INSTITUTIONAL CHANGE IN JAPAN
JAPANESE LIFETIME EMPLOYMENT: A CENTURY'S PERSPECTIVE

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Institutional Change in Japan

Japanese Lifetime Employment: A Century's Perspective

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Abstract

The economic stagnation in the 1990s in Japan posed a serious challenge to the practice of "lifetime employment." Despite pessimistic predictions, however, empirical studies have found no major changes to the practice pertaining to core employees. Why does lifetime employment persist in Japan? This paper develops a conceptual framework motivated by personnel economics and sociology and explores the persistence and stability of Japanese lifetime employment from a historical perspective.

In this paper, we view lifetime employment as a set of interdependent human resource management (HRM) practices surrounding an implicit and long-term employment contract. We further examine these firm-level practices within the context of an employment system in which micro-level practices interact with macro-level institutions. Using this framework, we study the formation and transformation of lifetime employment, focusing on key historical events such as the Great Depression, Postwar Occupation, High Growth, Oil Crisis, and the Post-Bubble stagnation.

Our analysis shows that lifetime employment is a product of dynamic interactions among labor, management, and government in response to changing environment. The practice evolved gradually into a cluster of HRM policies, which was further reinforced by the *endogenous* formation of labor laws, state welfare system, and social norms. As a result, today's Japanese lifetime employment is deeply embedded into complementary practices and institutions, resulting in its resilience and stability. The paper concludes by offering some insights into the future course of Japanese lifetime employment.

1. Introduction

Sociologists and economists have long recognized the employment security and corporate loyalty shared by white-collar and blue-collar employees in large firms as a uniquely Japanese institution (Abegglen 1958; Dore 1973; Shirai 1983; Koike 1988). At the same time, many scholars have predicted the demise of so-called Japanese lifetime employment in the past. Cole (1971) argued that it was not sustainable under high economic growth, as chronic labor shortages would raise employees' outside options who would then be tempted to move from one job to another. Beck and Beck (1994) and others predicted that the economic slowdown in the 1990s coupled by the globalization of financial markets would change managerial incentives. Infusion of foreign capital and necessity of rationalization, they argued, would promote American-style personnel practices, such as layoffs, performance pay, and mid-career hiring, and undermine the precarious equilibrium between management and labor.

Contrary to the scholarly predictions and journalistic reports, empirical studies have so far detected no major changes in the practice of lifetime employment pertaining to "core" employees. Although quantifying the extent of lifetime employment has been difficult due to the lack of a simple empirical definition, for one measure, the proportion of long-tenure workers (ten years or longer) in Japan averaged 43 percent in the 1990s, while the same proportion in the U.S. was 26 percent (Auer and Cazes 2000). Following up the study by Hashimoto and Raisian (1985), Kato (2001) shows that ten-year job retention rates of core male employees (age 30 to 44 with more than 5 years of tenure) changed little from the 1977-87 period to 1987-97 period.[1] Tsuru (2002) documents that the ratios of long-term male employees to total workforce increased in the 1980s and remained stable throughout the 1990s at firms of all sizes.[2] Labor turnover data confirm these observations. As **Figure 1** shows, the establishment-level separation rates of manufacturing workers declined

[1] A ten-year job retention rate is a ratio of workers employed by the same firm after ten years to an initial number of workers.
[2] See also Chuma (1998) and Rebick (2001) for similar empirical assessments.

considerably during the high growth period (1960-75) and remained low thereafter, with only a mild upward trend since 1996. Note that the data cover smaller establishments (employing 30 or more workers) as well as female employees for which lifetime employment has been less prevalent. Moreover, “separations” in the data include intra-firm transfers of employees across establishments, a common employment adjustment method to avoid dismissals.

Why does lifetime employment persist in Japan? Why do we not observe a drastic institutional change despite the more-than-a-decade-long economic stagnation? The first objective of this paper is to introduce a conceptual framework motivated by personnel economics and sociology to study the stability and persistence of Japanese lifetime employment. In light of recent advances in personnel economics, we characterize today’s lifetime employment as a cluster of human resource management (HRM) practices that constitute a self-enforcing equilibrium. We also examine these practices within the context of the Japanese economic system in which firm-level practices interact with macro-level legal, political, and social institutions. The second objective of this paper is to apply this framework to a historical analysis and investigate the formation and transformation of lifetime employment over the last several decades.

What can history tell us? Our analysis delivers two main messages. First, Japanese lifetime employment is a product of dynamic interactions among management, labor, and government in response to changing environments. As such, the practice evolved into a set of sophisticated and interdependent HRM practices. Second, the firm-level practices were reinforced by the endogenous formation of macro-level institutions, such as labor laws, state welfare policies, and social norms. As a consequence, today’s lifetime employment is deeply embedded into complementary practices and institutions, resulting in its resilience and stability.

The rest of the paper is structured as follows. Section 2 lays out a conceptual framework. Section 3 presents a historical analysis, documenting the evolution of Japanese lifetime employment. Section 4 speculates the future course of lifetime employment, and the last section concludes.

2. Re-conceptualizing Lifetime Employment

Recent literature in personnel economics has emphasized a complementarity among HRM practices, the property defined by the increasing marginal benefits of some practices in the usage of others.[3] Since the early 1980s, a number of American manufacturing firms introduced aspects of Japanese-style HRM practices, such as small group activities and flexible job assignments, to improve labor productivity. In many instances, their experiments failed (Brown and Reich 1989; Osterman 1994). These and other observations stimulated the theoretical literature that underscores the importance of adopting a *set* of HRM practices at once as opposed to a piecemeal introduction of a few (e.g. Kanemoto and MacLeod 1992; Kandel and Lazear 1992; Baker, Gibbons, and Murphy 1994; Milgrom and Roberts 1995). Although empirical identification of complementarities proved to be difficult, using micro survey data, a growing number of studies find evidence in support of the theory (e.g. MacDuffie 1995; Ichniowski, Shaw, and Prennushi 1997; Kato and Morishima 2002). In light of these advances, we re-conceptualize lifetime employment as a cluster of complementary HRM practices.

Lifetime employment commonly refers to long-term employment contracts (i.e., indefinite contracts specifying no fixed duration) with an implicit handshake between employers and regular employees. Since Japan's statutory laws stipulate that either party can terminate such contracts at any time with a short advance notice, the contracts have to be

[3] See Ichniowski and Shaw (2003) for a comprehensive literature review.

internally enforced, that is, there must be an incentive for both management and workers to conform to their promise.[4] Observe, however, that long-term employment is intrinsically fragile as any changes in product or labor market conditions would affect ex post incentive of one of the two parties. For example, during economic prosperity workers have a greater incentive to leave their firms, while during recessions employers have a stronger incentive to renege on their promises. So what makes long-term employment contracts self-enforcing?

