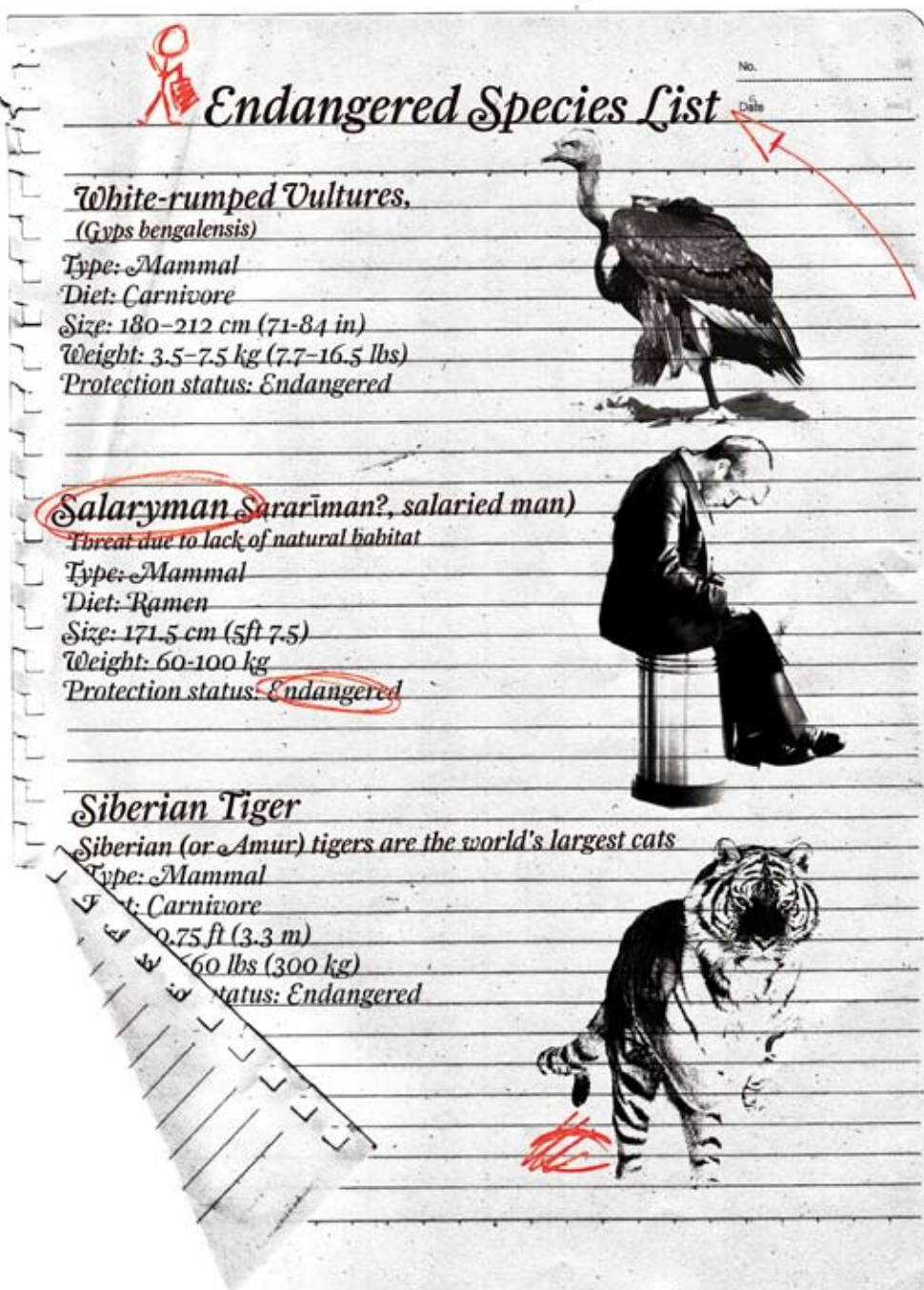


Sayonara salaryman?

Change and continuity in Japan's permanent employment system

More than a decade of reforms have made Japan a global leader in non-regular employment; lay-offs have become common and many expect that the current market environment will bring about an overhaul of Japanese HR strategies. Yet, despite all this, we find that the system of permanent employment has hardly changed.

