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The Japanese Employment System after the Bubble Burst: New Evidence

Ryo Kambayashi and Takao Kato**

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**Kato is W.S. Schupf Professor of Economics and Far Eastern Studies, Colgate University; Research Fellow, IZA Bonn; and Research Associate, Center on Japanese Economy and Business (Columbia Business School), Tokyo Center for Economic Research (University of Tokyo), and Center for Corporate Performance (Aarhus School of Business). Ryo Kambayashi is Associate Professor, Institute of Economic Research, Hitotsubashi University. Kato is the corresponding author: Email; tkato@mail.colgate.edu. Address: Department of Economics (Person 222), Colgate University, 13 Oak Drive, Hamilton, NY 13346. Phone: 315-228-7562 Fax: 315-228-7033

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I. Introduction

This paper provides the first rigorous and systematic evidence on the reality (as opposed to the rhetoric) of the once-celebrated Japanese employment system during Japan's long-term stagnation.

In the 1980s, reflecting the impressive rise of Japanese firms as world-class competitors, the Japanese employment system became a source of wonder for many corporations around the world and a popular subject of research for scholars in industrial relations, human resource management, and labor economics. The Japanese employment system consists of clusters of practices that are often distinct from the traditional Anglo-American model of flexible labor market and hierarchical labor-management relations that are apt to be adversarial. A variety of specific employment practices have been considered key elements of the Japanese employment system. We pay particular attention to the following practices which we believe are complementary to each other and hence constitute a coherent set of elements of the Japanese employment system.

1. the practice of "lifetime employment" (or implicit long-term employment guarantees for the regular workforce) and the reward system which fosters lifetime employment (e.g., seniority wage system in which wage is detached from specific job and seniority plays a significant role in wage determination).¹

¹ The term "lifetime" is somewhat of a misnomer since except for executives, Japanese workers have been typically subject to mandatory retirement that occurs around age 60. A precise definition of the practice of lifetime employment is therefore implicit long-term employment contract that ends at mandatory retirement for the regular workforce. In addition, the practice of "lifetime employment" does not necessarily mean that layoffs never happen in large Japanese firms. It has been documented that Japanese firms, even large ones, did lay off some of their regular employees, following the first oil crisis

2. Employee involvement and problem solving activities at the grass roots level intended to provide workers with opportunities to exert discretionary effort, acquire useful local knowledge, and share it with their co-workers, and higher-level engineers and managers. They include Shopfloor Committees (SFCs); QC circles; Zero Defect; Kaizen; and JK activities.
3. Incentive schemes, such as employee ownership and profit sharing, which reward workers for their wholehearted participation in such employee involvement programs.
4. Extensive information sharing mechanisms (often called Joint Labor-Management Committees, JLMCs) involving cooperative enterprise unions to minimize information asymmetry and facilitate the alignment of interest between labor and management.
5. Careful screening and extensive training aimed at increasing worker ability to effectively participate in employee involvement/problem solving activities and information sharing meetings.²

In stark contrast to the traditional Anglo-American model of flexible labor market and hierarchical labor-management relations, the Japanese employment system is based on a premise that frontline workers can play a significant role in enhancing the firm's overall competitiveness in the market.³ First, frontline workers acquire a variety of local knowledge through their frequent interactions with their equipments in the case of manufacturing and their customers in the case of service. Some of such local knowledge may prove to be a significant source of competitive edge for the firm (e.g., implementing a series of small yet useful ideas to improve

(see, for example, Koike, 2005, Suruga, 1998, Nakata, 2003, Chuma, 2002).

² Scholars somewhat differ in the relative importance of each practice (see for example, Koike, 2005, Aoki, 2000, Itoh, 1994, Morita, 2001; 2005, Moriguchi and Ono, 2004 and Rebick, 2005).

³ We define frontline workers broadly, including all workers who are working in trenches, regularly interacting with machines in the case of manufacturing and customers in the case of service (such as machine operators, customer service representatives, sales professionals, and lower-level engineers and managers).

productivity, quality, and customer satisfaction and reduce costs may eventually help the firm out-compete its rivals). In addition, the accumulation of such local knowledge tends to be most effective when frontline workers collaborate with each other and engage in knowledge sharing.

Second, the firm encounters a variety of shocks. Some of such shocks are local in nature and dealt with most effectively by frontline workers themselves without involving formal and inevitably time-consuming interventions from higher-level management. Such local adjustments to shocks by frontline workers are often most successful when they collaborate with each other.⁴

In short, the key objective of the Japanese employment system is to tap into the ability of frontline workers to produce valuable local knowledge through their collective efforts and share it with management; and deal with local shocks autonomously through collaboration among themselves.

Each of the aforementioned employment practice plays a distinct yet complementary role in achieving this objective. Specifically, employment involvement and problem solving activities at the grass roots level provide frontline workers with regular opportunities to exert discretionary effort, acquire useful local knowledge, and share it with their co-workers, engineers and managers as well as cope with local shocks effectively.

The importance of providing such opportunities is self-explanatory. After all, a key objective of the Japanese employment system is to tap into frontline workers' discretionary effort and ability to produce valuable local information. Without such opportunities, there will not be any performance gain.

JLMCs also provide labor and management with regular opportunities to engage in extensive information sharing at the top level. As such, JLMCs tend to complement local EI

⁴ See, for instance, Koike (2005).

programs. Our own extensive field research at multiple Japanese firms demonstrates vividly that top management sometimes value information gathered from frontline workers by employee representatives more so than information collected by line supervisors. Second, even if front-line workers are given an opportunity to produce useful local knowledge, they will not do so unless the following two conditions are met: (i) the interest of front-line workers is aligned with the firm; and (ii) some degree of job security is assured for front-line workers.

Providing workers with such opportunities to produce useful local knowledge and share it with management is not sufficient. Obviously if the interest of workers is not aligned with that of the firm, workers will have little incentive to put effort to produce performance-enhancing local information and share it with management. The interest alignment between workers and the firm is fostered by two types of human resource management policies: (i) information sharing mechanisms through which management shares important information with workers, and fosters their loyalty and commitment to the firm; and (ii) financial participation schemes (such as employee stock ownership, profit sharing, gainsharing, and broad-based stock option) by which the financial wellbeing of workers is more tied to the final wellbeing of the firm.

Job security can be an important necessary condition for the Japanese system to work. For instance, local knowledge accumulated through collaboration of frontline workers is often firm-specific in nature, and its value will be considerably lower outside of the firm. As such, in the absence of the practice of long-term employment, frontline workers will have less incentive to accumulate such firm-specific human capital. Furthermore, even if workers obtain valuable local knowledge, they may not share it in the absence of long-term employment. For example, performance-enhancing local knowledge discovered by frontline workers may result in labor-saving technological change. Imagine that a frontline worker has just discovered a way to

perform his/her job more quickly and thus afford performing his/her co-worker's job as well. This may result in a loss of his/her co-worker's job or even worse his/her own job (which is now performed by his/her co-worker). Unless some degree of job security is credibly assured, the frontline worker will have an incentive not to reveal such performance-enhancing local information with management.⁵

Finally, even if frontline workers are given an opportunity to produce valuable local knowledge and share it with management AND have the appropriate incentive to do so, such useful local information may never be generated or shared widely in the firm in the absence of appropriate ability and skill of workers. As such, careful screening and recruitment are often an integral part of participatory employment systems such as the Japanese employment system.

There is some evidence that the afore-mentioned Japanese employment system indeed helped Japanese firms enhance their productivity.⁶ However, during Japan's prolonged stagnation following the bubble burst, the popular rhetoric within Japan as well as outside of Japan shifted and became less positive about the Japanese employment system, and even began to include a call for the replacement of the Japanese system with the Anglo-American model.⁷ In short, the popular rhetoric about the Japanese employment system appeared to have swung as Japan's stagnation continued from the darling of the Japanese economy to a major impediment to the robust recovery of the Japanese economy.

While the rhetoric of "the end of the Japanese employment system" has been rampant, however, data limitation has been preventing researchers from providing much rigorous and

⁵ For the importance of job security in the participatory employment system such as the Japanese system, see for example Levine (1995) and Carmichael and MacLeod (1993).

⁶ See, for instance, Jones and Kato (1995), Ohkusa and Ohtake (1997), and Kato and Morishima (2002).

⁷ See for example a series of proposals and recommendations made by influential associations of Japanese business leaders, such as Keizai Doyukai (Japan Association of Corporate Executives) and Nippon Keidanren (Japan Business Federation) in the last decade.

useful evidence on exactly what happened to the Japanese employment system during Japan's long-term stagnation and what role it played in prolonging the stagnation.⁸ This paper fills this important gap in the literature by providing much-needed rigorous evidence on changes in the Japanese employment system after the bubble burst (or lack thereof). In so doing, we hope to provide new insights on the important controversy over the role of the Japanese employment system as a possible structural impediment to the robust recovery of the Japanese economy.

The rest of the paper provides our preliminary results on changes in a number of key elements of the Japanese employment system or lack thereof along with a relevant literature review.

II. The End to “Lifetime Employment” at Last?

Though “lifetime employment” is not a universal phenomenon among Japanese firms, they apply to the core of the Japanese labor force, or blue-collar male employees in large firms and white-collar male workers (see, for instance, Koike, 2005). Furthermore, the employment relationship in Japan is found to be considerably more of long-term nature than in the United States (See, for instance, Hashimoto and Raisian, 1985).⁹

Japanese employers always felt a need to introduce flexibility to their employment practices and began their attempts to weaken these traditional employment practices. Till recently, however, employers' attempts to weaken these traditional employment practices appear to have not produced any major changes.¹⁰ Therefore, it is of great topical interest to find out whether Japan's prolonged economic slowdown following the burst of the bubble economy is

⁸ A few earlier attempts include Genda and Rebick (2000), and Kato (2003).

⁹ According to Higuchi (1997), however, the difference in the importance of long-term employment between Japan and Western European nations appears to be much smaller than between Japan and the U.S.

¹⁰ See, for instance, Morishima (1992)

finally ending these traditional employment practices. While the rhetoric of “the end of lifetime employment” is presently rampant, concrete data on changes in employment practices are relatively scarce (Dore, 1996).

A closer look at the recent transformation of Japan's “lifetime employment” practice is of particular public policy interest. As explained above, the practice of “lifetime employment” is an integral and complementary element of the Japanese employment system, without which the other elements of the system such as employee involvement at the grass roots level and JLMCs will start working less effectively. The crumbling “lifetime employment” has far-reaching impact on the overall health of the Japanese employment system. Furthermore, it has been suggested (see Aoki, 1990 for example) that the Japanese employment system is complementary to the Japanese financial system (characterized by stable financial corporate grouping, such as banks and institutional shareholders as stable, long-term suppliers of capital). A closer look at the recent transformation of the Japanese employment system will provide fresh insights on a growing literature on the transformation of the Japanese financial system (see, for example, Hoshi and Kashyap, 2004 and Patrick, 1998).

Earlier, to study the possible transformation of Japan’s “lifetime employment” system, Kato (2001) used published and unpublished tables from various years of the Employment Status Survey (ESS) and estimated the ten-year job retention rates of Japanese employees (probability of a Japanese employee to work for the same employer for the next ten years) for the two time periods (ten years before and after the bubble burst). The ESS is the Japanese counterpart of CPS tenure supplements of the U.S.^{11,12} The Survey has been conducted by the Statistics Bureau,

¹¹ Interest in studies of the importance of long-term employment in the U.S. was rekindled in late 1990s in light of the rising popular perception of disappearing long-term jobs in the U.S. In response, a number of researchers in the U.S. have been using CPS tenure supplements to address this popular perception (see, for example, Farber, 1998, and Neumark, et. al., 2000).

Management and Coordination Agency every five years.¹³ Specifically Kato (2001) finds no evidence that the ten-year job retention rates of Japanese employees fell from the period prior to the bubble burst to the post-bubble stagnation period.

As Kato (2001) acknowledges, however, the latest data available to calculate the job retention rates at the time of his research were from the 1997 ESS, and Japan's stagnation turned out to have continued for five more years. It is quite plausible that those additional five years of stagnation might have finally caused Japanese firms to start weakening the practice of "lifetime employment." Fortunately, the relevant aggregate data from the 2002 ESS have become available at last. The new data allow us to extend Kato (2001) to five more years, and hence uncover whether those additional years of stagnation finally started to end "lifetime employment."

In short, we apply the job retention rate methodology developed by Hall (1982) and later applied to the Japanese data by Hashimoto and Raisian (1985) and Kato (2001) to published and unpublished tables from the ESS in 1987, 1992, 1997, and 2002, and calculate the ten-year job retentions of regular employees in Japan for the two overlapping time periods; (i) 1987-1997; and (ii) 1992-2002. We focus on regular employees (defined as "employees who work on a contract of no specific period of employment or of a specific period of more than a year, excluding executives"), for aggregate data from the 2002 ESS which are required to calculate ten-year job retention rates are available only for such regular employees. Focusing on regular employees in our study of changing "lifetime employment" appears to make sense since very

¹² There is, however, an alternative dataset available for Japan, i.e., the Wage Census data. Though the Wage Census data are obtained from an establishment-level survey and hence not comparable to CPS tenure supplements, they provide information necessary to calculate job retention rates. The use of this alternative data source turned out to produce similar results, i.e., no evidence for the weakening lifetime employment (Chuma, 1998)

¹³ Hashimoto and Rasian (1985) used earlier years of the same survey for Japan and CPS tenure supplements for the U.S., and compared the importance of long-term employment between the two nations in the 1960s and the 1970s.

few claim that non-regular employees, such as short-term contract workers, subcontract workers and part-time workers enjoy “lifetime employment” (see, for instance, Koike 1977).

On our reading of the literature, this paper is the first to calculate job retention rates of Japanese employees, using the 2002 ESS.¹⁴ Table 1 shows the ten-year job retention rates of all regular employees for the two time periods, 1987-1997 and 1992-2002. Follow the standard job retention formula used by prior studies (Hall, 1982, Hashimoto and Raisian, 1985, and Kato, 2001),

1. we first use the base year ESS (1987 for the period prior to the bubble burst and 1992 for the post-bubble period) and calculate the proportion of civilian noninstitutional population who are regular employees in each age-tenure category, say ages 35-44 with 0-9 years of tenure (or the total number of regular employees ages 35-44 with 0-9 years of tenure, divided by the civilian noninstitutional population in the corresponding age category or ages 35-44);
2. we then use the ESS ten years later (1997 for the first period and 2002 for the second period) and calculate the proportion of civilian noninstitutional population who are regular employees in ages 45-54 with 10 or more years of tenure (or the total number of regular employees ages 45-54 with 10 or more years of tenure, divided by the civilian noninstitutional population in the corresponding age category or ages 45-54); and
3. we finally divide the proportion regular employees ages 35-44 with 0-9 years of tenure as obtained in the first step by the proportion regular employees ages 45-54 with 10 or more years of tenure as derived in the second step.

¹⁴ Though we are the first to use the 2002 ESS to study job retention, the 2002 ESS data are being analyzed by several researchers. For instance, a recent working paper by Farber (2007) uses the 2002 ESS as well as the ESS from previous years and CPS Tenure Supplements and conducts an intriguing cross-national comparison of the evolution of long-term employment between Japan and the U.S. with particular focus on the role of unique institutions in labor adjustments to globalization in recent years.