In practice, the following areas in HRM are found critical in supporting lifetime employment in Japanese firms (Koike 1988; Shimada 1988; Sako and Sato 1997; Tachibanaki and Noda 2000; Kato 2000): (1) *human capital development* that raises an employee's productivity over his tenure and provides managerial incentives to retain the employee, e.g. corporate training, job rotations, small group activities such as quality circles; (2) *compensation system* that provides incentives for employees to exert effort, acquire desirable human capital, and remain with the firm, e.g. seniority-plus-merit wage, internal promotion, bonuses, corporate pensions; (3) *employment adjustment methods* that protect the level of employment, while providing management with alternative ways to reduce labor costs during business downturns, e.g. hiring freeze, intra- and inter-firm transfers, voluntary retirement; and (4) *internal enforcement and coordination mechanisms* that facilitate information sharing, enable employees to monitor management, and encourage labor-management cooperation, e.g. enterprise unions, join labor-management committees, workplace socialization. In short, today's lifetime employment consists of a set of sophisticated and interdependent HRM practices that encompasses multiple aspects of work organization and labor-management relations.

In our framework, we further embed micro-level HRM practices within the broader context of an employment system of the Japanese economy (Aoki 1990; Moriguchi 2000).

[4] As we discuss in detail later, there has been a development of case law precedents that restrict employers' right of dismissal to a certain degree.

Following Coleman (1990), we conceptualize lifetime employment as an outcome of the long-run interactions between micro- and macro-level institutions. At the macro-level, the government designs labor market regulations, union laws, and social welfare policies that impact incentives of labor and management.[5] Although these macro-level institutions are exogenous to individual employers and workers, in the long run, they are *endogenously shaped* as they interact with micro-level institutions. For example, dominant HRM practices influence government policies as they create or eliminate demand for particular laws or regulations. Similarly, we claim that social norms – notably loyalty, trust, and commitment that are often assumed to be fixed cultural traits – evolve endogenously as they are nurtured by micro-level economic and social exchange relations. In general, the long-run interactions between management, labor, and the government give rise to a stable employment *system*, in which micro-level institutions and macro-level institutions are complementary to one another.

In the following historical analysis, we focus on major historical events – the Great Depression, the Postwar Occupational Reforms, the High Growth period, the Oil Shock, and the Post-Bubble stagnation – and document how they shaped and transformed lifetime employment in Japan.

3. The Creation and Transformation of Lifetime Employment

3.1 Corporate Welfarism and the Challenge of the Great Depression

Lifetime employment traced its origins to corporate welfarism that emerged during the interwar period (Hyodo 1971; Hazama 1978; Gordon 1985; Moriguchi 2000). World War I (1914-18) brought about a rapid growth of heavy industries and a shortage of skilled labor force. Moreover, as mechanization advanced and firms grew larger, production technology

[5] Although it is beyond the scope of this paper, other institutions, such as corporate governance and supplied relations also affect the feasibility and effectiveness of HRM practices. See, for example, Aoki (1988) and Nishiguchi (1994).

and work organization became increasingly firm-specific. To train and retain skilled workers (*jukuren-ko*), who were well-known for their footlooseness and lack of corporate loyalty, major employers began introducing a variety of HRM practices (Kyochokai 1924).

In particular, leading firms set up corporate apprenticeship schools rather than relying on public vocational schools, and gradually reduced mid-career hiring in favor of workers trained in-house. Initially, however, a majority of apprentices left their employers after, if not during, a training period for better wage offers (Hyodo 1971, p.407; Hazama 1978, p.513). To reduce labor turnover, which often exceeded an annual rate of 80 percent during the 1910s, employers introduced pecuniary incentives, such as service bonuses, periodic pay raises, and retirement allowances, which were previously offered only to white-collar employees, to blue-collar workers. Management awarded pay raises to a fixed percentage of workers based on their merit and length of service, and instituted retirement allowances whose amount increased with the years of service. Compared to the postwar practices, however, the amount and coverage of these benefits were small and their payments irregular (Showa Dojinkai 1960, pp.265-80).

In response to the surge of the labor movement in the late 1910s, leading employers also introduced plant-level employee representation or "factory councils" to facilitate labor-management communication and preempt employee discontent (Kyochokai 1926). Unlike enterprise unions in the postwar period, these councils consisted exclusively of blue-collar employees, reflecting a sharp status distinction between blue-collar and white-collar employees within an establishment during the prewar period. Moreover, in most cases, management restricted the subjects of council meetings to issues such as health, safety, recreation, and efficiency improvements, refusing to discuss wages, hours, and benefits.

Early corporate welfarism was confined to a minority of prosperous employers in the economy – such as Mitsubishi Shipyards, Sumitomo Metals, Hitachi Engineering, Nippon

Electric, and Yahata Ironworks – consisting of no more than a few hundred large private and state-owned establishments mostly in capital-intensive industries. The number of establishments instituting factory councils, for example, was fewer than 200 throughout the 1920s (Kyochokai 1929, Chapter 9). Although the HRM practices became less erratic and more systematized among these establishments during the interwar period, employers retained full discretion over qualifying or disqualifying individual employees as well as modifying or discontinuing the practices at will with legal impunity. In the word of a contemporary government official, the vaunted corporate welfarism rested entirely on "the whims of capitalists" (Garon 1988, p.172).

The Japanese economy was troubled by successive downturns in the interwar period, including the 1921 post-WWI recession, the 1923 Kanto Great Earthquake, and the 1926 Financial Crisis. The largest shock was the Great Depression of 1929-31 during which time the nation's industrial production declined by 8 percent. Numerous firms, including largest employers, reduced wages, cancelled benefits, and undertook large-scale layoffs. The level of employment fell by more than 8 percent in 1929-31. In protest, workers organized strikes and public demonstrations. In 1930 alone, more than eight hundred disputes broke out involving 72,000 workers, and over one million working days were lost (see **Figure 2**). The surge of labor disputes prompted the government to exhort business leaders not to dismiss workers en masse for fear of widespread unemployment and social disorder. Workers' protest and government pressure urged management to develop measures to avoid dismissals. Two major methods of employment adjustment, which became common practices after WWII, emerged during the interwar period.

First, when dismissals became inevitable, major employers solicited workers to accept voluntary retirement (*kibo taishoku*) in exchange for augmented retirement allowance. Although voluntary retirement was *de facto* dismissal, management consulted employees in advance and the sum of retirement allowance received by the employees, which increased with their length of tenure, was nontrivial (Shakaikyoku 1936).[6] The practice of voluntary retirement was often effective in moderating workers' discontent and helped maintain cooperative relations between management and remaining employees (Gordon 1985, p.201; Nishinarita 1988, pp.183-92).

