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Discussion Paper No. 724

**LABOR RELATIONS AND
LABOR LAW IN JAPAN**

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and
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Labor Relations and Labor Law in Japan*

Atsushi Tsuneki and Manabu Matsunaka

I. Introduction

The Japanese economy has provided economists with many puzzles. It possesses various apparently unique properties such as the main bank system, mutual share holdings among group companies in the capital market, vertical relationship among firms (*keiretsu*)¹, and various interventions of the bureaucracy in the market

* The earlier version of the present article was first written when one of the present authors (Tsuneki) was visiting the Institute of Law and Economics at the University of Hamburg during 1999-2000; it was published in German as Atsushi Tsuneki, *Arbeitsbeziehungen, Arbeitsrecht und Arbeitslosigkeit in Japan*, in *ÖKONOMISCHE ANALYSE DES ARBEITSRECHTS : BEITRÄGE ZUM VII. TRAVEMÜNDER SYMPOSIUM ZUR ÖKONOMISCHEN ANALYSE DES RECHTS* (22.-25. MÄRZ 2000) 279 (Claus Ott & Hans-Bernd Schäfer eds., 2001). We would like to thank the Institute for their hospitality and, in particular, Professor Hans-Bernd Schäfer for his kind consideration and various fruitful discussions on our research on law and economics. In this article, we have completely revised the older version and extended it taking into account the drastic change in the Japanese economy and legal environment after the 1990s. We would like to thank Professors Tomotaka Fujita, Yuji Genda, Hideshi Itoh, and particularly Fumio Ohtake for their comments and suggestions on some earlier versions of the present article. All remaining errors are ours.

¹ The nature and functions of the Japanese main bank system were surveyed by Masahiko Aoki, Hugh Patrick & Paul Sheard, *The Japanese Main Bank System: An Introductory Overview*, in *THE JAPANESE MAIN BANK SYSTEM 3* (Masahiko Aoki & Hugh Patrick eds. 1994). For a summary of characteristics of Japanese enterprises including *keiretsu* and so-called Japanese employment system, see D. Eleanor Westney, *Japanese Enterprise Faces the Twenty-First Century*, in *THE TWENTY-FIRST-CENTURY FIRM*:

economy.² A conspicuous example is the so-called Japanese employment custom, which is usually characterized by permanent employment and seniority.³

Although standard neo-classical economics regarded it as a source of inefficiency, which goes against the competition in the labor market and leads to considerable waste in terms of human resource allocation, so that it is reformed in order to increase the competitiveness of the labor market⁴, this argument is unable to explain why post-war Japan succeeded economically at least until the 1980s, while protecting the apparently inefficient customs.

It was not until recently that many economists have begun to argue that a series of properties shown by the Japanese economy should be understood as a rational

CHANGING ECONOMIC ORGANIZATION IN INTERNATIONAL PERSPECTIVE 105, 106-35 (Paul DiMaggio ed. 2001).

² Basic observations on the Japanese industrial policy were surveyed by e.g., TAKATOSHI ITOH, THE JAPANESE ECONOMY 196-205 (1992). Recently, there are discussions that cast doubt on the efficacy and even presence of systems which are said to be peculiar to Japan including main bank and bureaucracy led industrial policy. See, e.g., Yoshiro Miwa & J. Mark Ramseyer, *The Fable of Keiretsu*, 11 J. ECON. & MGMT. STRATEGY 169 (2002) (arguing that keiretsu has no substance and hence cannot be a characteristic of Japanese economy); Yoshiro Miwa & J. Mark Ramseyer, *Does Relationship Banking Matter?: The Myth of the Japanese Main Bank*, 2 J. EMPIRICAL LEGAL STUD. 261, 272-99 (2005) (arguing that none of the features of so called main bank system is empirically supported).

³ See, e.g., Kenichi Imai & Ryutaro Komiya, *Characteristics of Japanese Firms*, in BUSINESS ENTERPRISE IN JAPAN: VIEWS OF LEADING JAPANESE ECONOMISTS 19, 23 (Kenichi Imai & Ryutaro Komiya eds. 1994).

⁴ See, e.g., GEORGE J. BORJAS, LABOR ECONOMICS 163 (2d ed. 2000).

and efficient system that supported the economic success of post-war Japan.⁵ In the area of labor relations, Koike has argued that the apparently group-oriented nature of Japanese labor relations and organizations can be naturally understood as a superior economic system to adjust to an uncertain and changing economic environment.⁶ Some game-theoretic contributions argued that the labor relations in both the United States and Japan can be characterized as two possibly efficient equilibrium of the same game played by similarly rational players facing different institutional environments.⁷

Building on this rationalistic understanding of the Japanese employment customs, this article discusses the relationship between Japanese labor law and employment customs. It addresses the question of whether the Japanese labor law enforced the establishment of the Japanese employment customs, or whether it adjusted itself to the already established system in the process of post-war economic development in Japan. We simultaneously consider whether or not the Japanese labor

⁵ See, e.g., Masahiko Aoki, *Toward An Economic Model of the Japanese Firm*, 28 J. ECON. LITERATURE 1 (1990) (survey of the economic analysis of the Japanese firm); RYUTARO KOMIYA, MASAHIRO OKUNO & KOTARO SUZUMURA, *THE INDUSTRIAL POLICY OF JAPAN* (1988) (economic analysis of Japanese industrial policy).

⁶ See KAZUO KOIKE, *THE ECONOMICS OF WORK IN JAPAN* 63-68 (1996).

⁷ See Masahiro Okuno, *Monitoring Cost, Agency Relationship and Equilibrium Modes of Labor Contract*, 1 J. JAPANESE & INT'L ECON. 147 (1987); Yoshitsugu Kanemoto & W. Bentley MacLeod, *The Theory of Contracts and Labor Practices in Japan and the United States*, 12 MANAGERIAL & DECISION ECON. 159 (1991). See also MASAHIRO AOKI, *INFORMATION, INCENTIVES AND BARGAINING IN THE JAPANESE ECONOMY* ch.3 (1988) (economic analysis of the Japanese Firm).

law enhanced the efficiency of the system, both in the economic growth process until the 1980s and the stagnation period that began in the 1990s and has continued until now.

Our basic conclusion is as follows. The Japanese employment custom developed naturally through an agreement among the members of Japanese employment society and attained efficient economic performance up till the 1990s. During the time, the Japanese labor law mainly worked toward setting the stage for private bargaining and respected its agreement instead of enforcing the desirable result directly through legal regulations. Through this indirect approach toward labor relations in Japan, at least part of the Japanese labor law made a highly positive contribution to the attainment of economic efficiency innate in Japanese labor relations.

After the 1990s, when the long-run stagnation occurred in Japanese economy, the merit of the Japanese employment custom diminished and needed reform. At this stage, the Japanese labor law began to adopt a more market-friendly approach in order to cope with this change in some aspects. However, in some other important aspects, it has taken the stance of directly regulating the economy, particularly in the area of employment protection and working hours regulation. This was exactly opposite to the deregulation that had been necessary to recover the efficiency of the Japanese economy after the 1990s. Due to this mismatched regulatory approach toward Japanese

employment relations, the Japanese labor law has become one important factor that hindered the performance of the Japanese economy. If this tendency continues, the Japanese labor law will continue to levy huge social costs on the Japanese economic performance.

The remaining part of the article is organized as follows. In Part II, the article first clarifies the contents of the Japanese employment customs, referring to the major empirical researches on them, and presents the theoretical arguments that support the economic rationality of the customs. We also discuss why the Japanese employment customs considerably lost their efficiency after the 1990s.

In Part III, the article describes the historical outline of the Japanese labor law, its basic principles, and the various aspects of the Japanese labor law in general. In Part IV, the article analyses the economic effects of the Japanese labor law. Part IV. A. justifies our argument that the Japanese labor law made highly positive contributions to the establishment of efficient Japanese labor relations. Section IV.B. discusses the rational adjustment of the Japanese labor law to the structural change of the Japanese economy after the 1990s. Section IV.C. points out the recent development of regulations in the Japanese labor law. We examine working conditions and the promotion system, second, employment guarantee, and third, labor market policy, and

argue that some of them has become an important factor that expand the efficiency loss of the Japanese economy. Part V summarizes the overall discussions and provides some remarks on the future of Japanese labor relations and labor law.

II. Japanese Employment Custom: Fact and Theory

A. Fact Findings

It is now well known that “Japanese employment custom” (JEC hereafter) can be observed at least for some part in the U.S. and Europe, particularly for certain large, established companies.⁸ Therefore, it is not easy to precisely define the actual characteristics of the Japanese custom of employment.

However, with many careful empirical researches, several distinctive findings concerning the Japanese employment custom have been reported for companies in Japan. First, the long-term employment relationship (LTER hereafter) applies more to Japan than other developed countries. It is known that the tendency for long-term employment exists in some European countries such as Germany or France, and even in the large U.S. companies.⁹ However, the conclusive evidence by

⁸ See, e.g., KOIKE, *supra* note 6, at 40-41 (indicating that lifetime employment can be observed in the United States and in Western Europe); Westney, *supra* note 1, at 109 (discussing similarity and difference between Japan and other developed countries on employment system including lifetime employment).

⁹ See *supra* note 8 and sources cited therein.

empirical research shows that on average, Japanese workers stay in the same firm for longer periods than American workers, and that the turnover rate of the former is lower.¹⁰ These facts have been confirmed by other empirical researches concerning Japanese and European workers.¹¹

Second, both white- and at least some of blue-collar workers are embraced within the same system of long-term employment and career formation based on seniority and merit ratings.¹² They experience a wider range of mutually related jobs than workers in other countries. At the same time, job demarcation is more ambiguous. The delegation of *de facto* authority descends to the lower tiers of the production hierarchy, so that workers have a chance to utilize their first-hand knowledge in an attempt to improve the production system of their workplace.¹³ On-the-job training is actively provided by the older skilled workers to the younger unskilled workers.¹⁴

¹⁰ See Masanori Hashimoto & John Raisian, *Employment Tenure and Earnings Profiles in Japan and the U.S.*, 75 AM. ECON. REV. 721, 721-58 (1985).

