Job Security in JAPAN

Is Lifetime Employment on the Way Out?

By Edward J. Lincoln

Japanese labor markets provide a stark illustration of how varied labor practices can be in other industrialized nations, as well as some dangers in attempting to enhance employment stability.

Since the 1950s, Japan's labor markets have been characterized by several distinctive features. Perhaps the most notable among them is "lifetime employment," the practice at large firms of hiring workers directly out of school and retaining them until a mandatory retirement age (originally age 55, now around 60 for most companies). The lifetime guarantee is implicit, with no written contracts, but real nevertheless and estimated to cover about a third of all workers. Rather than hiring mid-career managers or blue-collar workers from the outside, firms promote exclusively from within.

A related feature of Japan's labor markets is steep seniority-based pay. As part of the incentive for employees to remain with the firm under a lifetime employment guarantee, wages follow a steep seniority profile. In addition, corporate pensions are not portable.

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To absorb those workers not fortunate enough to enter large corporations practicing lifetime employment, Japan's government protected several sectors of the economy (including agriculture, retailing, and construction) from large firms and international competition. These protected sectors, with their characteristically small labor-intensive firms and flexible wages, readily absorbed workers.

A final distinctive characteristic of Japan's labor market is weak company unions. Efforts to create American-style craft unions in Japan shortly after World War II were snuffed out, and unions today are predominantly company-based.

Fraying Badly Around the Edges

For years, many Japanese extolled the virtues of their labor markets. Unemployment was very low (under 1 percent in the 1960s, creeping up to a 2–3 percent range in the 1980s). Strikes were few (at least after a fairly turbulent period in the late 1940s and early 1950s) and eventually reduced to very short-term ritual demonstrations. The lack of craft unions and the guarantee of employment at large firms supposedly made workers more receptive to technical change than their American counterparts. And management believed that a worker's productivity increased continuously with length of employment, justifying their "lifetime" employment commitment.

But as a result of almost a decade of poor economic performance, today the system is fraying badly around the edges.

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From 1992 to 1997, Japan's economy grew at an average rate of only 1 percent, and since then has entered a real recession. Employment today is no higher than it was in 1992 and is currently falling at about a 1 percent annual rate. Part-time workers make up a rising share of total employment (24 percent in 1998, compared with 20 percent in 1992). Meanwhile, the unemployment rate has more than doubled since 1992, from 2.2 percent to 4.8 percent. In Japan, there is now a bulge in unemployment rates for both young workers (9.1 percent) and those aged 55 to 64 (5.6 percent) who either reached the mandatory retirement age or were forced into early retirement. These employment and unemployment data may not look serious from an American point of view, but have been quite shocking to Japanese.

Resistant to Change

When Japan's economy was growing rapidly, lifetime employment appeared to be a reasonable choice: large firms, after all, rarely experienced an economic downturn sufficiently long or deep to require cutting employment. But in a slow-growing economy with real recessions, the commitment not to fire workers slows the downward adjustment of employment. In addition, during the rapid growth years, the addition of new workers only at the bottom of the pay scale helped to hold down wages as employment expanded. But with employment flat, the total wage bill continues to rise because of the steep seniority-based pay scale.

Nor is all well in the small business sector that traditionally absorbed workers. The consequence of a quarter-century of protecting farmers, small shops, construction firms, and other industries has been high prices. Dissatisfaction with these prices has led to at least some decline in protection for agriculture and the retail trade.

If the existing system can no longer provide low unemployment or contain costs for large corporations, why not just get rid of it? The government's latest annual Labor White Paper makes such a suggestion, advising people to grow accustomed to the idea. But will this really happen? Longevity of membership has been a central part of Japanese group behavior. At the very least, large corporations would have a difficult time finding alternatives to building trust and loyalty among employees. Individuals would also need to shed the sense of shame and humiliation attached to unemployment, or the deep anxiety attached to having to seek employment entirely on one's own.

The more likely outcome over the next decade is that the current system will be modified, rather than eliminated. Some core of employees will continue to gain an implicit lifetime employment guarantee, though that may involve acquiescence in being shunted off to a job arranged by the paternalistic employer when times are bad. Some move toward merit-based pay will occur, but wage profiles will probably remain more seniority-oriented than they are in the United States. Some companies may adopt stock options for managers, but the notion of creating pockets of enormous wealth for some managers will be sufficiently troubling to prevent the practice from becoming widespread. In short, having lived comfortably with a distinctive set of labor practices for half a century, Japan is finding them difficult to discard. ■