Second, large firms began to use temporary workers (*rinji-ko*) as a buffer to insulate core employees from business fluctuations. Previously, temporary workers were commonly promoted to regular worker status after a short probationary period. During the interwar period, however, the status of temporary workers became fixed indefinitely. They were hired under short-term renewable contracts and let go first when business conditions deteriorated. As management disqualified temporary workers from retirement allowance plans, the cost of dismissing them was significantly lower than dismissing regular workers (Hyodo 1971, p.430; Hazama 1978, p.498).

To summarize, during the interwar period, leading employers introduced a set of HRM practices, such as company training, incentive pay, plant-level employee representation, and employment security, to foster core skilled workers. Workers' protest against employment reduction and the elimination of benefits, together with government intermediation during labor disputes, gradually established an expectation that these benefits were part of the "just reward" that could not be withdrawn at management's will (Gordon 1985, pp.196-206). In response, management developed methods of adjusting employment to mitigate the cost of long-term commitment in business downturns. As **Figure 1** shows, separation rates of production workers declined from over 60% in the early 1920s to below 50% in the late 1930s, part of which may be attributed to the spread of corporate welfarism. Although a vast

[6] For instance, in 1932 a male employee in a large establishment with 10 years of tenure received the average retirement allowance worth 150 days' wages plus 30 days' pay in case of voluntary retirement (Zensanren 1936a, 1932b; Moriguchi 2003).

majority of workers in the economy remained highly mobile, a set of stable and loyal workers began to emerge in leading firms.

Reflecting the development in firm-level HRM practices, complementary labor laws began to take shape during the 1930s (Moriguchi 2003, pp.31-33). First, prompted by rising unemployment, the government proposed a national unemployment insurance bill in 1932. In the legislative process, however, the bill was transformed into law that incorporated an aspect of unemployment insurance into corporate welfare practices. The law mandated every employer (with 30 or more workers) to establish a retirement allowance fund for an employee and pay an allowance in case of separation. Affirming prevailing HRM practices, the law permitted employers to vary an amount of the allowance depending on an employee's length of service and the reason for separation. After the enactment of the law in 1936, retirement allowance plans diffused to smaller-sized establishments in the economy.

Second, despite repeated legislative attempts by progressive politicians and government officials, trade union law never materialized in the prewar period. Business leaders strongly opposed union legislation throughout the period, claiming that factory councils provided employees with a form of employee representation that were more conducive to "labor-capital cooperation (*roshi kyocho*)" than trade unions. Although factory councils did not give independent voice to workers, evidence indicates that organized labor failed to gain workers' support in large firms that instituted corporate weflarism. As **Figure 2** shows, the absence of legal protection notwithstanding, trade unions organized more than 900 establishments and 400,000 workers by the mid-1930s. All major firms, however, remained nonunion. Trade unions were dissolved by the military government after the Japanese invasion of China in 1937.[7]

[7] For the evolution of corporate HRM practices during WWII and the impact of wartime labor regulations, readers are referred to Okazaki (1993) and Moriguchi (2000).

3.2 Postwar Occupational Reforms and the Turbulent Years

Immediately after Japan's surrender in 1945, the nation was placed under the indirect governance of the Supreme Commander for the Allied Powers (SCAP). Even before the enactment of the Trade Union Law, which recognized workers' right to bargain collectively for the first time, there was an explosion of the labor movement led by Japanese workers under the slogan of "democratization of management." Union density (the percentage of union membership in the total labor force) rose to 41 percent by 1946, compared to the prewar peak of 8 percent (see **Figure 2**). In many cases, workers spontaneously formed what they called "employee unions (*jugyoin kumiai*)" that consisted of white-collar and blue-collar employees within an establishment or a company. In contrast to the prewar industrial relations, newly established unions forcefully demanded the equal treatment of all employees, contractual employment guarantee, and direct participation in management in order to improve their status, welfare, and bargaining power. The labor movement quickly radicalized under the leadership of the Congress of Industrial Unions, often resorting to collective violence against managers during labor disputes.

While management was paralyzed by economic disorder and political turmoil, many employee unions won extremely favorable contracts during 1945-49 that stipulated generous wage increases, a variety of welfare benefits, and employment security (Gordon 1985, p.345). By 1950, a large majority of large firms (with 500 or more employees) instituted major corporate welfare programs (see **Table 1**). Many unions also won a "union shop" provision that required every regular employee of a company to be a union member, and in exchange, management won a clause requiring every union member to be an employee of the company. This exclusive employee membership later became a hallmark of enterprise unionism. As a dramatic symbol of labor victory, major unions also won pure "seniority wages" in which wages were determined based on employees' age, tenure, and family conditions, rejecting any merit-based components insisted by employers.[8] Labor's initial victory, however, was soon challenged by management's counteroffensive.

In 1949, the SCAP implemented a drastic deflationary policy to bring the Japanese economy under free market mechanisms, plunging it into a sharp recession. As generous government subsidies suddenly disappeared, many companies faced a choice between drastic rationalization and bankruptcy. The 1949-50 recession thus posed a serious challenge to long-term employment. Unions fiercely opposed rationalization plans, demanding complete withdrawal of proposed mass dismissals (Gordon 1985, pp.388-90). A sense of mutual mistrust between labor and management grew. The most violent labor disputes in Japanese history took place between 1949 and 1954, involving major companies, such as Toshiba, Hitachi, Toyota, and Nissan. As **Figure 2** shows, the working days lost in 1952 reached unprecedented 15 million days involving 1.6 million workers.

In almost all major strikes, management eventually prevailed (Yamamoto 1991). During prolonged disputes, radical union leaders typically lost support from core employees of the company who instead formed or joined the "second union (*daini kumiai*)." Management concluded an agreement with the second union, expelled the radical leaders, and undertook dismissals by a familiar method of voluntary retirement and augmented dismissal compensation. During the process, unions learned a hard lesson that their unrestrained demands might be unsustainable in the face of economic reality. Employers also learned that rationalization measures could provoke costly labor disputes. The second unions became the foundation for *enterprise unionism* characterized by labor-management cooperation in pursuit of corporate goals that took roots in most large Japanese firms in the following decade (Shirai 1992).

[8] In the 1960s, however, employers promoted ability-based wages to provide work incentives. By the early 1970s, a majority of firms adopted hybrid wages or "seniority-plus-merit" pay that combined seniority with a prominent merit component based on performance evaluation by supervisors (Tsutsui 1998, p.174).