The resulting ratio is the ten-year job retention rate of regular employees ages 35-44 with 0-9 years of tenure.¹⁵

As shown in Table 1, the ten-year job retention rates of regular employees fell significantly from the 1987-97 period to the 1992-2002 period for all age-tenure categories, and the magnitude of the fall was considerable for some categories. For instance, the average regular employee ages 35-44 with 0-9 years of tenure in 1987 had a 74 percent chance of being with the same employer ten years later (1997) whereas the average employee in the same age-tenure category in 1992 had only a 54 percent chance of being with the same employer ten years later (2002).

Regular employees ages 35-44 and 45-54 with 10 or more years of tenure tend to experience less deterioration in job stability, suggesting that employees who settle in their stable jobs quickly are most immune to the weakening of the “lifetime employment” system. For example, the average regular employee ages 35-44 with 10 or more years of tenure in 1987 had a 82-percent chance of remaining in the same firm for ten more years. The average employee in the same age-tenure category in 1992 still enjoyed a high probability (77 percent) of keeping the job for ten more years. Interestingly, for younger workers (ages 25-34), quick settling does not appear to make them more immune to the weakening of the “lifetime employment” system. We speculate that Japanese firms may be more concerned about the possible reputation effect of breaking their implicit long-term employment contracts with their senior workers. As such, they may be more willing to weaken their “lifetime employment” practice for younger workers whose expectation for “lifetime employment” have been already lowered due to Japan’s long stagnation.

¹⁵ Using the number of employees in each age-tenure category itself instead of using its ratio to the relevant civilian noninstitutional population will change the ten-year job retention rates very little. Since the 2002 ESS data are available only for broader age-tenure categories, unfortunately we are unable to use finer age-tenure categories as used in prior studies.

To see if there is any evidence for corresponding weakening of the seniority wage system that fosters “lifetime employment,” we created Table 2, using published tables from the General Survey on Working Conditions (Former "the General Survey on Wages and Working Hours System") conducted in 1996, 1999, 2004 and 2007 by the Ministry of Health, Labor and Welfare. The sample universe of the Survey is all firms in Japan that employ 30 or more employees and the Survey enjoys an unusually high response rate of close to 80 percent in 2007. .

First, the proportion of firms which abolished automatic annual pay raise during the last three years was less than 4 percent in 1996 and it rose to over 10 percent in 1999; and it fell somewhat to 7 percent in 2007 although it is still considerably higher than the 1996 level. The tendency to move away from seniority-based pay by abolishing automatic annual pay raise accelerated in late 1990s and in 2007 the proportion of such firms is still higher than at the 1996 level.

In parallel to the tendency to abolish automatic annual pay raise, more and more firms have been making their pay systems more sensitive to each worker’s ability; performance; and job. Specifically, the proportion of firms that made their pay systems more reflective of each worker’s job and task during the previous three years rose from 12 percent in 1996 to 23 percent in 2007. Likewise, the proportion of firms that made their pay systems more sensitive to each worker’s ability during the previous three years increased from 16 percent in 1996 to 22 percent in 2007. Finally, the proportion of firms that moved further toward pay for performance also rose from 15 percent in 2003 to 24 percent in 2007.

III. JLMCs and SFCs: Deepening Divide between Larger and Smaller Firms

JLMCs (Joint Labor Management Committees) have been considered the centerpiece of

Japan's employee participation and labor-management cooperation (see for example Shimada, 1992; and Inagami, 1988). Our own field research at J-FIRM (a large manufacturing firm with sales of over 3 trillion yen, nearly half of which is export sales and employment of close to 40,000 workers) demonstrates vividly the extensive scope and nature of JLMCs.

At J-FIRM, JLMCs at the headquarters level consist of five types of meetings: (i) management council meetings; (ii) committee meetings; (iii) restructuring meetings; (iv) production meetings; and (v) individual item meetings. At management council meetings, six to seven top managers (CEO, vice-CEOs, and director of personnel) meet with six to seven top full-time union officials regularly. Each meeting lasts half a day. Business strategies and plans, current status of corporate performance are discussed. The management council meetings are held normally twice a year. They are scheduled right before Spring Wage Offensive and Fall collective bargaining so that they can help facilitate each collective bargaining.

Union begins its preparation for management council meetings a month prior to the meeting. A full-time union official visits various shopfloors and talks to union representatives of establishments to find out what union members are concerned about and what they want to know from management. This is very time- and effort-consuming. Based on this field research, he writes up a list of questions. It is imperative to have careful field research to gather information from shopfloors. For example, careful field research at the shopfloor level revealed that in spite of management's overall decision to reduce a number of products it sells, it was not really happening although it looked as if it was happening on paper.

A list of questions is then given to management seven to ten days prior to the meeting. Management then prepares responses to those questions. At the management council meeting, management presents an answer to each question and then union further asks questions about the

answer. After the meeting, both management and union prepare separate proceedings and exchange each other's proceedings before dissemination. Some information shared during meetings is designated as "confidential" and is excluded from the proceedings. Our extensive interviews with both management and labor representatives to JLMCs reveal that "confidential information" is indeed confidential and can be easily deemed insider trading material. Union proceedings are distributed to all union members and management proceedings are distributed to all managers.

JLMCs at the headquarters level of J-FIRM have a number of sub-committees, including sub-committee on production, sub-committee on employee benefits and welfare, sub-committee on sales, and sub-committee on development. Sub-committee meetings on production are held regularly twice a year and are attended by six to seven managers from production department, domestic sales department, export sales department, and personnel department, and six to seven top full-time union officials. Biannual production and staffing plans are discussed. In addition to production sub-committee meetings, occasionally other sub-committee meetings such as sub-committee on employee benefits and welfare,, sub-committee on sales, sub-committee on development, are also held.

Restructuring meetings are held on an ad hoc basis. Decentralization, outsourcing, and plant closures are discussed. Production meetings are also held on an ad hoc basis. While during committee meetings on production the basic framework of employment adjustment such as worksharing is discussed, production meetings deal with changes in such framework in response to change in output demand. Individual item meetings are held also on an ad hoc basis to discuss items other than what is covered in other meetings.

At J-FIRM, during management council meetings and sub-committee meetings on

production, union first receives detailed explanations from management on business strategies and plans (including investment, opening and closing of plants, sales and production plans, introduction of new products). Union then asks questions, in particular asks for justifications for these plans but do not try to change the overall framework of the plans. Nonetheless, when they discuss the consequences on employees of these business strategies and plans during restructuring meetings, production meetings and individual item meetings, union decides jointly with management. For example, plant closures and outsourcing were proposed several years ago from top management to union representatives during their management council meetings. Although they did ask many detailed questions about why they were necessary, they did not try to change the decision to close the plant and outsource. Instead, they successfully negotiated with top management during restructuring meetings to delay the plant closure for several months and get favorable conditions for those employees who are transferred as a result of the plan closure and outsourcing.

We present evidence on changes in the incidence, scope and nature of JLMCs (or lack thereof), using published tables from the Labor-Management Communication Survey (LMCS) in 1989, 1994, 1999, and 2004. The LMCS has been conducted by the Ministry of Health, Labor and Welfare every five years and the most recent Survey was conducted in 2004. The sample universe of the LMCS is establishments of firms with more than 30 workers (50 workers prior to the 1999 LMCS). The LMCS has been enjoying an unusually high response rate (around 70 percent).

Since the sample universe expanded in 1999 and started including establishments of smaller firms, we report all of the results disaggregated by firm size. As shown in Figure 1, for establishments of large firms with 5,000 or more employees, the incidence of JLMCs (percent

establishments with JLMCs) has continued to increase from 1989 to 2004. For establishments of firms with 1,000-4,999 employees, the incidence remained around 65 percent during Japan's prolonged stagnation.

Figure 1, however, reveals the falling incidence of JLMCs among establishments of smaller firms. For instance, for establishments of medium-size firms with 300-999, 67 percent of establishments had standing JLMCs at the beginning of Japan's long stagnation and by the end of her great recession, only 43 percent of establishments had JLMCs.

In short, we find evidence pointing to a deeper divide between workers in large firms and the rest of the labor force. Employees working for larger firms in Japan are more likely to be provided with JLMCs than those working for smaller firms. This participation gap has widened during Japan's prolonged stagnation.

It is beyond the scope of this paper to pin down precisely what has been causing the deepening divide of the Japanese labor market during the Great Recession. Unfortunately, in the absence of panel data on the use of JLMCs by Japanese firms, it is at the moment impossible to know to what extent the declining incidence of JLMCs among establishments of small to medium size firms has been caused by the dismantling of existing JLMCs or by exiting of firms with JLMCs and entries of new firms without JLMCs. We suspect that the dismantling of existing JLMCs will be more difficult in unionized firms due to their resistance and that the termination of JLMCs would be easier in small to medium size firms that are mostly without union. It is assuring that the incidence of JLMCs, as shown in Figure 1, has remained quite high at around 80 percent for establishments of unionized firms.

The LMCS includes a couple of questions which shed light on changes in the scope and nature of existing JLMCs during Japan's prolonged stagnation. Figure 2 shows changes in

percent establishments with JLMCs, through which management regularly shares information on basic business strategies with labor from 1989 to 2004. For establishments of firms of all sizes, we find no evidence that basic business strategies have been eliminated from a list of regular agenda items for JLMCs. In fact, more establishments have been regularly sharing information on basic business strategies with labor. We produce similar figures for different agenda items (Figures 3-12). As shown in those figures, except for the introduction of new technology, we find similar results, or the lack of evidence for diminishing scope of information shared through JLMCs. For the introduction of new technology, there appears to be yet another evidence for deepening divide of the Japanese employment system, i.e., no change in the proportion of establishments with JLMCs, through which management regularly shares information on the introduction of new technology with labor for establishments of larger firms yet discernable fall for establishments of smaller firms.

On a number of specific agenda items, JLMCs sometimes go beyond information sharing and start functioning as a co-determination mechanism. Figure 13 presents changes in the proportion of establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on hiring and staffing. As shown in the Figure, we find no evidence that voice of employee representatives to JLMCs in establishments of larger firms has weakened on the issue of hiring and staffing whereas employee voice in establishments of smaller firms is found to be weakening on the hiring and staffing issue. Figures 14-19 show similar figures on different agenda items, and by and large confirm the bipolarization of the strength of employee voice in JLMCs between larger and smaller firms on other items.¹⁶

Aside from JLMCs and formal trade unions, many Japanese corporations have shop-floor

¹⁶ We focus on these seven items since very few JLMCs “co-determine” on the rest of the agenda items.

committees (SFCs) in which supervisors and employees on shop floor discuss issues such as shop-floor operations and shop-floor environments. Our own field research at J-Firm demonstrates vividly the nature and scope of SFCs. During SFC meetings at J-Firm, managers in charge of the shopfloor and union representatives for the shopfloor meet and discuss a variety of issues. First, management explains shopfloor production goals and labor representatives ask detailed questions about the goals. They will then jointly work out plans (especially staffing plans) to implement the goals. At the same time, SFC meetings are used to resolve shopfloor-level working condition issues, such as air-conditioning, smoking/non-smoking environment, bath rooms, taking paid vacation, cafeteria menu and so on.

Using published tables from the Labor-Management Communication Survey in 1989, 1994, 1999, and 2004, we produced Figure 20 which depicts changes in the incidence of SFCs from 1989 to 2004. As in the case of JLMCs, we again find some evidence for deepening divide of the Japanese labor market by firm size: the proportion of establishments with SFCs has been relatively stable (always above 70 percent) for establishments of firms with 5,000 or more employees whereas there is a clear downward trend in the proportion of establishments with SFCs for establishments of firms with fewer than 5,000 employees.

IV. Enduring Employee Stock Ownership Plans

Japanese ESOPs are perhaps best understood by comparing their main features with the better known U.S. ESOPs. Unlike U.S. ESOPs, Japanese corporations establishing an ESOP (called *mochikabukai*) do not receive any tax incentive to do so. To induce individual employees to participate in the ESOP, Japanese companies offer subsidies (typically with the firm matching each employee's contribution by giving 5 to 10% of the contribution as well as bearing ad-

ministrative costs). While ESOPs elsewhere frequently are structured so as to encourage strong participation by top management, in Japan, executives, as well as part time and temporary employees, are normally ineligible for membership. As is the norm elsewhere, individual participants' shares and dividends in the ESOP are held in a trust. Unusually, however, each participant has the right to withdraw his or her shares, and withdrawn shares are privately owned. Withdrawals are only permitted in 1,000 share, round lots. While members may freely exit completely from the ESOP, re-entry is restricted. Exiting employees will receive their shares in 1,000 share increments, and must sell the remaining shares to the trust at the prevailing market price. Upon retirement, model rules adopted by most ESOPs require retiring workers to exit completely from the ESOP. Finally, the general director (rijicho) represents stockholders in the ESOP. The general director is chosen by the plan's participants, on a one-participant, one-vote basis. At the general meeting of shareholders, the general director votes the stock held by the plan, deciding independently, rather than by tabulating votes of employee participants. The general director must be a participant in the ESOP and thus is not an executive (Jones and Kato, 1993 and 1995).

Since 1989, the Tokyo Stock Exchange (TSE) has been collecting data from all firms listed in TSE on their use of ESOPs. All TSE-listed firms, over 2,000 firms as of 2006 and including almost all major corporations in Japan, have been supplying such data to the TSE every year. As such, the TSE data provide the most accurate picture of the use of ESOPs by TSE-listed firms in Japan. Most importantly, to the best of my knowledge, this is the only source of data on Japanese ESOPs available for recent years.

Using the TSE data from 1989 through 2006, the most recent year available, I produced Figure 21. The figure confirms the rapid asset price deflation following the violent burst of the

financial bubble in the late 1980s and the subsequent prolonged recession that lasted until 2003. Thus, the real market value of outstanding shares owned by ESOPs, and the real value of the average stake fell sharply in the early 1990s, and recovery from this sharp drop was at best anemic till 2003.

A natural question concerning the responses of ESOPs to this seemingly powerful adverse financial shock is whether or not it discouraged employees from participating in ESOPs. The figure shows a surprisingly calm response by the labor force in firms with ESOPs to the burst of the financial bubble in the late 1980s and the subsequent long stagnation. Thus, the ESOP participation rate has been remarkably stable.

Consistent with the relatively calm response of employees, very few employers terminated their ESOPs in response to the adverse financial shock. Thus, as shown in Figure 21, the proportion of firms with ESOPs did not decline during Japan's Great Recession. Overall, it appears that neither employees nor employers have panicked in the face of the negative financial shock and the subsequent long recession. It appears as if such a calm response is paying off at last. For instance, in 2005 the average stake of ESOP participants finally recovered to the level of 1989, exceeding two million yen. In 2006, the average stake fell slightly yet still exceeded two million yen.

In short, neither hasty exit of employees from ESOPs nor the dismantling of ESOPs by employers took place during Japan's Great Recession. It is, however, still possible that a more subtle fine-tuning of the existing ESOP institutions might have occurred. To see if this is indeed the case, we were extremely fortunate that a large Japanese firm provided us with detailed internal data on their ESOP operation. This firm is a well-known manufacturing firm with sales of a few trillion yen, about one third of which is export sales, and employment of close to 40,000

workers. It is listed in the first section of Tokyo Stock Exchange.

This firm introduced its ESOP in 1971. The original objective of the ESOP was threefold: (i) enhancing the sense of participation and motivating employees; (ii) providing a source of retirement income; and (iii) acquiring a stable shareholder group. By the end of 1980, the ESOP participation rate reached one in four employees and their average monthly contribution reached 13,000 in 1995 yen. According to the Human Resources manager, there have been very few frenzied voluntary exits of employees from the trust and the ESOP is proving to be a stable shareholder.

