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Reforming the Labour
Market in Japan to Cope
with Increasing Dualism
and Population Ageing

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By Randall S. Jones

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ABSTRACT/ RÉSUMÉ

Reforming the labour market in Japan to cope with increasing dualism and population ageing

The proportion of non-regular workers has risen to one-third of total employment. While non-regular employment provides flexibility and cost reductions for firms, it also creates equity and efficiency concerns. A comprehensive approach that includes relaxing the high degree of employment protection for regular workers and expanding the coverage of non-regular workers by the social security system would help to reverse dualism. Given that non-regular workers receive less firm-based training, it is also necessary to expand training outside of firms to support Japan's growth potential, while enhancing the employment prospects of non-regular workers. Reversing the upward trend in non-regular employment may also encourage greater female labour force participation, which is essential given rapid population ageing that is already reducing Japan's working-age population by almost 1% each year. Expanding childcare facilities and paying more attention to work-life balance would also boost female employment, while also raising Japan's exceptionally low birth rate.

This Working Paper relates to the 2008 *OECD Economic Survey of Japan* (www.oecd.org/eco/surveys/japan).

JEL classification: J11; J3; J5; J7

Keywords: Labour market; dualism; employment protection; non-regular workers; part-time workers; labour force participation rates; vocational training; female employment; older workers; fertility rates; work-life balance; Japan.

* * * * *

Réformer le marché du travail au Japon pour faire face à un dualisme grandissant et au vieillissement démographique

Les travailleurs non réguliers représentent désormais un tiers de l'ensemble des salariés. Or, s'il réduit les coûts de la flexibilité pour les entreprises, l'emploi non régulier suscite aussi des préoccupations sur le plan de l'efficacité et de l'équité. Une approche globale, avec un assouplissement de la forte protection de l'emploi dont bénéficient les travailleurs réguliers et une extension de la couverture sociale des travailleurs non réguliers, aiderait à mettre fin au dualisme du marché du travail. Les travailleurs non réguliers ayant un accès plus limité que les autres à la formation en entreprise, il faudrait aussi développer la formation hors poste pour améliorer leurs perspectives d'emploi et renforcer ainsi le potentiel de croissance du Japon. Inverser la tendance à la hausse de l'emploi non régulier pourrait encourager une plus forte participation des femmes à la vie active, ce qui est essentiel dans un pays où le vieillissement démographique a déjà pour effet de réduire la population d'âge actif de près de 1 % chaque année. De même, le développement des services de garde d'enfants et un plus grand souci de l'équilibre entre travail et vie familiale contribueraient à stimuler l'activité féminine, tout en relevant le taux de natalité exceptionnellement bas du Japon.

Ce Document de travail se rapporte à l'Étude économique de l'OCDE de Japon, 2008 (www.oecd.org/eco/etudes/japon).

Classification JEL : J11; J3; J5; J7

Mots clés: le marché du travail; dualisme; protection de l'emploi; travailleurs non réguliers; travailleurs à temps partiel; taux d'activité; formation professionnelle; l'activité des femmes; travailleurs âgés; taux de fécondité; équilibre entre travail et vie familiale; Japon.

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REFORMING THE LABOUR MARKET IN JAPAN TO COPE WITH INCREASING DUALISM AND POPULATION AGEING

Randall S. Jones¹

1.1 Increasing dualism in the labour market is closely linked to Japan's unbalanced recovery, both as a cause and a consequence. The rising proportion of lower-paid non-regular workers (Figure 1) is pushing down wages and labour's share of income, thus limiting household income and private consumption, despite record high overall profits in the corporate sector. At the same time, firms, particularly small and medium-sized enterprises (SMEs) in the non-manufacturing sector, have relied on the cost savings generated by hiring non-regular workers to cope with rising input costs and the difficulty of passing on price increases in the context of weak domestic demand. Increased dualism creates equity concerns, as a large segment of the population is paid substantially lower wages, bears the brunt of cyclical changes in employment and is largely excluded from the social insurance system. In addition, labour market dualism acts as a drag on growth, as non-regular workers do not receive the same amount of training and thus fail to accumulate human capital to the same extent as regular workers. Given the importance of firm-based training in Japan, the growing segment of the labour force that benefits little from enterprise-based training, combined with the marked increase in the incidence of long-term unemployment, creates a need for greater vocational training outside firms. Wages have also been constrained during the past few years by demographic factors, notably the retirement of the baby boom generation born just after the end of the Second World War. Population ageing is reducing the working-age population and increasing the financial burden on the labour force. Measures to raise the labour force participation rate – particularly among women – and immigration are important policies to temper the impact of demographic change. At the same time, policies aimed at boosting female employment also should take account of the low fertility rate in Japan.

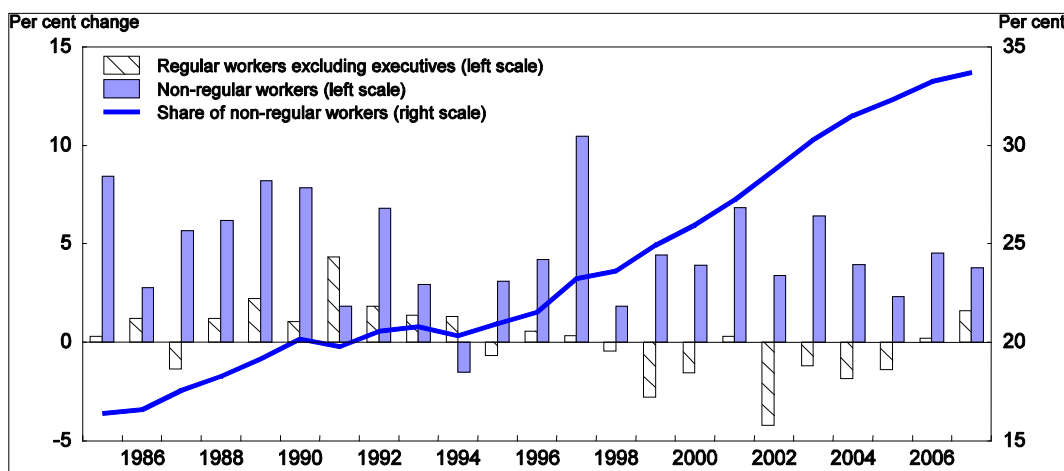
1.2 This paper begins by analysing the phenomenon of increasing dualism in the labour market, followed by a discussion of vocational training and the need for a government role in this area. The third section considers the impact of ageing and measures to limit the decline in the labour force. Policy recommendations are summarised in Box 1.

Falling wages and labour market dualism

1.3 Japan's labour market showed marked improvement during the 2002-08 economic expansion. Although total employment declined by 3.5% between 1997 and 2002, a majority of firms reported that they still had excess labour when the expansion began in 2002 and there was only one job offer for every two applicants. The unemployment rate peaked at a record high of 5.5% during 2002 and 2003, 1½ percentage points above its equilibrium (NAIRU) level, as estimated by the OECD (Figure 2). During the expansion, in contrast, employment rose by a cumulative 1%, despite the decline in the working-age population, thus reducing the unemployment rate below its equilibrium rate of 3.9%. The tightness in the labour market was also reflected in the improvement in the job-offer-to-applicant ratio, which remained above one between 2005 and 2007 on an annual average basis.