Contrary to popular belief, there was no statutory law that guaranteed lifetime employment in Japan. The Japanese Civil Code stipulated that, under an employment contract with no fixed duration, either party can terminate the contract at any time with a two-week advance notice (Article 627(1)). The Labor Standard Law of 1947 obligated employers to pay the equivalent of thirty days' wages when dismissing an employee (Article 20). Except for those restrictions, the legal codes supported the employers' right to dismiss employees. As **Table 2** documents, by the early 1960s, however, it was common for Japanese employers to circumvent dismissals by using other means, such as reduction of working hours, relocation of regular employees, separation of non-regular employees, and the suspension of hiring new workers. In the absence of statutory laws, what compelled management to protect employment of their workers in the face of declining sales and profits? The role of enterprise unions and the formation of case law provide key answers to this question.

In exchange for their cooperation with management in rationalization and productivity improvements, enterprise unions demanded employment security of their members, i.e., all regular employees, as their first priority. No explicit contractual guarantee of employment security, however, was found in union contracts. Instead the contracts established a clause that required the employer's *prior consultation* with a union in employment adjustment among other personnel issues. Importantly, joint labor-management committees (*roshi keiei kyogikai*), which were widely introduced during the 1950s and 1960s, played a critical role in facilitating information sharing and joint consultation and establishing mutual trust between labor and management. During business downturns, unions monitored managerial behavior and cooperated in transferring employees and soliciting early retirement. Enterprise unionism thus became a central internal enforcement mechanism for the emerging lifetime employment practice in large firms.

In a parallel development, starting in 1948 the Japanese courts began to rule increasingly in favor of employees in cases of dismissal (Sugeno 1992, pp.395-412; Tackney 1995, pp.420-27). Over the next three decades, the accumulation of judicial decisions gradually restricted the employer's right to dismiss employees at will.[9] In particular, when the dismissals due to business conditions became a major issue during the Oil Crisis in the 1970s, judicial decisions established minimum criteria that employers had to satisfy before resorting to dismissals, citing the "accepted idea of lifetime employment" and "existing ways of employment adjustment" (Sugeno 1992, p.408).[10] In other words, the interpretations of the law evolved endogenously to incorporate prevailing HRM practices and social expectations. In turn, the accumulation of case law precedents reinforced the HRM practices and transformed expectations into social norms. Since the late 1970s, the courts thus provided legal enforcement for lifetime employment to a certain degree, extending the practice to nonunion employers and smaller firms in the economy.

3.3 The High-Growth Period

The 1960s and the early half of 1970s are known as the "high-growth period." The period kickstarted from the "Income Doubling Plan" announced by the Ikeda cabinet in 1960, under which economic goals were set to more than double Japan's GNP in the course of the next decade. Actual results exceeded this as it took less than seven years to double personal incomes. The real GDP growth rate during 1960-1973 averaged 10 percent, and this unprecedented achievement propelled Japan into the ranks of industrially advanced countries.

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[9] The 1975 Supreme Court decision established a principle that an exercise of the right of dismissal must be based on "reasonable grounds" to receive general social approval (*Nihon Shokuen Seizo,* April 25, 1975, 29 Civ. Cases 456).

[10] The 1979 court decision specified that employers had to (1) exhibit a high degree of business difficulties; (2) make effort to take other measures, such as transfers and voluntary retirement, before resorting to adjustment dismissals; (3) use objective and fair standards in selecting workers to be dismissed; and (4) engage in prior discussion with workers in good faith even if no such provision existed in union contracts (Sugeno 1992, pp.408-9).

Corporate profits soared under continuous periods of double-digit growth. Rapid business expansion depleted the supply of labor available in urban centers, and large corporations aggressively recruited workers from rural areas. These companies constructed dormitories and various housing facilities to accommodate the influx of the new workforce. Their employees began to develop the mentality that their jobs would be secure and their earnings would automatically increase with the length of service. These expectations were fulfilled. The main managerial concern was recruiting and preserving the workforce. Dismissal became a remote concept. The practice flourished among large firms in the 1960s, and among smaller establishments in the 1970s. Accordingly, turnover rates of manufacturing workers declined considerably (see **Figure 1**).

Lifetime employment came into fruition under the favorable economic conditions of the high-growth period (Shimada 1994). Sustained periods of economic growth allowed companies to project longer time horizons as economic conditions became more predictable. For employers, stable employment relationships enhanced the concept of investments in human capital, i.e., the recognition that workers are an important *asset*, or an investment with real returns.

Companies started to provide considerable education and training to their workers, and developed sophisticated human resource management systems for evaluation, promotion, and compensation. For example, Koike (1997) documents how on-the-job training (OJT) became common practice among manufacturing firms in the late 1950s and 1960s. A long-term perspective shared by both labor and management was crucial for on-the-job training to be successful, because skill formation will be interrupted if the workers would move. The bonus payment system, which covered white-collar and blue-collar employees in all job categories, also spread during the same period, primarily as an instrument to adjust wage levels in response to labor market and firm-specific conditions (Ohashi 1989).[11]

Labor-management relations also stabilized during the high-growth period as firms started to realize the gains from the human capital investment. The annual private sector pay negotiations known as the Spring Offensive (*shunto*) was introduced in 1955. The Spring Offensive suffered from low membership, and thus little bargaining power over management in its initial stages. However, sizable wage increases determined by the negotiations during the high-growth period led to larger membership, both with respect to the number of firms and workers.[12] An important outcome of the Spring Offensive was the standardization of wage increase demands and settlements. In a remarkable display of consensus building, member companies exchanged information to minimize wage dispersion, believing that harmonious labor relations was beneficial for labor and management. Differences in wage increase settlements across firms and industries were common in the formative years of the Spring Offensive, but "virtually disappeared" during the mature period in the mid 1960s (Koshiro 2000).[13]

As expectations of employment security became reality, long-term employment became the norm governing the employment relationship in subsequent periods. Regular workers in large firms were increasingly attracted to the economic benefits of the renewed system – mainly "automatic" wage growth – which enabled them to smooth out their consumption and savings over a longer-time horizon.[14] They also enjoyed social benefits such as the status accorded to joining prestigious corporations. Vogel (1963)'s reference to

[11] The bonus system dates back to the prewar period, but its beneficiaries were mostly high ranking white-collar workers (Jones and Kato 1995). By 1985, 97 percent of firms that have 30 employees or more paid semiannual bonuses to their employees (Ministry of Labour statistics cited in Ohashi 1989).

[12] Membership increased from 730,000 in 1955 to 5.6 million in 1965 (Ministry of Labor statistics, cited in Takanashi 2002).

[13] For example, the coefficient of dispersion for wage increases was 0.29 in 1956 but fell below 0.1 in the 1960s (Ministry of Labor statistics, cited in Takanashi 2002).