¹¹ See, e.g., D.H. WHITTAKER, *MANAGING INNOVATION: A STUDY OF BRITISH AND JAPANESE FACTORIES* (1990) (providing a comparison between Japan and the U.K.).

¹² See KOIKE, *supra* note 6, at 34-41.

¹³ See J.R. Lincoln, M. Hanada & K. McBride, *Organization Structures in Japanese and US Manufacturing*, 31 ADMIN. SCI. Q. 338 (1986). See also James R. Lincoln & Kerry McBride, *Japanese Industrial Organization in Comparative Perspective*, 13 ANNUAL REV. SOCIOLOGY 289 (1987) (showing quantitative evidences that support facts stated in the text).

¹⁴ Therefore, labor contracts for regular (typical) workers in Japan do not include explicit agreements on the job contents. In contrast, labor contracts in the U.S. firms explicitly specify the kind of job and its performance standards. The authority is held by the management and engineers who derive the job

Third, the wage payment system is also common to blue- and white-collar workers.¹⁵ Wage is determined by seniority and promotion to the higher ranking hierarchy, which depends on merit assessments but the wage level is only remotely related to the types of jobs.¹⁶ Most empirical researches show that merit assessments are more important than seniority in this process, and the lifetime earning differences among workers are rather large despite the appearance of egalitarianism.¹⁷

In contrast, American workers are normally assigned jobs, with a wage directly attached to the job, which does not necessarily take into account other characteristics such as skill or education levels.¹⁸ A significant amount of wage increase in the U.S.

organization tightly, and workers must simply follow their orders in the process of production. See PETER B. DOERINGER & MICHAEL J. PIORE, *INTERNAL LABOR MARKETS AND MANPOWER ANALYSIS* 42-56 (1971) (explaining basic facts of the U.S. industry). For the basic facts in Japan, see KOIKE, *supra* note 6, at 50-61 & 66-72.

¹⁵ See KOIKE, *supra* note 6, at 26.

¹⁶ See Hashimoto & Raisian, *supra* note 10, at 728-32; A. L. Kalleberg & James R. Lincoln, *The Structure of Earnings Inequality in the United States and Japan*, 94 AM. J. SOCIOLOGY S121, S140-S145 (1988).

¹⁷ See Toshiaki Tachibanaki, *The Determination of the Promotion Process in Organizations and of Earnings Differentials*, 8 J. ECON. BEHAV. & ORG. 603 (1987); Toshiaki Tachibanaki, *Education, Occupation, Hierarchy and Learnings* 7 ECON. EDUC. REV. 221 (1988) (empirical researches showing that promotion and associated increase of earnings differentials are more critically dependent on evaluation rather than seniority); Hiroyuki Fujimura, *Seiseki Satei no Kokusai Hikaku* [International Comparison of Merit Ratings], 362 NIHON RODO KYOKAI ZASSHI 26 (showing that wage increase is rather inelastic to seniority).

¹⁸ See sources cited in *supra* note 16.

occurs when workers move up the job ladder.¹⁹ Moreover, Koike observed that although the features explained above in relation to Japanese firms broadly applies to white-collar workers in large companies in the U.S. and Europe, they are characteristic of Japan in that this system is extended to blue-collar workers.²⁰

Fourth, labor unions are not industry-based unions as in the Western countries, but company-based ones.²¹ The labor union has a long-term relationship with the employer and represents all workers of an enterprise, including both white- and blue-collar workers.²² The management of the firm is chiefly determined by inner promotion, and those selected for the management usually have some experience in labor union activities.²³ Therefore, management and labor are more likely to have common interests, and the labor union indirectly has the power to influence the

¹⁹ See KOIKE, *supra* note 6, at 54-61; DOERINGER & PIORE, *supra* note 14, at 65-71. The facts pertaining to the U.S. are also broadly applicable to major European countries. See also MITSUO ISHIDA, CHINGIN NO SHAKAIKAGAKU: NIPPON TO IGIRISU (1990) [Social Science of Wages: Japan and Britain] (pointing out this difference chiefly in comparison with Japan and the UK.).

²⁰ See KOIKE, *supra* note 6, at 13-27.

²¹ See ITOH, *supra* note 2, at 226 (1992); TAKASHII ARAKI, LABOR AND EMPLOYMENT LAW IN JAPAN 164-65 (2002).

²² See KOIKE, *supra* note 6, at 212-16.

²³ See e.g., Hiroyuki Fujimura, *Keieisha no Kyaria to Hōshū no Jittai* [The State of the Career and Payment of Managers], in GENDAI NIHON NO KŌPORETO GABANANSU [Corporate Governance in Modern Japan] 135 (Takeshi Inagami & Rengō Sogō Seikatsu Kaihatsu Kenkyusho eds. 2000).

management decisions through discussions between labor and management.²⁴

Fifth, there are many non-regular workers (atypical workers) such as part-time workers and dispatched workers that are differentiated from regular workers in promotion, payment, and employment guarantee.²⁵ Therefore, the Japanese labor market has a dual nature, wherein the part of the market that consists of regular workers is internalized within the firm, while non-regular workers participate in an outside spot market and engage in more frequent career turnovers. Note that this dual nature is universally observed in the developed capitalist countries.²⁶ However, it is characteristic of the Japanese economy to clearly distinguish regular and non-regular workers at the time of recruitment.²⁷

These five properties apparently depict the group-oriented nature of the JEC, in view of the respect for the protection of employment and seniority, cooperative behavior among workers at the shop-floor, close connection between labor and

²⁴ See KOIKE, *supra* note 6, at 195-216 (indicating the detailed international comparison of the functions of the labor union and its performance evaluation).

²⁵ Recently the percentages of these atypical workers are increasing particularly in service sector. See, e.g., Ryuichi Yamakawa, *Labor Law Reform in Japan: A Response to Recent Socio-Economic Changes*, 49 AM. J. COMP. L. 627, 628-29 (2001).

²⁶ See DOERINGER & PIORE, *supra* note 14, at 164-83 (discussing the existence and its economic implications of the dual labor market in the US).

²⁷ It is said that atypical workers have been dismissed before regular workers in recession and therefore served as buffers. See Yamakawa, *supra* note 25, at 629.

management, strictly distinct treatment of regular and non-regular workers and so on.²⁸

Alternative interpretations on the JEC and its economic success have been provided by using psychological or comparative-sociological approach such as *amae* (dependence) or Confucianism where the nature of the JEC is attributed to the mentality or spiritual tradition inherent in Japan.²⁹ However, this culture-based explanation of Japanese industrial relations is doubtful first because the custom that is observed, at least partially, for all developed capitalist countries other than Japan.

It is also questionable from the historical point of view. As pointed out by several researchers, this custom did not exist from the beginning of the Japanese economy. It was newly established in the 1940s during World War II as a part of wartime economic regulations, and maintained itself through the democratization program to strengthen the position of laborers led by the Allied High Command after the war.³⁰ The Japanese management has retained this method from the high growth

²⁸ See, e.g., JAMES C. ABEGGLEN & GEORGE STALK JR., KAISHA, THE JAPANESE CORPORATION 198-99 (1985) (attributing these properties of Japanese firms to the group-oriented nature of Japanese).

²⁹ For the brief summary of the cultural theory of Japanese industrial relations, see MARCUS REBICK, THE JAPANESE EMPLOYMENT SYSTEM 18-19 (2005). Abegglen & Stalks Jr. asserted that Japan as group-centered society which was formed by the value system based on the Confucian ethic. ABEGGLEN & STALKS JR., *supra* note 28, at 198. See also RONALD DORE, TAKING JAPAN SERIOUSLY (1987) (asserting the contribution of Confucianism on the Japanese system of enterprise and society); MICHIO MORISHIMA, WHY HAS JAPAN SUCCEEDED (1982) (analyzing the effect of Confucianism adapted to Japan on the economic development of Japan since Meiji Restoration).

³⁰ See, e.g., WILLIAM B. GOULD, JAPAN'S RESHAPING OF AMERICAN LABOR LAW 17-43, 106-16 (1984);

period until the 1980s, since it displayed a good performance during the period. Before the 1940s, the Japanese economy had a classical market system with a competitive labor market that facilitated the highly frequent turnover of workers. The possibility of permanent employment and participation of labor in management was very limited, and labor unions were industry-based, not enterprise-based unions, as observed in other developed countries.³¹

B. Appraisal from the Theoretical Point of View

The JEC is usually characterized by its egalitarianism based on the LTER and the seniority system with respect to promotion and remuneration.³² However, in reality, the process of promotion and remuneration is far more meritocratic than it appears, based on the assessments of the employer. In addition, on-the-job training (OJT hereafter) activity is linked to the process of frequent rotations to accumulate workers' firm specific human capital.

Tetsuji Okazaki, *The Japanese Firm under the Wartime Planned Economy*, in *THE JAPANESE FIRM: SOURCES OF COMPETITIVE STRENGTH* 350, 357-59 & 369-70 (Masahiko Aoki & Ronald Dore eds. 1994).

³¹ For the detailed explanation of the situation of the labor market in Japan before 1940's, see W.

