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# Still work to be done

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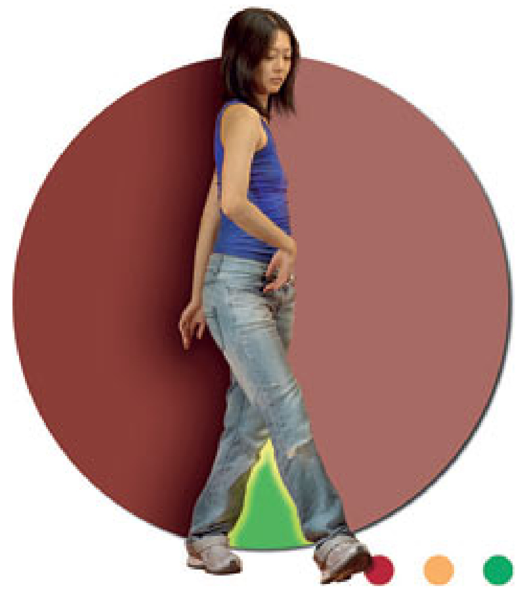
**Japan's labour market is becoming more flexible, but also more unequal**

Illustration by Jac



IN THE summer of 2007 Toshifumi Mori moved back to Japan, having spent 14 years in America, Canada, Britain and Germany working for Mitsubishi, one of Japan's big industrial groups. He was struck by some of the advertisements he saw on the Tokyo subway. Such hoardings, he feels, "tell you what's in". Alongside the posters promoting mobile phones and beer he was surprised to see advertisements for headhunters and recruitment firms. "There was nothing like that 15 years ago," he says. He joined Heidrick & Struggles, one of several companies both promoting and profiting from a more flexible Japanese labour market.

Where he worked before, the traditional Japanese "lifetime employment" model was deeply entrenched. It is often said that this model is now collapsing and that the era of "jobs for life" has come to an end. But the reality is more complicated. For one thing, the traditional lifetime-employment system existed for only a few decades, and only at large Japanese firms; it was never universal. The system is now slowly crumbling, but only at the edges, notes Akira Kawamoto, the director of research at RIETI, a government think-tank. Most of the "salarymen" inside the traditional system will stay there until they retire. But the labour market is becoming more flexible in several ways.

Mid-career job changes, once unheard of, are no longer quite such a rarity. The strict seniority system is giving way to a greater emphasis on performance-based pay and promotion on merit. And the number of "non-regular workers" (a term that encompasses temporary, part-time and contract workers) is increasing. But much of this reflects efforts by Japanese companies to shore up the lifetime employment system for its "regular workers", involving necessary concessions to keep the old system going. Useful though the reforms have been, they have also raised concerns about the growing inequality between regular and non-regular workers.

Under the traditional system, companies hired graduates and then invested heavily in their training and development. To keep workers loyal and protect their investment, they offered lifetime employment on steadily increasing pay, with generous fringe benefits and a lump sum on retirement. Employees worked their way up through the ranks, so age and seniority were tightly intertwined. This made it hard for people to switch companies in mid-career. Women who left to have children found they could return only to more junior, part-time positions. People competed fiercely for jobs at the best companies—but once they were in, their performance made no difference to their pay. "At Mitsubishi your salary went up by the same amount, no matter how hard you worked. My friends at foreign firms found this unbelievable," recalls Mr Mori.

But this is now changing. Young people who start work at a big company no longer expect to stay there for their entire career. Some of them want more of a challenge, says Mr Mori; others "have seen what happens to people who move to another company and do well". Foreign firms in Japan helped things along by poaching staff from Japanese firms, offering attractive benefits and better prospects for promotion on merit. "That creates more mobility," says Mr Mori. "People hear success stories by word of mouth. If some people jump and become top managers, others want to do the same." This is particularly noticeable in financial services, he says, but is spreading to other industries too. A common strategy is to start at a Japanese firm, move on to a foreign firm and then return to a Japanese firm in a more senior position.

## Signs of movement

A greater willingness to switch jobs also reflects declining confidence in the guarantee of lifetime employment, says Sakie Fukushima of Korn/Ferry, an executive-search firm. When she moved to Korn/Ferry in 1991, she says, on average only one in ten of the candidates she called was prepared to meet her. “Others would say they were not interested in moving or were scared by the term ‘headhunting'—we were thought to be industrial spies.” But after the dramatic collapse in 1997 of Yamaichi Securities, a securities-trading firm, there was “a huge change in psychology” as people realised that companies could fail. Today, she says, seven or eight out of ten people she contacts are prepared to meet her. “Many do not move, but they are interested to see what their options are.”

For their part, Japanese firms have become more willing to hire outsiders. With the fall from grace of the Japanese model in the 1990s and the increasing competitiveness of foreign firms, Japanese companies started to realise that they might benefit from outside expertise. There was also a “Carlos Ghosn” effect. When he first arrived at Nissan, Mr Ghosn was held in contempt by the corporate establishment. But within two years he had turned the company around, prompting a rethink among Japanese bosses.

