

# Evolution of Japanese Employment Systems in the Lost Decade and After

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## Abstract

This paper examines how 'lifetime employment' has evolved in Japan in the 'lost decade' and after.

It finds that, despite large scale redundancies after the financial crises in 1997-1998, the mutual commitment or a social contract between employees (and their representatives) and their employer concerning dismissal avoidance did not disappear. Two kinds of sub-systems that are useful for reducing the possibility of dismissals; 'Employment Adjustment Systems' and 'Employment Portfolio Systems' were reworked to cope with the critical economic conditions.

**Key Words:** employment system, lost decade, employment adjustment, employment portfolio, Japan

## 1. 'Lifetime Employment' as a Set of Three Sub-systems

It is said that Japanese corporations shifted away from the 'lifetime employment' system in the 1990s, the 'Lost Decade', after the collapse of the bubble economy, and that employment systems in Japan now more closely resemble the 'global standard,' that is the Anglo-American type of employment system. I believe, however, that this is too simplistic a view of what actually happened during that period.

An immense misconception exists concerning the nature of what is called 'lifetime employment.' The Japanese employment system is not one in which "management cannot or does not dismiss workers," but rather one in which "management works hard not to dismiss workers and in return workers and their organization work hard not to be dismissed."

Since a market economy is invariably characterized by changes and fluctuations, it is impossible to give guarantees that workers will never be discharged from the company. In the actual business world, if a corporation experiences a severe downturn, it must dismiss workers or apply 'voluntary redundancies' measures. Figure 1 clearly shows how

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companies reduce their workforce using these measures. Since this is especially hard on workers, labor and management will consider forms of cooperation that may prevent this from occurring. Thus, in reality, the so-called ‘lifetime employment’ is merely a system of “working hard not to dismiss workers and working hard not to be dismissed” through the efforts of both the management and labor sides to make ‘their’ company successful.

Thus, the first sub-system that supports ‘lifetime employment’ is the mutual commitment or a social contract between employees (and their representatives) and their employer concerning dismissal avoidance. To make this mutual commitment practical in a market economy, business and labor have gradually developed two kinds of sub-systems that are useful for reducing the possibility of dismissals; ‘Employment Adjustment Systems’ and ‘Employment Portfolio Systems.’

The term ‘Employment Adjustment Systems’ refers to various measures of adjusting employment levels during an economic downturn or some other difficult business situation. Before resorting to dismissals or ‘voluntary redundancy’ measures, employers use 1) overtime reduction, 2) hiring freezes, 3) intra-firm transfer, 4) working day reductions, and 5) inter-firm transfer. Since the mid-1970s, Japanese courts have required employers to take these measures as a condition for a dismissal for business reasons to be considered reasonable.

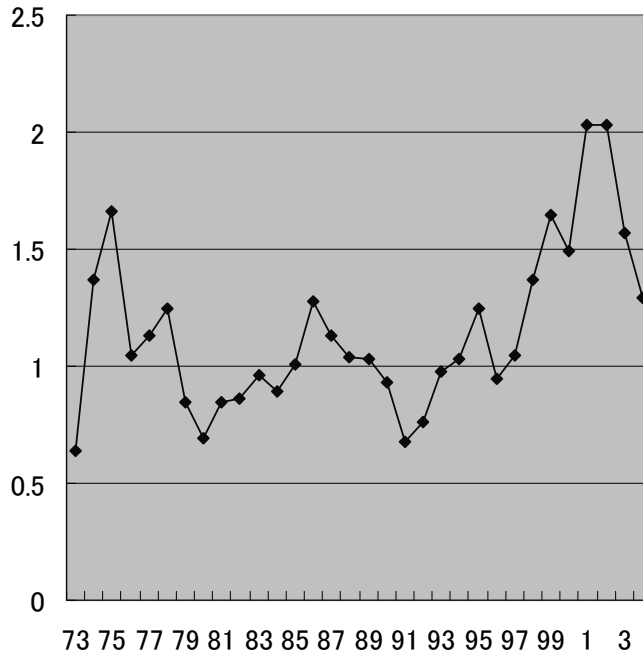
The term ‘Employment Portfolio Systems’ refers to strategic usage of various types of ‘non-regular or atypical’ workers in addition to ‘regular or typical’ workers. The types of these non-regulars include ‘part-timers,’ ‘arbeiters,’ ‘agency workers,’ ‘subcontract workers,’ ‘LTC (Limited-term Contract) workers,’ and so on. One reason to rely heavily on these non-regular workers is to reduce the risks associated with regular employment, the numbers of which may not be easily reduced during an economic downturn or in other difficult business circumstances.