However, there were a few subtle changes in the commitment of employees to the ESOP. First, as shown in Figure 22, in 1990, more than 1,000 continuing participants increased their monthly contributions whereas only 100 continuing participants reduced their monthly contributions. The ratio of the former to the latter number, called the “Commitment Ratio” was over 1000%. During Japan’s Great Recession, the number of ESOP participants who increased their monthly contributions has continued to decline, except for a brief recovery of 1996, and in 2000 reached all-time low of a little over 100. There was no sign of turn-around in 2001.

In contrast, the number of ESOP participants who decreased their monthly contributions increased in the early 1990s and has been fluctuating rather mildly ever since. Most importantly there is no comparable downward trend in the number of ESOP participants decreasing their contributions. As a result, the Commitment Ratio continued to fall, except for the brief recovery of 1996-1997, and in 2000 reached all time low of almost 70%. In other words, at the beginning of Japan’s Great Recession, there were ten times more employees increasing their monthly contributions to the ESOP than decreasing their contributions. After ten years of prolonged recession, there were actually fewer employees increasing their monthly contributions than

decreasing their contributions. There was no sign of clear turn-around in 2001.

Second, as shown in Figure 23, over 70% of new recruits of 1990 decided to participate in the ESOP. As Japan's Great Recession progressed, the figure continued to decline, again with a brief exception of 1996, and reached all time low of 11% in 2000, followed by evidence of a turn-around in 2001. It appears as if new recruits have become more careful about making commitments to the ESOP and hence this firm.

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Table 1 Ten-year job retention rates of regular employees: 1987-97 and 1992-2002

Age	Tenure	Ten-year job retention rate 87-97	Ten-year job retention rate 87-97	Changes in ten-year job retention rate
25-34	0-9	67.00%	63.00%	-4.00%
	10+	75.28%	63.68%	-11.60%
35-44	0-9	73.78%	53.90%	-19.88%
	10+	82.74%	76.60%	-6.14%
45-54	0-9	56.55%	41.06%	-15.49%
	10+	48.77%	45.87%	-2.90%

Source: Calculated from published and unpublished tables from the Employment Status Survey, 1987, 1992, 1997, and 2002.

Notes:

Regular Employees are defined as “Employees who work on a contract of no specific period of employment or of a specific period of more than a year, excluding executives.”

Table 2 Percentage of firms with weakened seniority wage systems: 1996, 1999, 2004 and 2007

	abolish automatic pay raise	expand part of pay that is determined by the content of tasks and jobs	expand part of pay that is determined by ability to carry out jobs	expand part of pay that is determined by outcome and performance
1996	3.8	12.1	15.7	15
1999	10.5	11.3	15.8	15.5
2004	N/A	15.5	17.6	20.7
2007	7.1	23.3	22.1	23.7

Source: General Survey on Working Conditions(Former “General Survey on Wages and Working Hours System”), 1996, 1999, 2004 and 2007

Figure 1 Changes in percent Establishments with JLMCs in 1988, 1994, 1999 and 2004

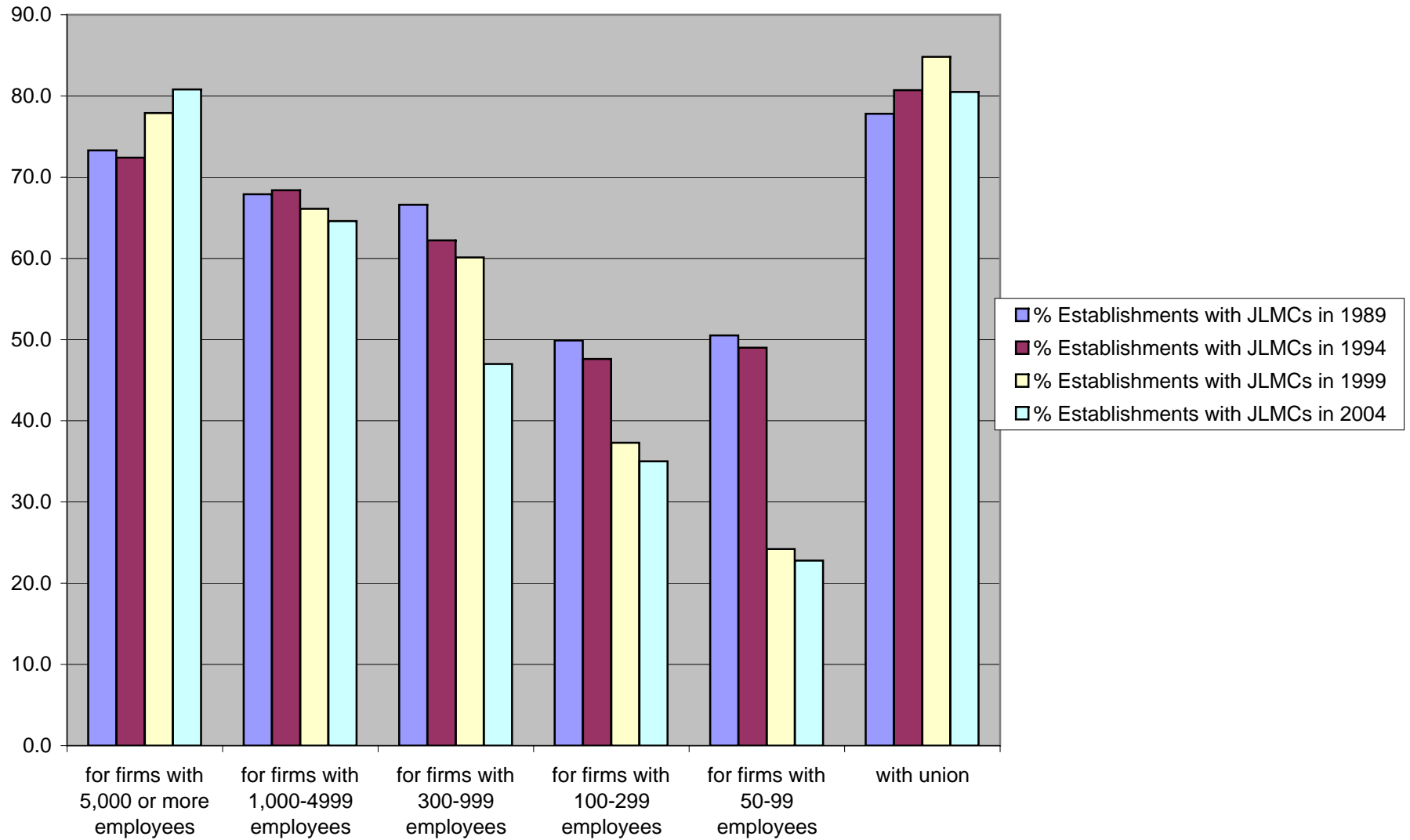


Figure 2 Changes in percent establishments with JLMCs, through which management shares information on *basic business strategies* with labor

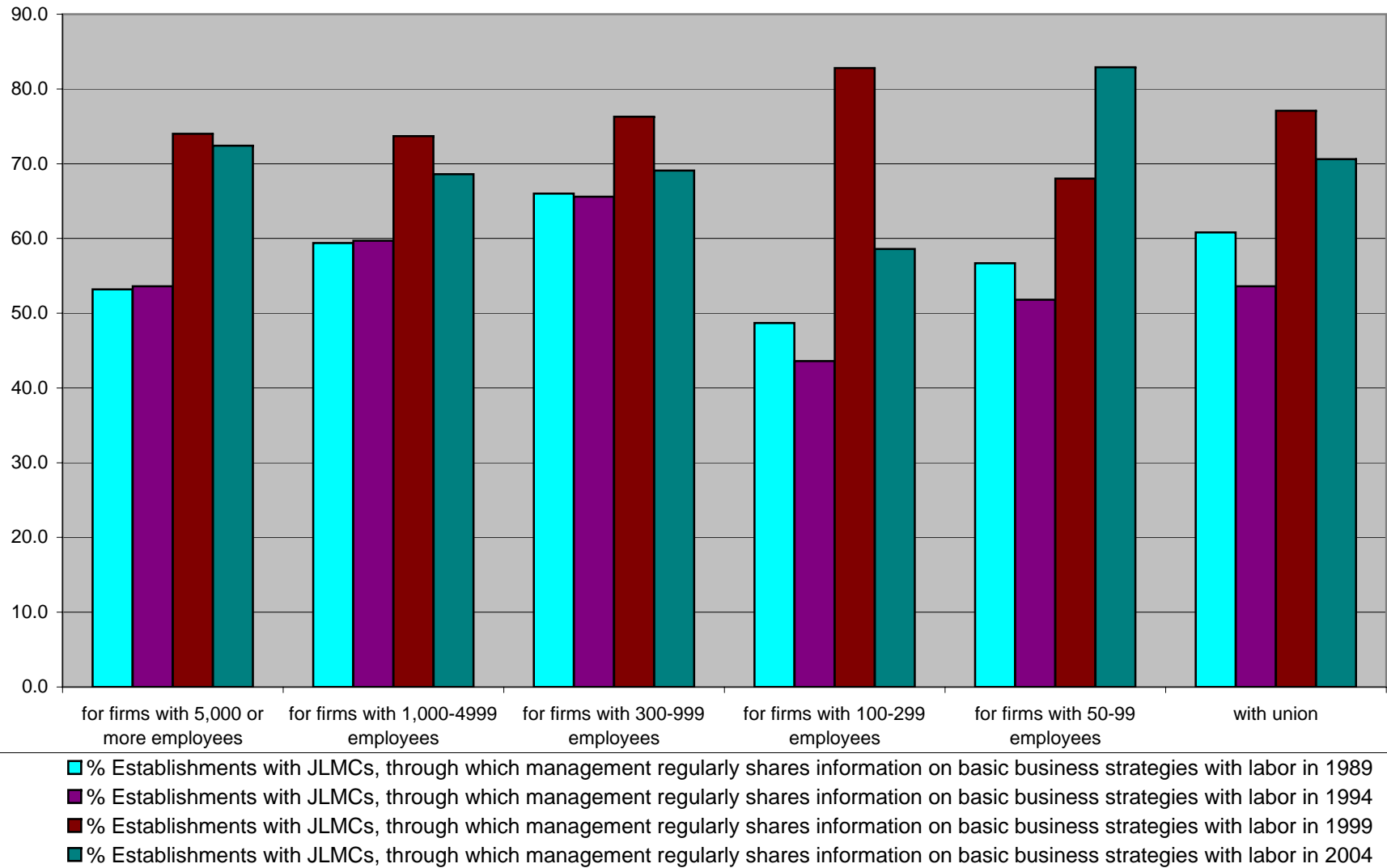
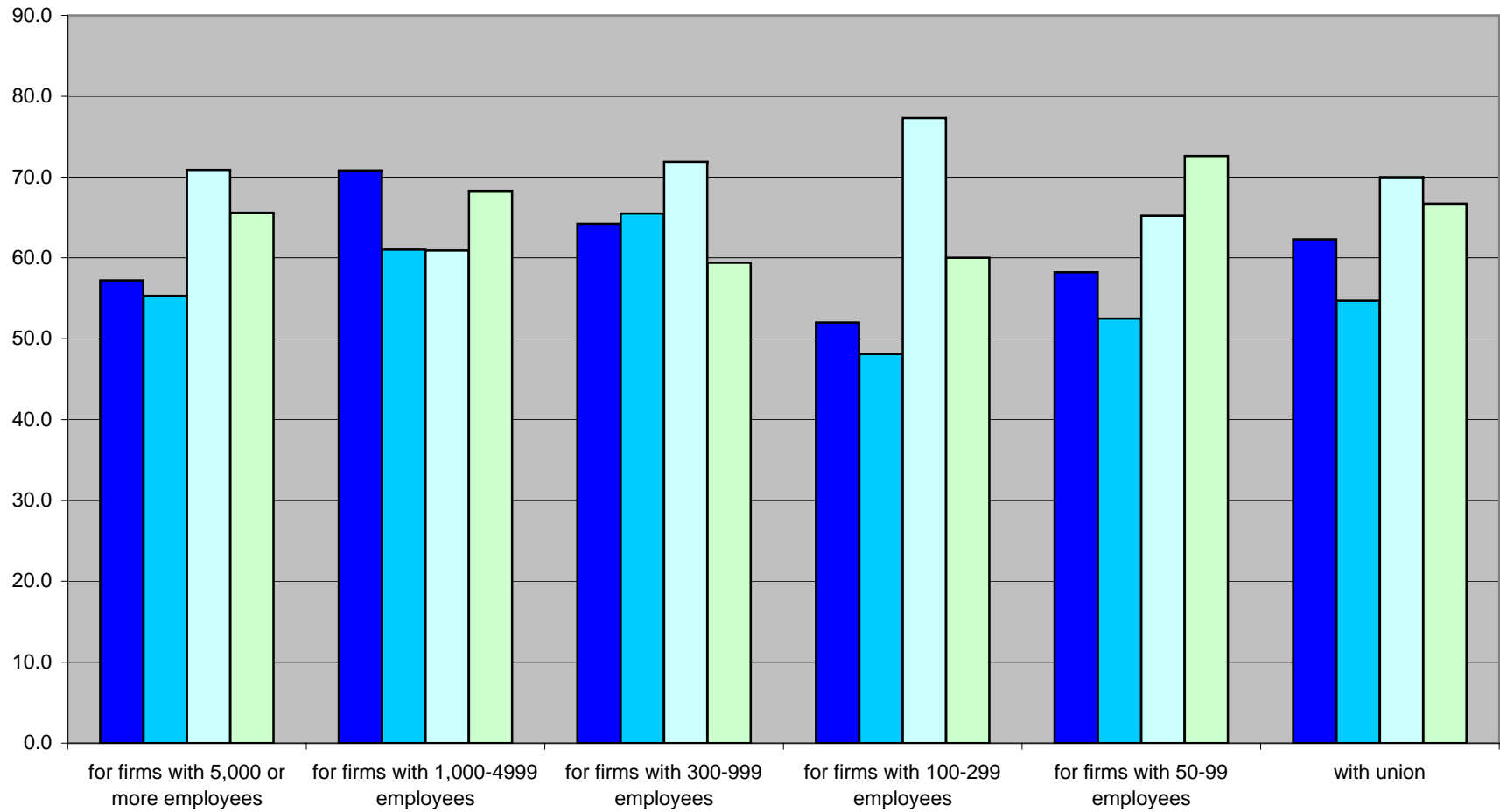
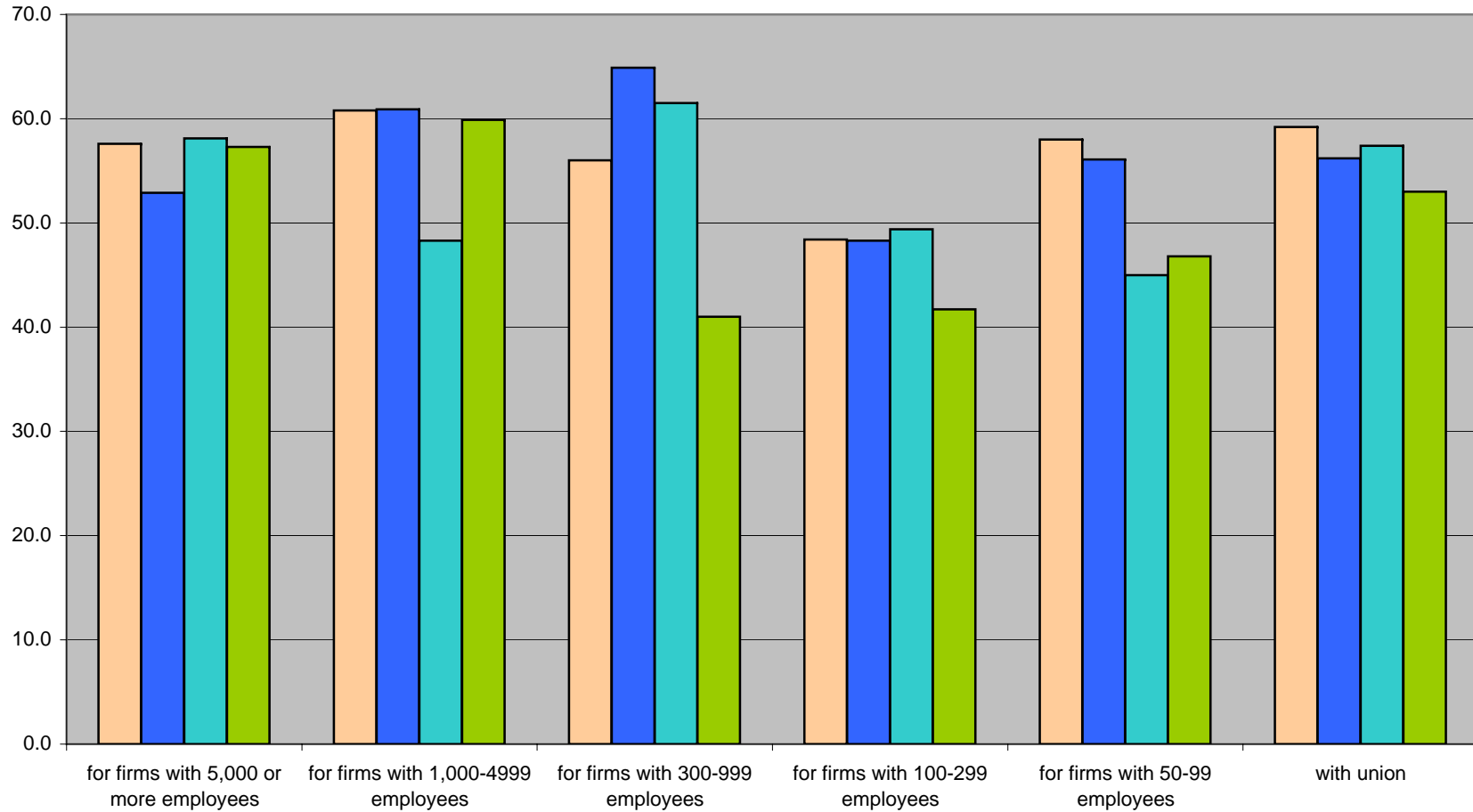


