

Salaries as a System

By Robert J. Ballon

Postwar Japan, in order to achieve competitiveness, had to compensate for the domestic scarcity of natural resources by relying on its human resources. Work compensation had to be devised accordingly. In the short span of one generation, low wages were transformed into some of the highest in the world. Of the many factors involved in this transition, one is described here, the salary system.

In the eyes of many observers, "seniority wages" are counterproductive and to discard them is now one of the panoply of measures called *risutora* (from "restoration" loosely meaning restructuring or adjustment), which is the recovery strategy of large firms reported in bold headlines by the mass media. What came to be called almost mythically "seniority wages" has been a general norm more than a general practice. In current rounded figures, out of the 65 million Japanese in the labor force, the norm is applicable to 45 million regular employees (the rest are eight million self-employed and 12 million family workers and part-time employees); however, it is administrative practice in only the public sector and large firms. Thus, at best, it applies to 15 million or so regular employees, including the 12 million labor union members, the remaining three million being largely found in managerial positions; for them it is one feature of their internal labor market.

That such norm and practice alike are a problem is nothing new. At every major downturn of the economy, the alarm has been sounded: e.g., the recession in 1965, the slowdown of the growth rate in the mid-1970s, the doubling of the international value of the yen in the short span of 1985-86, and now the aftermath of the economic bubble. The problem is not that stability and seniority in work compensation have to be eliminated—they are universal concerns, in Japan as elsewhere—but that work compensation, though

constantly modified, has had such a decisive and long-lasting impact on postwar success by virtue of a salary system tailored to mobilize human resource capacities.

The Salary System

In general, the salary system, as applied to regular employees, determines up to 80-90% of the payroll, the remainder going to part-time employees as an indispensable buffer for short-term business fluctuations. The system is now branded for its reliance on seniority (or age). Let it first be noted that the Japanese technical term, *nenko*, usually translated as seniority, implies more; it means "merit in years," a concept that, besides age and years in the company, covers experience, abilities, and status as well as social needs. Initially, the system was developed not in order to institutionalize seniority, but in order to provide "living" wages by paying attention to individual social needs to the extent made possible by the performance of each large or small enterprise. After more than a decade of bitter industrial strife in the early postwar years, labor unions—possibly trapped by the their postwar characteristic of limiting membership and negotiations to the regular employees in each of the firms they organized—contributed substantially to the system. For unionized and other regular employees it was most effective in the surprisingly rapid transition from subsistence income to discretionary income and all its economic and social consequences for enterprises and workers alike.

Overall, the salary system implies, on the one hand, that for the firm the payroll is considered less as an immediate liability and more as a long-term investment in human resources, and on the other hand for the regular employee, that the salary is less a short-term compensation and more a participation over time in corporate performance, i.e., the security of income from employment.

In a sense, salary amounts could then be compared to installments of some life-income proposition. According to Japan Productivity Center, when in 1994 a firm hired a male university graduate as a regular employee and expected him to retire at the standard age of 60, it would implicitly commit itself to about ¥287 million in total earnings, namely, ¥194 million in monthly earnings (basic salary and monthly allowances), ¥74 million in seasonal allowances and ¥19 million for the separation allowance.

Whereas under a Western-style labor contract the *quid pro quo* (given amount of pay for a given job) is decisive, in Japan's regular employment, salary amounts are determined neither by contract nor by the job to be performed, but by where it is performed, that is by the *salary system* prevailing in one's enterprise. The system encompasses four components: monthly earnings—(1) the basic salary and (2) monthly allowances; and, deferred wage payments—(3) seasonal allowances and (4) the separation allowance.

These basic features are now a well-entrenched custom in both private and public sectors. They systemize nationwide the multiple differentials each enterprise has to accommodate largely on its own, i.e., market dynamics, industry conditions, size of operations, evolution of the labor market (education and gender), as well as internal requirements such as profitability, average age of its workforce, skill and ranking differentiation, etc.

Monthly Basic Salary

The basic salary is the backbone of the system. It is the major portion of monthly earnings and combines in a flexible manner the following two factors:

The "merit in years" that in practice is associated with age and social needs, and embodies a form of mutual commitment of enterprise and employee.

And, flexible consideration over time, of task classification and ability without explicit reference to a specific job, so as not to hinder constant on-the-job training and frequent job rotation.

As a rule, the increase of the basic salary occurs in small but steady increments, generally about two percent, usually every 12 months, and is formulated by each enterprise in salary tables. After 10 or so years of service, cumulative performance evaluation begins to determine the speed of progression along this continuum; it switches the better performer onto a faster track and in due time picks the best performer for management responsibilities (Figure 1). Since vocational pursuit is not a general feature of education, the slow rate of salary increase in the initial years of employment (after graduation from school) compensates for the training costs incurred by the employer.