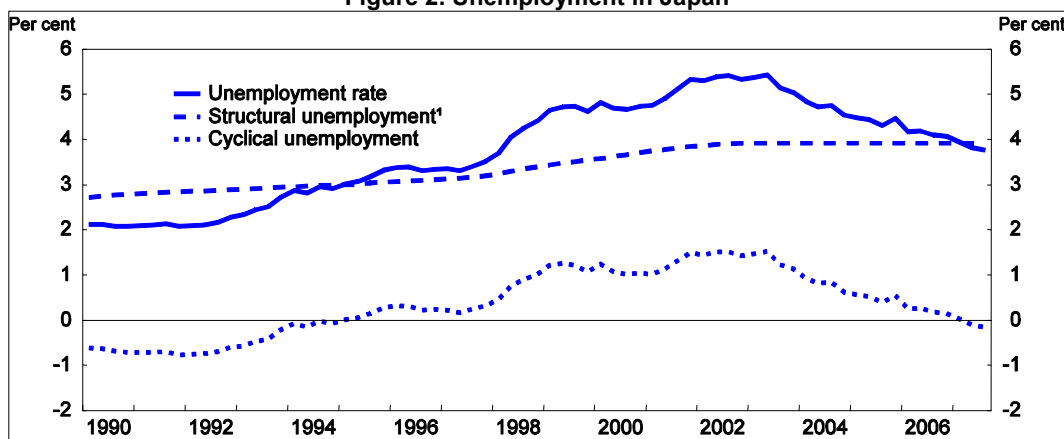
1. Randall S. Jones is head of the Japan/Korea Desk in the Economics Department of the OECD. This paper is based largely on material from the *OECD Economic Survey of Japan* published in April 2008 under the authority of the Economic and Development Review Committee (EDRC). The authors would like to thank Andrew Dean, Val Koromzay, Stefano Scarpetta, Masahiko Tsutsumi and Taesik Yoon for valuable comments on earlier drafts. Special thanks go to Lutécia Daniel for technical assistance and to Nadine Dufour for technical preparation.

Figure 1. The share of non-regular workers is rising



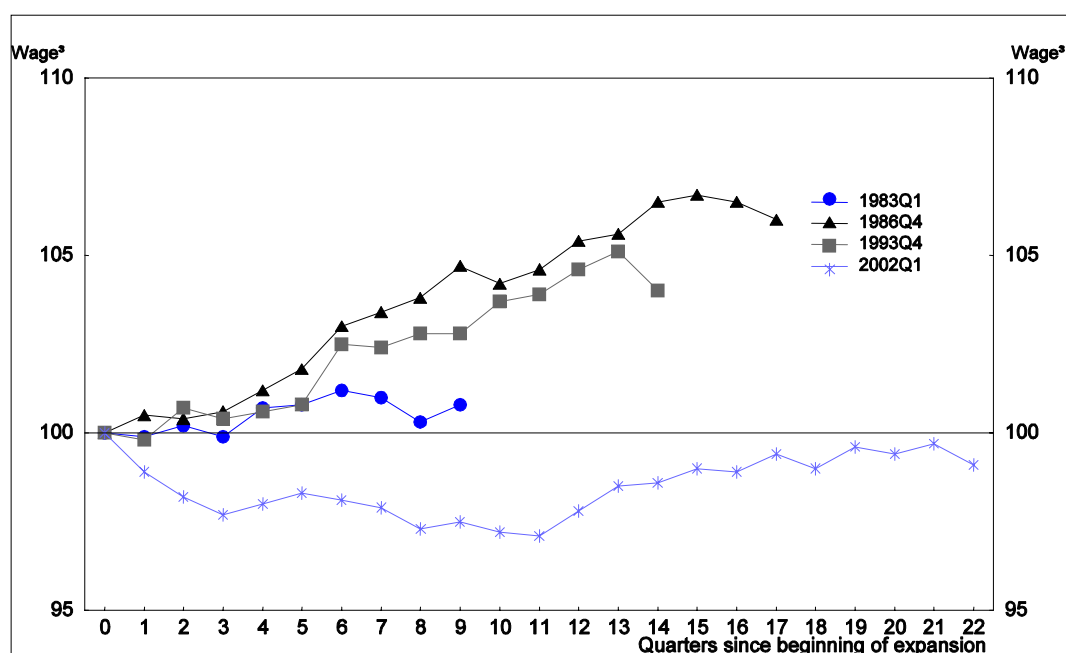
Source: Ministry of Internal Affairs and Communications.

Figure 2. Unemployment in Japan



1. OECD estimate of the unemployment rate consistent with a non-accelerating rate of inflation (NAIRU). Source: OECD, *Economic Outlook*, N° 82 database, OECD, Paris.

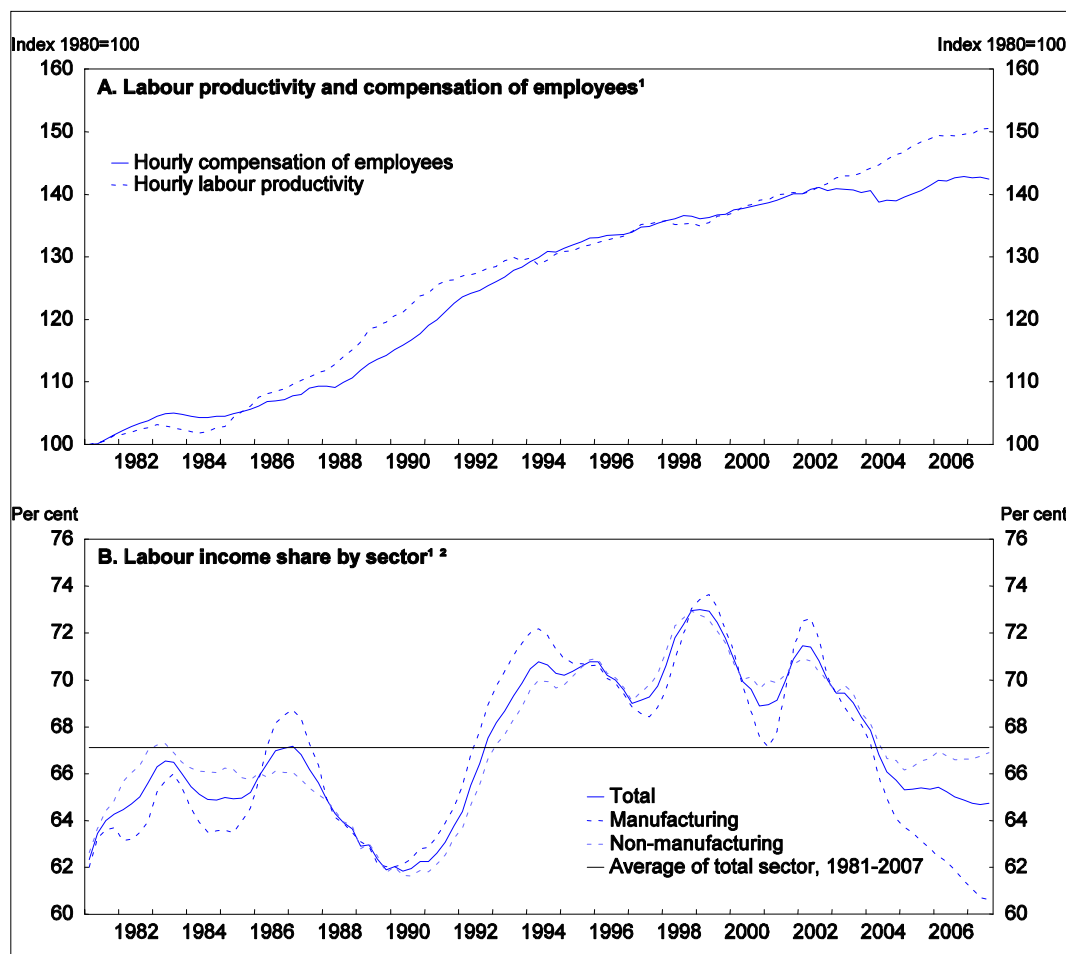
1.4 Despite the improvement in labour market conditions in recent years, wages have declined by 1% in real terms since the start of the economic expansion, which was the longest in Japan’s post-war history (Figure 3). Although wage growth turned positive in 2005, it returned to a downward trend in the second half of 2007. In contrast, previous expansions recorded significant increases in real wages, such as the 6% rise during the upturn that began in 1986. The downward trend in wages during this expansion cannot be explained by weak corporate profitability, as profits per employee have risen more than 80%, far exceeding the increases in previous upturns. Moreover, falling wages are not a result of weak gains in labour productivity, which has increased at a 1.8% annual rate since 2002 (Figure 4). Consequently, labour’s share of income has fallen significantly, from a peak of 73% in 1999 to less than 65% in 2007 (Panel B). However, there is a marked difference between sectors: labour’s share has rebounded in non-manufacturing, where profits and productivity have been weak, in contrast to the decline in the manufacturing sector to a record low.