Galenson & Konosuke Odaka, *The Japanese Labor Market*, in *ASIA'S NEW GIANT: HOW THE JAPANESE ECONOMY WORKS* 614 (Hugh Patrick & Henry Rosovsky eds. 1976). *See also* ANDREW GORDON, *THE EVOLUTION OF LABOR RELATIONS IN JAPAN* (1985) (survey on the historical development of Japanese labor relations).

³² *See, e.g.*, ITOH, *supra* note 2, at 210-13 (summarizing this conventional wisdom for Japanese industrial relations).

It has been observed that production systems do not only deal with routine work, even if it appears to be a highly technological process that should be optimized with respect to the engineering methods.³³ There are always uncertain accidents, demand shocks, or technological innovations that require adjustments in the production system. According to Koike, human capital and termed intellectual skills become necessary to deal with this problem.³⁴ This is common knowledge related to the production system to which the laborer belongs and which is developed by the Japanese OJT that requires workers to train in a broad class of jobs.³⁵ Japanese firms have an advantage in coping with unexpected shocks by using the accumulated first-hand knowledge of workers on the production process.³⁶ This is combined with a work organization that has a broader division of jobs and in which authority is delegated to the lower tiers of workers in the production hierarchy. This approach has allowed Japanese firms to frequently experience higher productivity than other developed countries.

Such a system succeeds only when workers are offered incentives for making efforts to accumulate strictly firm-specific intellectual skills. This includes the

³³ See KOIKE, *supra* note 6, at 63.

³⁴ *Id.* at 63-68.

³⁵ *Id.* at 68-72.

³⁶ *Id.* at 241-59.

willingness to rotate among various types of jobs depending on the economic environment or the process of OJT, and the willingness of senior workers to accept and train young workers on the job. It is well-known from the classical human capital theory that a competitive labor market does not ensure an efficient level of investment in firm-specific human capital.³⁷ Owing to the firm-specific nature, firms do not have an incentive to pay for workers' investment effort, and given this expectation, workers lose their incentive to invest. Even explicit contractual arrangements cannot solve the problem due to the problem of third-party verifiability.³⁸ As courts cannot observe the level of human capital investment, a worker will not invest if he is paid prior to investment: further, he will be less motivated to invest as he cannot rely on a firm's promise to pay later for the same reason of verifiability.

To solve the problem of under-investment in firm-specific human capital, it is necessary to provide incentives for workers to invest and for firms to pay appropriately for the workers' efforts: i.e. the LTER should be a self-enforcing implicit contract that does not involve verifiability problems. Several features of the JEC listed in the

³⁷ See, e.g., Jacob Mincer, *Investment in Human Capital and Personal Income Distribution*, 66 J. POL. ECON. 281 (1958); Jacob Mincer, *On-the-job Training: Costs, Returns and Some Implications*, 70 J. POL. ECON. 50 (1962); GARY S. BECKER, *HUMAN CAPITAL: A THEORETICAL AND EMPIRICAL ANALYSIS WITH SPECIAL REFERENCE TO EDUCATION* (2d ed. 1975).

³⁸ It is a basic problem taken up by the incomplete contract theory. See Oliver E. Hart & John Moore, *Incomplete Contracts and Renegotiation*, 56 ECONOMETRICA 755 (1988).

previous section can be understood as a system to provide incentives for workers to invest in human capital.

One important trait of the Japanese LTER is that the short-run pay is inelastic to observable performance measures. At first sight, the compensation related to performance indexes such as output, sales, or profits appears to stimulate workers' efforts. However, this type of an incentive payment encourages workers to improve their short-run performance, without being interested in the accumulation of intellectual skills that are useful in the long run. Therefore, this type of compensation may sacrifice long-term productivity gains to short-run performance due to the accumulation of intellectual skills.³⁹

When the observable performance measures do not completely reflect the efforts of workers and the direct monitoring of workers is not very expensive, this type of incentive pay does not hold any advantage for firms. These two conditions apply to Japanese organizations in which the group production system is developed and in which the management is more concerned with long-term efficiency. This is the main reason

³⁹ See Hideshi Itoh, *Japanese Human Resource Management from the Viewpoint of Incentive Theory*, in *THE JAPANESE FIRM: SOURCES OF COMPETITIVE STRENGTH*, *supra* note 30, at 233, 240-57 (arguing that the Japanese system of human resource allocation and remuneration is both rational and efficient).

that this type of short-run incentive pay has not prevailed in Japan.⁴⁰

In the JEC where wage payment is inelastic to both short-run performances and types of jobs, the incentive to work hard and train is provided by the promotion process and the associated increase in wages that occurs in the long run. As explained in the previous section, merit assessment matters more than seniority, and the lifetime earning differences among workers are considerably large.⁴¹ As promotion is based on subjective assessments rather than objective measures, the effort of workers is more effectively aligned with the intentions of the management.

This process of promotion can be interpreted as a type of tournament wherein firms are committed to the lifetime employment of workers and their appropriate

⁴⁰ In other developed countries such as the U.S., it is also known that the remuneration system is not very elastic to the short-run performance indexes, at least for large companies and with the exception of the compensations for executives, although this tendency is not as conspicuous as in the case of Japan. However, they adopt a different system of remuneration from Japan in that wages are directly attached to jobs instead of persons. See DOERINGER & PIORE, *supra* note 14, at 65-71. This system of wages determined by the types and difficulties of jobs also works as a strong incentive device to increase workers' efforts, since this system works as a tournament among workers for the limited number of good positions. For a theoretical analysis of this type of economy, see Lorne Carmichael, *Firm-Specific Human Capital and Promotion Ladders*, 14 BELL J. ECON. 251 (1983); James M. Malcomson, *Work Incentives, Hierarchy, and Internal Labor Markets*, 92 J. POL. ECON. 486 (1984); W. Bentley MacLeod & James M. Malcomson, *Reputation and Hierarchy in Dynamic Models of Employment*, 96 J. POL. ECON. 832 (1988). However, this system is not effective for the accumulation of intellectual skills either, since workers do not have an interest in learning broad class jobs or in helping to develop the skills of other workers. This system is also the cause of organizational inflexibility in a changing environment, since any drastic change in the job design is protested by the workers in high positions in the hierarchy.

⁴¹ See *supra* note 17 and accompanying text.

remuneration.⁴² Here, the management determines the position of workers in the hierarchy depending on seniority and their long-term performance at the workplace. This mechanism provides sufficient incentives for workers to work hard and invest into firm-specific capital provided that the promise of the firm to remunerate workers is reliable.

Unfortunately, this system has a disadvantage in that it may protect against the moral hazard that firms renege on the wage payment to workers who do make sufficient efforts. As the amount of effort and wage which should be paid for that effort cannot be completely verified, the firm has an incentive to cut the wages of workers, although their job performance and accumulation of firm specific human capital are sufficient. Owing to this absence of credibility, workers are not willing to invest in human capital, and the LTER will fail.

To rectify this disadvantage, this implicit contract should be self-enforcing through the bargaining between the employer and the labor union. Here, employers must keep their promise of remuneration in order to protect their reputation because they fear that labor unions will retaliate in the future by not cooperating with the

⁴² The idea of tournament was originally provided in Carmichael and Malcomson. See Carmichael, *supra* note 40; Malcomson, *supra* note 40. Then it was adapted to the analysis of Japanese labor relations. See Kanemoto & MacLeod, *supra* note 7; Yoshitsugu Kanemoto & W. Bentley MacLeod, *Firm Reputation and Self-Enforcing Labor Contracts*, 6 J. JAPANESE & INT'L ECON. 144 (1992).

management.⁴³ For example, they might go on a strike or bargain for a higher wage increase or better working conditions in the following year's negotiations. As a result of this negotiation process, it may succeed in attaining efficient reputation equilibria in the long run.

C. Interpretation of the Stylized Facts and Some Other Implications Derived from Economic Theory

The theoretical analysis in section II.B. makes the rationalistic interpretation of the stylized facts in the JEC possible. Long-term employment and seniority wages are actually interpreted as devices to provide incentives to workers for the efficient accumulation of firm-specific skills,⁴⁴ and ambiguous job demarcation and the delegation of authorities to the lower tiers of production hierarchies are regarded as mechanisms facilitating the use of firm-specific skills for the improvement of the production system.⁴⁵ The intra-firm labor union is used for the communication between labor and management, and the negotiation in the intra-firm is more

⁴³ See Kanemoto & MacLeod, *supra* note 42 (applying the reputation effect to the analysis of Japanese firms.). The reputation effect was first put into economic analysis by Klein and Leffler. Benjamin Klein & Keith. B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981).

⁴⁴ See *supra* notes 41 & 42 and accompanying text.

⁴⁵ See *supra* notes 33-40 and accompanying text.

important than an industry-wide problem.⁴⁶ The dual nature of the Japanese labor market can be naturally understood as the returns provided to the regular workers for their extra effort in investment into the firm-specific human capital, which was not necessary for non-regular workers.

To explain why certain efficient traits that characterize the Japanese LTER are observed in the Western countries, but only for white-collar workers in large firms, it is necessary to consider the conditions for the bargaining process between labor and management in order to perform effectively. It is well known that the coordination of expectations between two players is necessary for attaining efficient reputation equilibrium.⁴⁷ More concretely, firms should build a good reputation to keep their promises with the workers.

This observation seems to imply that the Japanese system of management can only be introduced for the class of workers that is relatively protected against the business cycle or technical innovations, since it is this type of workers that firms can keep promises regarding remuneration for long time and their words become credible. It

⁴⁶ See *supra* note 43 and accompanying text.