[14] Inoki (2000) writes that by 1965, more than 95 percent of total households owned black-and-white television sets, and by 1970, 90 percent of households owned washing machines and refrigerators.

Japan's "new middle class" points precisely at this time period when the job of the salaryman characterized by security and prestige became a desirable status among the majority of the Japanese.

Lifetime employment, however, also entailed the social costs. Sanctions for deviating from the norm were met with certain penalties. The stigma attached to job changers hampered their chances of reemployment and resulted in their wage loss.[15] Job separations signaled a "lack of sincerity" much like a divorce (Dore 1983). As commitment to the employer became customary, workers became reluctant to accept as social equals those individuals hired with prior job experience (Cole 1971b). Large companies respected the implicit agreement and their employees were seldom dismissed. However, as Crawcour (1978) explains, "when dismissal did occur it was an industrial death sentence with consequences far more severe than they would be in many other industrial societies" (p.240). Social pressures to conform to the norm thus functioned as a powerful enforcement mechanism for long-term employment.

3.4 The Oil Crisis

The stability of the employment relationship was seriously challenged with the First Oil Shock in 1973, followed by the Second Oil Shock in 1979. Real GNP growth averaged 4.7 percent between 1975 and 1980, and 3.7 percent between 1980 and 1985. Employers initially responded to the shock by upholding their renewed commitment to employment stability. Much like the methods used to adjust employment levels in the Occupation period (see **Table 2**), dismissal was the last resort. Instead, large and medium-sized firms made concerted efforts to reduce overtime, transfer workers within the firm, reduce new recruits, sell

[15] Empirical studies of the Japanese labor market have found a negative correlation between the number of job changes and earnings. See for example, Kato and Rockel (1992) and Ono (2004).

corporate assets, cut executive bonuses and salaries, and cut dividends (Shimada 1979).[16] In spite of these efforts, the shocks proved to be overburdening even for largest firms, forcing them ultimately to adjust their regular workforce mainly in the form of voluntary retirement and permanent transfers. During December 1973 and February 1978, more than one million regular employees lost their jobs (Koshiro 1983).[17]

In response, there was an initial surge of labor disputes in 1974-75 involving more than 5.3 million workers (see **Figure 2**). Several cases of dismissals were brought before the court, leading to the judiciary decisions that restricted the right of dismissals due to business conditions as discussed earlier. Most enterprise unions, however, eventually approved employment adjustment plans and cooperated with management to carry them out. Prior consultations at joint labor-management committees were particularly useful in facilitating labor-management cooperation during the crisis. Furthermore, in 1975 the labor movement adopted a voluntary wage restraint policy intended to promote macroeconomic stability (Takanashi 2000). In a move that reflected the high priority accorded to employment security, organized labor accepted a substantial reduction in real wages in the Spring Offensive of 1980 immediately following the Second Oil Shock (Shimada 1992).

It is against this backdrop that the government launched the Employment Stability Project in 1977. The Ministry of Labor and the Ministry of Trade and Industry were both determined to preserve employment security because they and the business community believed it was the key to industrial and social harmony (Cole 1979). The objectives of the Project were twofold. The first aim was to stabilize employment by transferring workers from declining industries to new more profitable lines of business. Employers who were forced to temporarily lay off workers due to business fluctuations were offered rebates to

[16] See Brunello (1988) for a detailed analysis concerning how employers used employee transfers during the First Oil Shock.
[17] However, the impact of the oil shock on employment adjustment was considerably smaller in Japan than in the U.S..: a comparative study revealed that the manpower reduction measured by the number of employees involved in Japan was only one third of that in the U.S. (Shinozuka 1978).

transfer workers, often into newly established affiliates.[18] Second, the Project provided incentives for employers to keep their workers employed by subsidizing the costs involved with re-training workers in the skills necessary for new lines of business. Subsidies were also provided in circumstances where employers wished to implement short-time schedules, including those who were working zero hours or temporarily staying at home (Genda and Rebick 2000). Hashimoto (1993) finds that the government-led employment stabilization movement reduced employment sensitivity to the business cycle, i.e., firms responded to business fluctuations mainly through adjustment of work hours rather than employment.

It is often argued that Japan survived the Oil Crisis much better than their Western counterparts. Such views should not overlook the considerable measures undertaken by government, management, and labor to minimize the extent of the external shocks triggered by the oil crisis. As Shimada (1992) argues, the priority on employment stability established during the 1970s formed a backbone of the Japanese employment system in the subsequent decades.

3.5 The Bubble Economy and Its Aftermath

The conclusion of the Plaza Accords in September 1985 triggered a sharp appreciation of the yen relative to the dollar. During the next ten months, the value of the yen jumped from 240 to 150 yen per dollar. The enormous price disadvantage of Japanese imports consequently led to a decline in product demand, and lifetime employment was once again tested as employers faced pressures to let workers go. However, the downturn was short-lived; the economy bottomed out by the end of 1986 and managed a quick recovery. The low-interest rate policy intended to stabilize macroeconomic performance soon led to aggressive corporate investments. Asset inflation, mainly through the appreciation of land and stock prices,

[18] For example, the major shipbuilding firm, Ishikawajima Harima Heavy Industries, established an affiliated firm specializing in designing sound reduction construction machinery. Other manufacturing firms also ventured into real estate and other service sector industries (Cole 1979).

encouraged further investments. This upward spiral led to the so-called bubble economy (Noguchi 1994).

The wealth effect stimulated consumer demand, and corporations responded by expanding their productive capacity. Employers hoarded labor at unprecedented levels. In previous episodes of expansion, employers exercised caution in hiring and recruiting, and adjusted to upward swings through overtime work. However, corporate confidence was high and the forecast so positive during the bubble years that corporations recruited as much labor as possible. The result was a complete turnaround, from a buyer's market to a seller's market. Labor shortage problems became pervasive especially among large firms who continued to hoard workers at an aggressive rate. The demand for college graduates was greater because firms desired a higher quality labor force, and because they were able to pay higher salaries. In the peak year of 1991, large firms with more than 1000 employees hired 145,600 new college graduates, or 64.7 percent of the total pool of college graduates, which represented a 60 percent increase compared to the mid-1980s (Ariga, Brunello and Ohkusa 2000).

The prolonged period of asset inflation showed initial signs of collapse in 1991. By October, stock prices had fallen 50 percent from their 1989 peak. In December, the Economic Planning Agency acknowledged that the economy had entered a slump. To deal with the recession, employers once again resorted to the conventional methods of adjustment, by reducing overtime work, reducing new hiring, transferring workers to subsidiaries, and encouraging early or voluntary retirement. Employee dismissal remained the last resort, but became inevitable. Chuma (1994) claims that reductions in the core workforce started as early as the spring of 1993.