Figure 3 Changes in percent establishments with JLMCs, through which management shares information on *sales and production plans* with labor



- % Establishments with JLMCs, through which management regularly shares information on sales and production plans with labor in 1989
- % Establishments with JLMCs, through which management regularly shares information on sales and production plans with labor in 1994
- % Establishments with JLMCs, through which management regularly shares information on sales and production plans with labor in 1999
- % Establishments with JLMCs, through which management regularly shares information on sales and production plans with labor in 2004

Figure 4 Changes in percent establishments with JLMCs, through which management shares information on *introduction of new technology* with labor



- % Establishments with JLMCs, through which management regularly shares information on introduction of new technology with labor in 1989
- % Establishments with JLMCs, through which management regularly shares information on introduction of new technology with labor in 1994
- % Establishments with JLMCs, through which management regularly shares information on introduction of new technology with labor in 1999
- % Establishments with JLMCs, through which management regularly shares information on introduction of new technology with labor in 2004

Figure 5 Changes in percent establishments with JLMCs, through which management shares information on *hiring and staffing* with labor

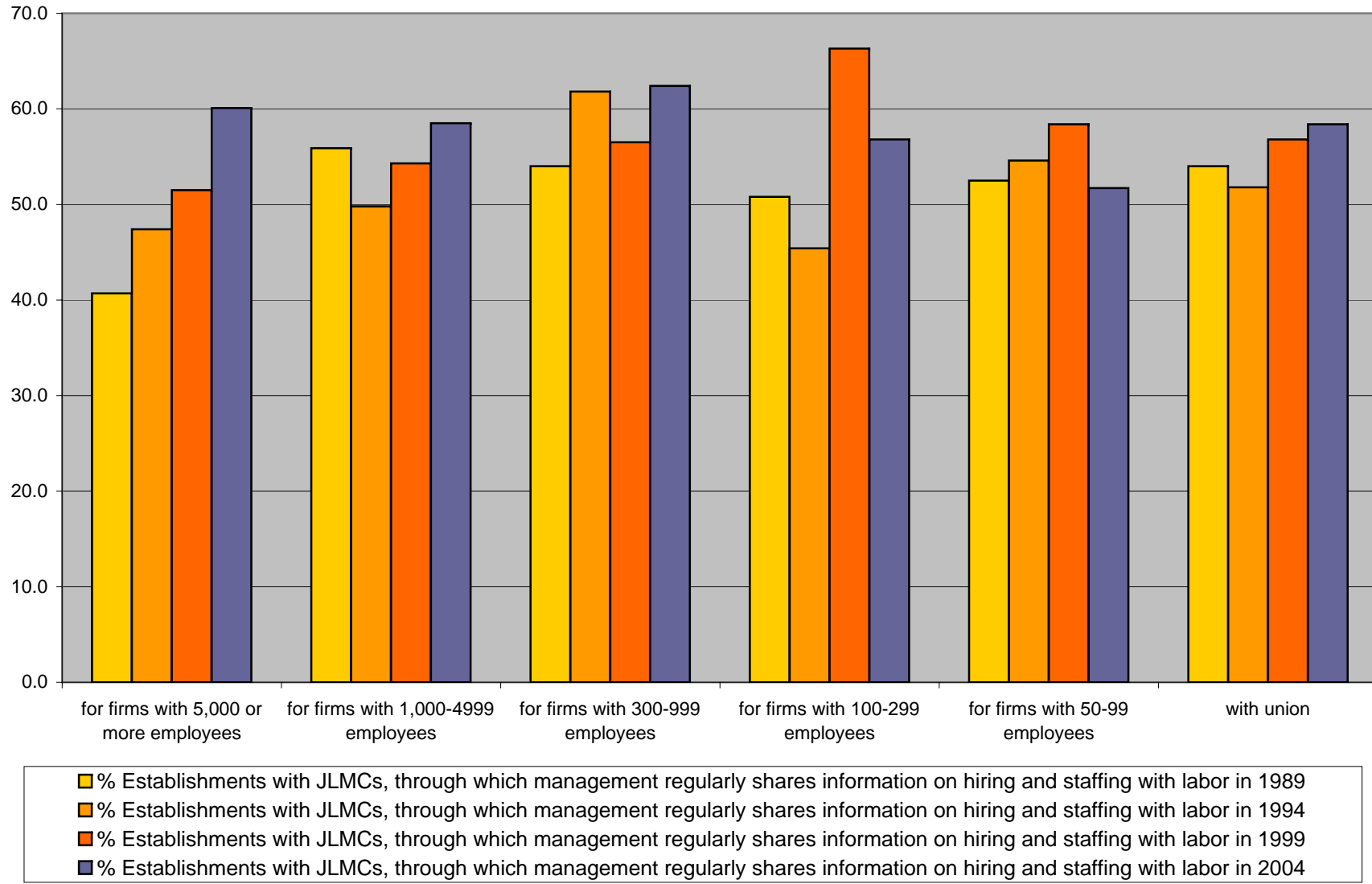
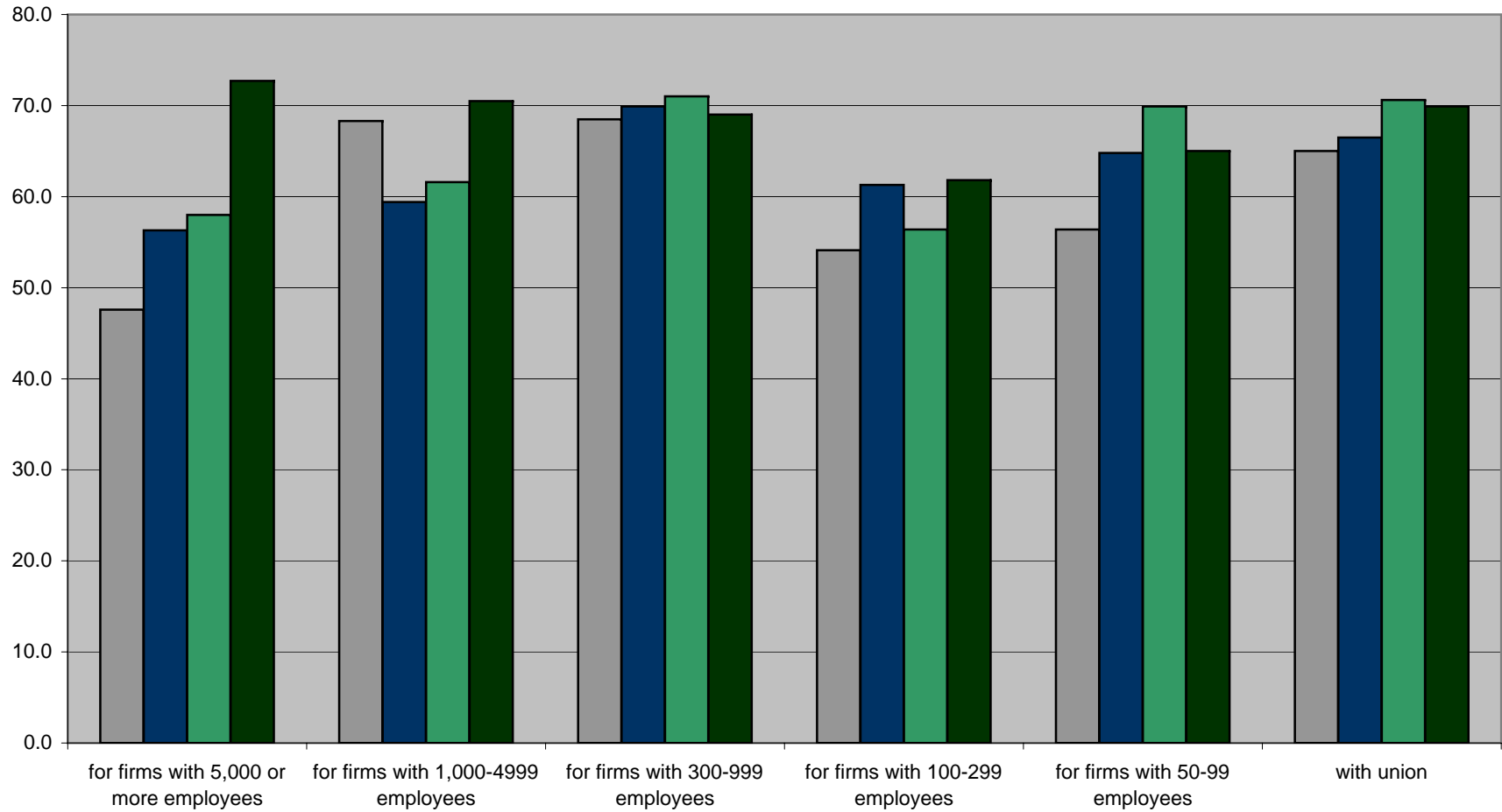
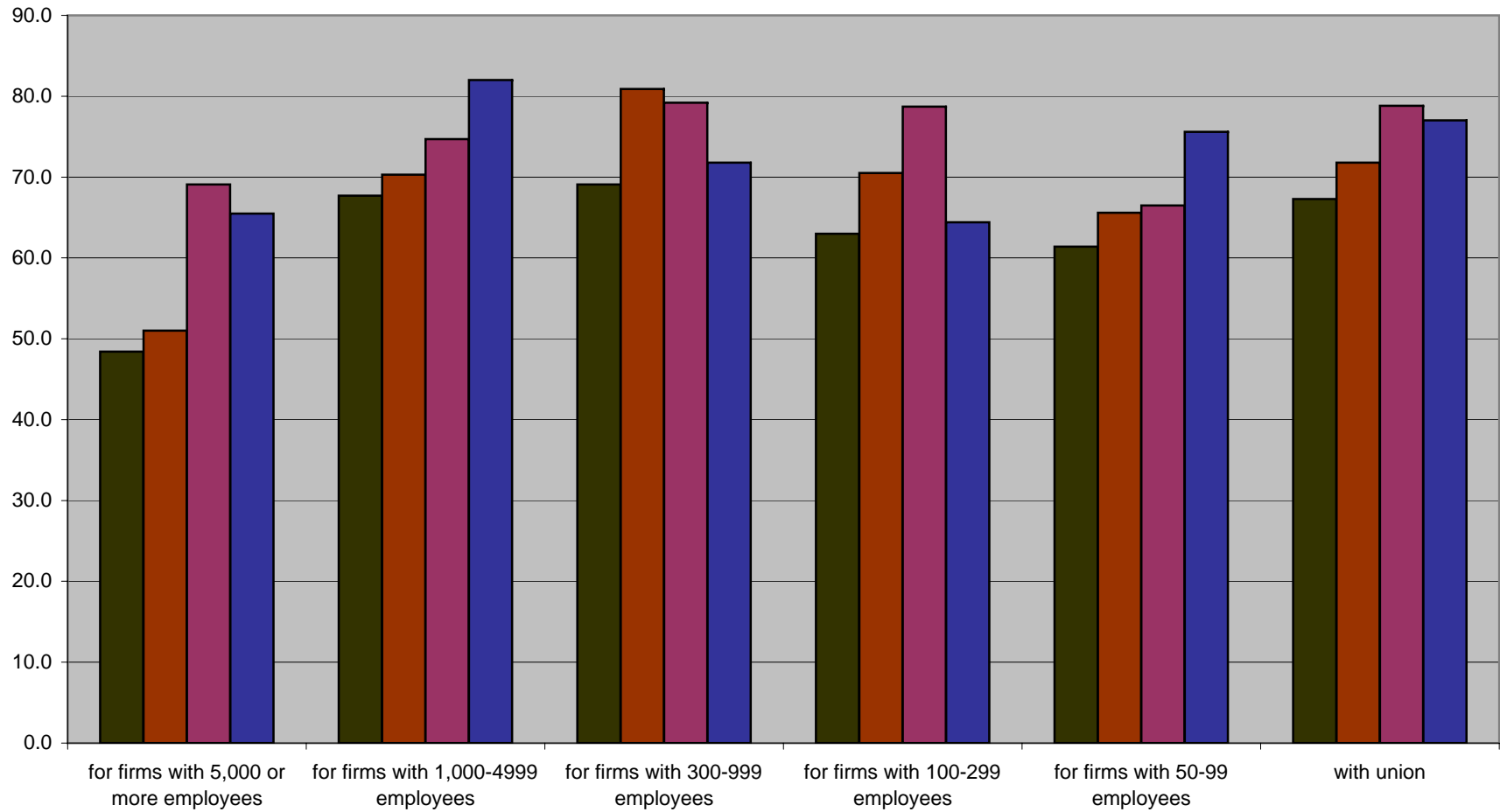


Figure 6 Changes in percent establishments with JLMCs, through which management shares information on *transfer of employees* with labor