Figure 3. Wage developments in this expansion compared to past upturns¹Wages equal 100 at the start of each expansion²

1. This figure includes all expansions beginning since 1980 except the aborted recovery of 1999, which only lasted eight quarters.
2. Wage growth per employee in real terms (adjusted by the CPI).
3. Wages are total cash earnings per worker at firms with more than 30 workers. The wage is a moving average (three quarters) of seasonally adjusted data.

Source: Ministry of Health, Labour and Welfare, *Monthly Labour Survey* and OECD.

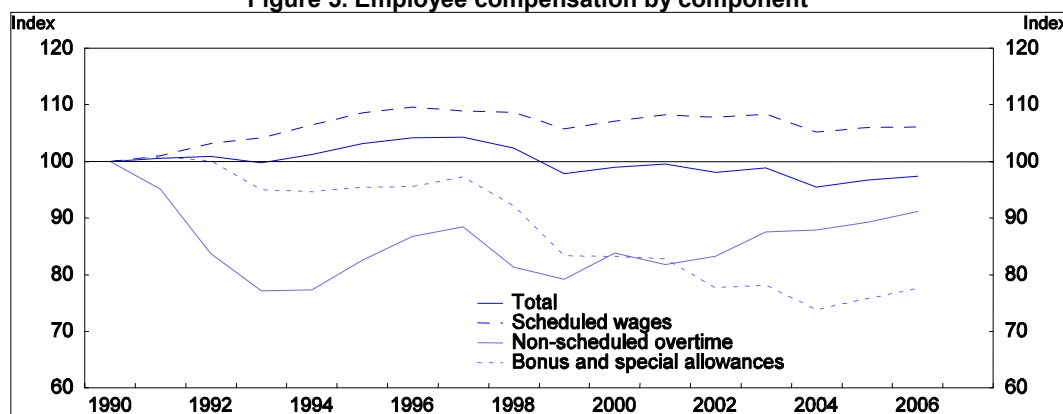
Figure 4. Productivity, wages and the labour income share



1. Four-quarter moving average.
2. Labour share is defined as personnel costs/ (personnel costs + depreciation + business profits).

Source: Cabinet Office, *National Accounts*, Ministry of Internal Affairs and Communications, *Labour Force Survey*, Ministry of Health, Labour and Welfare, *Monthly Labour Survey* and Ministry of Finance, *Financial Statement Statistics of Corporations by Industry*.

1.5 Real wages declined during the expansion despite a 14% rise in overtime pay between 2002 and 2007 (Figure 5), driven by increased output in the manufacturing sector. The sluggishness of overall wages was instead largely explained by weak gains in scheduled earnings, which are negotiated each year. In addition, bonus payments, which have traditionally played a profit-sharing role in the Japanese labour market, dropped by 3% between 2002 and 2007 despite buoyant profits. Bonus payments have become less important in recent years, falling from 27% of employee compensation in the early 1990s to 21% in 2007, due in part to the increasing proportion of non-regular workers, who generally do not receive bonuses.

Figure 5. Employee compensation by component^{1 2}

1. Figures are real (deflated by CPI) terms with 1990 = 100.
2. Establishments with more than 30 workers, all industries.

Source: Ministry of Health, Labour and Welfare, *Monthly Labour Survey*.

The increasing proportion of non-regular workers

1.6 Despite an increase in 2007, the number of regular workers has declined by almost 3% since the expansion started in 2002, lowering its share of total employees from 71.3% to 66.3% over that period (Table 1). Falling regular employment was more than offset by a rise in non-regular employment, which now accounts for more than one-third of total employment. Non-regular employment includes part-time workers, about two-thirds of this category, plus temporary and dispatched workers. By sector, the largest increases in non-regular employment were recorded in “other services” and in medical and nursing care (Table 2). Not surprisingly, the proportion of non-regular employment is highest in services, notably restaurants and hotels (65.4% in 2006) and “other services” (49.3%). In contrast, the share of non-regular employment has been relatively low and stable at around 20% in the manufacturing sector, which has benefited from the export-led expansion.

1.7 As for the supply side, the non-regular workforce includes young people on temporary contracts, married women working part-time and older persons who are re-hired by their former companies on fixed-term contracts. Table 3 summarises the major differences between workers by their employment status:

- Non-regular workers are concentrated among younger and older age categories, with a quarter under the age of 30 and almost a third over the age of 50. Overall, their average age is three to four years older than regular workers (Panel A).
- More than half of female employees are non-regular workers (Panel B). Consequently, two-thirds of non-regular workers are women.
- Non-regular workers tend to be less educated, as only 12.1% have a university degree compared to 31.4% for regular workers (Panel C).
- Nevertheless, the proportion of professional and technical workers among non-regular workers (13%) matches that of regular workers (Panel D).
- As noted above, non-regular workers are most prevalent in the service sector (Panel E).

Table 1. Employed persons by status

Year ¹	Total ²	Regular workers		Non-regular workers		Of which			
		Million	Per cent	Million	Per cent	Part-time workers ³		Other ⁴	
	Million	Million	Per cent	Million	Per cent	Million	Per cent	Million	Per cent
1985	40.0	33.4	83.6	6.6	16.4	5.0	76.2	1.6	23.8
1990	43.7	34.9	79.8	8.8	20.2	7.1	80.6	1.7	19.4
1995	47.8	37.8	79.1	10.0	20.9	8.3	82.4	1.8	17.6
2000	49.0	36.3	74.0	12.7	26.0	10.8	84.7	2.0	15.3
2001	50.0	36.4	72.8	13.6	27.2	11.5	84.7	2.1	15.3
2002	48.9	34.9	71.3	14.1	28.7	10.2	72.8	3.8	27.2
2003	49.4	34.4	69.7	15.0	30.3	10.9	73.0	4.0	27.0
2004	49.3	33.8	68.5	15.6	31.5	11.1	71.1	4.5	28.9
2005	49.2	33.3	67.7	15.9	32.3	11.0	68.8	5.0	31.2
2006	50.0	33.4	66.8	16.6	33.2	11.2	67.4	5.4	32.6
2007	51.2	33.9	66.3	17.3	33.7	11.7	67.5	5.6	32.5

1. Data is as of February until 2001 and as of the first quarter since 2002.

2. Total excluding executives.

3. The significant fall in the number of part-time workers in 2002 and rise in the other category is due to a change in the questionnaire. Part-time workers are defined as those working less regular hours on a daily or weekly basis than regular workers in the same workplace.

4. The category "other" includes those working on short-term contracts, dispatched workers (employed by temporary worker agencies), entrusted workers and other types of non-regular workers.

Source: Ministry of Internal Affairs and Communications, *The Special Survey of the Labour Force*, from 1984 to 2001 and the *Labour Force Survey (Detailed Tabulation)* since 2002.

Table 2. Employment by industry and employee status

Industry	Growth from 2002-06			Composition in 2006
	Total employment ¹	Regular employment	Non-regular employment	Share of non-regular employment
Construction	-9.5	-11.9	2.9	18.4
Manufacturing	-4.9	-5.6	-1.4	20.7
Transport	-1.0	-4.7	13.6	23.1
Wholesale and retail	-1.0	-7.3	8.3	44.3
Restaurants and hotels ²	-3.7	-8.8	-0.6	65.4
Medical and nursing care ²	15.0	11.6	23.2	33.1
Other services ²	17.9	1.6	42.3	49.3
Total	3.7	-1.7	16.8	33.2

1. Excluding executives.

2. From 2003 to 2006.

Source: Ministry of Internal Affairs and Communications, *Labour Force Survey (Detailed Tabulations)*.