The aftermath of the bubble economy dragged on as firms were confronted with not only a mountain of bad loans, but a mass of surplus labor. Despite increasing pressures to let workers go, management continued to uphold the lifetime employment practice throughout the 1990s (Genda and Rebick 2000; Rebick 2001; Kato 2001). Job retention rates and employment durations remained virtually unchanged in comparison to the 1980s. Management kept core employees employed by resorting to transfers, whether they be intra-firm or to subsidiaries within a corporate group (Sako and Sato 1997; Kato 2001). Enterprise unions mainly negotiated wage increases that were in line with productivity gains, and their willingness to accept virtually no wage growth kept unemployment rates low in the 1990s (Genda and Rebick 2000). No major outbreak of labor disputes has been observed since the mid-1970s (see **Figure 2**). On the other hand, repeated concessions signaled the union's lack of bargaining power, leading many workers to see their unions as "powerless" (Kawakita 1997).

Two forms of government intervention in the 1990s also contributed to the maintenance of employment security. First, a new system was established in 1997 to provide special subsidies for job creation and skill formation in fifteen new growth areas, such as information technology and social welfare. Second, the government paid employers direct subsidies to retain or employ older workers (Genda and Rebick 2000). The system of deferred compensation implies that employees closer to a firm's mandatory retirement age are paid more than their marginal product, which makes them more vulnerable to dismissals than younger workers. Government subsidies were therefore targeted specifically to protect older workers during the economic downturn.

The piecemeal adjustment to protect older workers had the undesirable consequence of depressing youth labor markets. Kato (2001) finds that employment remained stable for core workers in the 1990s as reviewed previously, but less so for younger workers and middle-aged workers with short tenure. The primary cause of the problem was that employers, faced with the post-bubble surplus of labor, dramatically reduced their intakes of new hires (Rebick 1998). Furthermore, labor hoarding during the bubble years left a diamond-shaped age composition of the workforce, with an overstock of workers in their thirties. This imbalanced age composition misaligned the system of internal promotion. Eventually, the bulk of the bubble-cohort must be promoted, or it will demoralize subsequent cohorts. However, management faces a dilemma because the average quality of the bubble-cohort is likely to be lower than that of the subsequent cohorts due to the lower recruiting standards used during the period (Ariga, Brunello and Ohkusa 2000). The lack of organizational restructuring has therefore worsened the labor market conditions for younger employees. Their promotion rates have slowed down, and their training opportunities within firms have been depressed (Genda 2000).

4. The Future of the Lifetime Employment System

In the midst of the longest economic stagnation in the nation's history, doubts about the future of lifetime employment have surfaced once again and continue to captivate the public's attention. A February 2002 survey by Nikkei Research reported that over half of 800 firms surveyed "could no longer sustain" permanent employment practices.[19] In the business community, Matsushita's announcement of 8,000 job cuts through voluntary layoffs during fiscal year 2002 was received as a turning point in Japanese industrial relations.[20] Matsushita, in both its organization and history, represents a microcosm of the Japanese firm, often credited as the first to effectively implement lifetime employment. Its announcement was an impetus for change, as it triggered an avalanche of corporate downsizing plans among other Japanese companies. As of November 2001, 82 firms had announced plans to discharge a total of 120,000 workers by fiscal year 2004.[21] Is this the end of Japanese

[19] A survey of 805 firms listed in the Tokyo Stock Exchange and JASDAQ reported in *Nihon Keizai Shimbun*, February 26, 2002.
[20] This view has been popularized in the media. See for example, a *Nihon Keizai Shimbun* article entitled "Can Matsushita Come Back?" (August 4, 2001).
[21] *Nihon Keizai Shimbun* (European Edition), November 18, 2001.

lifetime employment? Or will the practice maintain its resilience and resurge once economic conditions recover?

There is some evidence suggesting that employment adjustments in the 2000s may be tougher than in the previous decades. Conventional measures of employment adjustment are becoming more difficult to implement. Reassigning or transferring workers to other parts of the business may no longer be a viable solution. Smaller firms that serve on the receiving end of surplus workers from large companies are getting saturated with workers; moreover, they face hardship themselves, and can no longer absorb such “redundancies from above” (Ono 2002). Early or voluntary retirement risks adverse selection, i.e. management may lose high-ability workers instead of the targeted low-ability workers. Further, early retirement is likely a bad deal for the average worker. Studies have shown that, in many cases, the lump-sum compensation offered through these plans would not compensate for the loss in earnings when viewed over a lifetime (Ichinose 2001).

Despite increasing pressures to reduce redundant labor, recent survey results confirm that dismissal of regular employees continues to be the last resort among Japanese firms (see **Table 3**). The Japan Institute of Labor (2001b) reports that preferences for employment adjustments among Japanese employers have changed little. Maintaining a reserve of excess labor under economic duress, however, is not without its costs. Ono and Rebick (2003) estimate that the quantity of surplus labor retained among Japanese employers is around 5 percent of total employment, or about the same as the unemployment rate in 2002. The impact of this efficiency loss on labor productivity is certainly not negligible. Further, as discussed previously, the burden of protecting the core workforce falls disproportionately on younger workers. In March 2002, the unemployment rate among workers between the ages of 15 to 29 recorded 9.6 percent, in comparison to the nation’s average of 5.2 percent.

One obvious prescription is a more flexible labor market. But the Japanese labor market that matured under the premise of lifetime employment has yet to develop an infrastructure that facilitates an efficient reallocation of workers across corporate boundaries. **Table 4** shows the top five reasons why workers do not, or cannot change jobs. The reasons accentuate the sentiments of many Japanese workers who feel "stuck" with their current employers. The internal labor markets that presume entry from below impedes the mobility of workers who are separated from their firms in mid-career (Ono and Rebick 2003; Recruit Works Institute 2001). Older workers are more likely to be endowed with higher levels of firm-specific skills, and by definition, this makes it more difficult to transfer their skills to other firms. The seniority-plus-merit pay makes it even harder for workers to leave their employers because it likely results in wage loss. Hence, it is an equilibrium for mid-career workers to remain with their current employers; they don't want to quit their firms and other firms don't want to hire them.

A notable example of employers' aversion to older workers is found in job postings where employers explicitly impose age restrictions on their new hires. In 1999, over 90 percent of Japanese firms were found to impose age limits – generally 35 to 40 – on their job openings (Japan Institute of Labor 2001c). This so-called "age limit" problem continues to be the most common reason for workers not changing jobs in the Japanese labor market (see **Table 4**). Under pressure for reform, the government introduced guidelines to abolish age limits in recruiting and hiring in October 2001 as part of the revised Employment Measures Law. However, the guidelines specify ten *exceptions* where age restrictions are acceptable. One of the exceptions is phrased almost specifically to prevent disruptions in the seniority system.[22] As it stands, the guidelines are mainly viewed as a cosmetic gesture, and their

[22] Exception 4 in the guideline reads: "Cases where recruiting or hiring is intended for workers under a certain age in situations where, in order to make wage payments regardless of age to new employees, companies will be required to revise present regulations determining wages mainly in accordance with age" (Japan Institute of Labor (2001a)).

immediate impact on job mobility remains questionable. In short, a labor market for job changers has not yet developed in Japan, without which the worker with general human capital will suffer severe penalties from job separations.

