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By Leonard Schoppa

In January the leaders of two great automobile companies made separate appearances before the media of their respective countries to demonstrate how Japanese- and American-style capitalism continue to differ.

In the United States, Bill Ford, the chairman and chief executive of the automobile company that bears his family name, announced that his firm is embarking on a recovery plan that involves laying off 30,000 workers over the next six years, many of them in the next twelve months. The latest cuts bring the total announced job cuts of the Big Three auto firms over the past five years to 140,000—one-third of their former workforce.

In Japan, Okuda Hiroshi, the former chairman of Toyota Motor Company who is retiring as the head of Nippon Keidanren, the big business federation, stepped before the microphones with a very different take on how jobs are connected to corporate recovery. Rather than extolling the virtues of layoffs and restructuring, he marked the occasion of his departure from the post of Keidanren chair by attributing the recent recovery of the nation's economy to Japanese firms' reluctance to lay off workers, even during times of sluggish earnings. News reports added that the incoming Keidanren chief, Mitarai Fujio, was just as committed to "lifetime employment" as Mr. Okuda.

The juxtaposition of these two episodes raises important questions about how much Japanese-style capitalism has changed after a decade and a half of stagnant growth, banking crises, and "restructuring" (the katakana term resutora indicates that it remains a foreign concept). The conventional wisdom is that much has changed. Japanese firms have adopted many features of Anglo-American style profit-maximizing management and regularly issue statements extolling their growing return on equity. Firms have announced restructuring plans that involve large reductions in the size of corporate workforces, middle-aged workers have actually been laid off in a few troubled sectors like finance, and many workers report much greater anxiety about job security than in the past.

These developments in the Japanese economy have often been presented as evidence that globalization is propelling a worldwide "race to the bottom" that is forcing nations like Japan, the United States and Germany to abandon systems of social protection, such as lifetime employment and welfare states, that get in the way of the market. In these stories, the villains (or heroes, depending on your perspective) are corporations. Prioritizing profits over people, they move production across borders to places where they can operate most cheaply, using their leverage to extract wage and benefit concessions back home and forcing governments to relax regulations, liberalize labor markets, and appease employers.

If all of this is true, what are we to make of Okuda's defense of lifetime employment? Is he simply offering false praise of a system that no longer exists? Or do core elements of the old Japanese style of capitalism remain intact after all of hue and cry of the past decade? If the latter is true—as I will argue—why haven't Japanese firms behaved the way the "race to the bottom" story expected? And what are the consequences of such strategies for Japan's economy and society?

Lifetime Employment System Still Intact

The lifetime employment system refers to structures and norms that have led large Japanese firms to keep core workers on the payroll even when faced with stagnant or declining earnings. It never covered all workers (estimates in the 1980s were in the 30 to 35 percent range) since smaller firms were less constrained than larger ones and because part-time and temporary workers enjoyed much weaker bargaining power and fewer job protections. But it distinguished Japanese employment practices from American (and post-Thatcher UK) patterns because it offered large numbers of white and blue-collar workers a degree of job security and the opportunity to attain skills and rise to positions of intra-firm responsibility that workers in many other nations, as well as those working at the margins in Japanese enterprises, never enjoyed.[1]

The legal heart of the system was (and is) the prohibition of "abusive dismissal" in Japanese labor law. Courts have interpreted these restrictions as barring layoffs of regular fulltime employees for anything short of the most dire conditions. Firms must be facing "a compelling and unavoidable necessity" (such as imminent bankruptcy) before they are allowed to carry out such dismissals. Before they can do so, they are expected to have eliminated overtime work, suspended new hiring, farmed out workers to related companies, and fired temporary and part-time workers. They are also expected to abide by "reasonable standards applied fairly" when selecting persons to be dismissed. In practice, these expectations have been so restrictive that large employers have uniformly avoided outright dismissals of workers, preferring instead to negotiate gradual workforce reductions with their unions, relying mostly on attrition and early retirement incentives, along with transfers and out-placements.

