

Damage control: yen appreciation and the Japanese labor market

The strong yen induced firms to reduce labor costs and restructure some export-oriented industries, but had minimal effect on unemployment

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When the yen began its steep rise in late 1985, "Chicken Little" cries were heard throughout Japan. Headlines predicted massive job losses, an end to the export orientation of Japan's economy, and a decline in living standards of working people. Since then, significant changes have indeed been occurring in the Japanese labor market and in the structure of the economy, and some workers have suffered economically. But by late 1987, Japanese economic "damage control" had minimized most of the negative effects of the yen's appreciation and it is now clear a "leaner and meaner" economy has emerged as a result.

The appreciation of the yen (or "endaka" as it is called in Japan) apparently accelerated ongoing economic trends, but the genesis of most of the changes predates 1985. Interestingly, many of the changes are similar to those that have occurred in the U.S. economy in the past decade. For instance, both Japan and the United States, motivated by Asian competition to reduce labor costs, are moving from manufacturing industries toward information and service industries, thereby causing some worker displacements; are experiencing a decline in the rate of unionization, compelling labor unions to seek new ways to gain clout; and are experiencing an unprecedented increase in the rate at which women are entering the labor force.

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In any case, changes in the Japanese economy and in labor practices and customs are occurring simultaneously. Often these phenomena are closely related, and have been given impetus by the appreciation of the yen.

Endaka and the economy

Competitive position. The slowdown in world demand and the emergence of the "Four Economic Tigers" of East Asia (Korea, Taiwan, Singapore, and Hong Kong) have, for some years, been doing to Japan's manufacturing industries what the Japanese recently did to U.S. manufacturers—that is, increasing sales at the expense of U.S. manufacturers (the auto, steel, and textiles industries are good examples). The appreciation of the yen put further pressure on Japan's competitive position and intensified the need for lower production costs, particularly labor costs.

Since the early 1970's, shipbuilding, steel, textiles, and other traditional Japanese manufacturing industries have declined precipitously in terms of employment. Although employment in auto manufacturing has not yet been cut, the movement of plants to the United States and the emergence of suppliers from other countries will soon lead to employment contraction in the auto industry. The primary cause of structural change in Japan's manufacturing sector is not yen appreciation, but excess world production capacity. The Four Economic Tigers are also putting pressure on Japan's high technology industries by moving up from simple assembly operations and traditional manufac-

turing industries to the manufacture of technology-intensive components. For example, during 1986, Japanese imports of semiconductors, computer parts, and other products employing sophisticated technology from Asia's newly industrializing countries increased significantly.

Domestic demand. The slow growth in Europe, combined with the large U.S.-Japan bilateral trade deficit, had Japan under considerable pressure to expand domestic demand and increase imports. Japanese and U.S. trade balances have improved in dollar terms following the appreciation of the yen, but progress is slow.

During 1986 and 1987, Japan experienced a significant increase in real income because Japan could afford to import more for the same amount of exports than was possible before the yen appreciated.¹ According to the Bank of Japan, the yen's appreciation played a significant role in bringing about the strong domestic demand-led economic expansion currently underway in Japan.² In fact, the economy is so strong that there is now some concern in Japan that the yen might depreciate.

In September 1987, Japan's Labor Standard Law was amended to provide for an 8-hour phased reduction in the present 48-hour, 6-day workweek to 40 hours, 6 days, to be completed early in the next decade. This is the first amendment of the Labor Standard Law in 40 years, and is regarded as an integral part of the government's commitment to restructure the economy and replace "export-led" growth with increased domestic demand. Ironically, this amendment will have little effect on major corporations, most of which already have a 40-hour workweek as a result of collective bargaining contracts. Given Japan's reliance on the "just-in-time" inventory system,³ many analysts doubt that the smaller contracting and subcontracting firms, which sometimes work long hours to meet deadlines, will be pushed very hard to meet the ambiguous 1990's goal.

Corporate profits. Japanese government sources have reported that, as a result of the yen's appreciation, industrial sales and profits have fallen, leading to a loss of 440,000 jobs in 1986, mainly in export-oriented establishments such as manufacturers of autos, auto parts, and electrical machinery and equipment and similar goods. Employers responded by cutting labor costs using reduced overtime, shorter working hours, early retirement, and relocation assistance services to facilitate placement in related or subsidiary firms.

Clearly, the appreciation of the yen resulted in lower corporate profits in the export-dependent sectors, and put pressure on firms to trim labor costs. However, the hardest hit sectors were already suffering from long-term structural difficulties. The yen's appreciation may simply have provided a welcome opportunity for firms to more vigorously trim labor costs and to shut down inefficient

plants—changes which would have occurred without the appreciation of the yen.