Finally, the long-term threat which not only may undermine the employment system but economic growth itself is Japan's aging population. The rate of aging in Japan is the fastest in the world, compounded by longer life expectancy and lower fertility. The implications for the economy are ominous. The aging population will eventually lead to an inverted pyramid shaped age composition of the workforce and increase the burden for the active labor force to support the private and public pension system. To summarize, the Japanese labor market faces a labor surplus problem in the short-run, and a labor shortage problem in the long-run. These problems are yet to find solutions.

5. Conclusion

This paper examined the historical process in which Japanese lifetime employment was shaped and became institutionalized over the past century as a result of the dynamic interactions among labor, management, and government. Pioneered by leading firms during the interwar period, the lifetime employment practice matured into a cluster of HRM policies, diffused to a wider set of firms, became more deeply institutionalized, and was increasingly socially-embedded at each historical event examined in our paper. In particular, we documented the endogenous formation of macro-level institutions that reinforced the lifetime employment practice. The development of state welfare policies, enterprise unions, case laws, government subsidies, and social norms are primary examples of such institutions. We argued that the practice's remarkable stability and resilience to economic shocks cannot be explained without the existence of these complementary institutions.

What does the history tell us about the future of Japanese lifetime employment? So far the system has emerged from each economic shock by consolidating itself more firmly with necessary adjustments and innovations. As long as the complementary institutions continue to support it, lifetime employment will likely persist. But should it change?

According to our analysis, the shift from spot labor markets to long-term employment was initially driven by efficiency considerations. By achieving greater productivity through higher human capital, it produced benefits to both management and labor in the form of higher profit and greater employment security. The government endorsed the corporate practices as it brought about economic development and industrial peace at a relatively low social welfare cost to the state. However, the efficiency of lifetime employment is by no means guaranteed: it depends on several key parameters, most importantly, the growth rate of the firm, the nature of human capital, and labor market conditions. In particular, during the high-growth period and again in the bubble economy, under the economic conditions favorable to management, the lifetime employment practice was extended to a much wider segment of the economy with perhaps little gain in long-run economic efficiency. Once extended, labor's oppositions, government regulatory support, and court decisions tended to make it difficult to reverse the practice. Even for elite corporations, core proponents and traditional mainstay of lifetime employment, an increasing importance of professional occupations with general human capital may limit the returns from lifetime employment. In general, in evaluating the future economic implications of the system, one must discern long-run trends in the key parameters.

Furthermore, after several decades since its inception, lifetime employment has become deeply embedded in the society, inseparably integrated into political, legal, and social institutions. As such, the continuation of the system is no longer dictated by its firm-level efficiency concerns. For example, as employment security became a norm and a fundamental premise upon which the society is built, the social benefits of employment security are far greater than its direct economic benefits. The system, however, also created social costs that were originally unforeseen. For instance, lifetime employment produced a stark status difference between regular and non-regular workers, promoted occupational segregation by gender between career and non-career jobs, and brought about high unemployment for the young and the old during recessions. In other words, it is important also to evaluate the social implications of lifetime employment which go far beyond the original efficiency implications.

To give careful assessment of the social and economic implications of Japanese lifetime employment is beyond the scope of this paper. By providing a historical perspective, however, this paper underscores the importance of understanding the dynamic process that shaped the practice and the complementarity between the corporate HRM practices and macro-level institutions in carrying out such assessment.

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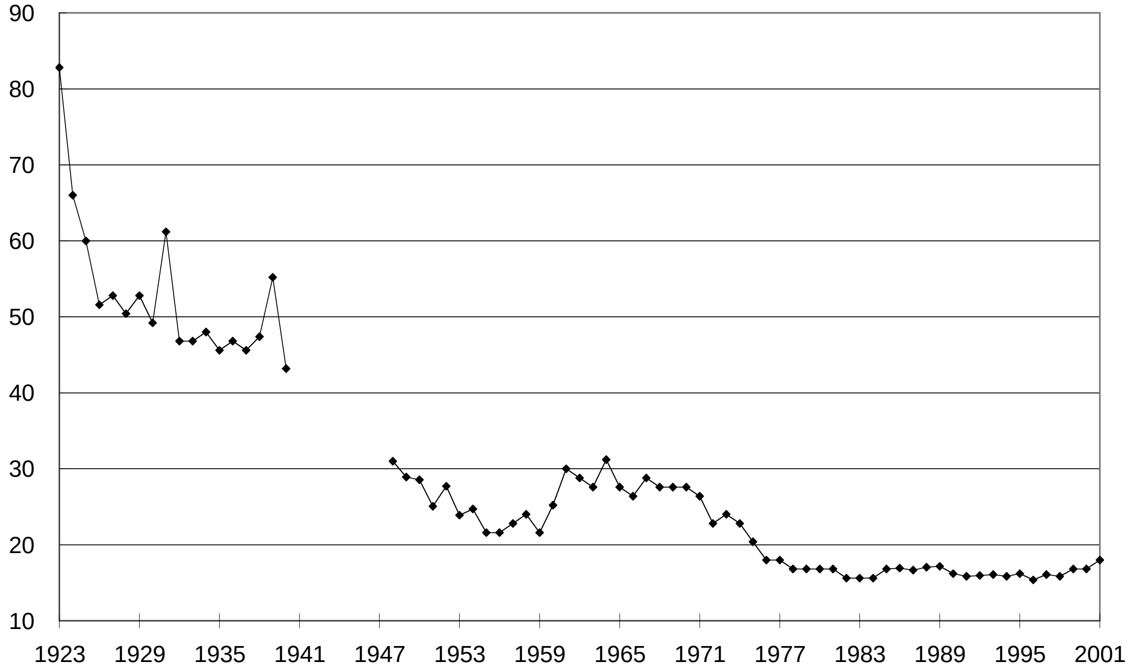
Figure 1. Separation Rates of Manufacturing Workers, 1923-2001



