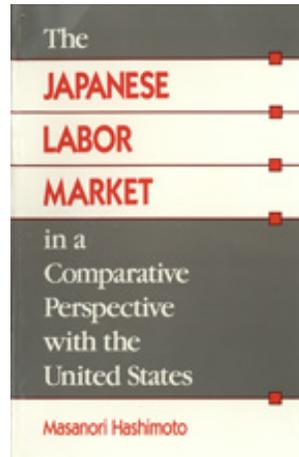

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Introduction

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The Japanese Labor Market in a Comparative Perspective with the United States: A Transaction-Cost Interpretation

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Introduction

Japan and the United States today represent the two most successful free market economies in the world. These two economies share many similarities: both operate in highly competitive and open markets; both have enjoyed strong positions in manufacturing and high technology industries; and both have experienced significant sectoral shifts in employment since the early 1970s. These and other similarities, however, should not make one overlook important differences between the two economies. It is these contrasts that offer fertile bases for new insights. Whether the differences are due to cultural, traditional, or economic factors, it seems undeniable that they ultimately manifest themselves in the conduct of employers and employees, and in the labor market institutions.

Many of the differences have already been noted in the literature. They include the following:

1. In Japan, long-term employment is more prevalent, employer-employee attachment is stronger, and employee tenure in a firm has a more substantial effect on worker earnings when compared to the United States (Hashimoto and Raisian 1985, 1989; Mincer and Higuchi 1988). The labor-management relationship is evidently more cooperative in Japan than in the United States—turnover rates are considerably lower, and the number of days lost in labor disputes much smaller.¹

2. The Japanese and U.S. economies differ in the ways that employment, hours of work, and inventories adjust over the business cycle. Layoffs and dismissals are extremely rare in Japan. Instead, adjustments in hours of work, wages, and inventories assume a relatively greater role over the business cycle in that country than in the United States (Gordon 1982; Hashimoto and Raisian 1987, 1988; Abraham and Houseman 1989).²

3. The two economies have typically coped differently with declining manufacturing industries. Since the 1970s, workforce reductions in Japan were achieved with less reliance on outright dismissals than in the United States.

4. In the Japanese wage system, workers typically receive a significant portion of earnings in bonuses, whereas bonuses received by U.S. workers are rarely significant (Hashimoto 1979; Freeman and Weitzman 1987). In addition, wage bargaining in Japan is synchronized to the annual spring offensive (*shunto*)—an arrangement that helps make wages more flexible there than in the United States (Gordon 1982; Taylor 1989).

5. Japanese labor contracts are brief, leaving much room for continuous adjustment by mutual consent of the parties involved (Hanami 1981). Labor and management engage frequently in joint consultations, and major decisions are arrived at after an extensive sharing of information and the consensus-building procedure called *nemawashi*.³

6. Unions in Japan are enterprise-based. Although most unions belong to national-level federations, the basic issues of wages, working conditions, and like factors are negotiated at a firm level. Unlike the local of an American industrial union, the Japanese enterprise union, which typically includes white-collar nonsupervisory employees as well as blue-collar workers, is not merely an administrative unit of a national union.⁴

The book argues that many of the differences in labor market practices between the two countries—or for that matter among any countries—reflect contrasts in the investment made in the employment relationship. What factors determine the investment differences? To answer this question, one might expect the theories of employment contracts, which have been the focus of many recent theoretical studies, to offer some guidance.⁵ As they now stand, unfortunately, employment contract theories in the literature are not particularly suited for cross-country studies, as most were motivated by labor market phenomena in the United States.

For example, the main prediction from the implicit contract theories, first introduced by Azariadis (1975), Baily (1974), and Gordon (1974), and subsequently elaborated on by a number of researchers, is that in the

long-term employment relationship wages will be rigid, with workers facing a positive probability of layoff during economic downturns. This prediction seems to conform to the tendencies toward wage rigidity and the frequent use of layoffs that characterize the U.S. labor market.⁶ It is not consistent, however, with the experience of Japan, known for its long-term employment relationships. There, workers in the *shushin koyo* (permanent employment) system rarely experience U.S.-type layoffs, and their wages are quite flexible, as they contain semi-annual bonuses and are renegotiated every year. The implicit contract theories may have the potential to accommodate Japanese phenomena, but such an extension is not obvious.