- Non-regular workers are concentrated in SMEs (Panel F). Indeed, the proportion of non-regular workers is twice as high in firms with five to 29 employees, at 37.9%, as in firms with more than 1 000 workers.
- Most non-regular workers are paid an hourly wage while regular workers are paid on a monthly or annual basis (Panel G).
- The average number of hours worked by non-regular employees is significantly lower (Panel H), reflecting the large number of part-time workers in this category (Table 1). However, nearly half work more than 35 hours a week.
- There is a major difference in social insurance coverage: while virtually all regular workers are covered by the social insurance systems, less than half of non-regular workers are covered by employees' pension and health insurance, while two-thirds are covered by employment insurance (Panel I). However, some are covered as second earners in a household.
- Non-regular workers change jobs relatively frequently (Panel J): 21.5% have less than one year of tenure and only 13% have more than ten years, compared to 49.4% in the case of regular workers.

1.8 According to a 2006 survey of firms, reducing labour costs is the most important reason why firms hire non-regular workers (Table 4). Indeed, cutting labour costs was cited by 71% of firms (Panel A) as the major advantage of employing part-time workers (58.4% in the case of other non-regular workers). The proportion was somewhat higher than in a similar 2001 survey, suggesting that the corporate sector is even more focused on cutting costs in this economic expansion than during the 2001 downturn. On an hourly basis, part-time workers were paid only 40% as much as full-time workers in 2006.² In addition, hiring non-regular workers reduces firms' payments for bonuses and retirement allowances.³ Moreover, firms hiring part-time workers benefit from an additional 13% of savings in non-wage costs because employees working less than a certain number of hours are exempted from health insurance, pension contributions and employment insurance, thus eliminating the need for co-payments from employers.⁴ Firms justify the difference in wages between regular and part-time workers on a number of grounds: *i*) part-time workers have more flexibility in working hours (73%); *ii*) regular workers are expected to contribute more (33%); *iii*) regular workers are subject to more frequent and longer over-time work (31%); and *iv*) regular workers are expected to transfer to different work places (15%).

-
2. The difference has been relatively stable since 1993. However, according to the 2006 survey cited in Table 4, 40% of firms did not give any pay increase to non-regular workers, while only 20% did not give pay increases to regular workers. This reflects the fact that 34.4% of regular workers get regular promotions compared to only 7.7% for non-regular workers.
 3. The 2006 survey cited in Table 4 also asked firms why non regular workers cost less. For part-timers, firms cited wages (70.3%) bonuses (63.5%), retirement allowances (47.9%) and social security payments (35.1%). For other non-regular workers, the numbers were bonuses (70.6%), wages (64.2%), retirement allowance (54.8%) and social security payments (18.9%). In addition, around 6% of firms cited lower costs of training for part-time and other non-regular workers.
 4. Employees who work less than three-quarters of the hours worked by regular employees in an enterprise (on a daily, weekly or monthly basis) are exempted from employees' pension and health insurance contributions. Employees working less than one year or less than 20 hours a week are exempted from employment insurance.

1.9 The strategy of reducing labour costs through increasing non-regular employment appears to be effective, as there is a strong negative correlation between the rise in part-time employment and wage growth by industry (Figure 6). The four service industries with the largest increases in part-timers – retail, restaurants and hotels, medical and nursing care and other services – also experienced the largest wage declines. These four industries alone account for almost half of total employment in Japan.

1.10 The survey of firms also reported that employment flexibility is a second important objective for hiring non-regular employees; in 2006, 23.8% hired part-time workers to cope with temporary increases in demand (Column B) and 21.9% did so to facilitate adjustments in their workforce to business fluctuations (Column C). Similar proportions hired other types of non-regular workers for these reasons. The enhanced flexibility afforded by using non-regular workers is important to compensate for the high level of employment protection provided to regular workers. Indeed, Japan is ranked tenth out of 28 OECD countries in terms of the strictness of employment protection for regular workers, including voluntary practices by enterprises (OECD, 2004). The 2003 revision of the Labour Standard Law stated that any dismissal of workers that is not objectively justifiable and that is not considered to be acceptable by society's standards shall be deemed an abuse of power and is therefore invalid. Judicial precedents have set four conditions to judge whether employment adjustments as a result of corporate downsizing can be deemed to be an abuse of power by a firm; *i)* the necessity of the firm reducing its workforce; *ii)* whether efforts were made to avoid dismissals, such as taking alternative measures that could achieve the necessary reduction; *iii)* whether the selection of employees for dismissal was reasonable and objective; and *iv)* whether the overall dismissal procedure was judged to be acceptable.⁵ Given these conditions, enterprises cannot fully anticipate beforehand if measures to rationalise their workforce will be accepted by the courts.

5. Prior to 2003, the legal code did not specify any legal grounds for dismissing workers in principle. A reform proposed by the government in 2003 stated that corporations have the right, in principle, to dismiss workers. However, this was eliminated from the bill due to resistance from opposition parties and labour unions. The new law states that any dismissal of workers that is not objectively justifiable and that is not considered to be acceptable by social standards shall be deemed an abuse of power and therefore invalid.

Table 3. A comparison of regular and non-regular workers¹
In per cent unless indicated otherwise

A. Average age in years	Male	Female	Percentage under age 30
Regular workers	39.6	37.0	23.0
Non-regular workers	43.2	41.0	25.1
B. Gender	Male	Female	Female employees by status
Regular workers	47.3	18.2	44.4
Non-regular workers	11.8	22.7	55.6
C. Education ²	Lower secondary	Upper secondary	University
Regular workers	2.4	42.2	31.4
Non-regular workers	7.2	55.8	12.1
D. Occupation	Clerical workers	Service workers	Professional/technical workers
Regular workers	44.7	6.2	13.4
Non-regular workers	25.5	24.0	13.2
E. Sector ³	Manufacturing	Services	Construction
Regular workers	76.7	58.7	85.6
Non-regular workers	23.3	41.3	14.4
F. By size of company ³ (number of employees)	More than 1 000	30 to 999	5 to 29
Regular workers	81.0	66.6	62.1
Non-regular workers	19.0	33.4	37.9
G. Wage payment system	By hour	By day	By month or year
Regular workers	2.3	4.9	89.7
Non-regular workers	66.4	8.7	21.3
H. Working time	Average hours per week	Percentage below 35 hours	Average days per week
Regular workers	40.4	0.6	5.3
Non-regular workers	30.3	53.0	4.8
I. Coverage by social insurance	Employees' pension	Health insurance	Employment insurance
Regular workers	99.3	99.6	99.4
Non-regular workers	47.1	49.1	63.0
J. Tenure	Less than 1 year	1 to 10 years	More than 10 years
Regular workers	3.9	45.8	49.4
Non-regular workers	21.5	65.5	13.0

1. Non-regular workers include part-time workers, temporary workers, dispatched workers, workers on loan from other companies, and contract workers. This survey is based on a random sample of 16 232 firms (with more than five employees) and 35 094 workers engaged in those firms. The response rate was around 70%. The numbers in the table show the sample average of the answers to the survey.

2. Highest level of education attained.

3. Figures show the percentage of regular and non-regular employees in each sector and for each size of company.

Source: Ministry of Health, Labour and Welfare, *General Survey on Diversified Types of Employment*, 2003.