Monthly Allowances

Monthly allowances encompass specific considerations not included in the basic salary because they could jeopardize overall uniformity within the enterprise, or would cause a disproportionate increase in the base for calculating other components of the system. For example, promotion to managerial ranks is only moderately reflected in an increase of the basic salary, but a substantial monthly "position" allowance is provided; it is also meant to replace the overtime pay general employees earn as one monthly allowance. Some allowances are related to cost of living, though not measured by it (dependents, housing, etc., on average totaling about five percent of monthly earnings); others are related to work (position, attendance,

skill, etc.). Some enterprises also give a type of efficiency allowance either on an individual basis or, in production, on a group basis. One allowance reimburses a large part or all of the cost of commuting to and from the workplace.

Seasonal Allowances

Seasonal allowances (colloquially called *bonus*) are paid twice yearly, once in summer and again in winter. They are deferred wage payments that amount to about one-fifth of the annual earnings. They total less in smaller firms and more in larger firms. Importantly, they reflect current corporate performance to a limited extent (revenue rather than profit), as well as individual performance. They are usually expressed by a number of "months," i.e., one month includes the basic salary but only some monthly allowances. In 1994, for white-collar employees, the seasonal allowance averaged ¥770,000 in summer and ¥890,000 in winter, and for blue-collar workers ¥500,000 and ¥560,000 respectively. Hence, the peculiar pattern of worker household finance: daily expenses are covered out of monthly earnings, while seasonal allowances cover major expenses

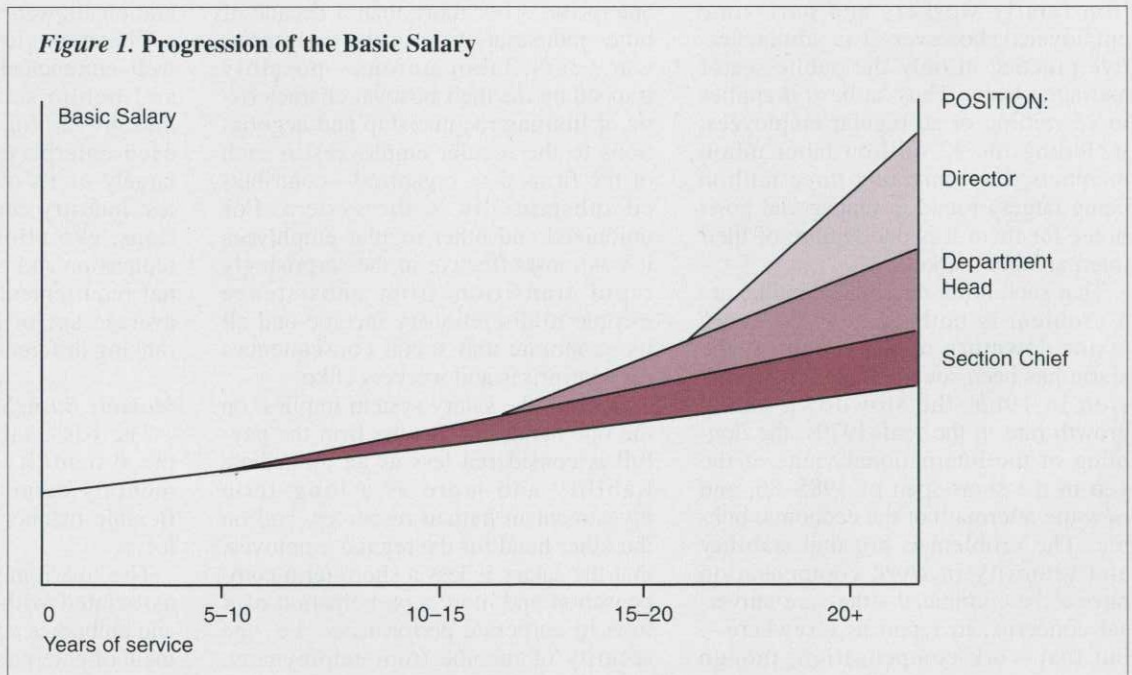
(long-term debt, purchase of durable goods, travel) and provide a major contribution to savings.

Separation Allowance

The separation allowance is another substantial deferred wage payment due whenever regular employment ceases. It consists of the basic salary of the month in which the separation occurs, multiplied by the number of years of service according to a progressive rate. This rate is generally lower when separation is at the employee's initiative than when it is "involuntary" (e.g. compulsory retirement age). In recent years, an increasing number of firms have called for "early" retirement with a substantial premium added to the allowance and employer's help in finding new employment. In large firms, a university graduate after 30 years of service would have been entitled to ¥22 million in 1985, but ¥27 million in 1993. At retirement age, this allowance may be combined with a pension system, public or private. Commonly, the expected separation allowance, by arrangement between the firm and its bank, is offered as collateral for housing loans to regular employees.