Clearly, a theory is needed that can help achieve a unified understanding of such labor market phenomena as labor turnover, earnings, and the strength of the employer-employee attachment. An important aim of such a theory should be to explain contrasts among labor market practices in different countries. Implicit contract theories, however, not having been designed to address the turnover issue, would have difficulty in achieving this aim. For example, one may assert, as the implicit contract theories do, that a typical firm has the incentive to offer a long-term employment contract, but what is there to prevent workers from leaving for another job during the life of the contract?

In fact, many U.S. workers do change jobs frequently, though job separations decline with years of tenure. Typical Japanese workers appear more reluctant than their U.S. counterparts to separate for the purpose of taking another job.⁷ Clearly, it is desirable for a theory of employment contract to treat the separation incentives of the employer and the employee as they relate to earnings and other characteristics of the employment relationship. In this vein, the potential usefulness of the theory of firm-specific human capital seems obvious, as it can account for how turnover and earnings change with tenure in the firm.⁸ As Rosen (1985) stated, “some consideration for differences in firm-specific human capital, labor mobility, and quasi-fixed factor ideas are required to fully account for international differences in labor market phenomena” (p. 1165).

It will be argued that cultural/traditional influences likely interacted

with technological progress in shaping many of the uniquely Japanese labor market phenomena. To analyze this interaction, chapter 2 discusses a theory that combines transaction-cost considerations with human capital theory. Transaction costs in this theory refer to the costs of communicating and verifying relevant information between employer and employees, and they are viewed as playing a central role in shaping many of the labor market institutions. Since culture and tradition can be interpreted as influencing transaction costs, the proposed theory offers a way of bringing these noneconomic factors into economic analysis.

In previous works, I have argued that positive transaction costs are the key factor in the sharing theorem of the human capital theory, and proposed that wage flexibility enhances the value of contracts involving firm-specific human capital (Hashimoto 1979, 1981; Hashimoto and Yu 1980). Here, I extend those analyses and offer a conceptual framework for a comparative study of Japanese and American labor markets. I postulate that the employer and employee invest in the employment relationship in order to enhance their mutual well-being. I distinguish between two types of investments: investment in the employee's technical skills and investment in the reliability of all types of information exchanged within the firm. The effect of investing in the employee's technical skills on productivity is obvious. The investment in the reliability of information reduces mistrust, disputes, and inefficient decisions, and thereby promotes cooperative industrial relations and productivity. In my framework, the usual term *training*, or *firm-specific human capital*, refers to the package of these investments. The greater these investments the more productive the employment relationship.

An increased investment in technical skills stimulates the investment in information reliability and vice versa. The independent variables are the costs associated with these investments and the worker propensity for mobility. The cost of investing in technical skills is a function of how well the formal education system prepares students for training by imparting positive attitudes for learning as well as by teaching basic skills. The cost of investing in information reliability reflects the transaction-cost environment, which in turn is affected by the degree of cultural heterogeneity of the workforce, the attitudes of the management

and workers, and the workers' abilities to function cooperatively as a group. Finally, a high worker propensity for mobility reduces the returns to these investments and so discourages training.

I hypothesize that there are more investments in Japan than in the United States because, for various reasons, the investment costs and the mobility propensity are lower in Japan. One of the theorems that emerges is that economic growth and technological progress can stimulate both types of investment and that each type, in turn, reinforces the other. Japanese investments in employment relations became pronounced in the 1960s, coinciding with that economy's rapid technological change and accelerated economic growth.

It might be said also that to fully understand labor market differences between countries, one would have to pay attention to differences in the laws regulating the labor markets and in the institutions of industrial relations. But laws and institutions are themselves endogenous, and a complete investigation must go even further by analyzing the manner in which they are shaped by exogenous factors such as culture and tradition. It is hoped that this study makes a contribution to future investigations by suggesting how influences of culture and tradition may be incorporated into an economic analysis.

Economists tend to shun invoking the influences of culture and tradition in explaining real-world phenomena, but it would seem inappropriate to deny the influence of these factors altogether, especially in cross-country comparisons. At the same time, an explanation based on culture and tradition alone would seem unsatisfactory, especially if it suggests unchanging persistence over time in labor market features. A more productive approach would be to investigate how traditional and cultural factors shape labor market characteristics in response to changing circumstances.