## **2. Employment Adjustments in the 1990s and After**

The first thing we should be aware of about employment adjustments in the 1990s and after is that there was a big gap between the Early Post-Bubble Years (1990-1996) and the Post-Financial-Crises Years (1997-2003). Let me call the former ‘EPBY’ and the latter ‘PFCY.’ EPBY was characterized by slow and moderate adjustments and PFCY saw a dramatic increase in adjustments with severe effects on workers. The shift in the mode of adjustments is clearly shown in Chart 1 (Ratio of Termination of Employment for Business Reasons). While the Production Index recorded minus in 1992 and 1993, the Ratio increased only modestly to a level similar to that following the Plaza Accord in 1985 (Nitta 2003).

1) The most important vehicle of employment adjustments in PFCY was working hour

Chart 1 Ratio of Termination of Employment for Business Reasons (1973-2004)



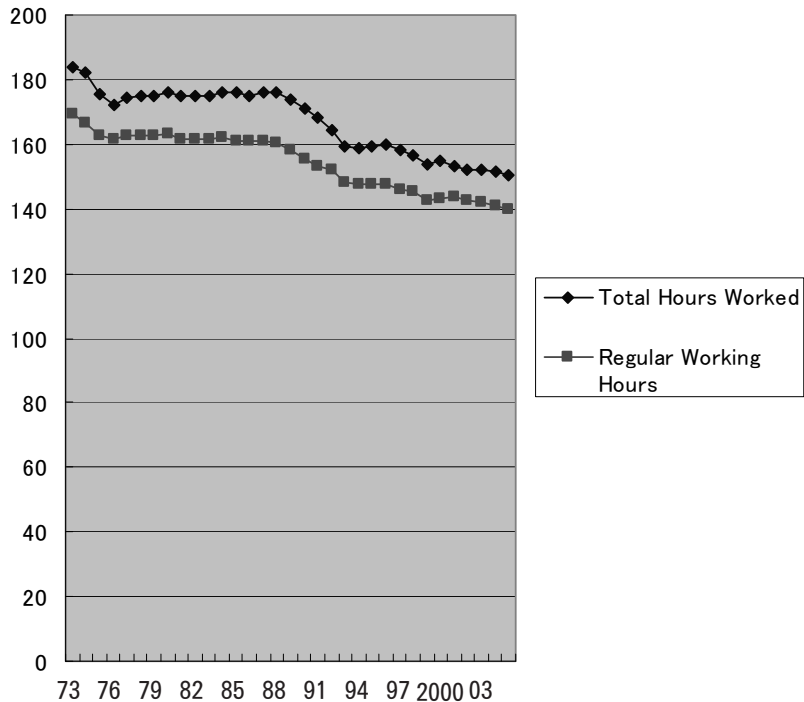
Source: Ministry of Labor, Health and Welfare, Employment Trends Survey

reduction, evident in Chart 2. Average Monthly Total Hours Worked declined 5.5% from 1991 to 1994. What was unique about working hour reductions in this period is the fact that Regular Working Hours declined 3.7%, which had a bigger impact than overtime reduction. This was not the result of an intentional work-sharing policy by the government, but an after-effect of the revision of the Labor Standards Law in 1988, which made the 40-hour work-week compulsory step by step. Thus, the working hour reductions in this period can be called ‘Unintended Work Sharing.’ One of the effects resulting from the ‘Unintended Work Sharing’ was increased hourly labor costs for businesses because monthly wages did not decline in accordance with the reduction of working hours.