Table 4. Reasons given by firms for hiring non-regular workers¹

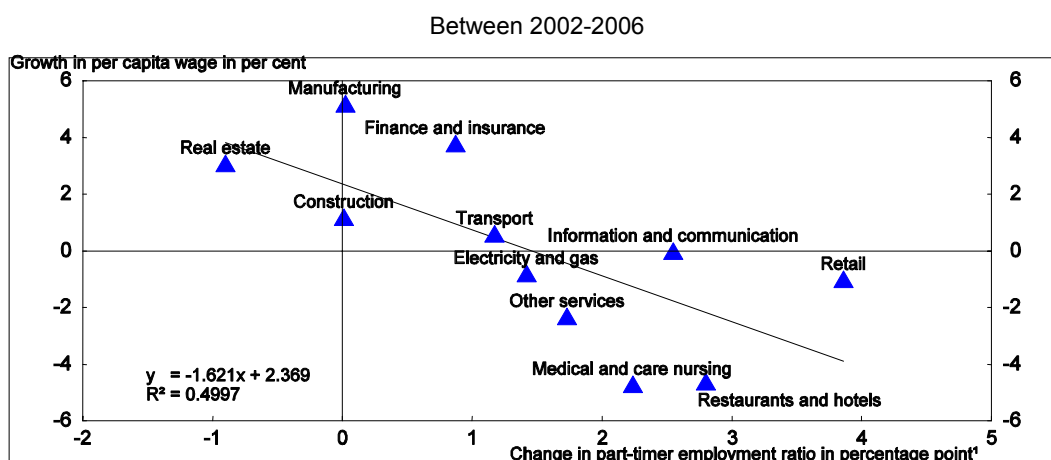
	Share of firms hiring non-regular workers	To reduce costs	To cope with temporary increases in demand	Facilitate adjustment to business fluctuations	To cope with busy periods in the day	To work on easy tasks	Easy to hire	To hire experienced and skilled workers	To re-employ retired regular workers	Difficulty in finding new graduates for regular jobs	Other answers or unknown
		(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)
2001 survey											
Part-time workers	56.6	65.3	27.3	16.4	39.2	31.4	17.8	12.2	12.4	5.8	6.5
Other non-regular workers ²	15.3	57.9	17.3	19.6	11.0	15.7	8.1	19.8	16.0	6.4	13.0
2006 survey											
Part-time workers	61.0	71.0	23.8	21.9	39.5	36.3	29.5	18.8	15.5	12.9	7.9
Other non-regular workers ²	17.3	58.4	18.8	19.0	9.0	18.6	15.0	31.9	29.3	16.1	17.1

1. Firms were allowed to give multiple answers. This survey was a random sample of 9 133 firms with more than 5 employees (the response rate was 72.8%).

2. Other workers are non-regular workers whose working hour is same as regular workers or longer.

Source: Ministry of Health, Labour and Welfare (2007b), *General research on the condition of part-time workers, 2006*.

Figure 6. The link between wage growth and part-time employment



1. Change in the percentage of part-timers in total employment.

Source: Ministry of Health, Labour and Welfare.

1.11 In a world of increasing competition, Japanese firms have an incentive to maintain a minimum number of regular workers and to adjust to demand fluctuations by relying on non-regular workers and outsourcing. While employment protection legislation applies to all workers in principle, non-regular workers, who in general are non-unionised, are less protected in practice. Employment protection is thus strongest for regular workers, who are defined as those with indefinite contracts. Moreover, many non-regular workers have fixed-term contracts, making it easy for the firms to terminate employment by not renewing the contract. In sum, non-regular employment helps firms achieve the profit-maximising levels of output and employment, while containing adjustment costs.

1.12 The survey of firms in Table 4 suggests a number of other reasons for the growing use of non-regular workers. *First*, a rising number of firms have hired experienced and skilled workers as non-regular employees, suggesting that labour mobility is increasing (Column G). *Second*, demographic factors have also boosted the re-employment of older persons, who retire as regular workers when they reach company retirement ages but continue to work on fixed-term contracts (Column H).⁶ *Third*, increasing competition for new graduates has forced some firms to rely on non-regular workers instead.⁷ The number of new graduates hired rose by 19% between 2002 and 2006, with the manufacturing sector recording a 32% increase, according to the Tankan Survey by the Bank of Japan. Given the declining pool of young people graduating from school, the number of firms hiring non-regular workers because of difficulty in finding new graduates jumped from around 6% in 2001 to between 12.9% and 16.1% for part-time and other non-regular workers, respectively, in 2006 (Column I).

1.13 In addition to part-time workers, other categories of non-regular employment, notably dispatched workers (who are employed by temporary worker agencies) and employees on fixed-term contracts, have increased significantly in recent years (both are included in the “other category” in Table 1). The rise in

6. In fact the category “To re-employ retired regular workers” includes both older workers and women who leave regular jobs. In 2006, the share of firms rehiring older persons as part-timers or other non-regular work was 8% and 22%, respectively. As for women, the proportion was around 7% for both categories.

7. Between 1997 and 2003, the number of new graduates hired fell by more than half, sharply raising the unemployment rate for those in the 15 to 24 age group to a double-digit level and boosting the proportion of idle youth who were not in the labour force or in school (the so-called “NEETs”).

these types of employees was facilitated by changes in labour laws. In 2003, the maximum length of fixed-term contracts was extended from less than one year to three years and to five years in the case of workers who have specialised knowledge or who are over the age of 60. The number of sectors where dispatched workers are permitted has been gradually expanded from 13 specific job categories and now includes manufacturing, although such workers are still prohibited in some areas, notably construction and much of the healthcare sector.

1.14 While for some workers, such as second earners in a household, lower pay can be compensated by the opportunity to work in flexible and diverse ways that match their lifestyle, the wide disparities in the treatment of non-regular workers raises a number of equity concerns. *First*, the large gap in wages appears to be too large to be explained by productivity differences, suggesting that there is an element of discrimination in the segmented labour market.⁸ *Second*, non-regular workers are poorly covered by the social safety net. *Third*, given that firms hire non-regular workers to enhance employment flexibility, non-regular workers bear the brunt of the adjustment in employment during periods of economic weakness, resulting in their short average tenure compared to workers (Table 3). *Fourth*, the traditional employment system in Japan, based on long-term employment stability, has encouraged firm-based training of workers, since long tenures make such investment worthwhile. However, given their short average tenure, non-regular workers receive less firm-based training in Japan.⁹ This has negative implications both for the individual non-regular workers and for Japan's potential growth rate.

1.15 The negative consequences of a dualistic labour market are reinforced by the limited mobility between the segments of the labour market. Not surprisingly, for those between the ages of 20 and 35, 76% of the men and 69% of the women who were non-regular workers hoped to become regular workers, according to a 2003 survey by the government.¹⁰ However, another government survey reported that only 23% of part-time workers who changed jobs in 2005 were hired as regular workers, compared to 31% in 1990. In sum, the dualistic labour market traps a large proportion of the labour force in low-paying jobs with little employment security, limited coverage by the social safety net and limited access to training.

8. In 2000, female part-time workers earned 55% as much as female regular workers. One study (Onoue, 2003) found that differences in age and tenure accounted for only 5 to 10 percentage points of the difference. In other words, after adjusting for the age and tenure of a part-time female employee, she earned only 60% to 65% as much as a regular female employee. The results are consistent across sectors. For example, in the service sector, part-time workers make 56% as much as regular employees. Adjusting for age and tenure reduces the gap by only 6 to 9 percentage points.

9. This was shown in Ministry of Health, Labour and Welfare (2007a), which surveyed 6 886 firms and 23 637 employees. According to firms, 72.2% provide "off-the-job" (formal) training for regular workers but only 37.9% provide it for non-regular workers. According to the survey of employees, 58.2% of regular workers said that they had received off-the-job training, compared to only 31% of non-regular workers. This problem is acknowledged in Ministry of Health, Labour and Welfare (2007c), which called for more focus on the lack of opportunities for non-regular workers to develop their human resources. It is necessary, therefore, to develop a system that allows all workers, regardless of their current employment status, to develop their human capital and thereby increase their earnings.

10. This is based on the "Actual conditions survey on the attributes of young people" in 2003 by the Cabinet Office. However, a survey covering all age groups, the "General survey on the actual conditions of diversification in employment styles" in 2003 by the Ministry of Health, Labour and Welfare found that only one-fifth of non-regular workers wished to become regular workers. This indicates that older workers and second earners in households are less concerned about non-regular employment.