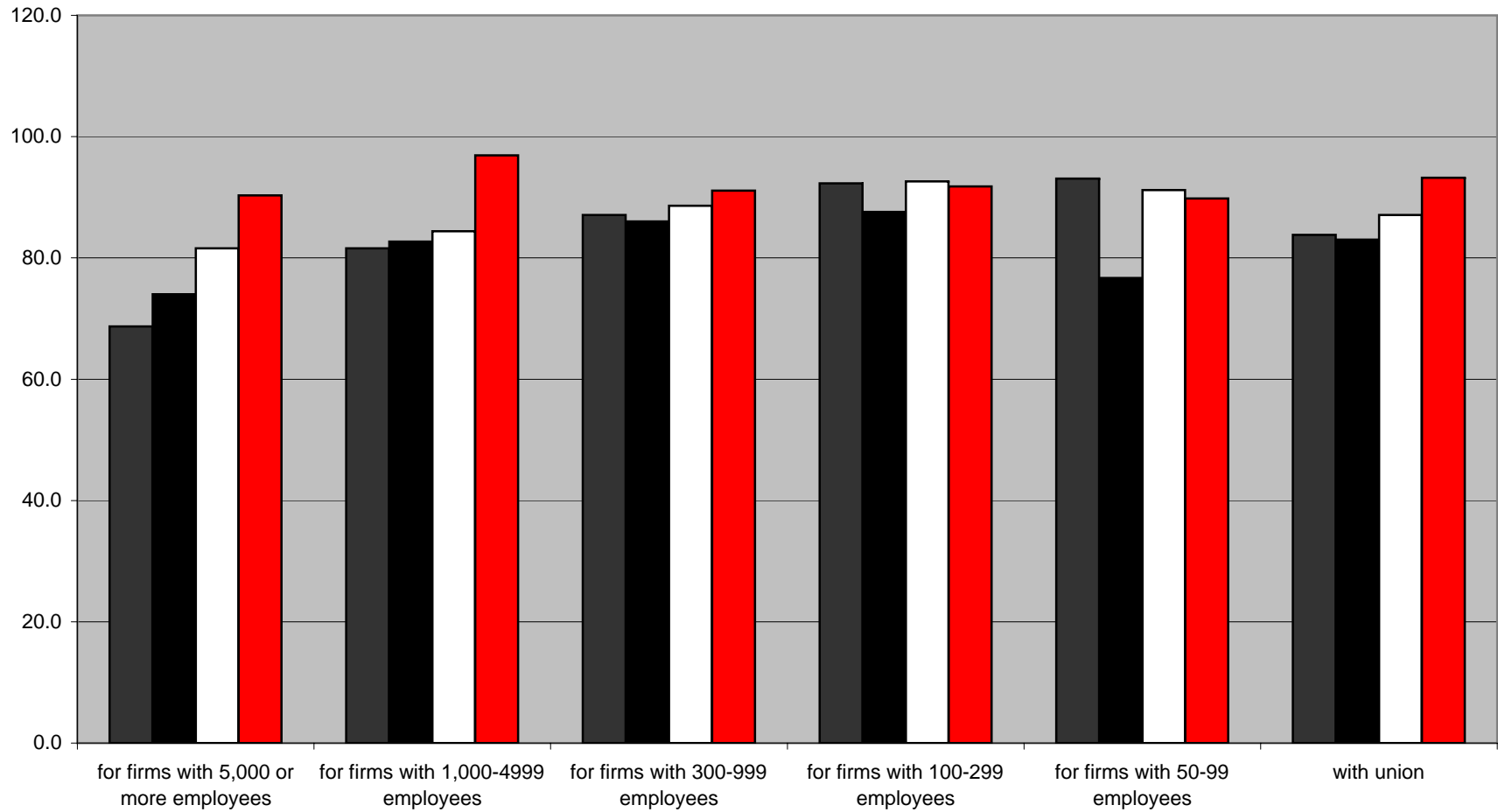
■ % Establishments with JLMCs, through which management regularly shares information on transfer of employees with labor in 1989
 ■ % Establishments with JLMCs, through which management regularly shares information on transfer of employees with labor in 1994
 ■ % Establishments with JLMCs, through which management regularly shares information on transfer of employees with labor in 1999
 ■ % Establishments with JLMCs, through which management regularly shares information on transfer of employees with labor in 2004

Figure 7 Changes in percent establishments with JLMCs, through which management shares information on *layoff* with labor



■ % Establishments with JLMCs, through which management regularly shares information on layoff with labor in 1989
■ % Establishments with JLMCs, through which management regularly shares information on layoff with labor in 1994
■ % Establishments with JLMCs, through which management regularly shares information on layoff with labor in 1999
■ % Establishments with JLMCs, through which management regularly shares information on layoff with labor in 2004

Figure 8 Changes in percent establishments with JLMCs, through which management shares information on *hours/holidays* with labor



■ % Establishments with JLMCs, through which management regularly shares information on hours/holidays with labor in 1989
 ■ % Establishments with JLMCs, through which management regularly shares information on hours/holidays with labor in 1994
 □ % Establishments with JLMCs, through which management regularly shares information on hours/holidays with labor in 1999
 ■ % Establishments with JLMCs, through which management regularly shares information on hours/holidays with labor in 2004

Figure 9 Changes in percent establishments with JLMCs, through which management shares information on *mandatory retirement* with labor

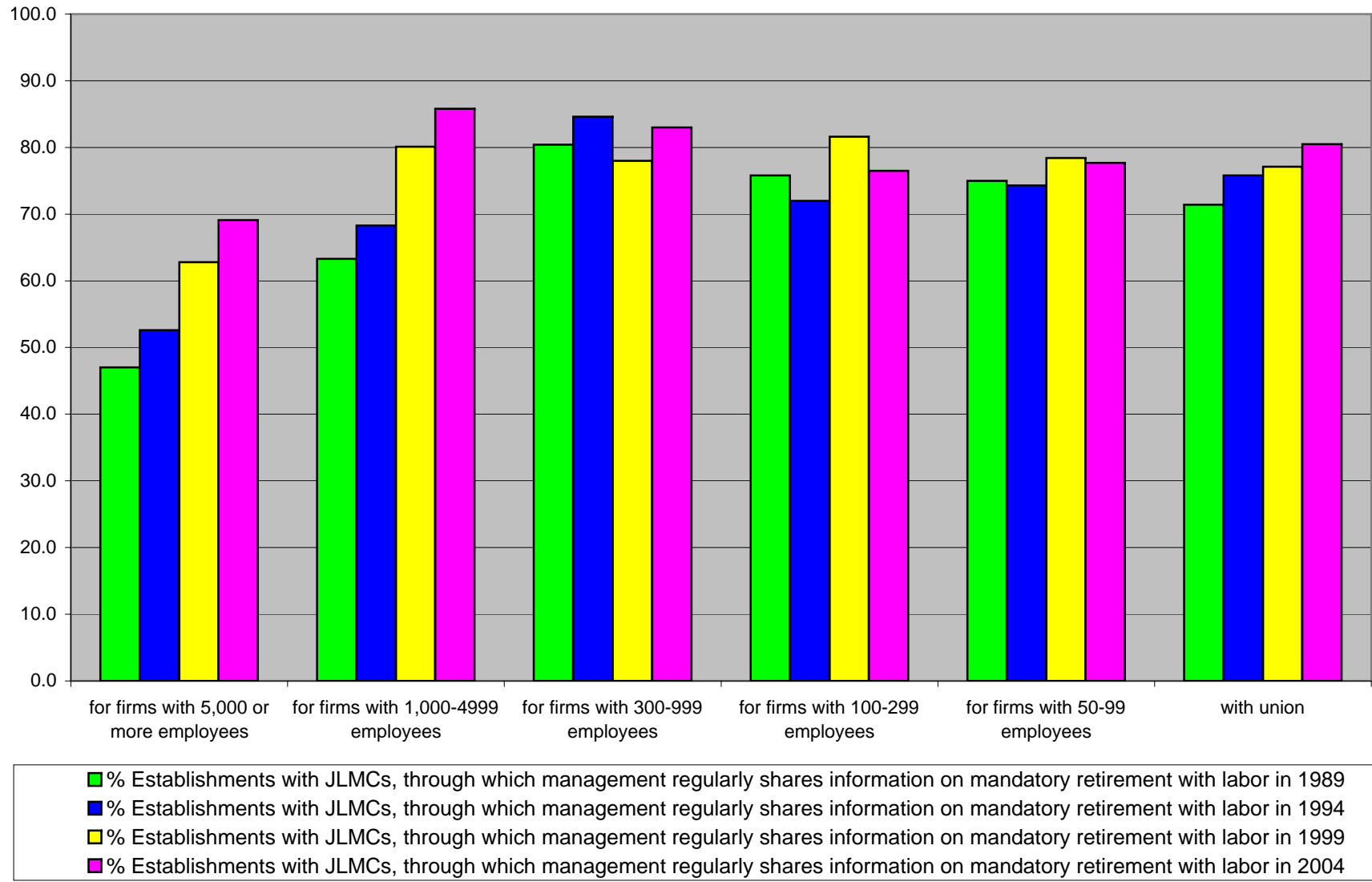
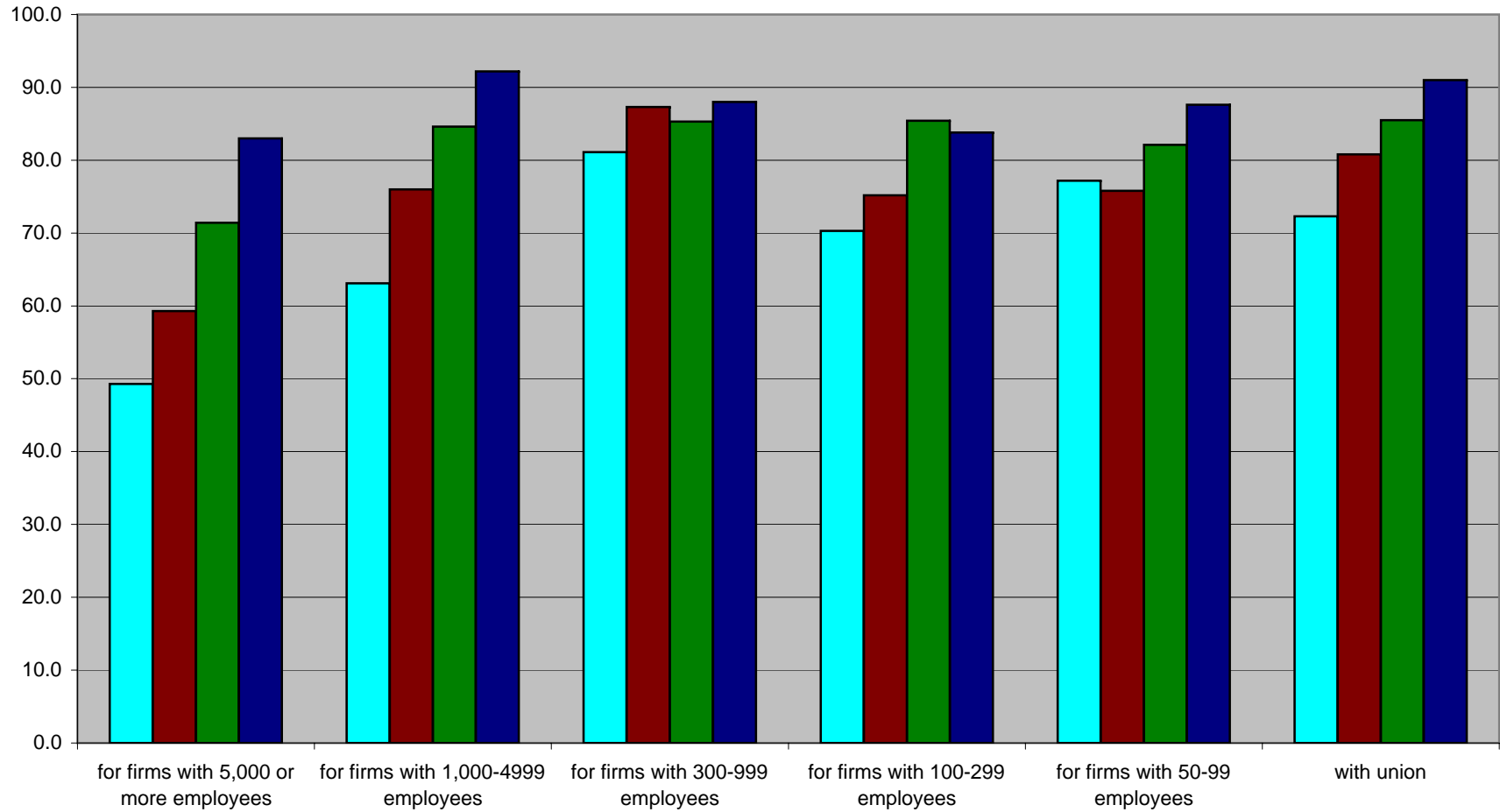
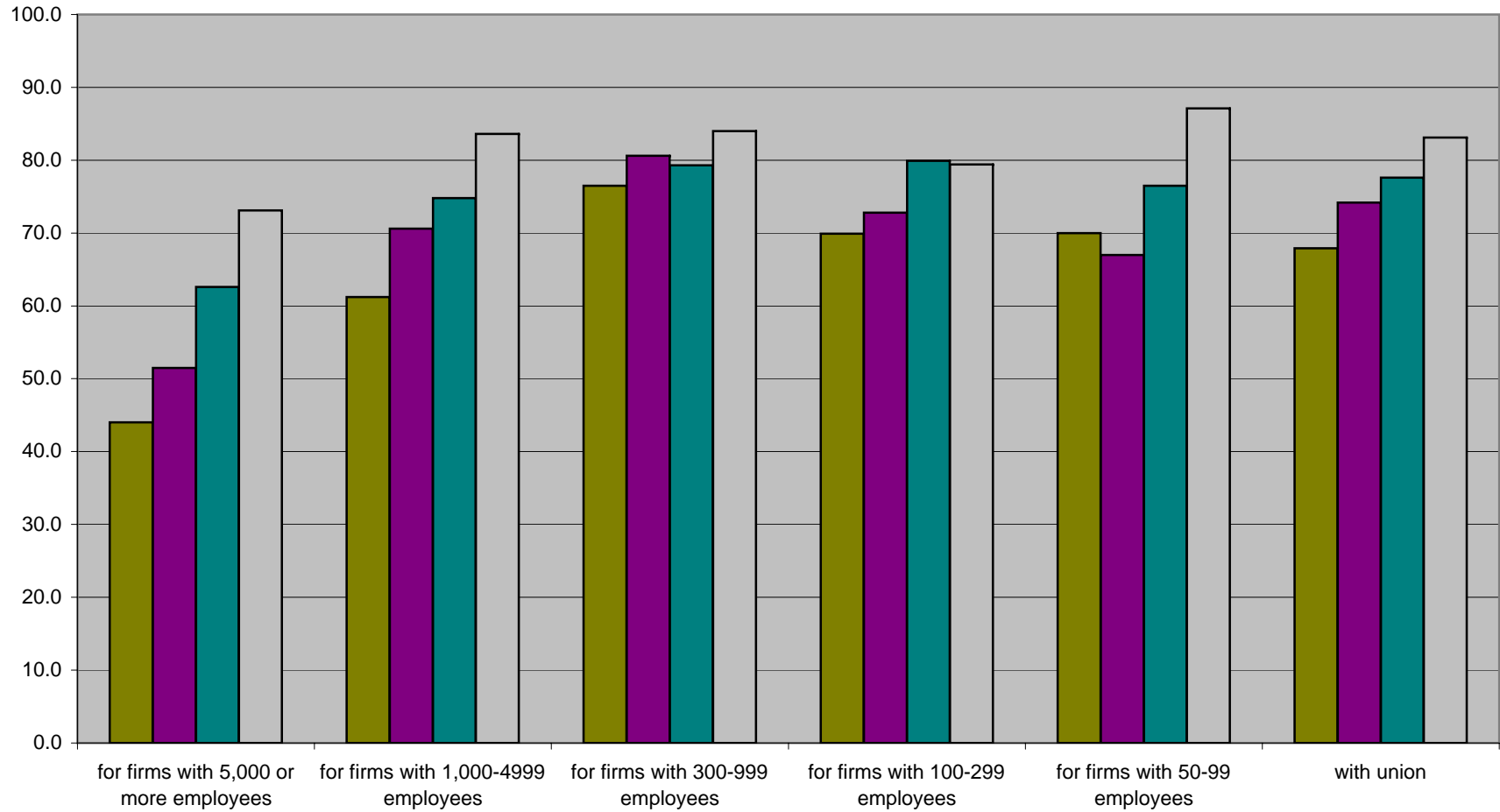


