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Reasons for Japan's Low Unemployment Rate

Since the beginning of the seventies, most OECD member countries have suffered from a substantial increase in measured unemployment rates. A notable exception is Japan, whose official unemployment rate is far below observed figures in other countries. This article examines the reasons why Japan's unemployment record has been better than those of the USA and West Germany.

In 1987 Japan's unemployment rate reached 2.9% compared to 6.1% in the USA and 8.9% in West Germany. Some observers claim that this low official unemployment rate, rather than being an economic miracle, is a statistical artifice hiding the real existing unemployment problems.¹ Japan's published unemployment figures are obtained from the "Labour Force Survey", a monthly survey where sample households are asked about their employment status. Here unemployed are defined as persons 15 years of age or over who during the survey week worked one hour or less, who were seeking work actively and who were available to start a new job immediately. Critics stress supposed definitional and methodical differences to international standards, and assert that Japan's statistics record cases considered as unemployed in the USA and West Germany as being outside the labour force or still employed. They suggest that the comparable unemployment rate might be considerably higher and correspond more to those of other countries.

Definitional Differences

The definitional differences between Japan and the United States appear to be insignificant, however. Following the recommendations by the International Labour Office both countries (and several European countries, too) regard people with more than one hour of work per week as still employed. Their concepts differ mainly in the definition of the unemployed vis-à-vis persons outside the labour force. Excluded from the

unemployed in Japan but included in the United States are persons who have sought jobs in the previous four weeks but did not take active steps to find work during the survey week, and persons who are currently without a job but are waiting to report to a new job within 30 days. On the other hand, the US definition records persons as outside the labour force who are included in the unemployed in Japan, especially persons who made their last job search prior to the survey month and who were awaiting the results, and persons arranging to start a new business. In the last period for which data are available, March 1980, these differences tended to cancel each other out.² Hence, the official unemployment rate in Japan still appears to be comparable to that of the USA.

The definitional (and methodical) differences are more substantial between both the United States and Japan on the one hand and West Germany on the other, where the official unemployment figures do not come from a labour force survey but are a count of

¹ Cf. Angelika Ernst: Japans unvollkommene Vollbeschäftigung, Hamburg 1980, chapter 1.6; Koji Taira: Japan's Low Unemployment: Economic Miracle or Statistical Artifact?, in: Monthly Labor Review, 1983, pp. 3-10.

² Cf. Eiji Shiraishi: International Comparisons of Unemployment Concepts, in: Monthly Labour Statistics and Research Bulletin, March 1982, pp. 13-20. The unemployment record is much less in favour of Japan if recent school and university graduates with prearranged jobs are included in the unemployed (as done by Koji Taira, op. cit., p. 6 for the March 1980 data). However, March is a very special month in Japan because it is the end of the fiscal and school year when firms traditionally hire new workers and graduates flood the labour market. In other months no such large number of persons would be waiting to begin a new job within 30 days. See on this point Constance Sorrentino: Japan's Low Unemployment: An In-depth Analysis, in: Monthly Labor Review, 1984, pp. 18-27.

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registrations at the public employment offices. Here people with jobs of less than 20 hours a week are regarded as unemployed if they wish to work more. Moreover, the unemployment rate is calculated as a percentage of the employed and the unemployed, and not as a percentage of the labour force as is the case in the USA and Japan. Therefore, the West German unemployment rate tends to be too high in comparison because it includes persons with more than one hour (but less than 20 hours) of weekly work in the numerator and excludes self-employed and unpaid family workers in the denominator – a comparatively large group, especially in Japan.

Comparable Unemployment Rates

Table 1 presents comparable unemployment figures for the three countries under discussion in the period 1980 to 1983. It shows in line (1) the numbers of totally unemployed following from the official employment statistics in Japan and the United States and from the "Microcensus" in West Germany. The statistics from the microcensus are similar in definition and method to those published in both other countries and are also used by the OECD, which publishes a standardized unemployment rate for its member countries.³ Line (2) presents estimates of the numbers of people on a forced part-time job for Japan and the USA while line (3) shows the resulting total number of underemployed for these countries and the official unemployed numbers for West

Germany. Lines (4) to (8) subdivide the labour force into its components, the numbers of employed and unemployed, self-employed, family workers and others.

Table 1 suggests that neither a redefinition of the Japanese (and American) unemployment rates in line with the concept used in West Germany (including people involuntarily working part-time and using the number of employed and unemployed as the denominator, as in unemployment rate B, Linie 10) nor an adjustment of the German unemployment rate to correspond to the Japanese or American data (totally unemployed as a percentage of the labour force as in unemployment rate A, line 9) would change Japan's position relative to either of the other two countries. Although the difference to West Germany narrows considerably (and the gap to the USA widens), Japan's unemployment rate was still the lowest in the periods investigated (except for 1980).

