The Myth of the Japanese Model of Employment

By Kojima Akira

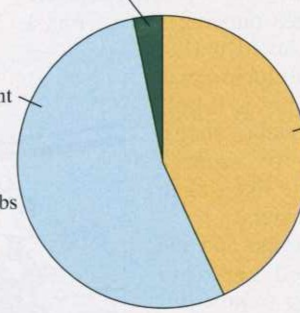
It is often pointed out that "lifetime employment," a "seniority-based promotion system" and "paternal corporate management," among others, characterize the Japanese employment system and practices. But the employment system and practices, referred to as "typically Japanese," have been undergoing drastic changes. In fact, some of these practices have already disappeared or have been transformed for some time. Structural changes in the Japanese economy and society have occurred even before Japan was plunged into the current protracted recession and stagnation. As a result, many "typically Japanese" employment practices have already become a myth.

Take "lifetime employment" as an example. "Lifetime" employment can never mean employment for life. In reality, it is "half lifetime" employment, since people are employed for only half the duration of their lives. It is said that the practice known as "lifetime employment" started about 90 years ago, when a manager of the Mitsui family, which would later establish the Mitsui concern, promised to employ workers until they turned 55 years old. By the mid-1980s, most Japanese companies had adopted this system. Initially, this system was "lifetime" employment in the strict sense of the word, because the average life expectancy of Japanese in prewar days was below 50. Therefore, it was correct to say that Japanese companies practically employed their workers until they died.

The life expectancy of Japanese has continually increased since the end of World War II and currently stands at around 80, the longest in the world. There is an old saying "Ars longa, vita brevis." But times have changed and life has also become long. While most Japanese companies have extended their mandatory retirement age to 60, retirees still have about 20 years left to live after leaving the company stage.

Most university graduates get jobs at the age of 22 or 23 and work for 37 or 38 years before they retire at 60. Living for 20 years after retirement is a long time. From this viewpoint, "lifetime" employment is never true to the word; it should be referred to as "half lifetime" employment.

Future Policies of Employing Full-Time Employees



Source : Japan Productivity Center for Socio-Economic Development "Survey on Changes in the Japanese Personnel System" (1999) in Ministry of Labor, White Paper on Labor 2000

Lifetime employment, or strictly speaking "half lifetime" employment, is itself not stipulated in management-labor contracts. It is merely a customary practice tacitly agreed upon between management and labor. Furthermore, such a practice is adopted only by major companies. Such a tacit understanding does not exist in small companies and backstreet workshops which far outnumber major companies. Even so, Japanese sociologists have given high marks to the Japanese employment system, since it has social significance in that it gave Japanese society a sense of security in regard to employment.

However, the protracted recession and economic adjustment that followed the burst of the asset-inflated bubble economy have subjected the stable, long-term employment system to structural changes. These changes picked up momentum in the latter half of the 1990s, particularly in the five quarters from the fourth quarter of 1997, a period that saw the Japanese economy shrink in real terms.

The current recession started with the burst of the bubble economy. The pace of adjustment of employment was initially slow, in stark comparison with the U.S.

In the U.S., companies start adjusting employment as soon as a recession hits. Such a measure results in a higher jobless rate, but reduces corporate labor costs and in turn allows corporate earnings to improve in a relatively short time. In Japan, on the other hand, employment is also adjusted as soon as a recession comes, but only in the form of reduced overtime. Jobs are seldom eliminated. In explaining such a practice it is often said that Japanese companies have a greater sense of social responsibility and show more consideration for their workers than other countries.

Some Japanese economists argue that Japanese corporate management is based on respect for humanity. Their views are shared by not a few corporate executives.

Japanese companies are doing their best to maintain employment levels even in the current recession that started in 1991.

The jobless rate stood at 2.1% in fiscal 1990, when the Japanese economy was at the height of the bubble boom. The rate remained unchanged in fiscal

1991 when the recession started. It rose only slightly to 2.2% in fiscal 1992 when the recession deepened and the government adopted a fiscal stimulus package. Up to fiscal 1994, the jobless rate hovered around the 2% range, which amounted to full employment.

Only several years after the start of the recession did companies take full-scale employment adjustment measures. But business leaders still tend to believe in maintenance of employment. When a major company declared it had to start cutting jobs, many other major companies criticized it for shirking its social responsibility, indicating their belief that companies have a moral obligation to maintain employment.