Figure 10 Changes in percent establishments with JLMCs, through which management shares information on *wage and bonus* with labor



- % Establishments with JLMCs, through which management regularly shares information on wage and bonus with labor in 1989
- % Establishments with JLMCs, through which management regularly shares information on wage and bonus with labor in 1994
- % Establishments with JLMCs, through which management regularly shares information on wage and bonus with labor in 1999
- % Establishments with JLMCs, through which management regularly shares information on wage and bonus with labor in 2004

Figure 11 Changes in percent establishments with JLMCs, through which management shares information on *severance pay/pension* with labor



■ % Establishments with JLMCs, through which management regularly shares information on severance pay/pension with labor in 1989
■ % Establishments with JLMCs, through which management regularly shares information on severance pay/pension with labor in 1994
■ % Establishments with JLMCs, through which management regularly shares information on severance pay/pension with labor in 1999
■ % Establishments with JLMCs, through which management regularly shares information on severance pay/pension with labor in 2004

Figure 12 Changes in percent establishments with JLMCs, through which management shares information on **education/training** with labor

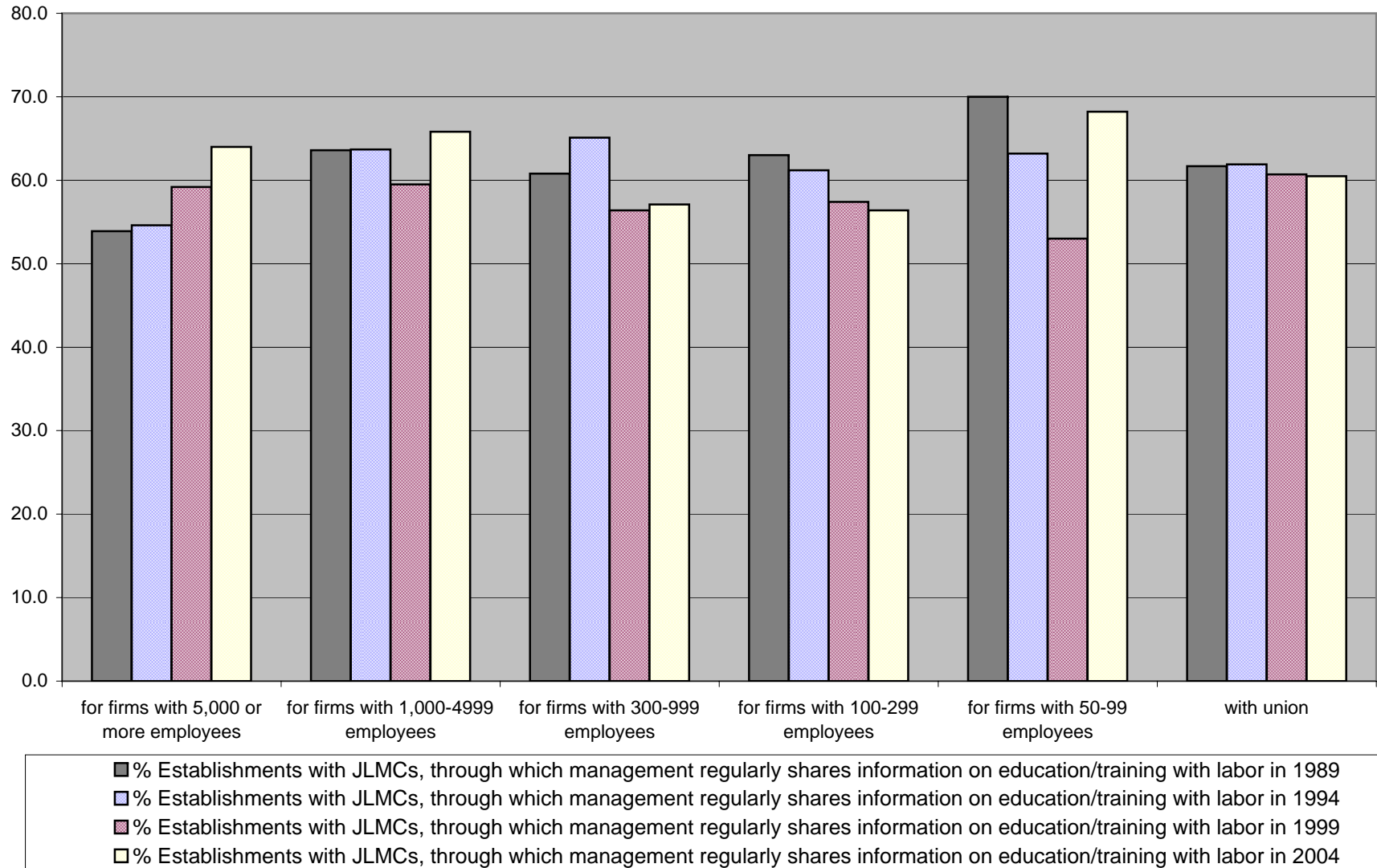
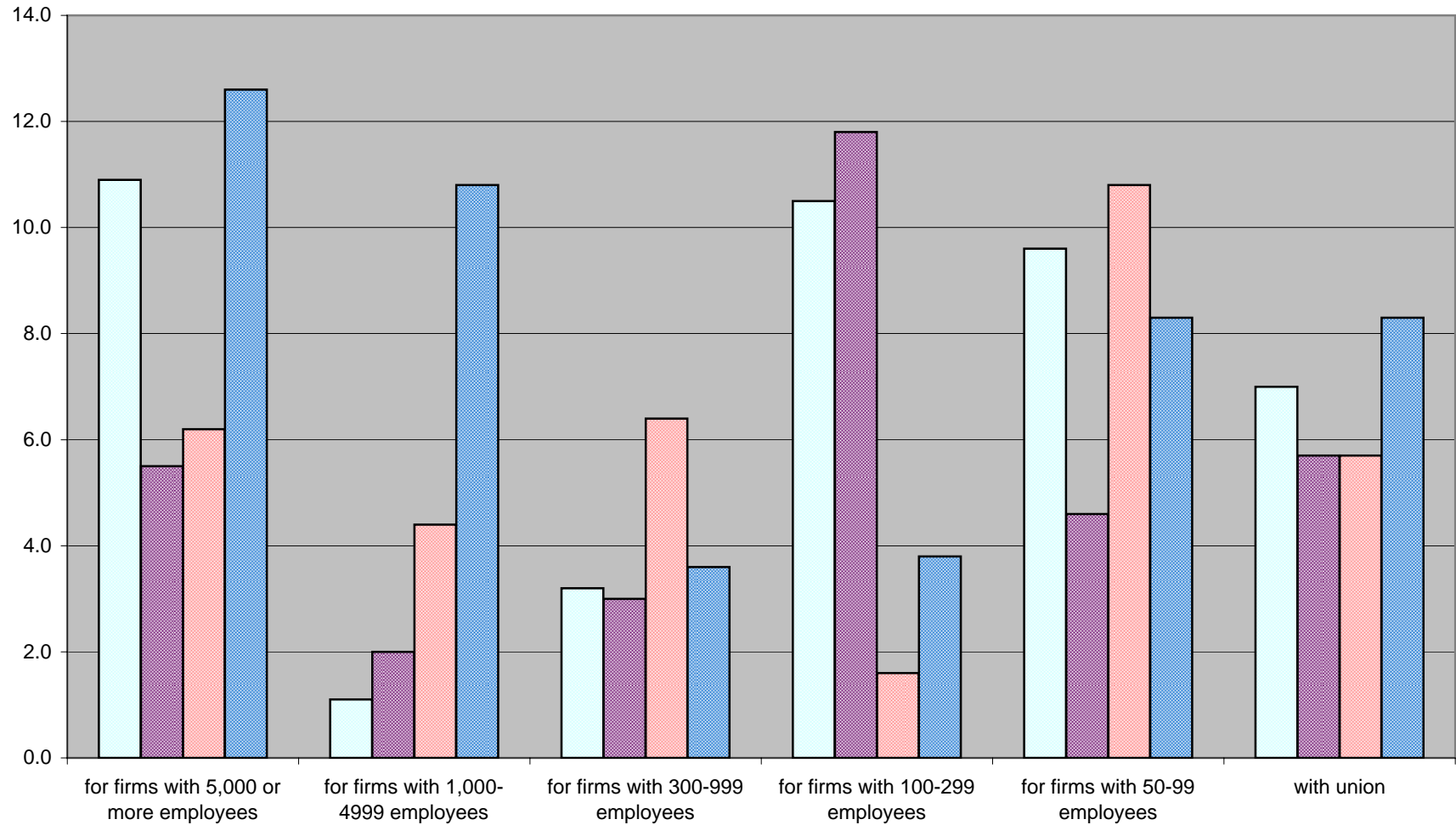


Figure 13 Changes in percent establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on **hiring and staffing**



■ % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on hiring and staffing in 1989
■ % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on hiring and staffing in 1994
■ % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on hiring and staffing in 1999
■ % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on hiring and staffing in 2004

Figure 14 Changes in percent establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on *transfer of employees*

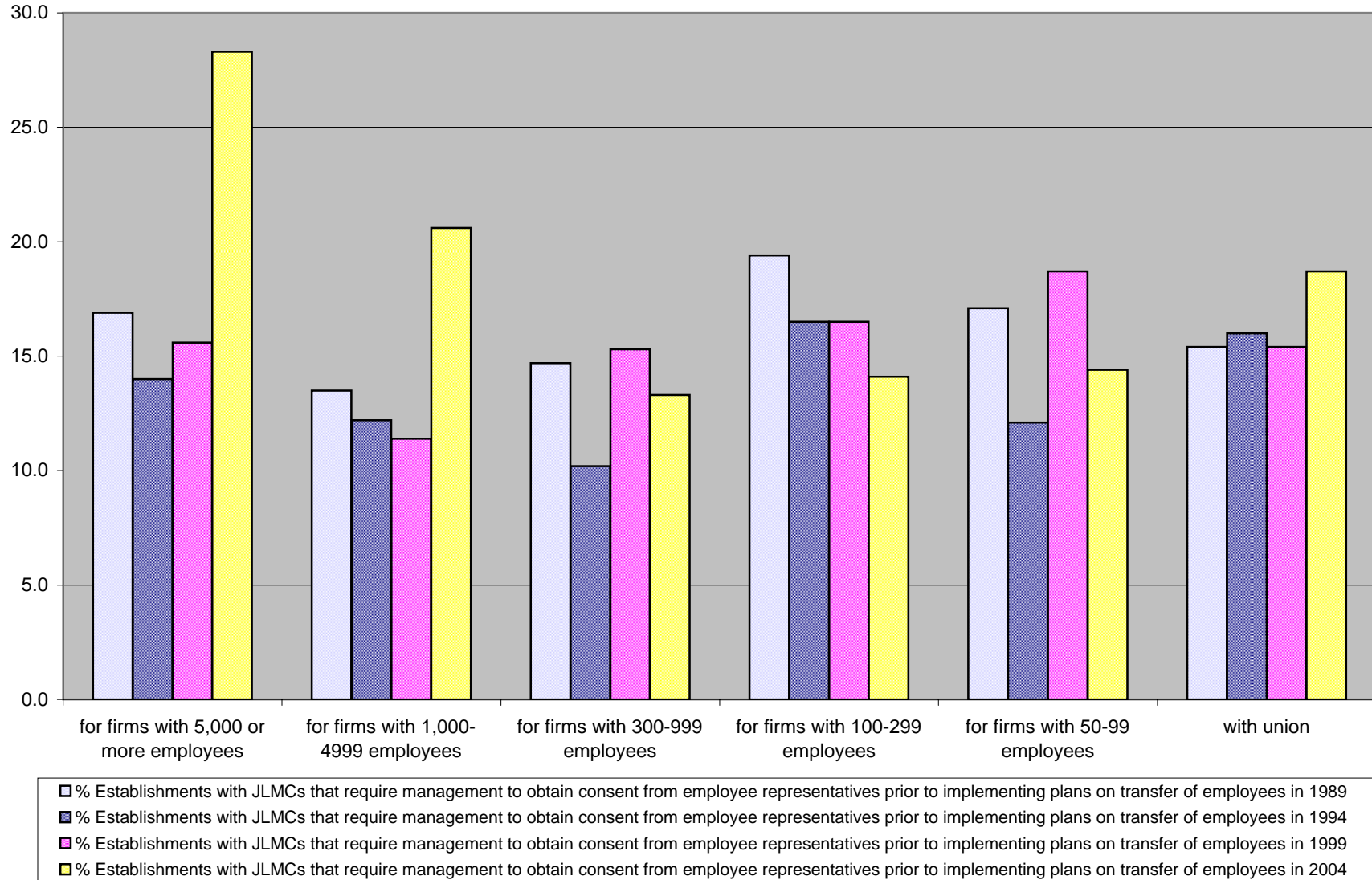


Figure 15 Changes in percent establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on *layoff*