Both deferred wage payments, sea-

Figure 1. Progression of the Basic Salary



sonal and separation, are substantial payroll liabilities; they are mostly handled on a pay-as-you-earn basis, though tax-free reserves are allowed. Of the 30,000 or so firms capitalized at ¥100 million or more in 1993, 62% had a reserve for seasonal allowances and 53% for separation allowances; of the 2.3 million smaller companies, these were 12.8% and 4.2% respectively.

"Annual salary" is a recent concept; though it was not uncommonly found in smaller firms, it is now much talked about as a way of selectively enforcing more explicit performance-based pay (particularly for managers and technicians) and reducing, but not eliminating, the automatic progression of the basic salary; it would not exclude the separation allowance.

A Flexible System

The resilience of the salary system appears to be due to a dynamic balance of economic and social considerations whereby the enterprise and its regular employees develop a mutual stake (not without pains) in corporate performance. It was greatly facilitated by an institutional context making adjustments inevitable. In Japan, salary negotiations do not take place when the collective labor agreement is about to expire. Since 1955, they are an annual event in the context of the Spring Wage Offensive (*shunto*) when, in order to keep up with increasing costs and standards of living, organized labor advocates nationwide a wage increase (called *beisu-appu*). On that general basis, each labor union negotiates with its enterprise the "practical" amount that includes some periodic increase. For example, if the settlement is, say, 5%, in practice it stands for 2% automatic progression of basic salaries +1.5% raise of their level +1.5% added to some monthly allowances. Somewhat later in the year, the average settlement becomes a standard for the public sector and the mass of unorganized smaller firms. Seasonal and separation allowances are mostly negotiated separately but not independently.

In the spring of 1974, following the first oil shock, just when the growth rate

was about to be reduced by half, organized labor obtained a whopping average wage increase of 33% (¥29,000). In 1985, in firms with 30 or more regular employees it stood at ¥8,782 (4.8%), reached the peak of ¥13,247 (6.0%) in 1991, and in 1995 for the companies listed on the First Section of the Tokyo and Osaka Stock Exchanges amounted to ¥8,376 (2.83%). As corporate payrolls have been buffeted by incessant yen appreciation and adverse demographics (an aging population and a shortage of younger workers), the annual increase dwindled steadily.

Today, some observers believe that *shunto* has outgrown its usefulness. Admittedly, noisy street demonstrations have long been replaced by media headlines, and most colorful displays of "solidarity" have faded. However, the salary system it helped develop remains effectively in place. At the national level, the advocated standard is now the "salary" of a male regular employee aged 35 with 17 years of service in manufacturing (though official statistics give 38 and 12.7 as respective averages), a standard reflecting the rationale of costs of living and apparently a blunt advocacy of seniority. At the enterprise level, however, employers' expected rebuttal is productivity and ability-to-pay, though in their financial statements major companies report the average age of their regular workforce as a vital piece of information. Also, the salary system itself remains concerned with "age," namely the rapidly growing shortage of younger workers and the even more rapid increase of older workers. It is not, however, a glorification of "seniority wages." The ambivalence in wage negotiations is precisely what the plight of regular employees is about, and it is the plea of enterprises as well. At stake are the long-term dimensions of work compensation—for the firm, economic and institutional; for the employee, social and individual—to be resolved not only in the terms of amounts, but more effectively in the terms of a flexible system.

In the process, recent developments in the labor market have to be assimilated, such as increasing female participation,

changes in working hours, multiple-job opportunities, etc. What supports the continuity of the salary system is: (1) the evolving interdependence between the large-and small-firm sectors in economic as much as in social terms, and (2) the nature of Japanese enterprise: not only a set of material resources requiring *management* of human resources, but primarily a source of value added in the form of a learning organization promoting the *development* of its human resources.

Painfully apparent at this stage is continuity for which the price to pay is change. Income from work that had been raised to the ideal represented by the large firm's closed internal labor market, gravitates back to the reality embodied in nimbler and smaller firms which from the overwhelming majority of firms and which account for over 70% of employment. In actuality, what many Japanese employees, especially the younger ones, are wishing for is *less* management and *more* development.

To all parties, the security of a subsistence income appears practically assured. Discretionary income, on its part, had been sought to provide access to affluence and leisure; however, it is now coming full circle and rediscovering its challenge of value added eloquently expressed by *kaizen* (constant improvement). After World War II, Japan wasted no time in "restoring" its industry to prewar levels, and from there launched into a breathtaking expansion. In the early 1990s, such expansion "came home to roost," but *risutora* is again being pursued, coupled with the sensitivity of the need to maintain relative stability of employment. Pressed by the rapid aging of the population, Japanese enterprises remain more than ever concerned about their investment in human capital. ■

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