2) The financial crises of 1997 and 1998 hit the Japanese economy hard, and the mode of employment adjustments changed dramatically. From Chart 1, it is obvious that in 1999, as a consequence of the turmoil in 1997 and 1998, the Ratio of Termination of Employment jumped to 1.65%, which is similar to the level recorded in 1975, after the First Oil Shock. The ratio even climbed to 2.03% in 2001 and 2002. As a result of these large scale redundancies, the unemployment rate passed the 5% threshold in 2001.

Chart 3 eloquently tells what happened in those crisis years. The number of workers, including the self-employed, declined by 2.4 million, or 3.7% from 65,570,000 in 1997 to 63,160,000 in 2003. This represents a major loss of jobs. There was a drop in the number of jobs from 1973 to 1975 as a result of the first Oil Shock, but the reduction at that time

Chart 2 Monthly Working Hours (1973-2005)



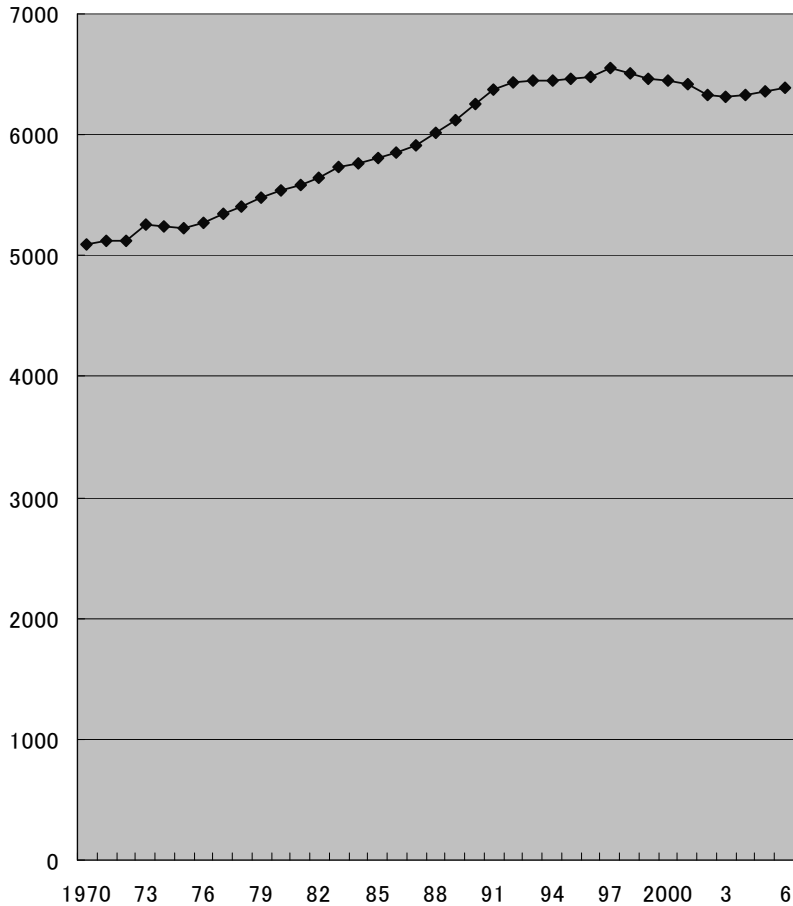
Source: Ministry of Labor, Health and Welfare, Monthly Labor Statistics

was a mere 360,000, or 0.7%. Facing drastic economic contraction, management had no choice but to resort to redundancy measures, mostly ‘voluntary redundancies.’

Chart 4 shows how those job losses were balanced by the labor market. A large scale reduction in the Participation Rate, particularly for men, followed. A large part of this reduction occurred for men in the age groups of 60 to 64 (74.5% in 1997 to 71.2% in 2002) and 65 to 69 (53.3% in 1997 to 48.1% in 2002). Participation Rates for those age groups still are much higher in Japan than in France or other European nations. This ‘early retirement Japanese-style’ clearly contributed to the way employment levels were adjusted in those years without causing severer effects. Although the government was pushing the fully pensionable age forward, it was still 61 in this period. In addition, employers pursued a private path to de-facto ‘early retirement’ using the schemes of ‘severance pay’ and ‘company pensions,’ without which the unemployment rate would have shot up to a much higher level than 5%.