The economic changes discussed above have caused, or are related to, many of the changes that have been experienced by Japanese workers in recent years. However, the appreciation of the yen was more a catalyst in than a cause of labor market changes.

Endaka and the worker

Labor force. Perhaps the most significant Japanese labor market trend has been the extraordinarily rapid aging of the population, brought about by declining death and birth rates. Although the declining rates were not caused by economic changes or by the yen's appreciation, older workers are affected by both events.

According to the Japan Institute of Labor, life expectancy in Japan, at 74.8 years for men and 80.5 for women, is now among the highest in the world. In 1950, only 4.9 percent of the population was age 65 and older; in 2025, older persons are projected to account for 21.3 percent, making the Japanese the "oldest" population in the world. According to the Institute, only about 15 percent of the U.S. population will be older than 65 in 2025.⁴ This demographic trend is putting great pressure on Japan's pension and welfare systems, and additional strain on the vaunted (often misunderstood) lifetime employment system.

Older workers' problems are complicated by Japan's seniority wage system. Because wage levels are related to seniority rather than to work performed, labor costs can be reduced most quickly by getting rid of older workers. To minimize labor costs, many firms have begun capping a worker's earnings at, say, 45 years of age, or transferring older workers to affiliate firms and subsidiaries.

According to Haruo Shimada, professor of economics at Keio University, the persons most adversely affected by the aging of the labor force will not be today's elderly, but those of the future. He contends that a 1985 revision of the pension laws will cause pension payments received by beneficiaries to decline steadily in real terms until a balance of pension system revenue and expenditure is reached. This means that workers now in their thirties and forties will, when they retire, receive pensions that are meager, relative to the money they have paid in. The uncertainties of the retirement system may provide a clue to why the personal savings rate of the Japanese is about four times higher than that of Americans, although it has been declining somewhat since the late 1970's.

Japanese women now are moving into the work force at a rate comparable to that seen earlier in the United States and Western industrialized nations. This increased participation has been facilitated by structural change in the economy because service and high technology firms are more willing to hire women, and for higher level jobs, than are traditional manufacturing firms.

There is some evidence, not compelling, that the attitude of young Japanese workers is edging away from the "Gung Ho" work ethic of earlier generations. Labor leaders say that young workers just are not interested in working as hard as their fathers and mothers.⁵ Media reports and surveys suggest that workers are unhappy with the cost of food, autos, and housing; with their ability to save; and with the amount of leisure time available to them.⁶ There is a growing feeling that Japan's new wealth is not being passed along equitably to its workers.

"Lifetime" employment system. Lifetime employment is perhaps the best known feature of the Japanese employment system. Lifetime employment is changing, however, due to demographics and increased international competition from countries with lower labor costs. Unfortunately, the concept of lifetime employment is often misunderstood. Lifetime employment is neither widespread nor guaranteed. It applies mainly to "permanent workers" in large corporations—far less than half of the Japanese workers—and is usually arranged through an "understanding" rather than through a contract or formal agreement. Moreover, the system never really provided lifetime employment. When it began in the 1950's, it guaranteed employment until age 55, perhaps a reasonable retirement age at the time; but now life expectancy has increased dramatically in Japan. Furthermore, many of the new service and information enterprises are relatively small and do not follow lifetime employment practices. Employees of these businesses tend to "job hop" more than the traditional smokestack industry worker does.

Labor movement. Declines in trade union membership and in the size of annual wage increases could make Japanese unions more adversarial. This may make adjustment to ongoing structural change more difficult in the future, particularly if the yen continues to strengthen.

Recently, a prominent Japanese trade unionist said, "We are seeing the end of blue collar trade unionism in Japan," referring to the "hollowing out" of mining and manufacturing industries and the rapid shift to information and service industry employment. He may also have had in mind the watershed decisions that have recently been made in the decade-long effort to unify the Japanese trade union movement. In any case, the percentage of the labor force which is organized has declined from 34.4 percent in 1975 to 28.2 percent in 1987.

Unification of the trade union movement has been sought for years, but 1987 will be remembered as a milestone in that effort. In November, the first step toward bringing all Japanese workers into one organization was taken when two federations and elements of a third merged, forming a new national organization known as "Zenminroren," or by its acronym, "Rengo." With 5.5 million members, Rengo is now Japan's largest labor or-

ganization. By 1989, most other unions are scheduled to affiliate with Rengo, which will then represent an overwhelming majority of Japanese trade unions. The purpose of the merger is to provide trade unions with more political and economic clout. The labor movement, which generally opposed the Liberal Democratic Party, has been frustrated by that party's virtually continuous rule since World War II. At the same time, it has seen the percentage of unionized workers decline and, because of the appreciation of the yen, has seen annual wage increases drop to record lows and smaller annual bonuses.