More portable pensions have further increased labour mobility. Under the traditional Japanese system, employees qualified for a lump sum at retirement (over and above the state pension scheme) after 30 years at the same firm, which strongly discouraged mid-career moves. But some firms, most famously Matsushita, a big electronics manufacturer, have introduced a new scheme in which employees waive the lump sum at retirement in return for a higher salary. They can then put some of their extra pay into a personal pension plan, akin to an American 401(k), which they can take with them if they switch employers. This is particularly popular with women, says Mr Kawamoto. Workers who opt for it do not seem to be seen as disloyal. The tax system could be changed to encourage more people to use the scheme, he suggests: as things stand, the tax on traditional retirement income is low, but the tax treatment of portable personal pensions is comparatively ungenerous.

Performance-related pay has been another example of Japanese firms' experimentation with American ways of doing things. In some cases it started off as a form of wage restraint in the dark days of the 1990s: companies cut basic wages and employees hoped that performance-related pay might make up the difference, which it did not always do.

The idea met with stiff resistance. When Fujitsu, a Japanese computer giant, introduced a performance-based pay scheme during the 1990s, it proved so unpopular that the company had to scale it back. Managers found that workers became demoralised if they were not given above-average grades for performance—which, by definition, most could not be. NEC, another Japanese computer giant, introduced a similar programme and also had to modify it. Many firms now offer performance-based pay and other incentives, such as stock options, only to certain categories of worker, and keep the performance-related component small.

Along with performance-related pay has come a greater emphasis on meritocratic rather than seniority-based promotion. In recent years some firms have appointed younger chief executives, in their 50s, but many salarymen are unwilling to work under managers who are younger than themselves or who used to be their subordinates. Even within Sony, one of the most Americanised companies, old habits die hard. “I offered someone a senior job and he said: ‘But I'm only 48!',” says Sir Howard Stringer, the company's chief executive. “People thought seniority and skill were totally intertwined.”

As the labour market has become more dynamic for regular workers, however, the gulf between regular and non-regular workers has widened. When the recession took hold in the early 1990s, the idea that Japanese firms would make workers redundant was unthinkable. Instead, to maintain lifetime employment, companies held down pay and benefits for existing employees and stopped hiring new graduates. Spurred by changes to employment law, they also began to take on more non-regular workers on lower pay and short-term contracts. Whereas in 1994 non-regular workers accounted for only 19% of the labour force, the figure has since risen to 33%. This created a “lost generation” of graduates who were unable to get full-time jobs during the 1990s, got stuck in low-paid, non-regular positions in which no training was provided and found it difficult to move into regular employment.

There are different grades of people without regular employment. First come the "freeters" (a combination of "free" and *Arbeiter*, the German word for worker), those in temporary or part-time employment, whether by choice or necessity. Some freeters enjoy flitting between jobs, but many would prefer regular employment. According to a survey carried out in 2003, 40% of temporary workers and 22% of part-time workers said they would rather have a regular job but could not find one. Next are the NEETs (those "not in education, employment or training") and the *hikikomori*, the twenty-somethings who withdraw from social life.


Most notorious are the so-called "net-café refugees", an underclass of non-regular workers who cannot afford accommodation in the cities where they work and instead sleep in rented cubicles in internet cafés. A recent government report put the number of such "refugees" at some 5,400 nationwide. That is not a lot, but it highlights an area of growing concern: inequality was one of the issues on which the Democratic Party of Japan fought its successful upper-house election campaign in July which led to the downfall of the prime minister, Shinzo Abe.

The protection of regular workers, in short, has come at the cost of a growing army of non-regular workers. The irony is that companies that claim to be committed to lifetime employment can meet this commitment only by cutting back on hiring regular workers and relying increasingly on non-regular workers. "Toyota and Canon say they are still keeping lifetime employment, but to do so they are introducing a large number of non-regular workers," says Keio University's Mr Seike. Canon, for example, now employs 70% of its factory workers on non-regular terms, up from 50% in 2000 and 10% in 1995. Non-regular workers typically earn half as much as regular workers for comparable work. About half of them are not covered by company pension or health-care schemes. But although the use of low-paid, non-regular workers reduces firms' costs, says Randall Jones of the OECD, it has the broader effect of constraining consumption, "so the expansion is still not firing on all cylinders."

That said, as the economic recovery causes the labour market to tighten—unemployment hit a nine-year low of 3.6% in July—companies are starting to move some non-regular workers into regular positions. UNIQLO, for example, a clothes retailer, said in March that it would turn 5,000 of its 6,000 non-regular workers into regular ones within two years, and Canon said it would do the same for 1,000 of its 13,000 factory workers. Companies are also readier to hire workers in their 30s, particularly those with specific skills, says Mr Mori. That is helping to mop up some of the lost-generation freeters.