Policies to cope with increased labour market dualism

1.16 The 1993 Part-time Workers Law was revised in 2007 in an effort to improve the working conditions of part-time workers. The revisions, which were fully implemented in April 2008, are aimed at achieving balanced treatment of all part-time workers relative to regular workers. The key points of the revision include:

- To reduce uncertainty about working conditions, the revision introduced an administrative penalty (up to 100 thousand yen) on employers that fail to explicitly disclose the possibility of wage hikes and whether the employee will receive the retirement allowance and bonus payments.
- The revised law prohibits discriminatory treatment of part-time workers who have the same job description, degree of job rotation and type of labour contract as regular workers. This provision thus applies only to part-time workers with regular contracts. However, no penalties are imposed on firms that fail to provide such treatment, although the government can issue orders to improve the situation.¹¹
- To encourage mobility, the revised law requests employers to implement measures to shift part-time employees to regular employee status through a system of internal promotions and transfers.
- The labour market dispute resolution mechanism that exists in all prefectures can be used by part-time workers.
- Public support for part-time workers is provided through subsidies to employers who provide fair treatment for part-time workers, based on certain criteria, such as introducing a common wage mechanism for regular and part-time workers and health checks. This system is operated by a non-profit organisation created by the government. It appears that a firm would be able to get up to 1.7 million yen (about \$16 thousand) from this subsidy scheme.

1.17 The direct impact of the provisions against discriminatory treatment may not be so large, as they protect only around 4-5% of part-time workers. However, over time, the provisions against discrimination could have a larger impact to the extent that it encourages employers to change management practice and improve the treatment of part-time workers. In practice, international experience suggests that it is often difficult how much of the wage gap between regular and part-time employees is explained by workers' characteristics (education, experience, etc) and how much is due to discrimination. Given these uncertainties, enforcing a prohibition on discrimination against part-time employees could subject firms to costly and time-consuming litigation that would discourage the employment of such workers. For example, if non-discrimination were interpreted as wage parity, the total wage bill could increase substantially. The end result could be a reduction in employment of part-time workers and in overall employment. In any event, the anti-discrimination provision will only cover a small fraction of part-time workers, as noted above. In addition, the introduction of subsidies for firms improving their employment practices for part-time workers raises concerns, as these subsidies often result in high deadweight costs.

1.18 A second concern is whether requesting employers to introduce schemes for mobility between part-time and regular status will have any effect. Management is already free to shift part-time workers to

11. The Labour Standards Law prohibits discriminatory treatment of employees based on gender, nationality, religion, etc. Violations are subject to fines and imprisonment. In general, though, this law has not been applied to discrimination against non-regular workers, on the grounds that wages are determined freely and independently by firms and workers.

regular jobs, so it is doubtful whether the government's request will have much impact. Moreover, given that forcing firms to increase the flow of part-time workers to regular worker status could lead to even worse results, the revised law should not be treated as an obligation. Instead, the government should address the underlying causes of immobility in the labour market, notably labour costs, employment flexibility and the lack of a secondary market for experienced workers. Enhancing mobility requires removing features that discourage regular workers from moving, for example by abolishing preferential treatment of retirement allowances and shifting firm-based pension and health insurance systems to individual-based systems. As for labour costs, while the government cannot narrow the difference in wages, it should decrease the overall gap in labour costs by increasing the coverage of non-regular workers by the social insurance system. In addition, it should reduce employment protection for regular workers to weaken the incentives to hire non-regular workers. Countries with strict protection for regular workers tend to have a higher incidence of temporary employment (Grubb *et al.*, 2007). While the incentive could be reduced by raising the effective protection for non-regular workers, such an approach would risk reducing overall employment. Finally, the government needs to ensure adequate training for non-regular workers.

Ensuring adequate vocational training in Japan

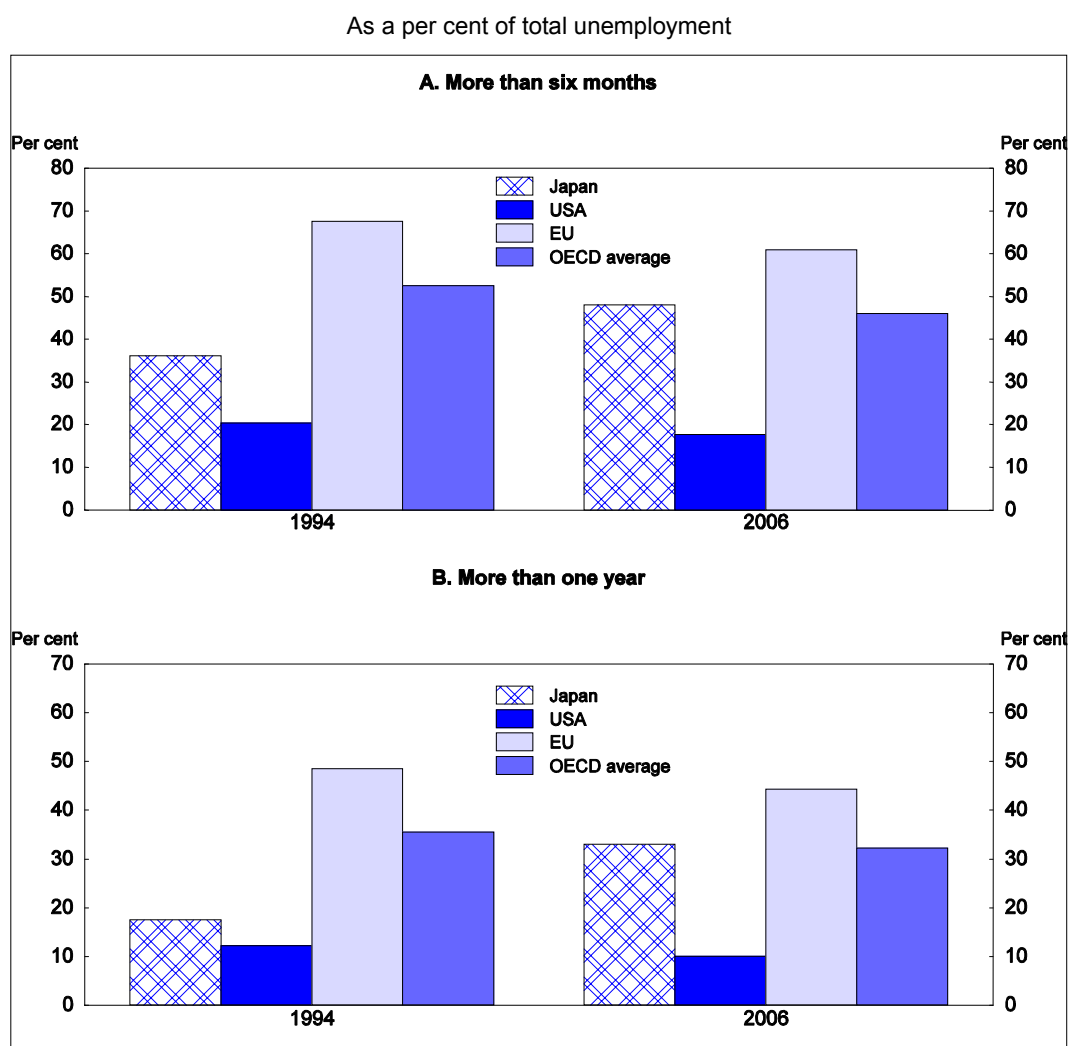
1.19 Traditionally, job training in Japan has been a company responsibility, especially in large enterprises, in a context of long-term employment relations. In contrast, public training programmes were relatively limited compared to other OECD countries. For example, public expenditure on training programmes for the unemployed amounted to only 0.04% of GDP in FY 2005, well below the OECD average of 0.17%. Direct provision of job training by the public sector varies by content and duration. For example, there are six-month training courses for those who need new skills to be re-employed, weekly training courses for those who wish to improve their skills, and long-term courses for youth who need to master skills and knowledge necessary to be employed. In addition, several training programmes are outsourced to private schools and institutions depending on the speciality. On average, nearly 0.5 million persons (0.6% of the working-age population) participate in programmes per year. Including financial support for employees and employers, total spending amounted to 145 billion yen (0.1% of government spending) in FY 2007.¹²

1.20 However, the rising proportion of non-regular workers who benefit little from firm-based training creates a need for a larger government role in this area. The problem is concentrated among the so-called "freeters".¹³ The government estimates that there were 1.87 million freeters in 2006, accounting for 5.9% of the 15 to 34 age group and 2.3% of the total working-age population. The problem is most serious among those in the 25 to 34 age group who graduated from school when the hiring of new graduates was sharply reduced and have since moved from one non-regular job to another with gaining much job experience. More generally, Japan has an increasing incidence of long-term unemployment in contrast to the downward trend observed in the OECD area in recent years (Figure 7). Indeed the proportion of unemployed who are out of work for more than one year has almost doubled from 17.5% in 1994 to 33% in 2006, surpassing the OECD average. Long-term unemployment poses a particular challenge as it leads to a deterioration in workers' skills, making it harder for them to find a job.