⁴⁷ For the general discussion on this issue, see, e.g., David Pearce, *Repeated Games: Cooperation and Rationality in* ADVANCES IN ECONOMIC THEORY: SIXTH WORLD CONGRESS 132 (Jean-Jacques Laffont ed. 1992); DREW FUDENBERG & JEAN TIROLE, GAME THEORY ch. 5 (1991).

is exactly the class of workers that belong to white-collar in the large companies.⁴⁸

This theoretical argument further provides some insight on the relative decline of the effectiveness of the JEC. The world economy after the 1990s is partly characterized by the drastic technological progress led mainly by the development of information technology and financial engineering.⁴⁹ When new businesses and industries came into existence, old technologies became obsolete within a short span of time. As the merit of JEC lies in the accumulation of firm-specific knowledge in the long run, it is more effective in an economic environment growing at a stable rate and with relatively small technical changes. It is therefore said that Japan needs a new system of labor relations and labor market to cope with this change.⁵⁰

III. Structure of the Japanese Labor Law

A. Historical Origin

Section II.A indicated that the Japanese employment custom was introduced during the 1940s through wartime regulations, developed during the high economic

⁴⁸ If firms in other countries do not have a good reputation, workers will strongly oppose the introduction of the Japanese system of management, which gives more discretionary power to the employer. *See* Kanemoto & MacLeod, *supra* note 42, at 146.

⁴⁹ *See* REBICK, *supra* note 29, at 41-42 (discussing this technical change and its effect on the career patterns of standard employees in Japan).

⁵⁰ *See, e.g., id.* at 32.

growth period, and was well established by the Oil Shock that occurred in the 1970s.⁵¹

The labor law was not sufficiently developed before World War II. There were several laws that regulated individual labor relations, such as protecting minor or female laborers, determining minimum safety standards, and number of working hours.⁵² There were also laws for regulating employment agencies and the requirement of workers' accident compensation insurance.⁵³ In addition, during war times some laws were enacted to control minimum wage⁵⁴ and work time.⁵⁵ These laws formed the basis of the enactment of the post-World-War-II laws, but they were very insufficient as compared to today's standards. Many tragic cases concerning the working conditions of laborers, particularly female or minors, have been reported.⁵⁶ Furthermore, labor movements were repressed under criminal law, and efforts to legislate labor unions met

⁵¹ See *supra* notes 30 & 31 and accompanying text.

⁵² Kōjōhō, [Factory Law] Law No. 46 of 1911; Kōjōhō Shikourei [Ordinance for Enforcement of Factory Law], Imperial Ordinance No. 193 of 1916. These had been repealed when Labor Standards Law (*Rōdō Kijunhō*) were enacted in 1947.

⁵³ Rōdōsha Saigai Fujohō [Worker's Injury Assistance Law], Law No. 54 of 1931; Rōdōsha Saigai Fujo Hokenhō [Worker's Injury Assistance Insurance Law], Law No. 54 of 1931.

⁵⁴ Chingin Tōseirei [Wage Control Ordinance], Imperial Ordinance No. 128 of 1937.

⁵⁵ Kōjō Shūgyō Jikanrei [Factory Employment Hours Ordinance], Imperial Ordinance No. 127 of 1937.

⁵⁶ Those tragedies can be easily found in reports by government agencies, in nonfiction books, and in novels in those days. See, e.g., NŌSHOUMUSHŌ [Ministry of Agriculture and Commerce], SHŌKOU JIJŌ [Commercial and Industrial Affairs] (1903).

with failure, until the end of the war.⁵⁷

The situation changed drastically after the war. The Allied High Command promoted a social policy for protecting workers and their Labor Union activities, as a part of its democratization program toward Japan. The Labor Union Law was enacted in 1945⁵⁸ and it was revised in 1949 to its present form.⁵⁹ At the same time, with the support of the new law and reflecting the urgent economic conditions of the post war period, the union density (rate of the union membership among workers) exceeded 50%.⁶⁰

In addition, there were changes in the area of individual labor relations. The New Constitution of 1946⁶¹ established the basic right to work, defined the principles

⁵⁷ See KAZUO SUGENO, JAPANESE EMPLOYMENT AND LABOR LAW 5-8 (Leo Kanowitz trans. 2002).

Although great deal of effort had been put into legislating laws for unions from 1919, it finally failed in 1931. But many discussions had been made in that process and this made rapid legislation of union laws just after World War II possible. See *id.* at 7-8; KAZUO SUGENO, RŌDŌHŌ [Labor Law] 5-6 (7th supplemented 2d ed. 2007).

⁵⁸ Rōdō Kumiai-hō [Labor union Law], Law No. 51 of 1945.

⁵⁹ Rōdō Kumiai-hō [Labor union Law], Law No. 174 of 1949. For brief summary on formation and amendment of Labor Union Law in English, see Mitsunari Doko, *The Labor Relations Commission as an Organization to Resolve Collective Labor Disputes*, 3 JAPAN LABOR REV., no.1, at 32, 32-35 (2006).

⁶⁰ KŌSEI RŌDŌSHŌU [Ministry of Health, Labour and Welfare], RŌDŌKUMIAI KISO CHŌSA JIKEIRETSUHYOU DAI 1 HYŌU [Basic Survey on Labor Union Table 1] (2006) (indicating that in 1947 the union density rate had been 45.3% and it increased to 53.0% in the next year. In 1949, the year in which present Labor Union Law was legislated, the rate raised to 55.8%).

⁶¹ KENPŌ [The Constitution of Japan].

for the legislation on labor conditions,⁶² and guaranteed the right to organize and bargain and act collectively.⁶³ In 1947, the Labor Standards Law⁶⁴ and the Workers' Accident Compensation Law⁶⁵ were promulgated, which complemented the insufficient pre-war laws and raised the level of protection of laborers to the International Labour Organization's (ILO) International Labour Standards. Further, the basic laws on unemployment were voted during this period to cope with the disastrous labor market conditions.⁶⁶ The basic framework of the Japanese labor law was constructed between 1945 and 1955 and continues to be used even today.⁶⁷

B. Basic Principles

Next, we will describe the basic principles on which the Japanese labor law is founded. First, as well as in other contracts, there is freedom of contract and consequently the contract between a worker and an employer is enforceable.⁶⁸ In reality,

⁶² See *id.* art. 27 (providing that standards of working conditions including wage, rest time shall be set up by law).

⁶³ See *id.* art. 28.

⁶⁴ Rōdō Kijunhō [Labor Standards Law], Law No.49 of 1947.

⁶⁵ Rōdōsha Saigai Hoshou Hokenhō [Workers' Accident Compensation Law], Law No. 50 of 1947.

⁶⁶ To cope with unemployment caused by deflationary policies under Dodge Line, Unemployment Insurance Law was amended and Emergency Countermeasures Law was enacted. See SUGENO, *supra* note 57, at 9-10. For details of situation of employment in these days, see RŌDŌSHOU [Ministry of Labour], SHOWA 24 NEN RŌDŌ KEIZAI NO BUNSEKI [Analysis of Labor Economics 1947] ch.2 (1947).

⁶⁷ See SUGENO, *supra* note 57, at 8-10.

⁶⁸ See *id.* at 3-4. Freedom of contract is a basic principle in Civil Law. Without laws modifying or restricting this freedom, parties of contracts are free to agree upon whatever provisions they want and it

it is not so free as it may first appear. It is commonly explained as follows. Since the bargaining power between workers and employers is extremely unequal, labor contracts can be rather unfair and unreasonable in determining the terms of working conditions.⁶⁹ Hence supporting the laborers who only have a weak bargaining power in order to rectify this unfair distribution of the bargaining power and to facilitate the attachment of fair and reasonable agreements in labor contracts is justifiable.⁷⁰

For this purpose, there are three approaches adopted in the Japanese labor law. First, it provides compulsory minimum standards for working conditions such as wages,⁷¹ working hours,⁷² and safety.⁷³ They are regarded as protecting workers against unfair outcomes that arise when the conditions for labor is completely left for free negotiations between them.⁷⁴

There are also regulations against discriminatory treatment. Once hired,

will be enforceable, as long as it is not against public policy. MINPO [Civil Code], art. 90 (providing that contracts and other acts should be nullified if it is against public policies). Labor laws function as a restriction on this freedom.

⁶⁹ *See id.* at 76.

⁷⁰ *See id.*

⁷¹ *See* Saitei Chinginhō [Minimum Wage Law], Law No. 137 of 1959, art. 5, paras. 1 & 2. For details, see *infra* note 131 and accompanying text.

⁷² *See* Rōdō Kijinhō [Labor Standards Law], Law No.49 of 1947, art. 32, paras. 1 & 2.

⁷³ *See id.* art. 42; Rōdō Anzen Eiseihō [Labor Safety and Health Law], Law No. 57 of 1982.

⁷⁴ *See* SUGENO, *supra* note 57, at 18.

employers may not treat employees discriminatory by race, sex, ideology, and so on.⁷⁵

While discriminatory treatment by nationality, race, ideology and others are explicitly prohibited only after workers are hired (i.e. discrimination at the stage of recruitment and hiring is not explicitly restricted), discriminatory treatment by sex at the stage of recruitment and hiring employers, such as excluding female from recruiting,⁷⁶ is severely prohibited by Equal Employment Opportunity Law.⁷⁷ It has long been argued that Japanese female workers are discriminated against in the recruitment process and in their treatment within the firm: therefore, they are unable to hold regular positions in the LTER.⁷⁸ To rectify this situation, the Equal Employment Opportunity Law⁷⁹ was

⁷⁵ See Rōdō Kijinhō [Labor Standards Law], Law No.49 of 1947, arts. 3 & 4 (prohibiting discriminatory treatment of employees in general); Koyō no Bunya ni okeru Danjo no Kintōna Kikai oyobi Taigū no Kakuho ni Kansuru Hōritsu [Equal Employment Opportunity Law], Law No. 113 of 1972, arts. 5-9 (prohibiting especially discrimination by gender).