3) Thus, there was a major shift in the mode of employment adjustments in 1997-98. The next question is whether this means the end of ‘lifetime employment’ or not. It may do so since the large-scale redundancies showed the workers that even blue chip companies such as Nissan or Matsushita (Panasonic) could not protect its employees from market forces. These events clearly weakened their sense of economic security.

Chart 3 Number of Workers in ten thousand persons (1971-2006)

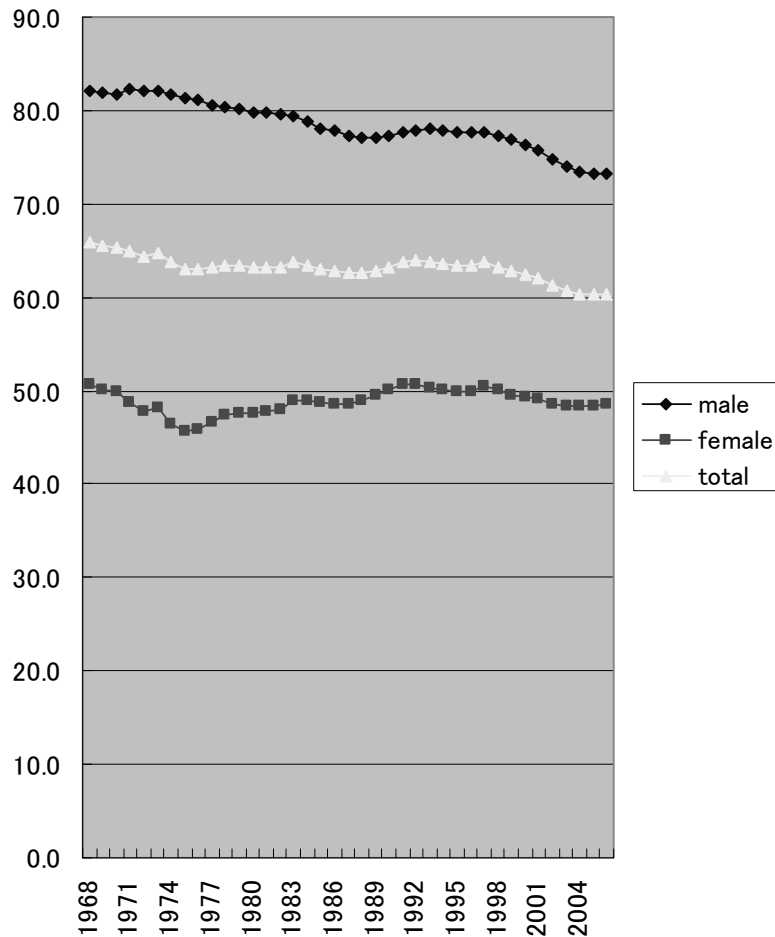


Source: Ministry of General Affairs, Labor Force Survey

The answer to the question posed above, however, may not be a simple ‘yes.’ In most cases, the measures taken were ‘voluntary redundancies,’ not outright dismissals. Companies did try to take other measures, such as imposing a hiring freeze or reducing working hours, in order to avoid redundancies.

Probably the most important point is the strategy that mainstream employers took in those turbulent years. It can be termed a ‘Dualist Approach’ (Nitta 2007), which is different from the ‘Boundaryless Workplace Approach’ taken by US executives (Stone 2004). The ‘Dualist Approach’ can be typically seen in the well-known ‘Employment Portfolio’ Strategy formulated by Nikkeiren (Japanese Employers’ Association: now a part of Nippon Keidanren, the top organization of big businesses) in 1995. According to this Strategy, companies try to utilize more flexible workforce types (Type II and Type III) to cope with rapidly changing economic conditions, but retain a core of stable workers (Type I) to maintain the core competence of the organization and commitment by the employees

Chart 4 Average Labor Participation Rate (1968-2006)



Source: Ministry of General Affairs, Labor Force Survey

(Nikkeiren 1995).