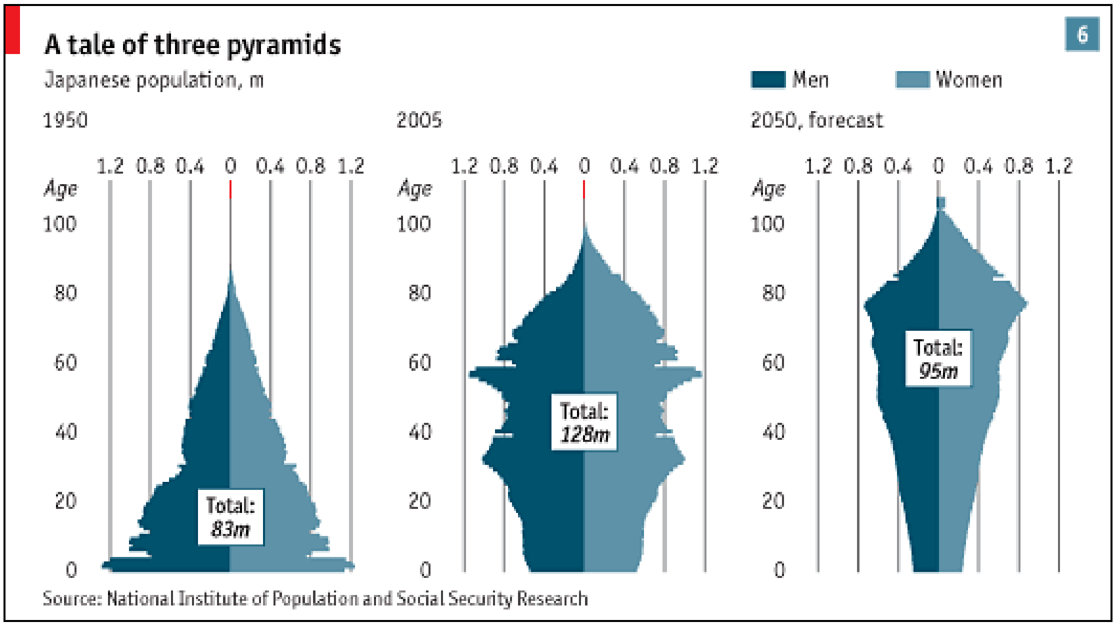
The danger remains that Japan will find itself with a generation of middle-aged workers with inadequate levels of training, says Mr Seike. What is needed, he says, is a scheme to encourage companies to invest in training those in their 30s, with some of the training costs provided by the government. But the best way forward would be to close the gap between regular and non-regular workers by reducing the pay and benefits of the first group and creating better conditions for the second.

## Tick, tick

The reform of Japan's labour market is being driven by the need to become more competitive and flexible in the face of global competition. But Japan also needs to tackle a longer-term threat: the ageing of its population. The share of its population aged 65 or over, currently 21%, will rise to 25% by 2014 and 36% by 2050. Japan's fertility rate has also been declining, hitting a low of 1.26 in 2005, though it has since risen slightly, to 1.32. But that is still far below the replacement rate of 2.1 children per woman. So as well as ageing, Japan's population is now shrinking. By 2030 Japan will have two workers for every pensioner; by 2050 there will be only 1.5. Large-scale immigration, the solution favoured in other rich countries, is not culturally acceptable in Japan. So it will have to put more women and old people to work in order to maintain its workforce.

To this end, the government has already passed a law requiring companies to raise their mandatory retirement age or provide retraining and re-employment for older workers. Most companies favour the second option: the seniority-based pay system makes the oldest workers the most expensive, so it is cheaper to offer them lower-paid work in semi-retirement than to keep them on as full-time employees.

Japan's elderly are still willing to work, unlike their counterparts in Europe, notes Mr Seike. In theory, older workers could be put to good use training their younger colleagues. Raising the retirement age to 70 would roughly halve the rate of decline of the workforce. Increasing the participation rate of women from its current level of 61% (versus 69% in America) would help even more. Japan's working-age population is expected to decline by nearly one-fifth by 2030, and boosting female participation would be the single most effective means of limiting the decline.




Many of the measures needed to do that, such as reducing the inequality between regular and non-regular workers and placing more emphasis on merit-based pay and promotion, would also improve flexibility more generally, notes Kuniko Inoguchi, who was minister for gender equality under the Koizumi government. But other measures that would specifically benefit women, such as better provision of child-care facilities, are also needed. Only 33% of children between the age of three and the mandatory school age (six in Japan) are in formal child care, compared with the OECD average of 73%. New rules for corporate child-care schemes and maternity leave for non-regular workers came into force in April. Big companies tend to offer child-care facilities already, but 90% of women in jobs work at small firms, which need to be persuaded to follow suit, says Ms Inoguchi.

Japan is doing its best to combine the stability and equality of its old labour-market system with the dynamism of the new. But as it becomes clearer that conditions for non-regular workers need to be improved and more women have to be encouraged to enter the workforce, the crumbling of the old system will accelerate.