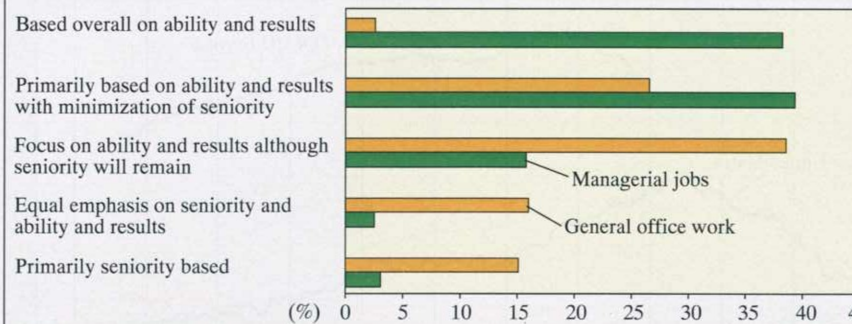
But things began to change in 1997 with a further deepening of the recession.

In November that year, major companies went bankrupt one after another. Sanyo Securities Co, a mid-sized securities firm, folded, closely followed by the failure of Yamaichi Securities Co., one of the Big Four securities houses and Hokkaido Takushoku Bank, the first of Japan's 10 "city" commercial banks to go bankrupt. Japanese financial institutions began to tighten credit, resulting in a credit crunch. Deflationary pressure weighed heavily on the Japanese economy, which faced its worst crisis since the end of World War II.

Against such a background, major Japanese companies could no longer afford to regard job cuts as taboo. They began to feel a sense of crisis: they feared that unless they adjusted employment and curtailed labor costs, they could no longer earn profits and their shares would be sold on the market, which in turn would plunge their business into a crisis.

"Risutora," the Japanese abbreviation of the English word "restructuring," became a Japanese catchword. But the meaning of *"risutora"* used by Japanese was very different from the original meaning of "restructuring" in the U.S., where the term originated. In the U.S., restructuring refers to a company's rebuilding of its corporate strategy and system in order to strengthen its structure, whereas in Japan *"risutora"* was used to refer to adjustment of employment or curtailment of manpower costs.

Future Direction of Wages System



Source : Japan Productivity Center for Socio-Economic Development "Survey on Changes in the Japanese Personnel System" (1998) in Ministry of Labor, White Paper on Labor 2000

It has transpired that it is a myth to regard lifetime or long-term employment as the essence of Japanese corporate management.

As mentioned above, "lifetime" employment is in reality "half lifetime" employment. Accordingly, I will henceforth use the term "long-term" employment, instead of "lifetime" employment in discussing the subject.

Judging from the length of time Japanese workers are employed in the same company, relatively "long-term" employment is still the norm in Japan. Has "long-term" employment been upheld by corporate executives' sense of "social responsibility" or their spirit of "respect for humanity?" Many corporate employers would reply in the affirmative. Or rather, they believed so.

But, that may have been an illusion or a myth. Long-term employment may have been based only on corporate merits and corporate rationality. This is this writer's provisional conclusion.

The Japanese economy continued to grow fast in the 1960s, at an annual rate of 10% or so. Though the oil crunch slowed the pace of growth, the economy still grew 6-7% on average in the 1970s and 4% in the 1980s. Throughout the postwar years, at least up to the 1980s, any downturn, or recession, was trifling and ended after a short period, followed by a rapid V-shaped recovery and long-term growth. This meant that any surplus in employment resulting from recession ran its course in a short period of time, with the Japanese economy short of manpower in the long run. In such a situation, corporate employers rightfully found it more advisable to refrain from adjusting temporary surplus manpower and to focus instead on maintaining experienced workers. As a result, long-term employment continued without interruption. If workers remain employed in the same company for a long period of time, corporate spending on on-the-job training (OJT) does not mean an increase in manpower cost but becomes an investment. The experience and skill thus acquired not only remain intact in the company but also help to enhance the loyalty of employees. Whether or not corporate employers were conscious of their "social responsibility," it is important to see that there was rationality in the maintenance of long-term employment.

In the current recession that started in 1991, however, it is becoming less economically rational to maintain long-term employment. This is because the current recession differs from past recessions in that 1) the recessionary period is much longer, 2) the prospect of recovery after the recession is unclear, and 3) the long-term growth rate is following a downward trend.