⁷⁶ See Rōdōsha ni taisuru Seibetsu wo riyū to suru Sabetsu no Kinshitou ni kansuru Kitei ni sadameru Jikou ni kanshi, Jigyounushi ga Tekisetsu ni Taisho surutamenō Shishin [Guidelines on Appropriate Measures Employers should Take concerning Provisions Prohibiting Sexual Discrimination of Worker], 2006 RŌKOKU 164, art. 2, para. 2, item 2.

⁷⁷ Koyō no Bunya ni okeru Danjo no Kintō na Kikai oyobi Taigū no Kakuho ni Kansuru Hōritsu [Equal Employment Opportunity Law], Law No. 113 of 1972, art. 5. The Duty of employers to provide women with equal opportunities as compared with men was not mandatory until 1997 amendments of Equal Employment Opportunity Law. For the 1997 amendments, see Yamakawa, *supra* note 25, at 636-40.

⁷⁸ This difficulty can be explained by using the statistical theory of discrimination. See Edmund Phelps, *The Statistical Theory of Racism and Sexism*, 62 AM. ECON. REV. 659 (1972); Joseph E. Stiglitz, *Approaches to the Economics of Discrimination*, 63 AM. ECON. REV. 287 (1973). Japanese firms require workers who work on a long-term basis to accumulate firm-specific human capital. In this sense, female laborers have a high risk of early retirement to raise their children, as it is difficult to determine whether

enacted in 1985 and developed to its present form in 1997.⁸⁰

Second, to rectify the unequal bargaining power between labor and management, it guarantees workers the right to bargain collectively by forming unions.⁸¹ Third, to improve the labor market mechanism, information and employment placement service is provided by public employment agencies,⁸² and those seeking

individual female workers really wish to work in the long run. This provides sufficient reason to firms to treat female workers unfavorably, even if they have no discriminatory ideas.

⁷⁹ Koyō no Bunya ni okeru Danjo no Kintō na Kikai oyobi Taigū no Kakuho ni Kansuru Hōritsu [Equal Employment Opportunity Law], Law No. 113 of 1972.

⁸⁰ See ARAKI, *supra* note 21, at 108-22. The harmonization of work and family life has been one of the top legal policy agenda in order to cope with those problems. There has been a steady increase with regard to the share of female labor force holding permanent positions in firms in Japan from 1975 until today. See REBICK, *supra* note 29, at 113-18, Tbl. 7.2 (explaining recent extension of female labor force in Japan and indicating that the percentage of women in management posts has drastically increased since 1980s). It shows that this problem will be expected to disappear gradually for the reasons below. First, Japanese society is rapidly aging and hence it is essential for firms to employ female labor force as regular employees. Second, along with the change of industrial structure, the importance of the LTER is relatively diminishing, and the reduction and increased flexibility of working hours has been realized partly supported by the reform of labor law.

⁸¹ See KENPŌ [The Constitution of Japan], art. 28. Rights and privileges of labor unions and duties of employers are provided in Labor Union Law (*Rōdō Kumiai hō*). For example, Labor Union Law provides exemption from criminal punishment for actions in appropriate strikes. *Rōdō Kumiai hō* [Labor union Law], Law No. 174 of 1949, art. 1, para. 2. See also KEIHŌ [Penal Code], art. 35.

⁸² See Shokugyou Antei hō [Employment Security Law], Law No. 141 of 1947, art. 5. Until 1999, private employment placement service was strictly restricted to only few jobs and employment placement service was generally provided by governmental agencies. In 1999 amendments of Employment Security Law and Worker's Dispatching Law, this regulation was largely changed to liberalize restrictions on private employment placement service and to remove governmental monopolization. See Takashi Araki, 1999 *Revisions of Employment Security Law and Worker Dispatching Law: Drastic Reforms of Japanese Labor Market Regulations*, 38 JAPAN LABOR BULLETIN, no.9, at 5, 5-12 (1999); Yamakawa, *supra* note 25, at 642.

employment can receive subsidies, which includes unemployment benefits.⁸³

C. The Long-Term Employment Relationship and the Protection of Employment

Section II.A. pointed out a stylized fact that the LTER prevails in the above-middle sized Japanese companies. Due to the nature of LTER, considerable part of the working conditions is not explicitly written in the individual contracts.⁸⁴ Therefore, work rules (*shūgyō kisoku*) and collective agreements among union(s) and employer (*Rōdō Kyōyaku*) become important since they have a function of filling the

⁸³ See generally Koyō Hokenhō [Employment Insurance Law], Law No. 116 of 1974; Rōdō Hoken no Hokenryō no Chōshūtō ni kansuru Hōritsu [Law Concerning Collection of Labor Insurance Premium], Law No. 84 of 1973.

⁸⁴ See *infra* section III D. As for the term of labor contract, it had been severely restricted to write a fixed-term labor contract. Before 1998 amendment, article 14 of Labor Standards Law in principle prohibited fixed-term labor contracts that last longer than one year. See Hiroya Nakakubo, *The 2003 Revision of the Labor Standards Law: Fixed-term contracts, Dismissal and Discretionary-work Schemes*, 2 JAPAN LABOR REV., no.1, at 4, 7 (2004). This restriction was said to protect workers from being bound too long and therefore being deprived of freedom of resignation. See SUGENO, *supra* note 57, at 188-91. Since it can be circumvented easily and the fear of obligatory servitude became obsolete, the restrictions have been gradually liberalized. See Takashi Araki, *Changing Employment Practices, Corporate Governance, and the Role of Labor Law in Japan*, 28 COMP. LABOR L. & POL'Y J. 251, 276-77 (2007).

1998 amendment made certain exceptions: for certain types of labor contracts, such as scientific research, the maximum period may be three years. See Yamakawa, *supra* note 25, at 632. Further liberalizations were made in 2003 amendment. In the amendment, maximum period for all types of labor contracts became three years. Also, for certain types of contracts maximum period was extended from three years to five years. See KŌSEI RŌDŌSHŌU [Ministry of Health, Labour and Welfare], KAISEI RŌDŌ KIJUNHŌ NO GAIYŌU [Summary of Amended Labor Standards Law] 2 (2003), available at <http://www.mhlw.go.jp/topics/2003/11/dl/tp1111-1a.pdf>.

gaps. Also statutory and case law that restrict the power of employer will be critical in some situation such as dismissals.

The LTER is not the same as a series of contracts, which are renegotiated and updated every one to five years but is “a type of labor contract that has not specified its duration”.⁸⁵ Under Civil Code, both parties of this type of contract can cancel the contract at will: i.e. employers have the freedom to dismiss employees and workers have the freedom to resign. Civil Code provides that both employers and employees can terminate labor contract without fixed-term at their will and in this event labor contracts will be terminated two weeks after the request to terminate is made.⁸⁶ Also Labor Standards Law traditionally had provided only few explicit restrictions on dismissal.⁸⁷

But the freedom of dismissal has been strictly restricted under the doctrine of abusive dismissal that has been formed by case law. This doctrine has its foundation in the basic principle of Civil Law which prohibits abusive exercise of rights.⁸⁸ This principle of the abusive exercise of a right was first applied to the dismissal disputes

⁸⁵ See Rōdō Kijinhō [Labor Standards Law], Law No.49 of 1947, art. 14, para. 1.

⁸⁶ MINPŌ [Civil Code], art. 627, para. 1.

⁸⁷ E.g., Rōdō Kijinhō [Labor Standards Law], Law No.49 of 1947, art. 19 (prohibiting dismissal during periods of leave by maternity or by injury or illness caused by work.). See SUGENO, *supra* note 57, at 474.

⁸⁸ See MINPŌ [Civil Code], art. 1 para. 3.

through the accumulation of a majority of judicial decisions by the lower courts, which commenced immediately after the war and was particularly confirmed during and after the 1973 Oil Shock.⁸⁹ It was endorsed by the Supreme Court's decision in the late 1970s.⁹⁰ Then the doctrine of abusive dismissal had been codified in Labor Standards Law in 2003,⁹¹ and the provision has been moved into new Employment Contract Law⁹² that came into force on March 2008.⁹³

In sum, employers can dismiss workers only when there are reasonable grounds

⁸⁹ For the formation of doctrine of abusive dismissal, see Ryuichi Yamakawa, *Nihon no Kaikohōsei* [Japanese Law of Dismissal], in *KAIKOHŌSEI WO KANGAERU* [Examining Law of Dismissal] 3, 4-7 (Fumio Ohtake et al. eds., 2002).

⁹⁰ E.g., *Ichilawa v. Nihon Shokuen Seizou K.K.*, 29 MINSHŪ 456, 457-58 (Sup. Ct., Apr. 25, 1975); *Shiota v. Kōchi Hōsō K.K.*, 268 RŌDŌ HANREI 17, 18-19 (Sup. Ct., Jan. 31, 1977).

⁹¹ Before 2003 amendment, Rōdō Kijinhō [Labor Standards Law], Law No.49 of 1947, art. 18-2 provided:

A dismissal shall, where the dismissal lacks objectively reasonable grounds and is not considered to be appropriate in general societal terms, be treated as an abuse of that right and invalid.

Id., translated in LABOR STANDARDS ACT 13 (Japan Institute for Labour Policy and Training trans. 2003).

For a brief summary of doctrine of abusive dismissal and 2003 amendment, see Nakakubo, *supra* note 84, at 13-18. For about new Employment Contract Act, see *infra* note 92.