- 1) Long-term Competence Accumulation Type
- 2) High-level Expert Type
- 3) Flexible Employment Type

### 3. Employment Portfolio Systems in the 1990s and After

In order to cope with the economic turbulence and the impact of globalization in the 1990s, Japanese employment systems shifted their weight from Employment Adjustment sub-systems to Employment Portfolio sub-systems within the framework of 'lifetime

employment.’

### 3.1. Various Types of Non-regular Workers

This is not the place to go into the details concerning non-regular workers in Japan. However, outside observers should be aware that these are very difficult to define. Take the concept of the ‘part-timer’ in Japan. Those who are termed ‘part-timer’ or ‘part’ in short in Japanese workplaces are normally middle-aged or senior female workers performing less skilled tasks. The majority of them work shorter hours than regular workers and have a limited-term contract. We can term them ‘typical part-timers.’ There are also several kinds of ‘non-typical part-timers’ in Japan. Some work shorter hours, but without limited term contracts. The most puzzling type of ‘non-typical part-timers’ have working hours as long as regular workers! The term ‘part-timer’ here is simply another name for non-regular workers.

Further, although an ‘arbeiter’ originally meant a student part-time worker, we now

**Table 1 Shifting Composition of Workers by Status (1982-2002)**

	(in thousand persons)				
	1982	1987	1992	1997	2002
Total	57,888	60,502	65,756	67,003	65,009
%	100	100	100	100	100
Self-employed	9,536	9071	8,442	7,931	7,041
%	16.5	15	12.8	11.8	10.8
Family Workers	5,869	5255	4,712	4,052	3,114
%	10.1	8.7	7.2	6	4.8
Executives	2,751	3089	3,970	3,850	3,895
%	4.8	5.1	0.6	5.7	6
Regular Employees	33,009	34565	38,062	38,542	34,557
%	57	57.1	57.9	57.5	53.2
Part-timer & Arbeiter	4,675	6563	8,481	10,342	12,061
%	8.1	10.8	12.9	15.4	18.6
Part-timer	—	4677	5967	6998	7824
%		7.7	9.1	10.4	12
Arbeiter	—	1886	2514	3344	4237
%		3.1	3.8	5	6.5
LTC+. *	695	730	880	966	2,477
%	1.2	1.2	1.3	1.4	3.8
Agency dispatch**	—	87	163	257	721
%		0.1	0.2	0.4	1.1
Others	1325	1118	1008	1,025	946
%	2.3	1.8	1.5	1.5	1.5

Source: Ministry of General Affairs, Employment Status Survey.

\* Limited-term Contract Workers and Shokutaku(entruseted) Workers in 2002.

Shokutaku Workers and Others in 1997 and before.

\*\* Dispatched Employees of Woker Dispatching Agencies in 2002.

see many non-student ‘arbiters’ in various workplaces. It is often the case that the term ‘arbeiter’ simply refers to young non-regular workers.

As can be seen in Table 1, the number of ‘part-timers and arbiters’ together reached 12 million in 2002 and these groups account for about 3/4 of non-regular employed workers.

### 3.2. Increased Share of Non-regular Workers in the Working Population

A clear trend that can be observed from Table 1 is the increasing share of non-regular employees, particularly part-timers and arbiters in the total working population. This share increased from 8.2% in 1982 to 18.6% in 2002. An important point that can be seen in the Table is the fact that the share of regular employed workers did not fall until 1997, maintaining a level of about 57% of the total working population. What balances the increased non-regular employees is not the reduction of regular employees but a decline in the self-employment sector. The share of self-employed and family workers declined from 26.6% in 1982 to 17.8% in 1997.