This legal structure remains in place today, unchanged even after fifteen years of poor economic performance. Japanese employers have campaigned for some changes in employment regulations designed to expand the range of jobs that can be filled by workers who are not covered by the doctrine of abusive dismissal, but these efforts have so far produced only modest changes in the employment system.[2]

One initiative aimed at increasing the share of jobs that can be filled by workers dispatched by temp agencies (haken gaisha), but reforms adopted in 1999 kept this door closed for manufacturing jobs. The share of jobs filled by dispatched workers has grown only slightly in the years since the reforms were adopted, up from 0.5 percent of all workers in 1997 to 0.7 percent in 2002. Another reform campaign aimed at liberalizing conditions that govern term contract employment. While some modifications were made in the late 1990s, the share of workers hired under such contracts also remains small, up from 1.7 in 1992 to 3.6 percent in 2002.[3] Employment of temporary workers, which was a much larger share of the workforce even before the 1990s, has grown more quickly, especially among female workers, but the proportion of male workers hired under such arrangements remains under 10 percent.

The result of these limited changes is that core, male, middle-aged workers today enjoy job protections that are little different than those they enjoyed in the 1980s, a legal fact that is reflected in survey data asking employees about their work histories. These data show that the proportion of workers near the end of their work careers (ages 50-54) who are still working for the employer with whom they began working immediately after graduation is actually up since the 1980s. Among male university graduates, the share was up from 28.7 percent in 1985 to 41.3 percent in 2000, but it was also up among male high school grads, from 11.4 to 19.1 percent.[4]

Of course, continuities in the system of lifetime employment for core, middle aged male workers does not mean that the generation of workers entering the labor force now is enjoying the same opportunities as its predecessors. On the contrary, young people have found it difficult to land lifetime employment positions, and in some cases have found it hard to find any jobs at all. It is estimated that the number of jobless youth stands at approximately 2 million, of whom about 800,000 are not even looking for work: the so called "NEETs" who are not in education, employment, or training.[5] Another 2 to 4 million are working as freelancers (or "freeters," to use the terms that has been coined for them in Japan), in many cases because they could not find regular employment with the benefits and protections enjoyed by their fathers.

While the emergence of these phenomena can be blamed in part on the prolonged recession that took hold in the 1990s, they have no doubt been aggravated by efforts to preserve the lifetime employment system for older, core workers. Firms are not surprisingly hesitant to hire new young workers under regular employment conditions when they are struggling to pay the salaries of older workers hired under these arrangements two or three decades ago. Youth unemployment, the NEET phenomena, and freeters thus testify to the very real ways in which the traditional employment system is fraying at the edges—in large part because of efforts to preserve this same system for core, middle-aged workers.

Why No Race to the Bottom (Yet)?

Okuda implied in his January statement about the virtues of the lifetime employment system that Japan has retained this system because it is superior to the Anglo-American model. Indeed, the system has worked quite well for Okuda's firm, Toyota, and for other internationally competitive firms in growing markets like Canon—the home of the new Keidanren chief, Mitarai. These firms operate in industries where workers with firm-specific skills represent a critical source of their competitive advantage. They depend on highly-skilled and dedicated lifetime employees to produce the flawless and cutting-edge manufactured goods that are critical to their success.

Canon Worldwide

But such firms represent only a small portion of Japanese employers. Many firms in areas like steel and chemicals produce standardized goods that do not depend on workers with firm-specific skills to the degree Toyota or Canon do. Even at a firm like Canon, much of the work can be done by workers with basic skills. As the head of Canon's strategic planning department revealed to me in 2002, the production workers

Canon has hired in China under hire-and-fire conditions for wages that are just five percent the level paid in Japan are just as productive as those at identical Japanese plants. Canon needs some highly-skilled production workers to help it work bugs out of production processes for new products at Japanese factories before transferring work to China, but many of the 20,000 Japanese production workers on its payroll are dispensable. The firm has not laid off these workers (none of whom are quitting), the manager explained, "only because Japan has a lifetime employment system."