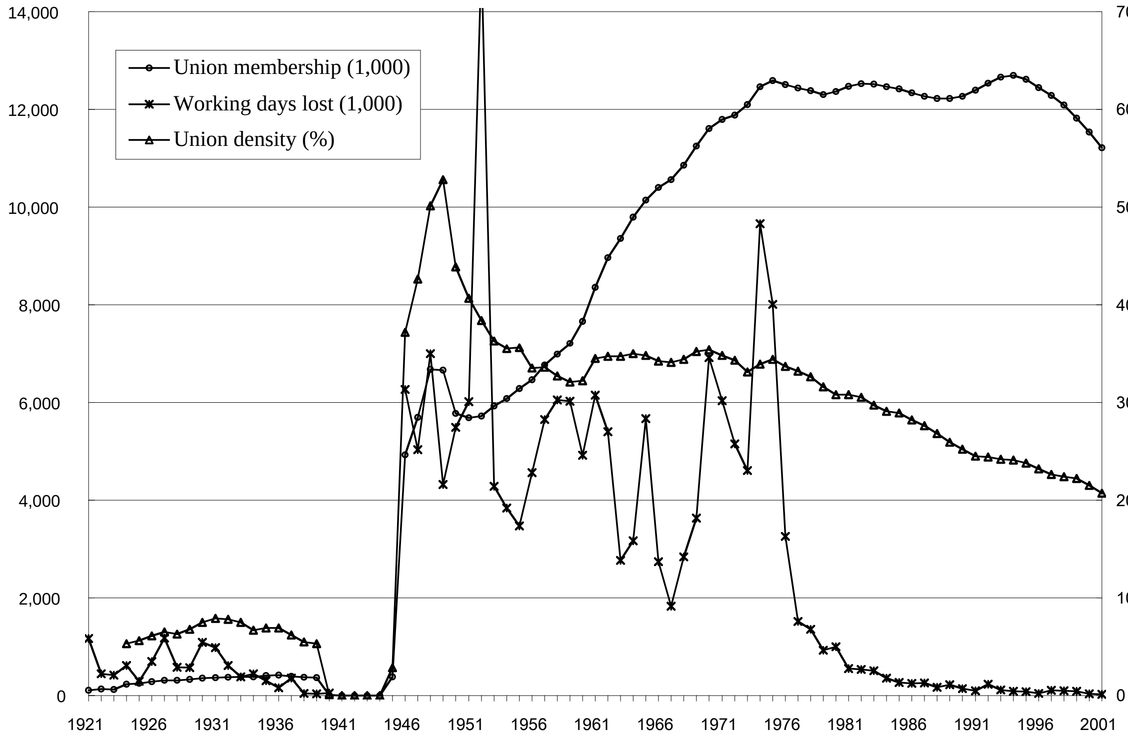
Sources: (a) 1923-1936: Nihon Rodo Undo Shiryo Iinkai (1959), *Nihon Rodo Undo Shiryo* (Historical Data of Japanese Labor Movement), vol.10; (b) 1937-40: Ohara Shakai Mondai Kenkyusho (1964), *Taiheiyo Sensoka no Rodosha Jotai* (Labor Conditions during the Pacific War); (c) 1948-2002: Rodosho, *Maitsuki Kinro Tokei Chosa* (Monthly Labor Survey).

Notes:

1) Separation rates (%) are annualized. Monthly separation rate is defined by the number of employees separated from an establishment (voluntary quits, layoffs, and discharges) within a month divided by the number of employees at the end of the previous month.

2) In (a), the surveys covered production workers in manufacturing establishments employing 50 or more regular production workers. In (c), the surveys covered regular employees (blue-collar and white-collar employees) in manufacturing establishments with 30 or more regular employees.

Figure 2. Union Membership, Density, and Working Days Lost, 1921-2001



Sources: (a) 1921-1946: Nihon Rodo Undo Shiryo Iinkai (1959), *Nihon Rodo Undo Shiryo* (Historical Data of Japanese Labor Movement), vol.10; (b) 1947-2001: Rodosho, *Rodo Kumiai Kihon Chosa* (Labor Union Basic Survey) and *Rodo Sogi Tokei Chosa* (Labor Disputes Statistics), various years.
Notes:
1) Trade union membership as of the end of June each year is reported.
2) Union density (%) is the union membership divided by the total number of employees in June each year reported in *Rodoryoku Chosa* (Labor Force Survey) by the Bureau of Statistics.
3) Working days lost is defined by the number of working days lost due to labor disputes accompanied by strikes and lockouts that lasted longer than half a day.

Table 1. Corporate Welfare Programs in 1949

Welfare Program	All Firms	500 or more workers	100-499 workers	30-99 workers
Company Housing	58.7	96.3	82.4	54.8
Dining Facilities	21.5	72.2	37.6	14.7
Company Loan	9.4	31.9	14.6	6.8
Medical Clinic	18.4	96.6	43.5	7.6
Health & Safety	50.1	94.6	75.4	41.0
Recreation Programs	26.4	77.4	50.4	17.3
Athletic Facilities	22.0	87.7	46.9	11.8

Source: Rodosho (1960), *Rodo Gyoseishi* (History of Labor Administration), Vol.2, p.1540.
Note: Percentage of firms adopting each program is reported.

Table 2. Employment Adjustments during Business Downturns in 1954-55 and 1962-63

Method of Employment Adjustment	1954-55	1962-63
Reduction of Working Hours	48	51
Relocation of Regular Workers	25	31
No Contract Renewals of Temporary Workers	19	13
Reduction of Outside Workers	3	14
No Hiring of New Workers	10	23
Dismissal or Voluntary Retirement of Regular Workers	17	8

Source: Tsuda, Masumi (1968), *Nenkoteki Roshi Kankei-ron* (Seniority-based Labor-Management Relations), p.174.
Notes: Percentage of firms using each method is reported. One firm may use more than one method. The survey covered firms with 30 or more regular workers in mining, manufacturing and transportation.

Table 3. Methods of Employment Adjustment in 2000

Adjustment Method	%
Restricting overtime work	11
Reassigning workers to other parts of the business	7
Temporary transfer (*shukko*)	5
Reducing (or stopping) mid-year intakes of new employees	4
Increasing holiday leave and days-off	2
Dismissing part-time and temporary workers	2
Dismissing or calling for the voluntary retirement of regular employees	2

Source: Ministry of Health, Labour and Welfare (2000), *Survey on Labour Economy Trend.*

Table 4. Top Five Reasons Why Workers Don't Change Jobs in 2001

Reason	%
I exceed the age limit of the job postings	40.8
My work experience is not transferable to the general society	23.4
Returns to seniority will be lost and I will suffer wage loss	21.8
I do not know how to look for jobs	19.1
I will lose personal contacts established through my work	14.1

Source: Recruit Works Institute (2001) *Working Persons Chosa 2000: Shutoken* (Working Persons Survey 2000: The Greater Tokyo Area).