12. For a detailed account of this issue, see Ministry of Health, Labour and Welfare (2006a). The government made a five-year plan to improve such programmes based on the advice of employers, employees and outside experts.

13. "Freeters" are defined as people between the ages of 15 and 34 who have graduated from school (for women, those who have graduated and are unmarried) and who are; i) employed as part-time workers, or as an *arbeit* (refers to a young person working a secondary or temporary job while engaging in some other activity, such as education); ii) unemployed and searching for a part-time job or an *arbeit* position; or iii) out of the labour force and expecting to find a part-time job or an *arbeit* position.

Figure 7. An international comparison of long-term unemployment



Source: OECD (2007), *OECD Employment Outlook*, OECD, Paris.

1.21 Job training and job search assistance activities are major themes of the "Challenge Again" plan launched in 2006 to assist those facing unemployment and financial difficulties.¹⁴ This initiative includes new and existing programmes:

- A total of 59 policies,¹⁵ including training, counselling and the creation of employment opportunities, are aimed at freeters. The objective is to reduce the number of freeters, which peaked at 2.17 million persons in 2003, to 1.74 million by 2010. Another objective is to ensure permanent worker status for 250 thousand freeters.

14. This programmes is described at (<http://www.kantei.go.jp/jp/saityarenzi/Outline.pdf>).

15. The total includes 15 new programmes, 39 existing programmes and the expansion of five existing programmes.

- There are 11 policies aimed at non-regular workers, including part-time workers. In addition to training, this includes the revision of the Labour Contract Law to specify rules on labour contracts for all workers, including non-regular workers such as employees on fixed-term contracts. Other important elements include the revision of the Part-time Workers Law to realise balanced treatment (see above), and the expansion of social security coverage.
- Ten policy actions have been introduced for adult re-education. These measures include the provision of education-related counselling and educational opportunities by the creation of “Challenge Again” education support councils in ten specific areas, and support for the development and implementation of practical education programmes at universities and technical colleges.

1.22 As many of the policies were only implemented in FY 2007, it is too early to evaluate their impact. Evidence from OECD countries suggests that appropriate training policies can improve the labour market position of specific targeted groups (OECD, 2004). In addition, higher spending on labour market training is associated with lower unemployment (OECD, 2006b). At a macroeconomic level, it is clear that investment in human capital fosters economic growth and long-term improvements in living standards. The success of training in Japan will depend on the design of the programmes and the extent to which they provide qualifications and expertise that are attractive to firms. It is essential to closely monitor the outcomes of these training initiatives in order to ensure a positive outcome.

Coping with a rapid population ageing

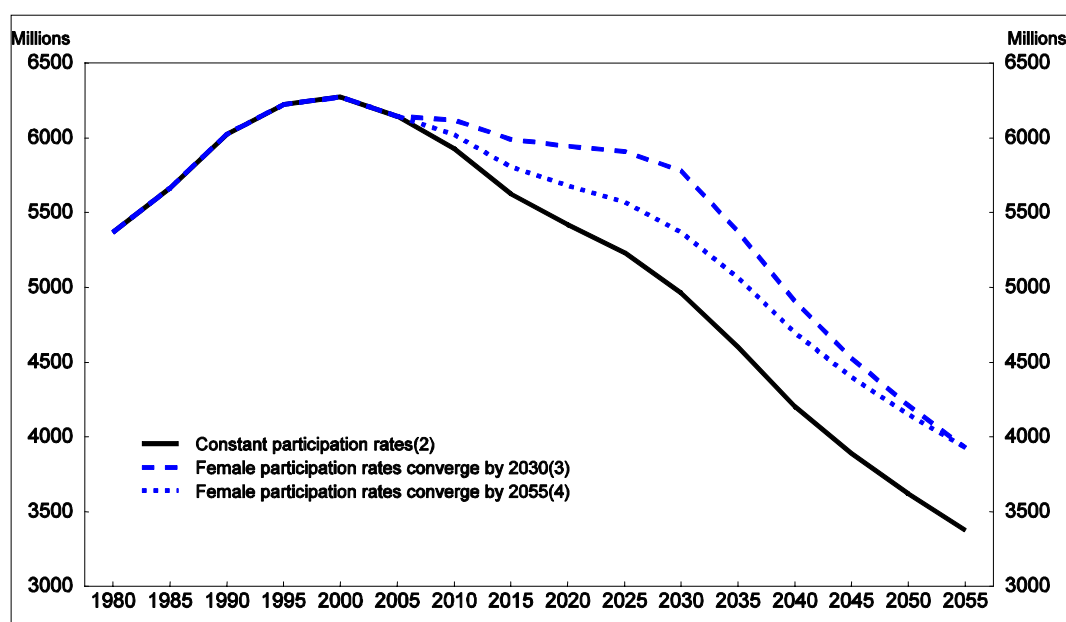
1.23 Japan’s working-age population (ages 15 to 64) declined by 3.4% between the decade 1996 to 2006. The upward trend in the participation rate partially offset the impact on the size of the labour force, which declined by less than 2%. The government projects an additional 9% decline in the working-age population over the next decade, the largest fall expected in the OECD area, suggesting that policies to promote labour force participation are a priority. The employment to population ratio for men, though, was the fourth highest in the OECD area at 81% in 2006. Moreover, the rate for older men – at 80% - is well above the OECD average of 63%. This suggests that the scope for increasing labour inputs depends primarily on raising the relatively low participation rate for women. For prime-age women (the 25 to 54 age group), the rate is the sixth lowest in the OECD area (OECD, 2006b). Moreover, the proportion of women who work part-time is one of the highest in the OECD area at 41%.

1.24 The size of Japan’s labour force depends importantly on female labour force participation. If the rate for each age cohort by gender remains at its 2005 level, the labour force would decline by a fifth by 2030, based on the government’s population forecast (Figure 8). In contrast, if female participation rates were boosted to the current level for men by the year 2030 for each age cohort, the decline in the labour force would be limited to 6%, about a third as much as in the case of unchanged participation rates, thus easing the burden of population ageing on the labour force. Looking further ahead to mid-century, changes in the female participation rate make less of a difference: the labour force would fall by 41% assuming unchanged participation rates compared to 31% if female rates converge to male levels. By that point, the proportion of elderly (over age 65) is projected to reach 72% of the working-age population, aged 20 to 64, the second highest rate in the OECD area (Figure 9). Coping with the demographic situation over the longer term thus depends on promoting labour force participation, as well as by increasing population growth by raising the fertility rate and allowing more immigration.¹⁶

16. The issue of immigration was discussed in depth in the 2006 *OECD Economic Survey of Japan*.

Figure 8. Long-term projections of the labour force

Labour force with different scenarios for female participation(1)