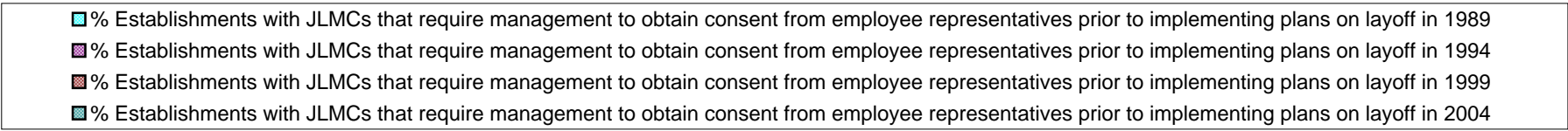
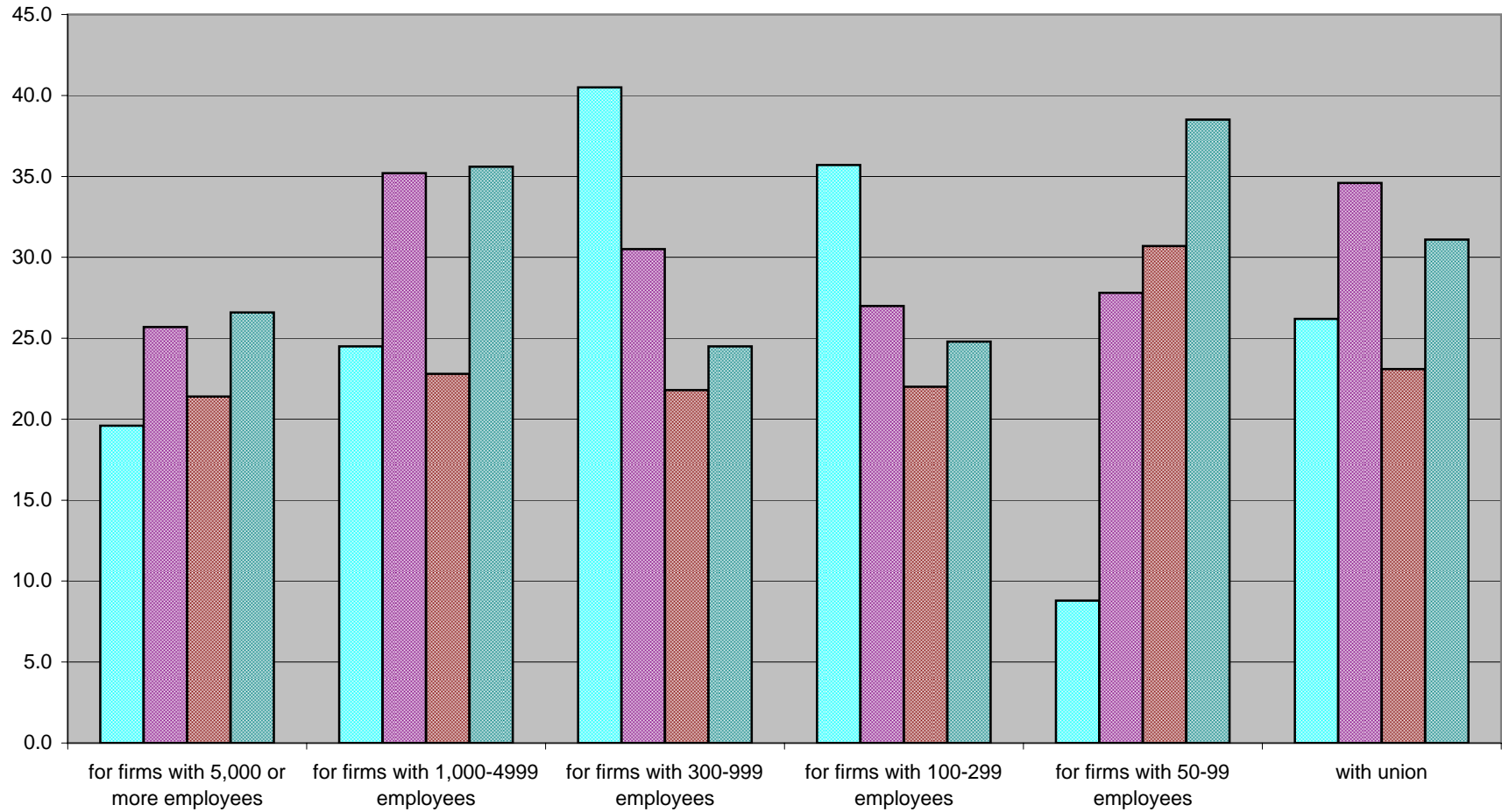
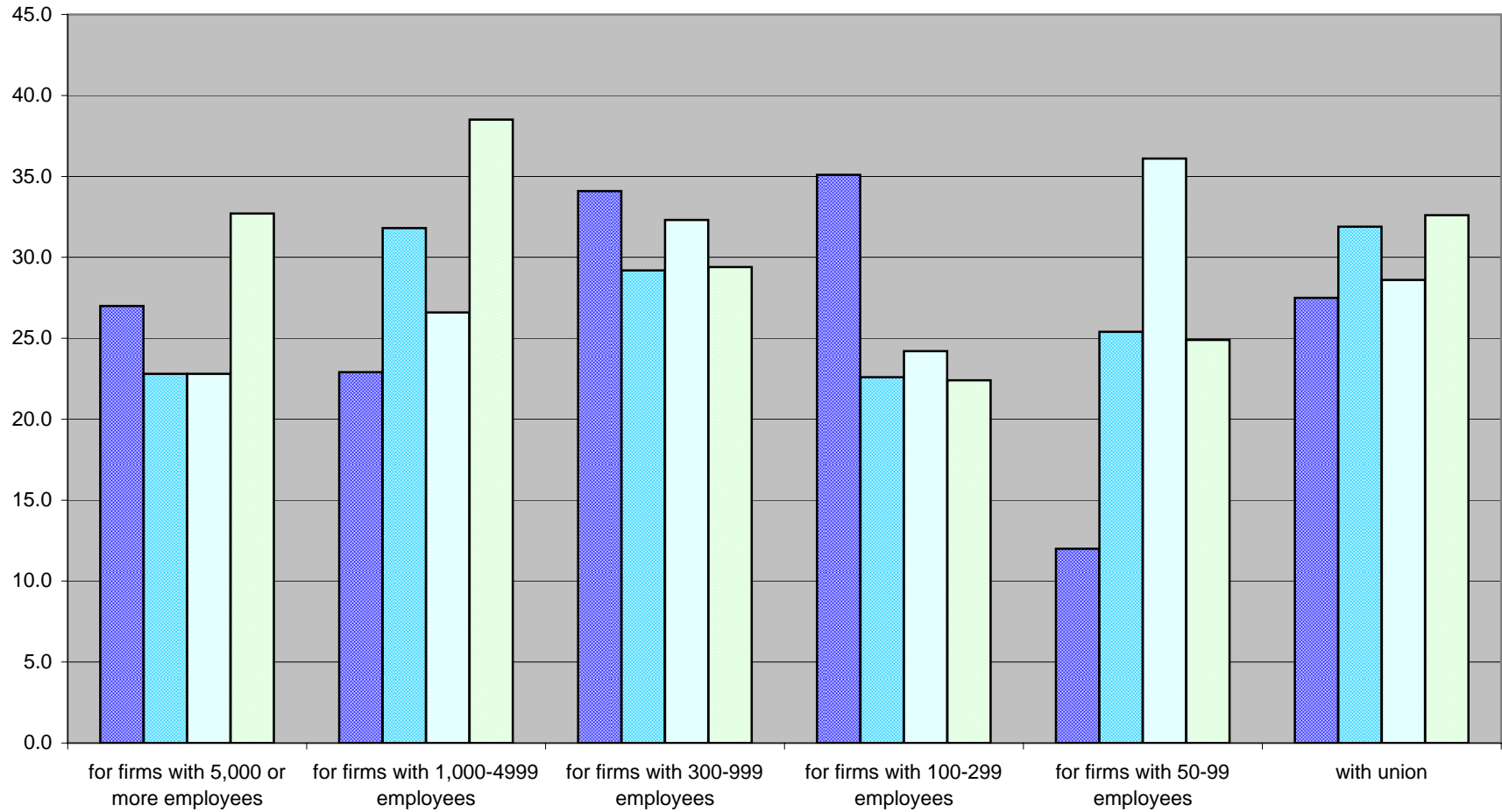
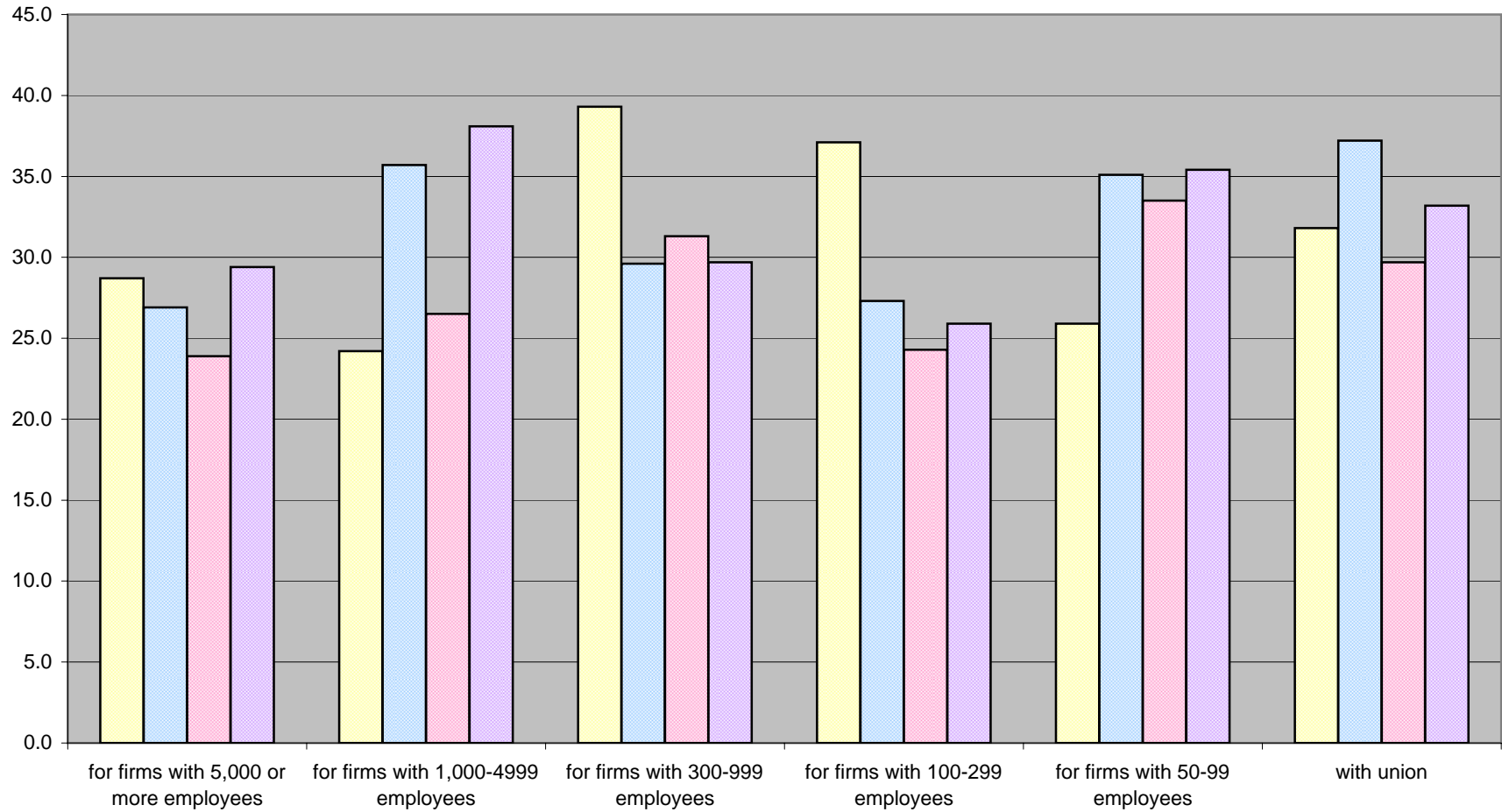


Figure 16 Changes in percent establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on *hours/holidays*



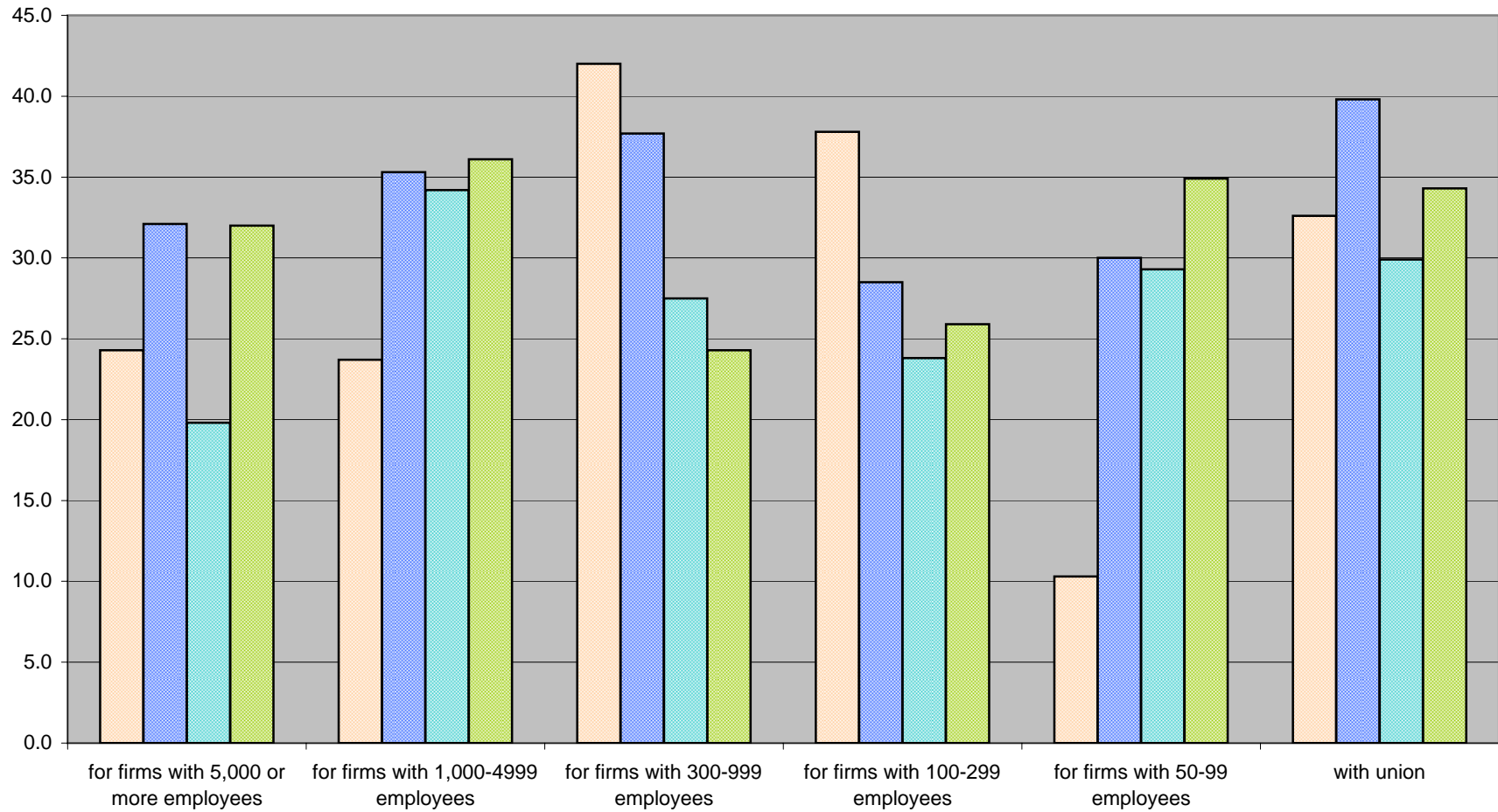
- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on hours/holidays in 1989
- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on hours/holidays in 1994
- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on hours/holidays in 1999
- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on hours/holidays in 2004

Figure 17 Changes in percent establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on **Mandatory Retirement**