If the lifetime employment system makes limited sense for Canon, it makes even less sense for contemporary Japan as a whole, given recent changes in the demographic and socio-economic context. When the Japanese economy was growing at 10 percent a year and the number of new young workers entering urban labor markets was growing just as fast, the lifetime employment system guaranteed companies a secure, skilled and loyal workforce. The seniority wage system that was part of the lifetime employment bargain meant these firms could underpay numerous young workers in exchange for overpaying and keeping on the payroll a much smaller number of older workers. Today, after Japan has been growing for the past fifteen years at only a little over one percent a year and the working-age population is shrinking rather than growing, most Japanese employers are stuck with aging workforces that leave them paying a very expensive bill for a system that no longer supplies them with many cheap young workers.

The rigidities of this system are especially problematic given changes in the global economy in which Japanese firms must operate. Whereas Japanese firms once grew by taking market share away from American and European firms with unionized, high-cost workforces, these same firms today are squeezed by upstart Koreans and Taiwanese (soon to be joined by Chinese companies) moving steadily up the product cycle, and American and European firms that are finding ways to survive by relocating operations to China, Eastern Europe, and other low cost locales. Surviving in this environment requires Japanese firms to constantly cut costs, innovate, and find new product niches—tasks that aging lifetime employees are not always well-equipped to handle.

The lifetime employment system also fits poorly with the changing gender role aspirations of Japanese women. The system worked well with the gendered division of labor that emerged in the 1960s and 1970s when many women, as well as men, bought into a family and work structure that counted on women leaving the workforce once they married so that they could devote their energies to caring for their families. The flexible labor force provided by female workers gave employers a cushion they could rely on to protect their core male workers, while most women, content to give up work during their child-rearing years, accepted a system that pushed them out after marriage and let them return only as part-time and temporary workers after their children were older.

Today, many young women find that the lifetime employment system, which confines most married women to poorly-paid and uninteresting part-time jobs, fits poorly with their enhanced career aspirations. Staying on the career track requires levels of dedication that few mothers can offer, given the limits of childcare services and the long work hours expected of such employees, so that most women end up choosing career or children, instead of both. Once mothers leave the career track, they have virtually no chance of finding well-paid and interesting work again because employers operating under the lifetime employment system hire workers at a young age and reward them for years of service. The number choosing to postpone or opt out of motherhood because of these rigidities in the employment system has contributed to the rapid decline in Japanese fertility rates, to a record low of 1.29 in 2004, far below the replacement rate. At the same time, those leaving work to care for children are depriving the Japanese labor force of an important supply of human capital just as the working-age population has started to shrink.

This shrinkage of the working-age population, which will decline by 30 million between 2000 and 2050, makes the lifetime employment system an anachronism. Japan needs to make full use of its young and middle-aged men and women in order to cover the costs of pensions and health care for a burgeoning population of retirees. The nation will only be able to tap the full talents of women if it develops a labor market with more lateral mobility so that they can move in and out of fulltime and part-time work. The shrinking labor force also means Japan will rely for future growth entirely on increased productivity of labor and capital. The lifetime employment system not only reduces labor productivity by keeping redundant workers on the payroll, it also constrains the productivity of capital through financial and regulatory structures designed to keep big, old, inefficient firms in business in order to uphold their employment obligations.

Given the many disadvantages of the lifetime employment system for Japan today, Okuda's stubborn defense of the system in his capacity as leader of the Japanese business community is hard to understand. Even if one grants that some firms, such as Toyota, continue to derive benefits from a system that encourages the development of firm-specific skills, one would have expected a far-sighted leader of the business world to work for modifications in the regime to adapt it to Japan's new demographic and socio-economic context and global competition. Why hasn't Okuda, and the Japanese business community more broadly, taken advantage of "globalization" to dismantle the system and build one that is more suited to Japan's new circumstances?[6] Toyota and many other Japanese firms are transnational firms that operate in many different locations, including places like China and the United States where their employees enjoy much fewer job protections. Why haven't they used the leverage their transnational status affords to force unions to give up job protections and compel the government to reform labor market regulations in the way American firms have over the past 25 years?