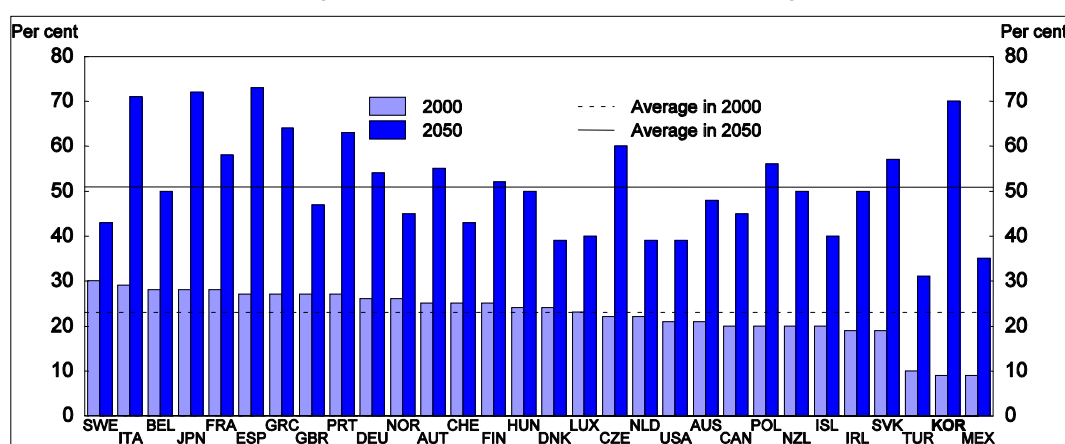


1. Labour force covers the 15 to 64 aged population.
2. The participation rates for men and women remain at their current levels for each age group.
3. The female labour participation rates converge by 2030 to the rates for males for each age group.
4. The female labour participation rates converge by 2055 to the rates for males for each age group.

Source: National Institute of Population and Social Security Research, *Population Projection for Japan* (December 2006 version), and Ministry of Internal Affairs and Telecommunications, *Labour Force Survey*.

Figure 9. Population ageing in OECD countries

Population aged 65 and over, relative to the population aged 20-64



Source: OECD (2006c), *Society at a Glance: OECD Social Indicators*, OECD, Paris.

Encouraging greater labour force participation by women

1.25 The government launched a package of 21 initiatives in 2006 to increase the female labour force by a quarter million by 2015. In particular, these policies are aimed at facilitating the re-employment of mothers, reflecting the fact that around 60% of women withdraw from the labour force when their first child is born. The initiatives include the provision of job counselling and specialised job placement centres for women with children. Despite these efforts, a number of the policy recommendations to boost female labour force participation contained in past *OECD Economic Surveys of Japan* remain important:

- Reducing dualism in the labour market would help expand regular employment, thus enhancing the attractiveness of employment for women. As noted above, women account for about two-thirds of non-regular workers.
- The tax and social security systems should be reformed to reduce disincentives to work by secondary earners.
- Increasing the importance of performance assessment in pay and promotion decisions would reduce the importance of seniority and tenure, thus narrowing wage gaps between genders.
- The availability of childcare facilities should be increased by easing the licensing regulations and encouraging more private-sector firms to enter this sector. There is not sufficient capacity in certified day-care centres in major urban area. Profit-making companies were allowed to enter this sector in 2000, subject to strict licensing conditions.

1.26 The biggest obstacle to greater integration of women in the labour market is probably some workplace practices that are difficult for those with family responsibilities. This problem has been acknowledged by the growing government emphasis on “work-life balance”. A 2005 law obliges firms with more than 300 workers to make an action plan to promote work-life balance. By June 2006, nearly all companies had submitted plans and the government is currently helping smaller enterprises develop similar programmes. Companies that introduce policies to help their employees balance work and childcare can receive awards from the government. In addition, it is important to strictly enforce the Labour Standards Law, which sets working time at 40 hours per week and limits overtime work to 15 hours per week, 45 hours per month, 120 hours per quarter and 360 hours per year.

Policies to increase the low birth rate

1.27 As noted above, measures to boost the fertility rate would help ease the demographic challenge in Japan. The fall in the birth rate (the total fertility rate), from 2.16 in 1971, to 1.26 in 2005, is a major concern of the government. Although it rebounded to 1.32 in 2006, it remains the lowest in the OECD area after Korea. The declining birth rate is due to delayed marriage and the fall in the number of children per couple. Empirical research (Date and Shimizutani, 2004) suggests that a number of factors influence the birth rate: *i)* labour force participation of women tends to reduce fertility, with the impact stronger for full-time than part-time workers; *ii)* a higher wage level for women is negatively correlated with childbearing, reflecting higher opportunity costs, while higher income for men is positively correlated; *iii)* child support by firms is positively correlated with the childbearing of female employees; and *iv)* the availability of childcare services promotes employment, marriage and childbearing.

1.28 The government implemented several plans to reverse the declining birth rate such as “The Angel Plan” in 1994 and “The New Angel Plan” in 2000, which focused on improving the environment for childbearing, including reforms in the areas of employment, social welfare and education. Nevertheless, the birth rate continued to fall during this period. More recently, the government has been increasing spending on policies aimed at boosting fertility. Such expenditures rose by 12% in FY 2007 to

1.7 trillion yen (0.3% of GDP). This funded a hike in the child allowance¹⁷ and raised the rate of child-care leave benefits. In addition, preferential tax treatment will be provided to companies that establish a qualified on-site day care centre. Finally, affirmative labour market policies related to young and non-regular workers will be introduced. To evaluate policies in these areas, the government established a committee, which issued its final report in December 2007. It stated that; *i*) effective fiscal expenditure is needed to support the social infrastructure for achieving good balance between working and childbearing and this should be regarded as investment rather than consumption; *ii*) the provision of healthcare and employment insurance, child welfare, and maternal and child healthcare need to be better co-ordinated; and *iii*) work-life balance should be decided freely between employers and employees while the government provides the necessary social infrastructure to achieve such a balance.

1.29 Efforts to expanding the availability of childcare are likely to increase the fertility rate (D'Addio and Mira d'Ercole, 2005), while at the same time encouraging women to work (Jaumotte, 2003). Policies that reduce the direct cost of children, such as child allowances, also boost fertility rates in OECD countries. However, such policies have also been found to lower female employment by reducing the need to work (Jaumotte, 2003). Given the more immediate priority of mitigating population ageing through greater female labour force participation, policy measures to increase fertility should focus on those likely to also boost female employment at the same time.

Conclusion

1.30 Japan's challenges of rising labour market dualism, weak productivity growth in non-manufacturing sectors, increased income inequality, low female labour force participation and a low fertility rate are inter-related. With Japan's working-age population projected to decline by more than 40% by 2050, it is essential to make efficient use of the country's human resources, including women and young people. Resolving these problems requires a comprehensive approach that is summarised in Box 1.

Box 1. Summary of recommendations to reform the labour market

Reverse the trend toward increasing labour market dualism

- Reduce employment protection for regular workers to reduce the incentive for hiring non-regular workers to enhance employment flexibility.
- Expand the coverage of non-regular workers by social insurance systems based in workplaces, in part by improving compliance, in order to reduce the cost advantages of non-regular workers.
- Increase training to enhance human capital and the employability of non-regular workers, thereby improving Japan's growth potential.

Raise the labour force participation rate of women, while encouraging higher fertility

- Reverse the rising proportion of non-regular workers to provide more attractive employment opportunities to women.
- Reform aspects of the tax and social security system that reduce work incentives for secondary earners.
- Encourage greater use of performance assessment in pay and promotion decisions.
- Expand the availability of childcare, while avoiding generous child-related transfers that may weaken work incentives.
- Encourage better work-life balance, in part by better enforcing the Labour Standards Act.

17. Child allowance is provided for those with a child below 12 years of age, unless previous annual income is above the limit, which varies by the number of dependent family members (for example, 5.7 million yen for a salaried worker with one dependent family member). For households with children less than 3 years old, 10 thousand yen per month is provided. For those with children aged over 3 years old, the first and second children are entitled to receive 5 thousand yen per month and the third and subsequent children are entitled to 10 thousand yen per month

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