In studying Japanese-U.S. differences in labor markets, one hesitates in appealing solely to culture and tradition, because some of the labor market differences appear to have emerged rather recently. For example, (1) Japanese labor turnover appears to have been quite high from the early 1900s through the early 1950s (Taira 1970; Shimada 1983; Gordon 1985); (2) the often-noted wage rigidity in the United States appears

to have emerged after the end of World War II, when a drastic decline in the responsiveness of wages to economic conditions took place (Gordon 1982); and (3) the Japanese style of industrial relations became prevalent after the late 1950s when the rate of economic growth began to accelerate as a result, in my opinion, of the productivity enhancement campaign (*seisansei undo*) launched in 1955.

Although labor market flexibility has been a topic of considerable recent interest, there have been only a few analyses of the underlying causes of differential flexibility across countries.⁹ It is hoped that the theory presented in this book will contribute to closing this gap. Also, the existing literature on transaction costs lacks an explicit model of how transaction costs affect behavior, though many of the discussions are thoughtful and provocative (e.g., Klein, Crawford, and Alchian 1978; Williamson 1975, 1985). An important contribution of this book is to incorporate transaction costs explicitly into the theory of firm-specific human capital.¹⁰

Employment Categories in Japan

Let me end this chapter by discussing the definitions of employment categories in Japan. The Japanese labor force includes persons 15 years of age or older, in contrast to the U.S. labor force for which the youngest age is 16 years. Employed persons in Japan are classified into those at work and those not at work (*kyugyosha*). This latter category consists of persons who are not currently working but are kept on payroll and counted as employed persons.¹¹ Some of the workers in this category may, in fact, be on temporary layoff (Hashimoto 1990c). If so, they would be classified as being unemployed rather than employed were they in the United States.

Whether at work or not, employed persons are categorized by employers as self-employed workers, family workers, and/or employees (see dotted line in table 1.1). The employee category, in turn, consists of regular workers, temporary employees, or day workers. Self-employment has the same meaning as the U.S. definition, and family

workers—those who work in an unincorporated enterprise operated by a member of the family—may be paid or unpaid.

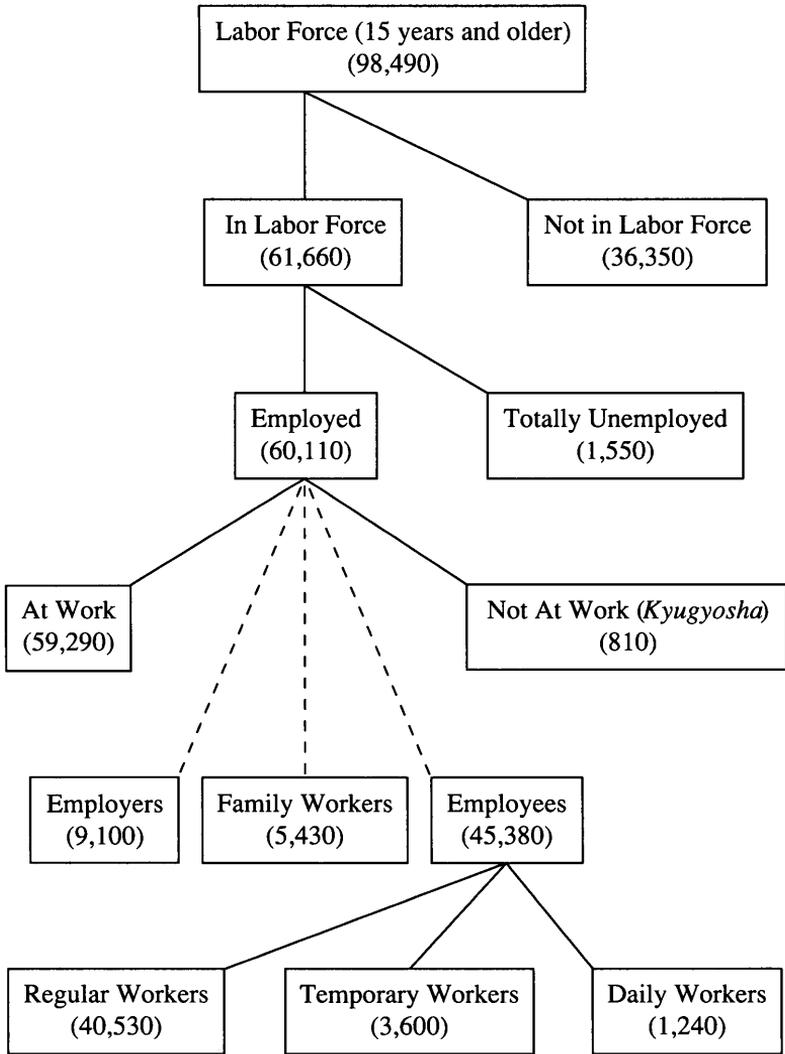
In 1988, self-employed and family workers amounted to about 18.8 percent of all nonagricultural employment, a much larger proportion than the U.S. figure of about 8 percent.¹² Japanese women are more likely to be family workers than are men. In 1988, 13 percent of employed females in the nonagricultural sector belonged to the family-worker category, as compared to 1.9 percent for males. The proportion for self-employment in the nonagricultural sector was 11.2 percent for females and 13.5 percent for males.