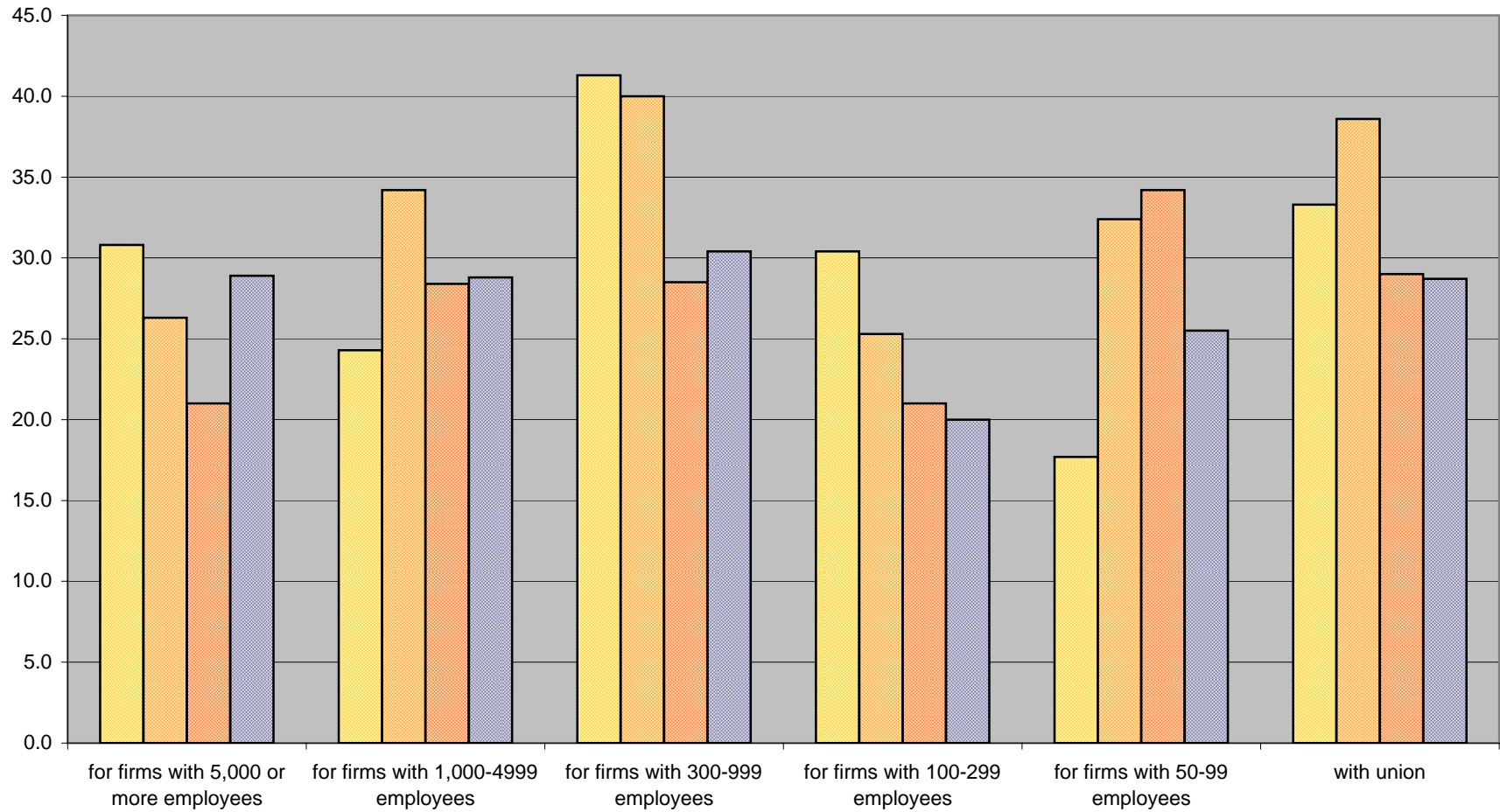
- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on mandatory retirement in 1989
- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on mandatory retirement in 1994
- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on mandatory retirement in 1999
- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on mandatory retirement in 2004

Figure 18 Changes in percent establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on **wage and bonus**



- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on wage and bonus in 1989
- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on wage and bonus in 1994
- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on wage and bonus in 1999
- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on wage and bonus in 2004

Figure 19 Changes in percent establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on **severance pay/pension**



- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on severance pay/pension in 1989
- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on severance pay/pension in 1994
- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on severance pay/pension in 1999
- % Establishments with JLMCs that require management to obtain consent from employee representatives prior to implementing plans on severance pay/pension in 2004

Figure 20 Percent Establishments with SFCs in 1988, 1994, 1999 and 2004

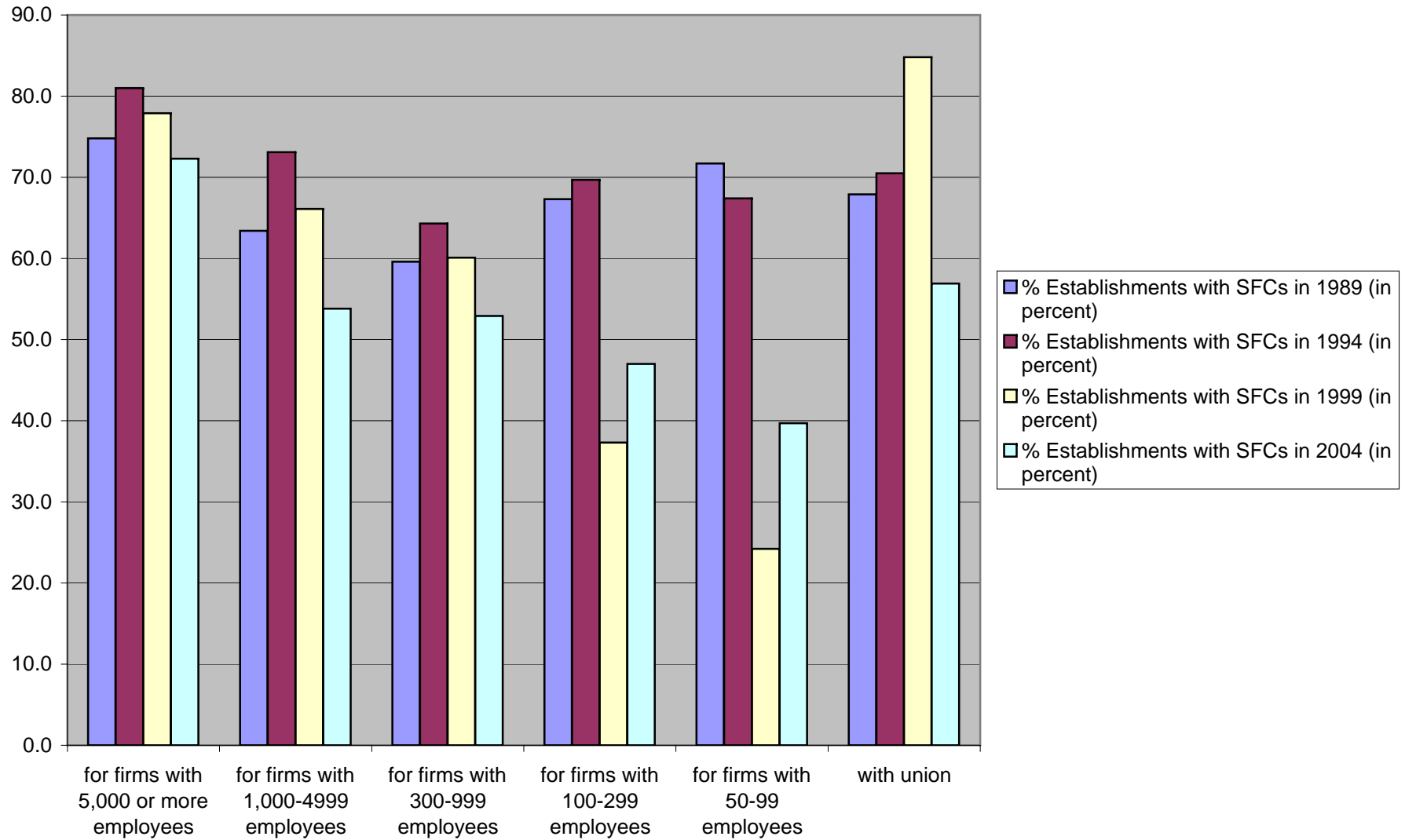


Figure 21 Japanese ESOPs from 1989-2006: TSE-listed Firms

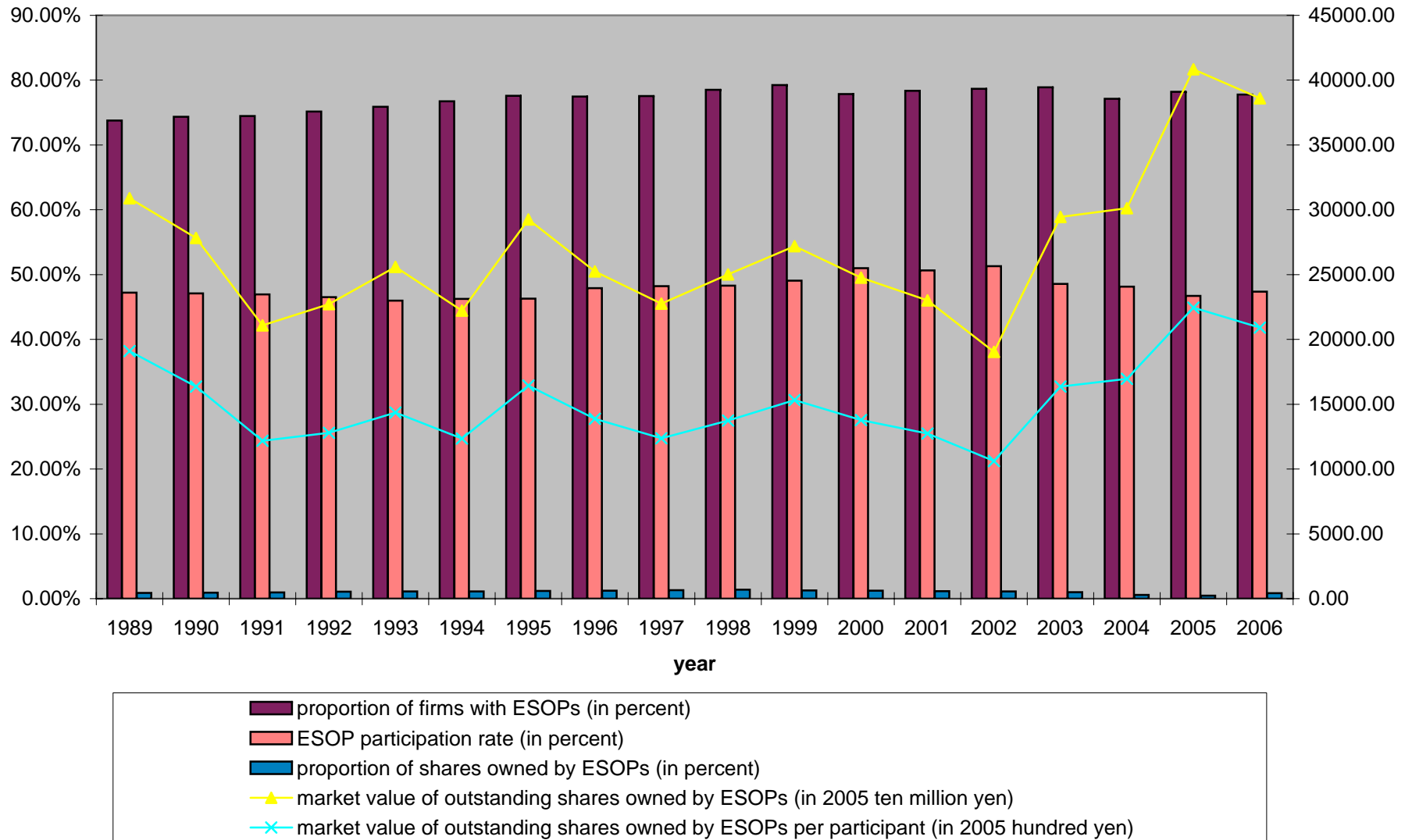


Figure 22 Participants Who Decreased and Increased Contributions: JFIRM

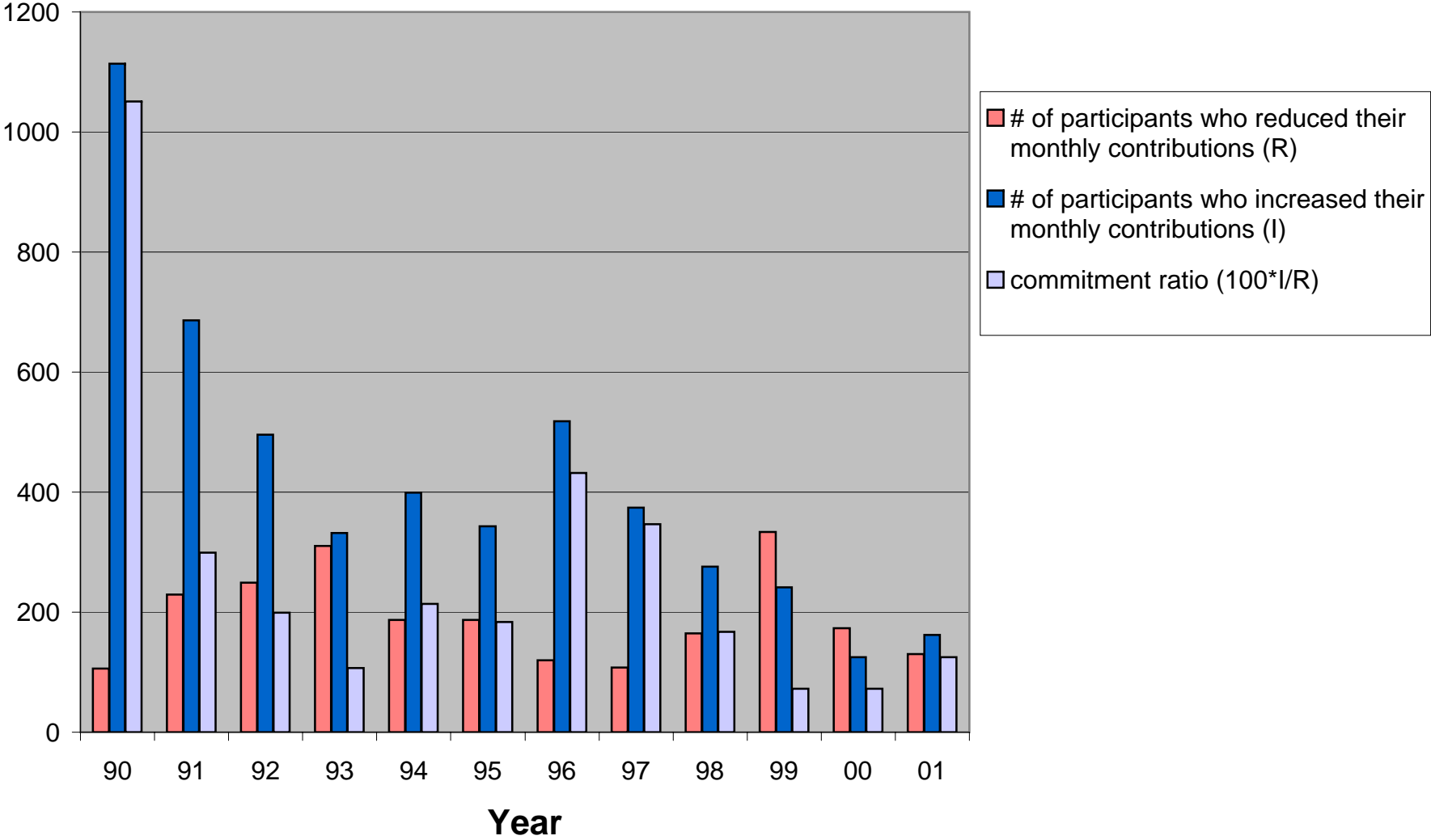


Figure 23 Changes in New Participants: JFIRM