⁹² Rōdō Keiyakuhō [Employment Contract Law], Law No. 128 of 2007, art. 16. This provision is identical to the former article 18-2 of Labor Standards Law and the latter provision was deleted from Labor Standards Law according to the legislation of new Employment Contract Law. See *id.* Supplementary provision art. 2 (providing the deletion of former articles 18-2 of Labor Standards Law).

⁹³ The Japanese approach on employment protection ranges between the level of European countries such as Germany and France, wherein there are explicit legislations regulating dismissals and in Anglo Saxon countries (US, UK, Canada, Australia, New Zealand) wherein the at-will based employment policy is adopted. See OECD, OECD EMPLOYMENT OUTLOOK 2006, at 96 & fig. 3.9 (2006).

to do so.⁹⁴ The doctrine required that to dismiss an employee, there must be objectively reasonable grounds so that it could receive general social approval.⁹⁵ For example, an order of dismissal based simply on the subjective sentiment of the employer cannot be passed under this principle. When the decision of dismissal is judged illegal, employer is compelled to continue the relationship⁹⁶; moreover, as the labor contract relationship has continued during the period between the invalid dismissal and the judgment voiding the dismissal, workers can claim the wages for this period.⁹⁷

This doctrine was originally formed in the case when the behavior of an individual worker is not appropriate. Then during the recession, particularly after the 1973 Oil Shock this doctrine was extended to the case of adjustment dismissal.⁹⁸ This was the time when the Japanese custom of employment adjustment was firmly

⁹⁴ See SUGENO, *supra* note 57, at 479.

⁹⁵ See, e.g., *Nihon Shokuen Seizo*, 29 MINSHŪ at 457; *Kōchi Hōsō*, 268 RŌDŌ HANREI at 18.

⁹⁶ See Rōdō Keiyakuhō [Employment Contract Law], Law No. 128 of 2007, art. 16 (providing that such dismissal will be invalid). See also SUGENO, *supra* note 57, at 482. This does not always mean that employers must put the abusively dismissed workers on the position he had assumed before. Rather it protects workers because the employer must pay wages as long as the labor contract is in effect. See Yamakawa, *supra* note 89, at 8. In sum, this provides an incentive to the employers who dismissed an employee unduly to restore her on an appropriate position or to negotiate with her for voluntary resignation. In the latter case, the employer will be paying some extra compensation.

⁹⁷ See SUGENO, *supra* note 57, at 483.

⁹⁸ See, e.g., *Shimazaki v. Tōyō Sanso K.K.*, 330 RŌDŌ HANREI 71, 78-79 (Tokyo High Ct., Oct. 29, 1979) (indicating that the doctrine of abusive dismissal rights is applied to the cases of adjustment dismissals); *Miyake v. Asahi Jigyō Kyōkai Charitable Corp.*, 427 RŌDŌ HANREI 63, 64 (Sup. Ct., Oct. 27, 1983). See also Yamakawa, *supra* note 89, at 8-9.

established. This custom was in sharp contrast with the system in the U.S., wherein a shortage of demand is promptly adjusted to by laying off workers.⁹⁹ At least in the large companies in Japan, dismissal was avoided by restricting overtime work, suspending mid-career hiring, transferring and farming out workers to related companies, terminating the employment of non-regular workers, and soliciting voluntary retirement by old workers.¹⁰⁰ Dismissing typical workers was not regarded as the first option employers should take in recessions.

The Doctrine of Abusive Dismissal required the four conditions below as just causes for the adjustment dismissal¹⁰¹:

- (1) the urgent necessity of dismissal for the continuation of management,
- (2) duty of efforts to avoid dismissal,
- (3) propriety of the selection criteria for the dismissed,
- (4) procedural propriety.

Condition (1) is the presupposition for adjustment dismissal.¹⁰² In judging

⁹⁹ See KOIKE, *supra* note 6, at 92-94 (about the system of employment adjustment in the US).

¹⁰⁰ Courts recognize that workers normally expect for lifetime employment and firms employ workers on the premise that workers would expect so. *See, e.g.,* Miyake v. Asahi Jigyō Kyōkai Charitable Corp., 427 RŌDŌ HANREI 64, 65-66 (Fukuoka High Ct., Oct. 24, 1979); Echi v. Chiyoda Kakō Kensetsu K.K., 629 RŌDŌ HANREI 19, 23 (Tokyo High Ct., Mar. 31, 1993).

¹⁰¹ *See, e.g.,* Tōyō Sanso, 330 RŌDŌ HANREI at 78-79. *See also* SUGENO, *supra* note, at 487-89.

¹⁰² *See, e.g.,* Toyoda v. Maruman K.K., 787 RŌDŌ HANREI 18, 27 (Osaka D. Ct., May 8, 2000) (indicating that necessity for adjustment dismissal had decreased and invalidated the dismissal.).

condition (1), Japanese courts have taken a view that adjustment dismissal should be reasonable means to resolve present or future deficits.¹⁰³ As mentioned just above, even when there are deficits, courts regarded that adjustment dismissal is a solution that can be selected only after reasonable efforts to avoid dismissal are taken.¹⁰⁴ Thus, in courts' view, employers should first search some ways to avoid adjustment dismissal.¹⁰⁵ With regard to condition (3), if there are no objective standards for the selection or if the standards are deemed objectively unreasonable, the adjustment dismissal will be void.¹⁰⁶ Condition (4), virtually implies the duty to explain and consult with the Labor Union in good faith, and is consistent with the method of employment adjustment of Japanese firms stated above.¹⁰⁷

When the disputed dismissal is judged as being void, the employer must pay the wages for the period in which he was dismissed, in the same way as in the case of

¹⁰³ See, e.g., *Tōyō Sanso*, 330 RŌDŌ HANREI at 78-79.

¹⁰⁴ See, e.g., *id.* at 78; *Asahi Jigyō Kyōkai*, 427 RŌDŌ HANREI at 64; *Maruman*, 787 RŌDŌ HANREI at 28.

¹⁰⁵ But this is not to mean that employers should test all available means before dismissing workers for adjustment. See, e.g., *Hirata v. Nakamichi K.K.*, 775 RŌDŌ HANREI 71, 80-81 (Tokyo High Ct., July 23, 1999) (rejecting the argument of plaintiff workers that defendant firm could have taken means other than adjustment dismissal such as work sharing on the ground that those means did not seem to function well in the defendant corporation.).

¹⁰⁶ See SUGENO, *supra* note 57, at 489.

¹⁰⁷ See *supra* notes 98-100 and accompanying text.

individual dismissals.¹⁰⁸ Contrary to European countries,¹⁰⁹ the option to end the employment relationship without an agreement of the worker, but in exchange for the payment of some compensation when the dismissal is judged as void is not permissible in Japan.

D. The Long-Term Employment Relationship as Relational Contract

The LTER is essentially incomplete in terms of aspects other than employment duration as well, due to its nature of relational contract under the condition of bounded rationality.

First, the LTER takes the form of a group contract, the contents of which are specified by the work rules (*shūgyō kisoku*), which generally apply to all workers in a firm.¹¹⁰ In most developed countries, the outline of the rules of a firm is regulated by the minimum standards set by the collective bargaining at the industry level, and the co-determination system between employer and workers' council decides the details of the rules.¹¹¹

¹⁰⁸ For the effect of invalid dismissals, see *supra* notes 96 & 97 and accompanying text.

¹⁰⁹ See ARAKI, *supra* note 21, at 27.

¹¹⁰ See Rōdō Kijinhō [Labor Standards Law], Law No.49 of 1947, arts. 89, 92 & 93; Rōdō Keiyakuhō [Employment Contract Law], Law No. 128 of 2007, art. 7.

¹¹¹ See SUGENO, *supra* note 57, at 495-96.

In Japan, the employer's right to set the work rules is the basic norm in the LTER. The employer has the power to set the rules and an inclusive right of direction and orders to the employees.¹¹² The Labor Standards Law requires every employer to frame work rules with regard to the main items¹¹³ and to make them known to all workers.¹¹⁴ The framing and the change of work rules must be submitted to the public agency known as the Labor Standards Inspection Office [*Rōdō Kijun Kantokusho*] so that they are supervised as being subject to the legal regulations and collective agreements among employers and workers.¹¹⁵ As such, the work rules substantially govern the labor contract.

It is therefore important to reflect the opinions of laborers within its content. Its most developed form is the co-determination system in Germany, wherein work rules are determined with the consent of the workers' council.¹¹⁶ If there is no agreement,

¹¹² See Rōdō Kijunhō [Labor Standards Law], Law No.49 of 1947, art. 90; Rōdō Keiyakuhō [Employment Contract Law], Law No. 128 of 2007, art. 7. See also SUGENO, *supra* note 57, at 115-19.

¹¹³ Rōdō Keiyakuhō [Employment Contract Law], Law No. 128 of 2007, art. 11; Rōdō Kijunhō [Labor Standards Law], Law No.49 of 1947, art. 89, paras. 1-10.

¹¹⁴ Rōdō Kijunhō [Labor Standards Law], Law No.49 of 1947, art. 106, para. 1; Rōdō Kijunhō Shikoukisoku [Ordinance for Enforcing Labor Standards Law], Ministry of Health and Welfare Ordinance No. 23 of 1947, art. 52-2.

¹¹⁵ See Rōdō Keiyakuhō [Employment Contract Law], Law No. 128 of 2007, art. 11; Rōdō Kijunhō [Labor Standards Law], Law No.49 of 1947, art. 89 & art. 92, para. 2.