What I found when I examined the role of large employers in the debate over labor market reforms was that their lack of interest in pushing for liberalization stems, ironically, from the very phenomenon that is often viewed as their primary source of leverage: globalization. The declining costs of investing and conducting transactions overseas has thrown Japanese manufacturers a lifeline that has given them the luxury of retaining the lifetime employment system for core workers at home.

Globalization theory describes the Japanese story up to a point. Just as it predicts, the liberalization of capital controls and the opening up of opportunities to invest abroad has encouraged a flood of overseas investment by Japanese manufacturers, first in developed country markets like the United States and Europe and then in low-wage developing countries as well. The annual outflow of manufacturing investment surged especially after the value of the yen spiked in the mid-1990s, topping two trillion yen (US$20 billion) for several years.

This increase in outward investment was so rapid that it transformed Japan from a nation populated mostly by firms producing in Japan for domestic consumption and export to one that was home to many of the leading transnational corporations in the world. In 1985, the share of foreign manufacturing value added to total manufacturing value-added for all Japanese firms was just 3 percent. By 1995 this figure had grown to 9 percent, and by 2003 it had reached 18 percent. Growth in the foreign manufacturing share was especially rapid for Japan's two most successful and internationalized industries, electrical machinery and transport equipment. The foreign production share for electrical machinery (e.g. Canon) grew from 12.6 percent in 1993 to 26.5 percent in 2002, while over the same period the share of foreign production in the transport equipment sector (e.g. Toyota) grew from 17.3 percent to 47.6 percent. About half of all Japanese transport equipment is now being produced overseas.[7]

While the globalization of Japanese business has proceeded at a breakneck pace, it has not produced the predicted "race to the bottom" in Japanese labor practices because investment does not speak for itself. For FDI to produce regulatory change, someone has to articulate the argument that "Japan must change in order to avoid hollowing out," and in the Japanese case these voices have been slow to emerge.

For most of the 1980s and 1990s, the Japanese government promoted investment overseas through state-run financial institutions and other support services. These policies reflected the government view that FDI was a "house-cleaning-and-renovating vehicle for Japan," helping it move industrial activities that could no longer be performed competitively at home to offshore locations even as it pushed firms to upgrade to higher value-added operations producing higher profits and paying higher wages.[8] It was hard to make an argument that FDI was causing problems, moreover, when there was little evidence firms were squeezing domestic investment in order to expand their overseas operations. Through the late 1990s, the ratio of overseas to domestic investment held steady at around 18 percent. Only in 2002 and 2003 did this ratio spike to 26 and 22 percent, respectively.[9]

If the government was not raising alarms about hollowing out, one might have expected Japanese labor unions, at least, to make more of a fuss. On the contrary, when the Rengo Labor Federation published a 200-page manifesto covering the gamut of issues of interest to Japanese labor unions in 2003, the topic of hollowing out got only brief mention in two subsections. Listing it fifth in a discussion of eight causes of deflation, the union called for stabilizing exchange rates at an "appropriate level" in order to stem this trend. Hollowing out was not mentioned again until it was given as a reason why the government needs to invest more heavily in research and development. The statement made no attempt to rally popular opinion against globalization, and did not even take issue with government policies that promote foreign investment, such as those providing financing for firms that set up factories overseas.

Finally, one would at least expect Japanese firms to use the opportunity afforded by overseas investment to extract concessions from workers at home by showing off their mobility advantage. American firms, certainly, have been notorious for linking decisions to close plants at home to announcements of major overseas investments. When Japanese firms announce overseas ventures, in contrast, they have tended to play down the impact on workers at home.

Almost every press release announcing new overseas investment by a Japanese firm has played up the benefits of the project for the corporation and the host country—and said absolutely nothing about potential costs at home. For example, when NEC announced plans to build a factory in the Philippines producing hard disk drives (its first factory of this type outside of Japan), it emphasized how it was creating 2,000 jobs in that country. Philippine engineers would be trained in the latest production methods. The press release did not say anything about how the overseas production would affect factories at home, but it implied that there would be little effect by pointing out that the new factory was designed to meet growing worldwide demand for this NEC product. Similarly, when Mitsui Chemical announced in 2000 its plans to expand production of PET bottle resins at its plant in Indonesia to 75,000 tons a year, it emphasized how the increased production would supplement and not replace production at its two Japanese plants, which would continue to produce 159,000 tons of this product.