The factors mentioned above mean that the surplus employment in the current recession will last much longer than in previous recessions and proportionately will continue to pressure corporate earnings over a long period of time. This was testified by the fact that corporate efforts to maintain employment levels from 1991 to around 1997 pressured corporate

earnings so badly that the cumulative earnings of all companies listed on the Tokyo Stock Exchange came virtually to nil, quite an abnormal situation. Stock prices tumbled, as a matter of course, further weakening corporate financial positions, and in turn deepened corporate management crises in a vicious cycle.

American economist Lester Thurow, currently a professor at the Massachusetts Institute of Technology, whom I met in Tokyo in the spring of 1999, pointed out that while the price-earnings (PE) ratio represents a yardstick for measuring the adequacy of stock prices, the "E" was virtually missing in Japanese companies.

The 1990s represented a decade in which globalization accelerated and an era of mega-competition was ushered in throughout the world. The trend has sustained itself since the beginning of 2000. The 21st century as a whole will be a century of globalization.

Globalization and mega-competition are pressuring the advanced economies to make important adjustments, with responses varying from country to country. To put it rather simply, there are three types of response: the European, American and Japanese types.

On the European continent, the jobless rate rose to double-digit figures in early 1990. The unified Germany saw its jobless rate jump to about 10% in both the eastern and western halves. The unified Germany's adjustment was at the expense of a large number of jobs.

The current jobless rate in the U.S. hovers around 4%, which amounts to more than full employment. But even after the U.S. economy bottomed out and rebounded in 1991, the jobless rate remained high: 7.5% in 1992, 6.9% in 1993, 6.1% in 1994, 5.6% in 1995 and 5.4% in 1996.

It goes without saying that employment figures are a lagging indicator and their improvement tends to lag behind business recovery. Yet, the U.S. employment situation had remained severe for quite a long time after the economy bottomed out. Only around 1998 did it begin to improve noticeably. These moves in the U.S. employment situation resulted from a combination of two factors: 1) adjustment of employment (or elimination of jobs), carried out for a period of several years after the economy hit bottom, producing results in the latter half of the 1990s, and 2) the creation of new employment opportunities, driven by the information technology (IT) revolution, which also began to take shape in the latter half of the decade.

In Japan, meanwhile, adjustment of employment was minimal for several years after the recession started, at the expense of corporate profits. Pressures on corporate earnings reached a limit around 1997, and companies found it unavoidable to abandon the policy of maintaining employment, the hitherto corporate sanctuary, in order to survive. After several influential companies started employment adjustment, others followed suit one after another, more at ease and more vigorously, as they found themselves untethered to do so.

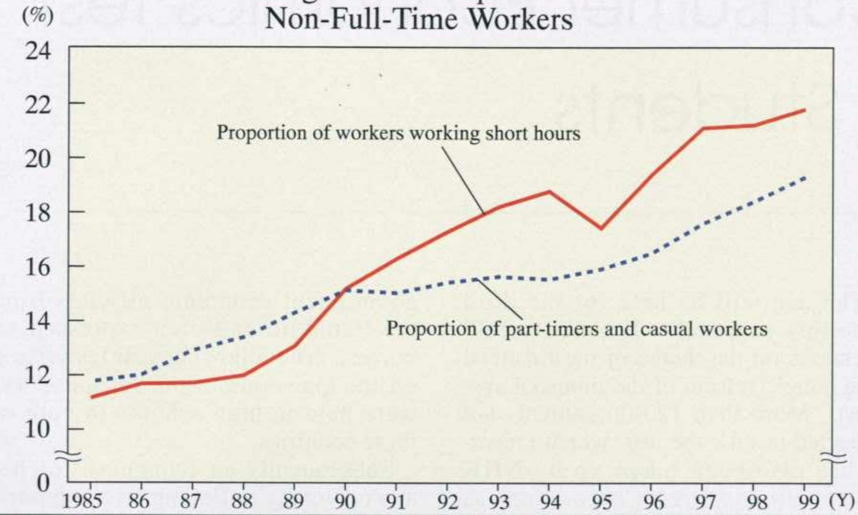
It is not that Japanese corporate employers no longer feel that the maintenance of employment is their social responsibility. They are simply becoming gradually less conscious of such a responsibility, as they push for the adjustment of employment after pressures on their earnings have reached a limit.

There was a debate on long-term employment at a conference of corporate employers from around the world, organized by the Nihon Keizai Shimbun in Tokyo last October. J.F. Welch Jr., the chairman of General Electric Co., emphatically defended restructuring and cast doubt on Japanese companies' employment policies. The moderator asked him, "You eliminated 170,000 jobs in the first three years of restructuring. Japanese business leaders do not reduce manpower. Is there anything Japanese business leaders can learn from GE's corporate management?"