Long-term Job Attachments

These results suggest that Japan's better unemployment performance is not caused by statistical differences alone but by peculiarities of the labour market itself. Many companies offer some of their workforce – so-called regular employees – a long-term employment guarantee up to a mandatory retirement between age 55 and 60 years ("lifetime employment system"). The actual importance of such job attachments in Japan relative to other countries is

Table 1
Alternative Unemployment Measures for Japan, the USA and West Germany, 1980-1983
(in 1000 persons and %)

	Japan				USA				W. Germany			
	1980	1981	1982	1983	1980	1981	1982	1983	1980	1981	1982	1983
(1) Totally Unemployed	1140	1260	1360	1560	7637	8237	10678	10717	766	1045	1560	2065
(2) Persons on forced part-time jobs	500	520	580	670	1714	1738	2169	1826	/	/	/	/
(3) Underemployed (1+2)	1640	1780	1940	2230	9351	10011	12847	12543	869	1271	1833	2258
(4) Employed and unemployed	40850	41630	42340	43640	96662	100277	101421	102025	23126	23403	23837	24096
(5) Self-employed	9510	9430	9430	9380	8605	8807	9111	9359	2420	2372	2329	2353
(6) Family workers	6030	5920	5870	5740	702	656	661	623	1079	1057	884	872
(7) Others	110	100	100	100	852	982	1190	1219	59	56	437	0
(8) Labour force (4+5+6+7)	56500	57080	57740	58600	106821	110812	123384	113226	26684	26936	27487	27321
(9) Unemployment Rate A (1 : 8)	2.0	2.2	2.4	2.7	7.1	7.5	9.5	9.5	2.9	3.9	5.7	7.6
(10) Unemployment Rate B (3 : 4)	4.0	4.3	4.6	5.1	9.7	10.0	12.7	12.3	3.8	5.4	7.7	9.4

Sources: Ministry of Labour, Japan: Year Book of Labour Statistics, Tokyo, various issues (line 1 Japan and USA; line 3 W. Germany; lines 4-6 all countries); Statistisches Bundesamt: Statistisches Jahrbuch für die Bundesrepublik Deutschland, Stuttgart, various issues (line 1 W. Germany); Toshiaki Tachibana: Labour Market Flexibility in Japan in Comparison with Europe and U.S., in: European Economic Review, Vol. 31, 1987, Table 3 (line 2 Japan); US Department of Labour Statistics: Monthly Labor Review, Washington, various issues (line 2 USA).

indicated by the average duration of employment spells on a given job and by the variability of the overall number of jobs: the average employed Japanese worker has a job tenure of nearly 12 years compared to only 7 years in the USA and to 8.5 years in West Germany. Moreover about 50% of the Japanese workforce have been in their current job for more than 10 years, while in both other countries the majority of workers have a job tenure of less than 5 years.⁴

Measures of job duration give only an incomplete picture of the importance of long-term employment attachments because they comprise only job spells that existed at the time under survey. Jobs that have ended prior to the survey are not counted at all. Therefore the longer duration of jobs in Japan could be compensated for by a higher variability in the overall number of jobs, resulting in lower employment stability of Japanese workers relative to other countries. However, the existing data do not confirm higher employment fluctuation in Japan: Japan shows the lowest deviation in the number of employees and the highest deviation in working hours among the three countries – despite even higher fluctuations in output (see Table 2). Periods of economic difficulties lead to adjustments in working time

per employee and to a comparatively lower extent to employment adjustments. This is quite different in the United States, which shows much lower fluctuations in working hours and higher employment instabilities. West Germany remains between both extremes in employment but also shows a high deviation in the number of hours worked.⁵

Nominal and Real Wage Flexibility

While changes in the scale of production have only limited effects on overall employment, there do not appear to be strong grounds for believing that Japanese companies have a low reactivity to changes in real unit labour costs. On the contrary several empirical studies⁶ suggest that the medium-run elasticities of labour demand with respect to labour costs are comparatively high. Stable employment even in Japan assumes a high flexibility of wages which must be able to adjust immediately to changes in macroeconomic demand and supply conditions.

The special remuneration practices of Japanese companies prevent a strong deviation of real wages from market clearing levels and seem to be capable of stabilizing employment in the presence of external shocks. Unlike in the USA, wage negotiations are reached annually during the nation-wide “spring wage offensive”, and adverse demand shocks are transmitted faster into wage adjustments. More important, and different also from West Germany, contracted wages cover only a part of the workers’ total remuneration. Beside his basic wages every employee – blue collar as well as white collar – receives annual or biannual bonus payments. As these bonus payments are not fixed during the spring wage negotiations, but depend on the company’s performance during the past six months, they represent an instrument suitable for stabilizing unexpected shocks ex post during the terms of the contract: a sudden decline in productivity increases manufacturing costs but cuts real bonus payments, and can be handled without a rise in unit labour costs and unemployment.

