilities, and if they are given work assignments that let them use those abilities to achieve positive results. Labor-management relations so far have tended to set average wage scales for each employee level, but this will change, with compensation being determined according to each worker's job skills and the extent to which they contribute to the company. Rules governing skill and contribution evaluations must be detailed, accepted as fair by the employees and supervised by managers and workers. In other words, the emphasis of the collective labor-management relations will change from results being determined to processes that lead to results. Hopefully both labor and management will work together to form a consensus on a new employment system that answers the needs of Japan's new economic structure. JJI

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