Much of what one reads about the uniqueness of the Japanese labor market refers to regular workers. Regular workers are under employment contracts with an unspecified length of employment duration, and many of them, especially in large firms, are in the *shushin koyo* (lifetime employment) system with *nenko* (tenure-based) wage schedules.¹³ Their earnings consist of regular wages and the famous twice-yearly bonuses, which sometimes amount to about 30 percent of their total receipts.¹⁴ Among male nonagricultural employees, 94.6 percent were regular workers in 1988, as compared to 80.6 percent of the females. Male regular workers have been a significant human resource in Japan, at least in the marketplace, with the employment practices for this category of worker serving as models for other workers in Japan.

Temporary workers have contracts with a period of employment lasting more than a month but less than one year, and day laborers with an employment period lasting less than a month. These contracts are renewable. Casual observations suggest that temporary workers in Japan tend to work for the same employers.¹⁵ Many of these workers in effect may have more than transitory attachments to their employers. It is difficult to make a similar distinction in the U.S. data. A student hired for a summer job, for example, is indistinguishable from a young household head with a permanent job.¹⁶

Employed Japanese women are more likely than men to be family workers, temporary workers, or day laborers. Also, almost 29 percent of female employees in the nonagricultural sector, as compared to 6.2 percent of males, worked fewer than 35 hours per week in 1988. Thus,

**Table 1.1 Employment Categories in Japan
(1,000 persons in 1988)**



SOURCE: Japan Productivity Center, *Katsuyo Rodo Tokei* (Practical Labor Statistics) 1990, p. 238.

Japanese women do appear to have a weaker attachment to the labor market than men.¹⁷ It should be noted, however, that the proportion of females who are family workers has been declining in Japan. In 1965, the proportion stood at 36.8 percent, but by 1975 it had declined to 25.7 percent. In 1986, it was 19.4 percent. This decline is one of the key factors behind the decline in female labor force participation in Japan that took place in spite of rising female wages during the postwar years (Hill 1983; Shimada and Higuchi 1985; Osawa 1988). According to these authors, participation of females in paid sectors experienced an upward trend, as expected, throughout most of the postwar years. It is the declining importance of family workers that contributed to the lowering of the overall participation rate for Japanese women.

NOTES

¹ The two countries have been diverging from each other in the number of days lost due to labor disputes. The days lost in Japan started to follow a downward trend around 1960, but in the United States the trend has been moderately upwards during most of the postwar years. See chapter 3.

² The weaker reliance on outright dismissals for workforce reductions undoubtedly is a factor in the lower unemployment rates in Japan as compared to those in the United States (Ito 1984).

³ *Nemawashi* literally means digging around the roots of a tree and trimming them in advance to ensure a successful transplant or to promote the bearing of abundant fruits. Its figurative meaning is to take every necessary step by communicating with individuals who are involved to bring about a desired outcome. Joint consultation is the primary channel through which management and labor deal with such issues as recruitment, dismissal, transfer and promotion, changes in production techniques and in management policies, plant closings, and industrial safety. Expediting communication and promoting harmonious relationships are the major objectives of this approach. Both the *nemawashi* and joint-consultation practices prevail throughout the economy, not just in the unionized sector. See chapter 3 for additional discussions.

⁴ The reader is warned against drawing any conclusions about which of the two countries is the odd man on the block. Many European countries, for example, have works councils (*Betriebsräte*) whose operations resemble Japan's joint consultation, and these countries appear to have more harmonious labor-management relations than the United States. Also, bonus payments exist in such countries as Belgium, West Germany, Italy, and the Netherlands to a greater extent than in the United States, though on average the proportion of bonus to total compensation is only about 10 percent in those countries—about half as large as in Japan. See chapter 3 for more details.

⁵ For informative surveys of many of the recent developments in this literature, see Rosen (1985) and Parsons (1986).

