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REFORMING JAPANESE LABOR MARKETS

Naohiro Yashiro

- Japan's labor laws are undergoing restructuring, which should affect the traditional employment practices of long-term job security and seniority-based wages.
- A law on equal pay for equal work will be implemented to narrow the wage gap between regular and non-regular workers.
- Preventing persistently long working hours has been a major policy target for encouraging the labor force participation of women and the elderly.

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Equal pay for equal work is a universal concept, but Japan is the exception. Japanese labor markets and labor unions are based not on occupations but on firms, so that the pay for equal work differs across companies. The average wage of non-regular workers in 2015 was on average 60% that of regular workers inside the firm. This has become a serious social issue with a growing number of non-regular workers, who make up nearly 40 percent of total workers. It is closely related to Japan's male-female wage gap, the second largest in the OECD next to South Korea, as women are more often non-regular workers. Prime Minister Shinzo Abe promised before the Upper House elections in August 2016 to eliminate the large wage gap by establishing a law on equal pay for equal work.

Nobody disagrees with the prime minister, but how to achieve this aim is a different matter. A major factor in the wage gap is the seniority-based wages of regular workers versus the market-based flat wages of non-regular workers. The wage disparities could not be eliminated without revising the seniority-based wages of regular workers, but this would not be welcomed by labor unions consisting mainly of regular workers. The employers also consider seniority-based wages necessary for keeping skilled workers in the firm and profit-sharing to be a basis for harmonious labor relations. In this sense, unlike other countries, there are no serious conflicts of interests between capital and labor in the company-based labor markets in Japan. However, there are various conflicts of interests between workers, such as regular and non-regular employees, those in large firms and small firms, and male and female workers. The principle of equal pay for equal work could only be achieved by partly sacrificing the vested interests of regular workers, in particular those in middle age males who are the largest beneficiaries of seniority-based wages.

The regular workers also pay for their advantageous position. They do not have the right to choose their own jobs. It is in a sense a "blank-check employment contract" in which their jobs and work locations are not predetermined. Most workers are employed right after graduating from college or high school, and are trained in the firm through frequent job rotations. As the

types of jobs differ, wages are not directly related to one's current job, but basically determined by one's length of work at the same firm.

This employment practice used to be quite efficient with the high rates of economic growth in the past. With a continuous expansion of the firm and the introduction of new technologies, narrowly defined occupations easily become obsolete. Employment guarantees and seniority-based wages are less costly with high rates of economic growth and a pyramid-like age composition of the population. They are also effective measures for penalizing workers who voluntarily quit the firm.


However, the merits of these Japanese employment practices turned into demerits with changing economic circumstances. Prolonged sluggishness in GDP growth since the early 1990s has increased firms' costs of hoarding excess workers during recessions. Seniority-based wages become costly with an increasing share of middle-aged workers. Nevertheless, major Japanese firms have maintained their traditional employment practices by increasing the share of non-regular workers who can be easily dismissed during recessions to protect the regular workers. This is neither efficient nor equitable, but Japanese firms are the victims of their memories of past success.

The following are some appropriate policy measures. First, seniority-based wages are no longer fair as they transfer the firm's limited funds for wages from the young to the older generation just as with public pensions. In addition, the scheme of increasing wages with age is closely related to mandatory retirement, which is considered as age discrimination in developed countries other than Japan. In this sense, equal pay for equal work is important for improving the current distortions in the Japanese labor markets.

An effective way of implementing the policy of equal pay for equal work would be to shift to firms the burden of proof that they are not discriminating against workers, replacing the current practice under which workers have to prove that they are the victims of discrimination. For example, Japanese firms might explain that regular workers have to move to local offices at the direction of their supervisors while non-regular workers do not. However, the actual wage gap is likely to be much higher than that explained by the sacrifices of regular

workers. Enforcing laws mandating equal pay for equal work would also be effective in reducing the unexplained wage differences among regular employees, in particular between male and female, and old and young workers. Firms might complain about the additional costs of individual evaluations, but they would eventually be rewarded by better human resource management.

Another issue is reducing working hours in Japan, persistently long by international standards. There are three explanations for this. First, it is a necessary shock absorber for avoiding lay-offs of regular workers during recessions, as there is plenty of room for cutting overtime hours worked. Second, intensive on-the-job training practice at Japanese firms is a time-consuming process, as junior workers have to work together with senior workers in skill transfers. This is one reason that the workers in Japan on average only take about 50% of the paid holidays granted them. Third, overtime hours worked at higher wages are an important source of employees' incomes. The current labor law limits the extent of overtime hours worked without the consent of labor unions, but in most cases they accept working longer hours. This is why the government is now considering setting a compulsory upper limit with no loopholes on working hours.

In sum, a major feature of Japanese labor markets is the conflicts of interests between regular and non-regular workers as well as between traditional families with a full-time homemaker and families with two earners who prefer shorter working hours to additional wages. These conflicts cannot be settled in the government's labor councils which formulate labor laws, as they consist of representatives of employers and labor unions who mainly belong to large firms. This is why strong leadership by the Prime Minister is necessary for labor market reform in Japan. 

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