Table 2
Standard Deviation of Quarterly Rates of Change of Output, Employment and Working Hours
(1968 I – 1986 IV)

	Industrial Production	Employment	Working Hours
Japan	7.548	2.361	1.719
USA	6.249	4.745	1.592
W. Germany	5.175	2.943	1.708

Source: OECD: Main Economic Indicators, Paris, various issues.

Table 3
Standard Deviation of Quarterly Percentage Rates of Change of Contracted Wages, Overtime Allowances, and Special Cash Payments in Japan

	1979 II – 1985 IV	1968 I – 1985 IV
Total	1.63	7.18
Contracted wages (excluding overtime premiums)	1.46	6.87
Overtime premiums	3.14	7.64
Special cash payments	4.12	14.94

Note: Overtime premiums for the period 1968 I to 1979 II are estimated on the basis of the number of hours worked overtime.
Source: Ministry of Labour, Japan, op. cit., various issues.

³ Cf. OECD: Standardized Unemployment Rates, Quarterly Labour Force Statistics, Sources and Methods, Paris 1985.

⁴ Cf. OECD: Employment Outlook, Paris 1984, Tables 31 and 33. The data refer to the following years: 1982 (Japan), 1983 (USA), 1972 (W. Germany); later data for Germany is not available.

⁵ See also Toshiaki Tachibana: Labour Market Flexibility in Japan in Comparison with Europe and the U.S., in European Economic Review, Vol. 31, 1987, pp. 647-684.

⁶ For a summary of these studies see Charles Adams, Paul R. Fenton and Flemming Larsen: Differences in Employment Behavior among Industrial Countries, in: International Monetary Fund, Staff Studies for the World Economic Outlook, Washington 1986, pp. 1-50.

Although bonuses amount to only one quarter of the annual income of a worker, their importance for the flexibility of wages in Japan is considerable. Table 3 shows the standard deviation of quarterly percentage rates of change of wages determined by labour contracts, allowances paid for overtime work and special cash payments without any previous agreement, contract or rule (of which bonuses form the major part). The variability of bonus payments in both periods investigated was more than twice as high as the deviation of total wages. Overtime premiums were next important, which reflects the fact that Japanese companies rely heavily on adjustments in working hours per employee (particularly in overtime worked) to changes in industrial production.

Shorter contract terms, overtime premiums and bonus payments suggest that real and nominal wages in Japan are extremely flexible and react faster than in other countries to changes in the macroeconomic supply and demand conditions. A recent study by the OECD⁷ confirms lower nominal and real wage rigidities for Japan compared to the United States and to West Germany. Price changes are completely transmitted into wage adjustments after six months, clearly demonstrating the importance of biannual bonus payments for wage adjustments. Moreover, Japan has the highest reactivity of wages with respect to the unemployment rate, resulting in very low real wage rigidities. The United States differs from Japan in that both nominal and real wages are rigid, which results from the long lags of wages with respect to prices and the low reactivity of wages with respect to the unemployment rate. West Germany again takes up a position between both extremes.⁸

Conclusion

With unemployment rates in other countries rising, the Japanese experience continues to contradict opinions that wage rigidities and mass unemployment are a natural outcome of a market economy. Japan's unemployment rate is lower than the unemployment rates in the USA and West Germany, even if one takes into account definitional differences between these countries. Japan's better performance is caused by an employment system which has a bias against a reduction in the number of employed workers and in favour of variations in hours worked per capita. Even more important, the division of annual labour income into basic wages, overtime premiums and bonuses allows companies to adjust wages flexibly to changes in macroeconomic supply and demand conditions, resulting in low rigidities of both nominal and real wages. Since divergences in the coefficient of real wage rigidity explain a large part of the differences in the unemployment rates⁹ among countries, Japan's more flexible remuneration system is probably largely responsible for the country's better unemployment record since 1970.

⁷ Cf. David T. Coe and Francesco Gagliardi: Nominal Wage Determination in Ten OECD Economies, OECD Economics and Statistics Department, Working Paper No. 19, Paris, March 1985, Table 12.

⁸ West Germany shows even higher wage rigidities than the USA if procyclical changes in productivity, which reduce the necessary wage reactions to an increase in unemployment, are not allowed for. See David T. Coe and Francesco Gagliardi, op. cit.

⁹ Cf. Dennis Grubb, Richard Jackman and Richard Layard: Wage Rigidity and Unemployment in OECD Countries, in: European Economic Review, Vol. 27, 1983, pp. 11-39; Friedrich Klauf and Axel Mittelschädt: Labour Market Flexibility, in: OECD Economic Studies, Vol. 6, 1985, pp. 7-45.

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