Until the early 1990s the Japanese employment system was praised for its flexibility. By the mid-1990s, however, it had become the target of severe criticism by domestic economists for putting Japanese corporations at a comparative disadvantage. The blocking of labor adjustment processes and modernization, such as increasing the ratio of full-time female employees, were holding the country back, they said. Today, changes in the Japanese labor market are cited by many observers as an illustration of the dramatic overhaul of "Japan Inc." in the last 15 to 20 years. Rising non-regular employment and the so called *fretter*-phenomenon have attracted wide public attention, as has the fate of part-timers, losing their jobs and company housing in the current crisis. Indeed, many see these as indicators of the slow demise of traditional Japanese life-long or permanent employment. Such views, however, tend to neglect the fact that the guiding principles of lifelong employment appear very much intact for the majority of the employed, those hunting for a job and firms looking for new employees. Most elements of the traditional employment system, be it seniority pay, long job tenures or corporate welfare have anything but disappeared. Only between 2003 and 2008 when Japan experienced a modest upswing in its labor market did the first traces of lasting change emerge. For instance, it has become much more acceptable to work outside life-long



employment and for some part-timers, the chances of returning to permanent employment have even improved due to changes in the demographic make-up of the labor force. As a result, more and more firms feel the need to do a better job in keeping and attracting talented employees—and use permanent employment for this.

Does performance matter?

For most of the 1990s and 2000s, however, things looked very differently. Consecutive governments expanded the scope of non-regular employment until the failure of the “White Collar Exemption” in 2007 (an attempt to scrap the legal requirement for overtime pay). The guiding principle was to enhance ‘labor flexibility through deregulation.’ And as restrictions for part-time workers (*arubaito*, *paato*) and contract workers (*baken*) were lifted, their number almost skyrocketed. Many firms saw this as an opportunity to replace regular with non-regular employees. Hino for instance, the truck division of Toyota Motor Corporation, reduced the number of regular employees between 1998 and 2002 from 9,500 to 8,600. And while it had only 684 non-regulars in 1997, their number had increased to 4,770 by early 2007. At Canon and its affiliates the number of non-regulars increased threefold to 40,000 in only four years. Most national surveys put the share of non-regularly employed to well over 30 percent, with the number of regular employees having decreased almost continually since the 1990s. When compared internationally, Japan is usually only behind the Netherlands. Yet, despite this, almost all other major elements of the traditional employment system seem intact. In particular, no reform so far has touched the high legal hurdles for dismissals of regular employees. Furthermore, the average tenure of a Japanese employee with a company actually increased between 1990 and 2004, from 10.9 to 12.1 years. Regarding labor adjustment strategies, we find that it has been almost exclusively the outsiders or labor market periphery who have been affected, that is, *paato* or *baken* workers, employees of small and mid-sized companies and female employees. But this has been true in past crises as well, and although so-called *risutora* (restructuring or job-hunting) measures are no longer taboo for regular employees, the *seishain* of the

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larger corporations so far have experienced surprisingly little change. Very few have been laid-off, although they may have experienced pay cuts, early retirement and or work sharing schemes.

Continuity also seems to best describe the development of another pillar of permanent employment, seniority-based remuneration. In spite of well-publicized attempts to introduce performance-based elements in line with United States and European standards, the actual change has been small. In the late 1990s especially, so-called performance based payment systems were merely used for implementing wage cuts and were meant to introduce additional incentives for better work. Furthermore, most firms have known performance related pay for a long time, and therefore, wages have actually displayed a lot of flexibility in the past. For instance, bonuses—which employees receive twice a year—can be adjusted on an ad-hoc basis. Seniority though, still is the main determinant of the basic pay employees receive. Economists sometimes model this as an incentive for firms to steadily invest in the skills of and for employees to obtain such firm-specific skills. The unfavorable development of real wages in recent years (real wage index in 2007 fell below that of 1995), the persistently low-entry salaries for new recruits in Japan and the modest wage differences between firms are further indicators of continuity and wage flexibility inherent in the old system. And in the context of recent discussions about manager pay in Europe and the United States, it is striking Japan never had such a debate. For instance, Toyota’s board of directors’ pay is compara-

tively modest and unlike many Western managers Japanese CEOs are also quick to cut their own salary when the business situation worsens.

Permanent employment makes economic sense—but is it sustainable and expandable?

The same is true for human resources practices. Although many companies for the first time took drastic measures during the recession in 1997 by decreasing the number of new recruits and by even cancelling the pre-employment contracts with their new recruits few companies actually changed the recruitment system in general. As in the past, the majority of graduates are recruited long before graduation. And even the generalist nature of corporate skill acquisition has not changed: Recruits often do not know their field of work when they enter the company on April 1.