Although it is difficult to forecast future trade unionism, it is certain that its nature is being fundamentally changed and that its mood is likely to become increasingly impatient. Given the power unions have under Japanese law, harmonious industrial relations simply could not exist in the face of widespread labor opposition. Thus, the continued willingness of unions to go along with the system is important to the operation of the economy.

Worker adjustment schemes. At the time of the 1985 yen appreciation scare, Japan had a number of programs to support workers whose jobs were threatened by structural economic changes. The programs provided subsidies for training and retraining workers, for relocation allowances, for inducing employers to maintain payrolls, and for promoting the development of local jobs. All of these programs helped to bring the unemployment level back down quickly in the wake of the appreciation of the yen.

Another facet of Japanese worker adjustment practices is that large corporations have always prided themselves on the "flexibility" of their work forces. Workers would commonly be transferred between jobs within the firm, a practice facilitated by good in-plant training and the seniority wage system. In really difficult economic times, workers might be transferred to the corporation's subsidiaries, or to its contractors in order to avoid layoffs—the bane of the Japanese employment system.

The appreciation of the yen brought this work force flexibility to new heights. Corporations, especially in the steel industry, have created hundreds of entirely new subsidiary enterprises to provide jobs for redundant workers, thereby cutting labor costs without layoffs. Salaries of workers sent to these firms are subsidized by the parent company for a limited time.

The operations of some of these new enterprises are related to the parent corporation and are an attempt to move to a higher level of technology, as well as to create jobs—textile corporations setting up fashion salons, for instance, or steel producers selling equipment diagnosis and inspection services. Others seem to have no such relationship—for example, steel companies have set up travel agencies, language schools, and meat markets.

Many of the new firms are surprisingly small. Most seem to employ fewer than 100 persons and many, fewer

than 25. One steel executive was quoted as saying, "Ten companies with ten employees each can cut our work force by one hundred." Unfortunately, employees of small firms which have no lifetime employment tradition, as well as "temporary" workers in large corporations, are unlikely to receive such benevolent attention.

Nevertheless, it is a tribute to the flexibility of the Japanese labor system that a 40-percent currency appreciation was accompanied by only a 0.5-percentage point increase in unemployment, from 2.7 percent to 3.2 percent. Latest monthly unemployment figures show a 2.6-percent rate, and it is now clear that the labor market adjustment brought on by the appreciation of the yen was nearly completed by the end of 1987.

Endaka effects exaggerated

It appears that assessments of the effect of the strong yen on Japanese workers have been greatly exaggerated. Clearly, the yen has had a powerful impact on relative prices. By decreasing the price of tradable goods relative to nontradable goods, the appreciation of the yen induced Japanese firms to reduce labor costs and shut down plants in export-oriented industries. However, the resulting in-

crease in Japanese unemployment was reversed rather quickly.

Nevertheless, Japan continues to face declines in world demand for important manufactures such as ships, steel, and textiles. New producers in industrializing countries are eroding Japan's competitiveness in these product areas, as well as in high technology and other goods. Increasingly, Japanese firms are moving production offshore.

These long-term changes in Japanese trade and comparative advantage are inevitable and resemble the U.S. experience. Clearly, the Japanese economy has not yet experienced economic dislocation of workers on the same scale as has the United States since the 1970's. But the yen's appreciation since September 1985 has accelerated movement of productive resources out of Japan's traditional manufacturing industries.

Currently in the 125-130 range, the yen-dollar exchange rate fell to around 121 in early January following the October 1987 stock market crash. Since January, the yen has been unstable. Further depreciation of the yen would jeopardize progress made in moving the Japanese economy toward greater reliance on domestic demand and on imports. □

—FOOTNOTES—

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¹The Bank of Japan estimates that real gross national product grew by 1.4 percentage points more in 1986 and 1987 than would have been the case if the yen had not appreciated starting in early 1985. This is estimated to be approximately one-half of the terms-of-trade loss experienced by Japan during the 1974-76 and 1979-81 oil crises. See *Balance of Payments Adjustment Processes in Japan and the United States*, Special Paper Number 162 (Bank of Japan, Research and Statistics Department, March 1988), p. 44.

²*Balance of Payments*, pp. 6-8.

³Under the "just-in-time" inventory system, manufacturing firms maintain the smallest possible supply of parts and materials. Contract suppliers are expected to deliver just before the manufacturer's supplies are exhausted.

⁴*Japanese Working Life Profile-1987* (Tokyo, Japan Institute of Labor).

⁵Authors' interview of labor leaders, Tokyo, September 1987.

⁶See, for example, results of Sanwa Bank survey reported in *Japan Times*, Aug. 20, 1987; and a news article appearing in *Japan Times*, Sept. 18, 1987.