¹¹⁶ See SUGENO, *supra* note 57, at 113.

then it is arbitrated by a public agency.¹¹⁷

In Japan, it is obligatory for the employer to seek the workers' opinions.¹¹⁸

However, it does not mean that employees (or union(s) of the firm) have veto power regarding the changes of work rules. If there is an agreement on changes of working conditions among workers and employer, the changes will be effective.¹¹⁹ In principle, if the amendment of the work rule is against workers' interest, it is necessary to gain the consent of the workers.¹²⁰ However, there are an important exception on the amendment of work rules: even if it is against the interest of workers, employers can amend the work rules and consequently change the working conditions unilaterally when the following two conditions are met.¹²¹

¹¹⁷ KAZUO SUGENO, *SHIN-KOYOU SHAKAI NO HŌ* [New-Law At Employment Society] 57 (Supp. ed. 2004).

¹¹⁸ *Rōdō Keiyakuhō* [Employment Contract Law], Law No. 128 of 2007, art. 11; *Rōdō Kijunhō* [Labor Standards Law], Law No.49 of 1947, art. 90, para. 1.

¹¹⁹ *See Rōdō Keiyakuhō* [Employment Contract Law], Law No. 128 of 2007, art. 8. This is so whether the changes of working conditions are provided in work rules or in individual employment contract between a particular worker and the employer.

¹²⁰ *Id.* art. 9 (providing that except for the case where the conditions provided in article 10 of the Employment Contract Law are met, the workers cannot change the work rules against the interest of the workers unilaterally) . New Employment Contract Law became effective in March 2008 and the provisions regarding the changes of work rules are one of the major contents of this law. Article 9 of this law is confirming that employers cannot always change the work rules against the interest of the employees without their consent. *See Kōsei Rōdōshō Rōdōkijunkyoku Kantokuka* [Inspection Division of Ministry of Health, Labour and Welfare Labour Standards Bureau], *Rōdō Keiyakuhō no Gaiyō* [The Outline of Employment Contract Law], 1351 *JURIST* 34, 38 (2008).

¹²¹ *Rōdō Keiyakuhō* [Employment Contract Law], Law No. 128 of 2007 art. 10.

First of all, the workers must be informed of the amended work rules which reflect the change of working conditions.¹²² Second and more important condition is that the amendment of the work rules must be reasonable considering various factors including the necessity of the changes of the working conditions, extent of the disinterest workers will suffer and the process of amendment.¹²³ In reality, the work rules are framed and revised through negotiations with the Labor Union, since the implementation of these rules is impossible without the Labor Union's support.

It can be said that Japanese employers are required to protect employment more intensely than employers in other developed countries because of both social norms and legal doctrines. In exchange, they are given a greater power of discretion to

¹²² *Id.*

¹²³ *Id.* This is based on the case laws about the changes of work rules. *See, e.g.,* Yoshikawa v. Shūhoku Bus K.K., 22 MINSHŪ 3459, 4363-64 (Sup. Ct., Dec. 25, 1968) (indicating that change of the work rule must be reasonable and affirmed the change of the defendant corporation in order to introduce mandatory retirement age); Satō v. Dai Shi Ginkou K.K., 51 MINSHŪ 705 (Sup. Ct., Feb. 28 1997) (in affirming the judgment of Tokyo High Court, the Supreme Court held that the change of work rules which extends the mandatory retirement age of defendant bank from 55 to 60 but in turn reduces the wages is valid. In this case, before the change of work rules defendant bank had already hired employees over 55 until 58 on the work conditions that is substantially same as the work condition just before the mandatory retirement and therefore the change of work rules could be considerably disadvantageous to the employees. The court affirmed the change on the ground that the necessity of the change was so large, the wage after the change is still high compared to other firm and the union of defendant bank had negotiated and agreed on the change.) Article 10 codified the summary of these case laws. *See* Takashi Muranaka, *Rōdō Keiyakuhō Seitei no Igi to Kadai* [The Significance and problems of the Legislation of Employment Contract Law], 1351 JURIST 42, 43-45 (2008). For the cases of work rule changes involving reduction of wages, see *infra* notes 132 & 133 and accompanying text.

set the work rules based on working conditions, personnel affairs, and enterprise order and discipline.

E. Working Conditions

The LTER is based on OJT and career promotion. In this process, the Japanese labor law has given employers the freedom to control personnel matters and enterprise order and discipline without much legal intervention. The legal bases are the work rules that form the main body of the labor contract in the LTER.

First, firms have the freedom of recruitment and Japanese employers have significantly more discretion in this aspect¹²⁴ than those in the U.S., wherein legislation on discrimination in the labor market is developed and thus discretion in hiring and recruitment is constrained.¹²⁵

Following recruitment, it is customary for Japanese firms to require active human capital investment by workers. This OJT is conducted only on the initiative of

¹²⁴ See, e.g., *Takano v. Mitsubishi Jushi K.K.*, 27 MINSHŪ 1536, 1543-46 (Sup. Ct., Dec. 12, 1973) (in remanding the case to Tokyo High Court, The Supreme Court indicated that in principle article 14 of the Constitution, which prohibits discriminatory treatment, does not restrict the discretion of firms in hiring and recruitment stage and thus investigating and asking about political ideology of candidate of recruit is not deemed illegal.).

¹²⁵ See ARAKI, *supra* note 21, at 60-62. But as mentioned earlier, Equal Employment Opportunity Law prohibits discriminatory treatment by gender at the stage of recruitment and hiring (*Koyō no Bunya ni okeru Danjo no Kintō na Kikai oyobi Taigū no Kakuho ni Kansuru Hōritsu* [Equal Employment Opportunity Law], Law No. 113 of 1972, art. 5). See *supra* notes 76-80 and accompanying text.

the firms.¹²⁶ The demand for OJT is linked with frequent rotations to train in various types of jobs. In addition, employers have broad discretion regarding personnel reassignments at least for typical workers (whose work place and/or job types are not explicitly restricted under employment contracts).¹²⁷ Sometimes, its violation results in punitive dismissal. The law supports the system by admitting the employers' right to order and conduct OJT.¹²⁸ As explained before, the Japanese wage payment system is not strongly associated with the type of job or location of the office.¹²⁹ Hence, the employers' having substantial discretion with regard to personnel affairs does not directly lead to serious damages for employees.¹³⁰

F. Wage Payment

With regard to the other aspects of working conditions, wage payment is clearly the most important matter. One legal restriction is the regulation of minimum

¹²⁶ See SUGENO, *supra* note 117, at 135.

¹²⁷ See, e.g., Moribe v. Kyūshū Asahi Hōsō K.K., 757 RŌHAN 21 (Fukuoka High Ct., July 30, 1996) (judging that there was no restriction of job types and therefore the reassignment of was valid), *aff'd*, 757 RŌHAN 20 (Sup. Ct., Sep. 10, 1998).

¹²⁸ See ARAKI, *supra* note 21, at 132-36.

¹²⁹ See *supra* section II.A.

¹³⁰ In contrast to the recruitment stage, discriminatory treatment using personnel reassignments by nationalities, ideologies, sexes or union activities are strictly restricted once hired. See Rōdō Kijūhō [Labor Standards Law], Law No.49 of 1947, arts. 3 & 4; Koyō no Bunya ni okeru Danjo no Kintō na Kikai oyobi Taigū no Kakuho ni Kansuru Hōritsu [Equal Employment Opportunity Law], Law No. 113 of 1972, arts. 5-9. See *supra* notes 75-77 and accompanying text for further details.

wages.¹³¹ For the wage payment system in the LTER, again, the autonomy of the management and laborers is broad. Naturally the wages under LTER must not be lower than the minimum wage, but there are no legal regulations with respect to the types of wage payments such as seniority, performance pay, or wages attached to the job. Bonus or retirement payments are not even legally required.

Owing to its importance, there are relatively more legal disputes concerning wage payments than other matters. In particular, during the Oil Shock and the 1990s recession, a drastic change in wage payment was often required for the survival of firms, and this unexpected change was frequently contested.

With respect to its legal arbitration, the courts flexibly accepted this adjustment by considering the “reasonableness” of the revision of work rules on payment, adopting a synthetic judgment for each case.¹³² One basic doctrine is that it is

¹³¹ In Japan, there are regional (for each prefecture) minimum wages and industrial minimum wages. These are based on investigation by Minimum Wage Council (*Saitei Chingin Shinsakai*). See Saitei Chinginhō [Minimum Wage Law], Law No. 137 of 1959, art. 16. Employers must, in principle, pay at least these minimum wages to workers (*id.* art. 5 para. 1) and Labor Standards Inspector (*Rōdō Kijun Kantokukan*) has the authority to investigate, inspect and question in order to ensure the performance of employers’ duties (*id.* art. 38).

¹³² See *Yoshikawa v. Shūhoku Bus K.K.*, 22 MINSHŪ 3459, 4363-64 (Sup. Ct., Dec. 25, 1968); *Satō v. Dai Shi Ginkou K.K.*, 51 MINSHŪ 705 (Sup. Ct., Feb. 28 1997); *Murose v. Michinoku Ginkou K.K.*, 54 MINSHŪ 2075 (Sup. Ct., Sep. 7. 2000) (denying the effect of work rule amendment that resulted in the reduction of the wage for workers who are above 55). See also SUGENO, *supra* note 57, 228-29, 489-91. For the law on the change of work rules, see *supra* notes 119-123 and accompanying text.

not impossible for employers to change the payment system, at least it is judged indispensable to protect the employment of workers.¹³³

The more significant restriction to support real wages in Japan after the late 1980s came rather from the regulation of working hours.¹³⁴ The Japanese Labor Standards Law that adopted the 48 hour workweek system was substantially revised in 1987 and, with gradual reduction of working hours, by 1997, the principle of the 40 hour workweek was put completely into practice.¹³⁵ When employers require overtime or rest-day work, employers must make an agreement with the Labor Union (or the representative of majority of the employees in the office) and must file the agreement with the Labor Standards Inspection Office.¹³⁶ In addition, employers must pay a wage premium for such work.¹³⁷ Although it has been said that Japanese workers are

¹³³ See, e.g., *Tamura v. TM K.K.*, 1641 RŌDŌ KEIZAI HANREI SOKUHOU 22 (Osaka D. Ct., May 28, 1997) (in affirming the reduction of wage as part of reconstruction of defendant corporation, the court affirmed that there was no objection by plaintiff and the reduction was not against the public policy. On the other hand, the court denied the effectiveness of cut of plaintiff's wage allegedly was due to the poor result of his job.) See also ARAKI, *supra* note 21, at 52-55. But in contrast to minor changes of work rules, it is not so easy to reduce the wage unilaterally. See, e.g., *Michinoku Ginkou*, 54 MINSHŪ at 2093-94.