This situation changed in PFCY. The Employment Status Survey (ESS) recorded a major decline in the share of regular employees to 53.2% in 2002. I must point out, however, that there were some problems with the Survey in 2002. A large increase is shown in the category of LTC+ and to a lesser extent in the category of agency dispatch. I cannot go into the details of these issues here, but because of changes in the categories of employment status, two percent of the decline in the share of regular employees might have been added to the real changes in the labor market. Still, the share of regular employees showed a significant drop after the turbulent years of financial crises in the late 1990s to early 2000s.

### 3.3. New Types of Non-regular Workers

Another major trend in the Employment Portfolio Systems in Japan in PFCY is the emergence of new types of non-regular workers.

(a) One is LTC workers. If directly translated into English, this category of workers are named ‘contract workers,’ which is misleading since in English terminology a ‘contract worker’ usually means an individual working on a subcontracting basis. An LTC worker in Japan generally refers to a fulltime worker with a limited-term contract. There is another puzzle about this category of workers. There are workers who work fulltime on a limited-term contract in the ‘part-timer’ or ‘arbeiter’ categories. From the point of view of legal status, it is difficult to differentiate the LTC workers here from ‘part-timers’ or ‘arbiters.’ However, in reality, there is a clear difference between the two in Japanese workplaces. Generally, LTC workers do jobs that require higher skill levels, and their wage levels are higher.



According to the 2002 ESS, only 16.6% of part-timers who usually work more than 35 hours a week earn more than two million yen (about US\$20,000) per year, while 56.9% of LTC+ workers earn more than two million yen.

Thus, an LTC+ worker, whose numbers have been increasing rapidly, tends to resemble a regular worker more than a part-timer or an *arbeiter*. Of course, there are differences between LTC+ workers and regular workers. For one thing, regular workers have higher salary levels. For instance, about 50% of regular workers earn more than four million yen a year, while only 11.4% of LTC+ workers attain that level of income.

This new type of LTC worker is found in many places in service sectors such as call centers or department stores. This category was first incorporated into the ESS in 2002, the balance between LTC+ in 2002 and LTC+ in 1997 may reveal the number of LTC workers, which amounts to 1.5 million people. Using other less extensive surveys, we can estimate that the share of LTC workers has significantly increased in the 1990s and after.

(b) Another category of workers which has dramatically increased in number is a new type of subcontract worker in the manufacturing sector. These workers are hired by subcontract firms and sent to factories of large corporations, typically in the automobile and electrical/electronics industries (Kobayashi 2002) (Kimura et al. 2004). It is difficult to determine the number of these workers from the statistics. A fraction of them may be found in the agency dispatch category of Table 1. About 200,000 agency workers were working in the manufacturing industry in 2002, according to the ESS. However, agency dispatch was not yet legally permitted in manufacturing in that year, being first legalized in 2003. Therefore, it is very likely that the respondents misunderstood their legal status. Most of these workers must have been subcontract workers rather than agency dispatch workers.

According to a special survey for agency workers conducted by the Ministry of Health, Labor and Welfare, there were 860,000 subcontract workers in the manufacturing industry, including old and new types in 2004. An old-type subcontract company, typically found in the steel and shipbuilding industries, tends to serve only one company. Keiretsu-like relationships exist between old-type subcontract companies and the manufacturers they serve. The new type of subcontract company usually sends employees to many companies.

As the episode concerning mistakes in the ESS shows, those new types of subcontract workers often resemble agency workers. Some argue that most of those new types of subcontract workers are 'disguised agency workers,' and in fact labor inspectors have found several cases in which that claim is correct. This is now one of the most widely debated legal and political issues in the field of employment relations.

#### 4. Conclusion

Even though the ‘lifetime employment’ concept survived the turbulent time of PFCY, the ‘Employment Portfolio’ Strategy, aggressively pursued by employers to keep the concept from disruption, resulted in another problem known as the ‘Gap Society.’ Although the ‘Employment Portfolio’ Strategy is not the sole factor behind the increased gaps in Japanese society, once known for its egalitarian image, the gaps between those who were able to find and keep a regular-status job and those who could not are certainly an issue to be dealt with in the policy arena.

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