This tendency to emphasize the positive in press releases is certainly a constant for corporations around the world, but for most Japanese firms this commitment to maintain domestic production (at least in factories employing their own core workers) was more than rhetorical. As Mireya Solis argues in her detailed study of Japanese FDI patterns, much of Japanese foreign investment has involved "expansion of overseas manufacture of the more standardized products" concurrently with "attempts to move into higher value added segments in domestic production."[10] She found this pattern to be common especially in the electronics industry, but it has also been common in automobiles, petrochemicals, steel, and many other industries that are dominated by large firms with lifetime employment systems.

Canon's approach to FDI, explained by the head of the company's corporate planning unit in a 2002 interview, nicely illustrates this pattern. When Canon first began moving production to Southeast Asia and China in the early 1990s and faced the question of what to do with domestic factories, it decided not to close these plants but to convert them to the manufacture of higher value-added products. More recently, it has converted factories into facilities that work closely with engineers to work the bugs out of the production process for the firms' newest product lines. Once the process is standardized, production is immediately transferred to China. A growing proportion of the firms' production is being done in China, but because Canon always has new products coming on line, it has a constant stream of products that need the attention of domestic engineers and experienced factory workers.

Canon's efforts to avoid laying off workers as it expands production overseas obviously makes it difficult for it to present its actions as part of the problem of hollowing out—even if it wanted to. The manager I interviewed did not use the term and showed no interest in characterizing his firms' decisions as part of a problem. He did admit, however, that his firms' actions have contributed indirectly to the decline of manufacturing employment in Japan as the firm has brought in-house some of the work that it used to subcontract to smaller factories located near its major production facilities, forcing many of these subcontractors to go out of business. These moves, and similar ones by other firms opening factories overseas, have ultimately led to a sharp contraction in the number of manufacturing workers in Japan—down from 15 million in 1990 to 11.5 million in 2004. They have also led to a contraction of manufacturing activity on the part of small subcontractors in districts like Tokyo's Ota Ward (the location of Canon's headquarters), and similar neighborhoods in the Kansai region. The number of small firms operating in Ota Ward fell by 25 percent between 1983 and 1995, and employment fell by over a third.[11]

These effects of Japanese firms' decisions to locate production work overseas, however, have all been indirect—involving small firms that are sometimes several subcontracting steps removed from the major firm moving overseas, with effects that show up months or years after the foreign venture begins production. Canon and other Japanese firms leading the expansion of overseas operations have shown no interest in claiming credit for these negative effects of their business decisions or in using them to extract concessions from policymakers in Tokyo. The job protection that core male employees continue to enjoy under this pattern of adjustment has been the main reason the Rengo labor federation, too, has failed to make "hollowing out" a battleground.

Globalization and the associated shift overseas of Japanese firms' employment and operations has not produced significant changes in Japanese labor practices because the ability of Japanese firms to "exit" has reduced their propensity to use "voice." Exit and voice have not worked in tandem to drive a "race to the bottom" in the way globalization theory presumes, but instead have worked against each other to delay the country's response to its changing socio-economic environment.[12]

Prognosis for the Future

The latest economic statistics coming out of Japan (growth in the fourth quarter of 2005 at an annualized rate of 7 percent!) suggest that the nation may have finally begun to put its "lost decade" behind it. Most manufacturing firms have now managed to shrink their workforces—mostly through attrition—to a point where they have few redundant workers on the payroll and are able to report growing profits. This is the basis for Okuda's claim that the lifetime employment system has contributed to the recovery.

The latest economic numbers conceal, however, the structural "shoals" that lie beneath the apparently calm waters. Because the working age population continues to shrink due to demographic factors, because Japan has thus far ruled out immigration as a means of overcoming labor shortages, and because Japan has begun raising tax and social insurance contributions significantly to finance the retirement of its baby boomers, the economy cannot grow at much above 2 percent a year over the long-term. With projected growth at this level, employers continue to hesitate to hire new regular employees under lifetime employment conditions. The system has been preserved for core middle-aged workers, but, as noted above, this goal has been achieved at the price of confining many young workers to irregular working conditions or no work conditions at all.