⁶ Note, however, that Akerlof and Miyazaki (1980) criticize implicit contract theories by demonstrating that they do not adequately explain layoff unemployment, as the proponents of these theories claimed. Also, just how rigid U.S. wages are seems to be controversial. Recent findings by

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Stockman (1983), Bills (1985), and Hashimoto and Raisian (1987a,b) suggest that U.S. wages may not be as rigid as some have claimed. In contrast, there is little controversy surrounding the flexibility of Japanese wages.

⁷ Nothing remains the same forever. There is evidence that job mobility may increase in Japan in the near future. See "Japan Cuts the Middle-Management Fat," *The Wall Street Journal*, 8 August 1989.

⁸ Firm-specific human capital refers to factors such as technical know-how, skills, and organizational knowledge, which raise worker productivity in a particular firm more than in others. The concept was first formalized by Becker (1962). See also Hashimoto (1981) for an extension of the analysis.

⁹ See, for example, Chinloy and Stromsdorfer (1987); *OECD* (1986); Freeman (1987); Koshiro (1986); Hart (1988); and Tachibanaki (1986).

¹⁰ The transaction-cost literature stresses the importance of contract-specific capital—mostly physical capital—in generating *ex post* opportunistic behavior. Obviously, the same considerations apply to firm-specific human capital.

¹¹ The Labor Standards Law specifies that those who became *kyugyosha* through fault of their employer must be paid at least 60 percent of their usual pay (Japan Labor Standards Bureau 1988). The official description simply states that these are (1) workers who are absent from work but who received, or are to receive, wages or salary for time off, and (2) self-employed workers whose absence from work has not exceeded 30 days. See Japan Statistics Bureau, Management and Coordination Agency, *Annual Report on the Labour Force Survey* (1988), 196. According to table 27 of that publication, in 1988 fully 89 percent of these workers were in nonagricultural industries. Among those, the highest proportion were in services (28 percent), followed by manufacturing (22 percent), trade and eating and drinking establishments (22 percent), and construction (14 percent). The remaining workers were distributed thinly among fisheries, electric and gas supply, transportation and communication, and government. Almost 75 percent of *kyugyosha* in nonagricultural jobs, and over 81 percent in manufacturing, were employees rather than self-employed persons. Slightly more than 58 percent in nonagricultural pursuits and 50 percent in manufacturing were males. It appears, therefore, that most of these workers are *bona fide* members of the employed class in nonagricultural sectors. See Hashimoto (1990c) for related discussions.

¹² The Japanese data for the discussion of the employment categories are from Japan Statistics Bureau, Management and Coordination Agency, *Annual Report on the Labour Force Survey* (1988), tables 26, 27; and the U.S. data from the U.S. Bureau of Labor Statistics, *Handbook of Labor Statistics*, Bulletin 2340 (1989), table 21.

¹³ Employment contracts lasting for more than a year are illegal in Japan. Exceptions occur in cases where a project is known to end in, say, three years and craftsmen are hired for that duration, or when employers obtain special permission from their prefectural authority to put workers in on-the-job training programs.

¹⁴ See Hashimoto (1979) and Freeman and Weitzman (1987) for analyses of Japanese bonuses.

¹⁵ For example, the president of a medium-sized Japanese manufacturing firm told me that the same farmers from a certain farming region return to his firm year after year during off-seasons as temporary employees.

¹⁶ There is, however, a growing temporary help industry in the United States. This industry is made up of establishments supplying temporary help to businesses, and currently accounts for about 1 percent of total nonagricultural employment. Also, the U.S. data categorize employment into part-time and full-time components. In 1988, 82 percent of nonagricultural wage and salary workers (16 years or older) worked at full-time jobs, though an additional 1.6 percent, who usually

work full time, worked at part-time jobs for economic reasons. In Japan, about 12 percent of employment consists of part-time workers, in contrast to the U.S. magnitude of 17 to 19 percent.

¹⁷ In 1988, the labor force participation rate in Japan was 48.9 percent for women and 77.1 percent for men (for those 15 years and older). In the United States, the comparable rates were 56.6 percent and 76.6 percent, respectively, for women and men. The Japanese data are from the Japan Statistics Bureau, Management and Coordination Agency, *Annual Report on the Labour Force Survey* (1988), table 1; and the U.S. figures, from the U.S. Bureau of Labor Statistics, *Handbook of Labor Statistics* (1989), table 1.