Welch replied that the aims of his company's restructuring had been misunderstood and he asked the audience to seriously consider the aim of restructuring. He emphasized that corporate employers would be committing the worst sin by propping up hopeless businesses and forcing hopeless work on employees. He wondered if it is not cruel for Japanese workers to spend 40 years under hopeless circumstances in one company under the lifetime employment system. In his opinion, such a practice is cruel and amounts to an abuse of power on the part of corporate employers.

His remark was in stark contrast to what Okuda Hiroshi, the chairman of Toyota Motor Corp., said at the same conference. Emphasizing that Japanese companies' competitiveness derives

Changes in the Proportion of Non-Full-Time Workers



Source: Management and Coordination Agency, Statistics Bureau, "Labor Force Survey", "Special Survey of Labor Force Survey" in Ministry of Labor, White Paper on Labor 2000

Notes 1: Non-agriculture and forestry industries

2: The proportion of part-time and casual workers is the proportion of employees accounted for by part-time and casual workers in the "Special Survey of Labor Force Survey". The figures are for February each year.

3: The proportion of workers working short hours is the proportion of employees with working hours of less than 35 hours in a week in the "Labor Force Survey". Working hours are calculated based on the week ending on the final day of each month (the week of 20 - 26 for December), and in April and December 1995 there was one more weekday than in 1994, which caused a significant decline in workers working short hours.

from humanity-based management, Okuda criticized Moody's for having downgraded Toyota's debt rating on the grounds that Toyota maintains lifetime employment. Such an assessment and analysis, which focused only on lifetime employment, was too nearsighted, he said.

The Japanese and American business leaders' philosophies were clearly at odds. But Okuda's remark should be seen against the backdrop of his company's positive business conditions. Toyota Motor and other member firms of the Toyota Group have continued to post solid results despite the recession, and thus can afford to maintain long-term employment, sustain stable management-labor relations, and keep experienced workers nurtured through in-house training. Only under such an environment can a company keep employees' loyalty.

As of 2000, hardpressed Japanese companies seem to find themselves increasingly less allergic to the adjustment of employment.

Japanese companies have begun to cut manpower not only in quantitative terms but also in qualitative terms. Specifically, the companies have been taking on part-time workers at the expense of regular workers. Part-time workers are generally paid less than regular workers. Furthermore, Japanese companies are moving to revise the seniority-based wage system under which workers are paid on the basis of length of service. An increasing number of Japanese companies are introducing an annual salary system under which employees above a certain age or certain rank receive an annual salary on the basis of ability and performance. Most companies are raising the ratio of results-based salary while reducing the ratio of fixed salary.

Corporate on-the-job training is also being subjected to important changes, as companies find their in-house training no longer capable of nurturing human resources competent to respond to rapid technological innovations, globalization of corporate management and other changes. A survey conducted by the Ministry of Labor in June 2000 showed that listed or OTC companies are hiring more mid-career white-collar workers. Mid-career employees account for 15.9% in the manufacturing sector, but the ratio stands at a high 39% in the service sector. Major companies used to recruit new university graduates on a regular basis every year and employ them for a long period of time.

Such employment practices are apparently changing. This is not merely due to the current recession. Several other factors are combining to necessitate changes in employment practices: 1) the long-term downtrend in economic growth, 2) changes in the technological paradigm which will uphold the future economy, that is, the prowess of knowledge-intensive or information-intensive technologies, 3) a decline in the economic growth rate expected by corporate employers, 4) increasing and expanding adjustment pressures on business operations on the back of rapid globalization, and 5) the raising of the pension eligibility age due to the aging of the population and a shortfall of pension funds.

If the pension eligibility age is raised, there will be a gap between the mandatory retirement age of 60 and the start of pension payments. Government policy makers and labor unions are currently reviewing the pension system and the mandatory retirement age. There is even a proposal for eliminating age-based discrimination, in other words, abolishing the mandatory retirement system itself.

The stereotyped image of the Japanese employment system, that is, "lifetime employment" and "seniority-based salary and promotion," has already become a myth and a thing of the past. Japan's lifetime employment system was once rational. It is now time for Japan to seek a new, rational employment practice under a rapidly changing environment. It should not be a process of developing a new myth, but a process of creating new employment practices in response to changes in various employment conditions. JJTI

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