Indeed, even some prominent advocates of labor market deregulation acknowledge the Japanese employment system inhibits several competitive advantages which are rational to keep. Thanks to permanent employment, employees are eager to acquire skills important to the company and the risk of losing such skills due to headhunting is small. Because the majority of employees see themselves as generalists and are thus prepared to constantly upgrade their skills, they can be easily transferred to other departments or subsidiaries. The same is true for temporal flexibility: Japanese employees are prepared to put in long hours, if necessary. Even seniority-based pay offers advantages since the most productive young

employees are comparatively cheap and the more expensive senior employees can be rehired after their retirement for much lower salaries, aiding the overall productivity.

Experts however see two major downsides to the permanent employment system. First, international capital markets and growing investor expectations make it increasingly difficult for Japanese firms to maintain welfare schemes and to stick to their obligation to maintain their workforce during downturns. Secondly, the permanent employment system alienates almost half the workforce—very few Japanese women land a career position, and even fewer can raise a family at the same time. The low rate of female labor market participation, the absence of senior female managers, combined with an exceptionally low birth rate, show the problem is especially acute in Japan.

Work-life balance— voting with their feet?

The 1990s produced some evidence that foreign companies can profit if they pursue HR policies different to their Japanese competitors. Offering talented candidates, especially female ones, a sensible working environment did work well in some cases. But so far mainly Japanese companies in especially competitive business areas have taken up this issue. The insurer Mitsui Sumitomo for example announced in 2008 that it would stop differentiating between *ippanshoku* (lower management) and *sougoushoku* (higher management) employees, implying that people with non-linear work biographies could have an opportunity to seek a 'late career.' Even some of the larger banks, among them the Bank of Tokyo-Mitsubishi UFJ, Resona, Mizuho and Mitsui Sumitomo Bank, announced in 2008 that they will transform large contingents of their part-timers into seishain. Also companies in the textile retailing sector who operate in a stagnant market have adopted such strategies to keep and attract able, good sales personnel and they have found that offering permanent employment helps them to achieve this goal. The rising competition for a shrinking number of employees could mean that this trend could sooner or later spill over to other industries much faster than one would expect in the current crisis.

Sayonara Salaryman?

If the current crisis can be overcome in a manageable timeframe, it is likely most changes discussed here will have been only

temporary. However, permanent employment will not remain quite what it is today. It will be modified to provide for a sensible work-life balance and to increase the attractiveness of firms in a shrinking labor market. In order to do so, firms will have to alter the first and foremost requirement of salarymen, that is, "the firm always comes first." Here, the long tradition of corporate welfare and the egalitarian corporate culture actually provide a good basis for such policies. All told, we are likely to see a transformation and an expansion instead of an end to permanent employment. But because not all industries will be equally hit by shrinking labor supply, even the most formidable economic circumstances won't bring about a final sayonara to precarious non-regular employment. ■

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Change and continuity at a glance

Increasing pluralism of work

patterns: Mainly due to rising female labor market participation and the expansion in non-regular employment the trend is also fuelled by changing attitudes and expectations. Young recruits have become skeptical of promises of permanent employment with the same firm and accordingly are more willing to switch firms.

Late and non-linear careers:

The number of companies offering "alternative career paths," e.g. by opening the career path to former part-timers will almost certainly increase due to the dramatically shrinking workforce.

Dismissals: Lay-offs have certainly become more common since the 1990s although Japanese firms still fear the stigma as a "bad employer." Prospects of an Anglo-Saxon hire-and-fire environment for seishain are slim though it does already exist for some temp workers.

Executive hires:

Firm-specific training and seniority-based career paths are still effective barriers against hiring experienced managers. Yet some minor changes (i.e. the transfer of corporate social entitlements) hint at a slowly expanding market for executive hires.

Performance-based pay:

Wage differentials remain small, especially when compared to other countries. Even most of the reformed remuneration systems function very similarly to traditional payment systems.

Opportunities for foreign

employers: Experts have been arguing for a long time that the social and economic rigidities of the Japanese employment system offer great opportunities for foreign employers that offer a better work-life balance. So far, however, this is largely a missed opportunity as most foreign subsidiaries simply replicate domestic HR policies.