Similarly, current labor market structures continue to make it difficult for mothers to stay on the job. The proportion of mothers in fulltime employment has actually declined over the past decade, despite the investment of resources in expanded childcare services, because of the lack of change in the structures of the lifetime employment system. At the same time, the same difficulties of combining work with family is one of the factors that have led large numbers of women to opt out of motherhood, keeping the fertility rate down at its record low level.

During its extended "lost decade," Japan could have been introducing more flexibility into its labor market. It could also have begun expanding unemployment insurance and job retraining and adapting higher education so as to replace the lifetime employment safety net with structures that support a labor market with efficient lateral job mobility. Had Japanese firms been limited to producing in Japan, had they had "no way out," they might have campaigned for reforms in this direction in order to lower their fixed costs of labor. Instead, because of the lifeline provided by the chance to produce abroad under labor market rules much more liberal than Japan's, these firms ended up preserving the lifetime employment system for one last generation of core male workers, at the expense of women and the younger generation—and perhaps at the expense of Japan's ability to navigate the shoals of its demographic and fiscal challenges without a major disruption in its economic performance.

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Notes

[1] Japan was not the only country to see the emergence of employment regimes providing high levels of job security in the postwar period. Many nations on the continent of Europe developed regimes that offered similar levels of job protection.

[2] See Miura Mari, “From Welfare Through Work to Lean Work: The Politics of Labor Market Reform in Japan,” Ph.D. dissertation, University of California at Berkeley, 2002; and Leonard Schoppa, Race for the Exits: The Unraveling of Japan’s System of Social Protection (Ithaca: Cornell University Press, 2006), pp. 118-121.

[3] Data from the Ministry of Labor, Rodo hakusho—Heisei 12-nen-han, 2000, 515, updated with data from the Labor Force Survey, on-line at http://www.mhlw.go.jp/english/wp/wp-l/29.html (accessed January 25, 2006).

[4] Hiroshi Ono, “Lifetime Employment in Japan: Concepts and Measurements,” Paper Prepared for the National Bureau of Economic Research conference in Tokyo, October 2005, p. 43—available.

[5] These figures are based on the government’s 2002 employment status survey of individuals aged 15-34. See Genda Yuji, “The NEET Problem in Japan,” Social Science Japan 32 (September 2005): pp. 3-4.

[6] In my book, Race for the Exits, I also ask why Japanese women have not worked harder to dismantle the gendered vision of labor inherent in the lifetime employment system.

[7] METI, Dai 33-kai wagakuni kigyo no kaigai jigyo katsudo kekka gaiyo, March 31, 2004, Figure 5-1—available (accessed February 10, 2005).

[8] Terutomo Ozawa, “Japan in a New Phase of Multinationalism and Industrial Upgrading: Functional Integration of Trade, Growth, and FDI,” Journal of World Trade 25 (1991), p. 51.

[9] See Schoppa, Race for the Exits, p. 86, updated with data from METI’s 34th Survey of Overseas Business Activities, available.

[10] Solis, Banking on Multinationals: Public Credit and the Export of Japanese Sunset Industries (Stanford: Stanford University Press, 2004), p. 178

[11] Fukushima H, “Introduction,” in Fukushima H, ed., Changes in Agglomeration Structure of Small and Medium-Sized Enterprises in the Machinery and Metal Industries: A Survey of the Actual State in Ohta-Ward, Tokyo (Tokyo: Research Institute of Economic Science, Nihon University, 2001), cited in David Bailey, “Explaining Japan’s Kudoka (Hollowing Out): A Case of Government and Strategic Failure,” Asia Pacific Business Review 10:1 (October 2003), p. 4.

[12] The terms “exit” and “voice” are drawn from Albert Hirschman, Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States (Cambridge: Harvard University Press, 1970). For a more detailed elaboration of competing views on how exit and voice work together in the globalization process, see Schoppa, Race for the Exits, pp. 6-13 and 18-27.