¹³⁴ See generally SUGENO, *supra* note 57, at 259-60.

¹³⁵ See Rōdō Kijinhō [Labor Standards Law], Law No.49 of 1947, art. 32, para. 1 (providing that "an employer shall not have a worker work more than forty hours per week"). See also *id.* art. 32, para. 2 (providing that "an employer shall not have a worker work more than eight hours per day for each day of the week.").

¹³⁶ *Id.* art. 36, para. 1.

¹³⁷ *Id.* art. 37, paras. 1 & 3.

overworked, working hours have continuously declined since the end of the 1980s because of the new legal regulations and the beginning of the recession.¹³⁸

G. Labor Union and the Dispute Resolution System

As the LTER is an incomplete contract, there are always chances of disputes concerning the interpretation of the contract to occur. The following are the two types of dispute resolution systems: bargaining and negotiation organizations and public agencies for the arbitration of the disputes.

In the former resolution system, the most important player is the labor union. The recent density of Japanese labor unions is below 20%.¹³⁹ This is much lower than the post-war rate of 50%¹⁴⁰; however, it is higher than that in other developed countries such as France or the U.S., wherein the union density is around 10%.¹⁴¹ Japanese labor

¹³⁸ See KŌSEI RŌDŌSHOU [Ministry of Health, Labor and Welfare], HEISEI 19NEN-BAN KŌSEI RŌDŌ HAKUSHO SHIRYOHEN [2007 White Paper on Welfare and Labor: Data Appendix] 118 (2007). In reality, it is very difficult to compare the working hours of different countries because of the difference of institutions and the nature of statistics. As a reference, White Paper on Welfare and Labor provides the data of the yearly working hours of the production workers in manufacturing in various countries in 2004. According to this data, workers in Japan and the U.S. work for approximately 1950 hours, those in the UK work for about 1900 hours, and those in France and Germany work for about 1530. *See id.* With regard to this data, the working hours of Japanese workers are still much higher than those of the workers in European countries: however, it is coming closer to the level of the U.K. and the U.S. *See id.*

¹³⁹ *See id.* at 140.

¹⁴⁰ *See id.*

¹⁴¹ OECD, OECD EMPLOYMENT OUTLOOK 2004, at 145 (2004).

unions are enterprise unions.¹⁴² Though they often join an industrial federation of unions, industry-level collective bargaining is not common.¹⁴³ In the case of industrial union, the negotiation aims at setting the criteria for generally regulating the labor conditions in the labor market. In contrast, Japanese labor-management negotiations mainly deal with intra-firm disputes.¹⁴⁴ In particular, after 1960, when the enterprise unions¹⁴⁵ began to establish the cooperative labor-management relationship and strengthened their management participation functions, Japanese labor unions grew closer in substance to the workers' council in Europe than to the European labor unions.¹⁴⁶

In the Japanese labor union law, the right of labor unions is strongly protected, reflecting the legislative intent immediately after the war to promote the right of

¹⁴² See SUGENO, *supra* note 57, at 500.

¹⁴³ See ARAKI, *supra* note 21, at 164.

¹⁴⁴ Note, however, that by using *Shun-to* (Spring Wage Offensive), labor unions also coordinate enterprise-level negotiations for the yearly increase in wage rates to a reasonable level, while adjusting it to the macroeconomic conditions of the year. See, e.g., REBICK, *supra* note 29, at 77 & 79.

¹⁴⁵ Even in small firms wherein labor unions do not exist, joint labor-management committee often exist: these committees perform the same role. See *id.* at 81-82.

¹⁴⁶ Unlike the European countries, the trial of labor unions to support political parties that have the ability to form a cabinet was not successful at present. See ARAKI, *supra* note 21, at 79. Instead, labor unions dispatch representatives to government administrative organizations in order to reflect their views in the economic policy of the government. See SUGENO, *supra* note 117, at 11 & 296-97.

laborers.¹⁴⁷ It consists of the right to organize, bargain collectively, and take collective action.¹⁴⁸ These days, explicit collective actions are rare, and collective bargaining is replaced with a more informal negotiation known as labor-management consultation.¹⁴⁹ However, these rights of the labor unions definitely hold the effect of a threat point in the negotiation and have served to promote the position of laborers.

The agreements between workers and employers formed through labor-management negotiations are either established as collective agreements (*Rōdō Kyōyaku*), which are superior to work rules,¹⁵⁰ or induce changes in the work rules.¹⁵¹ The system of labor-management consultation not only serves to improve the working conditions of laborers but also materializes the participation of labor in management, particularly when the managerial environment changes drastically.

When disputes cannot be resolved, public agencies engage in arbitration. In the case of collective disputes, the Labor Commissions (*Rōdō Inkai*) intervene.¹⁵² Although it is a part of public administration, its members are chosen from outside, such as

¹⁴⁷ See *Rōdō Kumiai-hō* [Labor union Law], Law No. 174 of 1949, art. 1 (providing that main aim of the Law is “to elevate the status of workers by promoting their equal standing with their employers in bargaining.”).

¹⁴⁸ See *id.* art. 6.

¹⁴⁹ See ARAKI, *supra* note 21, at 179-80.

¹⁵⁰ See *Rōdō Kijūhō* [Labor Standards Law], Law No. 49 of 1947, art. 92, para. 1.

¹⁵¹ See SUGENO, *supra* note 57, at 114-15.

¹⁵² See *Rōdō Kumiai-hō* [Labor union Law], Law No. 174 of 1949, art. 20.

academics or lawyers and representatives of unions and employers,¹⁵³ and its independences from the bureaucracy is guaranteed.¹⁵⁴ The basic principle of the Labor Relations Commissions is to respect the labor-management autonomy so that usually it does not compel the resolution of the disputes.¹⁵⁵ Though it orders remedial measures to rectify the consequences of unfair labor practices, it has no prosecution division, unlike its American counterpart.¹⁵⁶ Owing to the development of the labor-management consultation system, the number of cases dealt with by the Commissions is diminishing.¹⁵⁷

Individual disputes may go on to civil litigation. As Japan does not have a special Labor Court, the disputes are treated as normal civil cases. The most important feature of individual disputes in Japan is the small number of litigations. There are only 2000-3000 civil cases related to labor disputes that are filed to district courts every year.¹⁵⁸ This is in sharp contrast with European countries such as France and Germany,

¹⁵³ *Id.* art. 19, para. 1.

¹⁵⁴ *See* ARAKI, *supra* note 21, at 191-93.

¹⁵⁵ *See* SUGENO, *supra* note 57, at 673-74.

¹⁵⁶ *See* ARAKI, *supra* note 21, at 193-94.

¹⁵⁷ *See* KŌSEI RŌDŌSHOU, *supra* note 138, at 140.

¹⁵⁸ *See* Saikō Saibansho Jimusōkyoku Gyōseikyoku [Administrative Affairs Bureau, Supreme Court], *Heisei 19 nendo Rōdō Kankei Minji, Gyōsei Jiken no Gaikyō* [Outline of Labor Relations Civil and Administrative Cases for 2007], 60 HŌSŌ JIHŌ 2421, 2447 (2008) (2246 cases filed in 2007. From 1998 to 2007, 1708 to 2519 cases are filed.).

wherein 160,000-600,000 cases are treated per year by the Labor Courts.¹⁵⁹

There are numerous ways to explain why Japan experiences a much lower number of litigation than Western countries. The first explanation attributes this to the fact that the culture of avoiding disputes is inherent in the Japanese population.¹⁶⁰ The second explanation is the high litigation cost due to the small number of lawyers and judges, while the third is the development of a system to promote out of court agreements.¹⁶¹ In the case of labor disputes, labor-management consultations and the administrative schemes to promote pre-trial agreement are particularly developed. With the addition of high costs of litigation, everything possible is done to prevent disputes from going to courts.

H.Labor Market Policy

Finally, let us briefly look at the labor market policy in Japan. The Doctrine of

¹⁵⁹ *Id.* at 375.

¹⁶⁰ See, e.g., Takeyoshi Kawashima, *Dispute Resolution in Contemporary Japan*, in *LAW IN JAPAN: THE LEGAL ORDER IN A CHANGING SOCIETY* 41 (Arthur Taylor von Mehren ed. 1961).

¹⁶¹ This problem was studied in J. Mark Ramseyer & Minoru Nakazato, *The Rational Litigant: Settlement Amounts and Verdict Rates in Japan*, 18 J. LEGAL STUD. 263 (1989). In the case of a car accident compensation that it chiefly studied, it exclusively chose the third explanation, i.e., the broad possibility of an out-of-court compromise due to the transparency of judgment of Japanese courts, and argued that the Japanese party that was injured in the accident has sufficiently claimed its right to compensate for its loss. *Id.* at 278-81 & 289-90. In the case of labor disputes, however, we believe that the protection of the right of workers is not sufficient in the present system. Although the bargaining power of labor unions is effective in protecting employment and the average wage level, it is not effective enough in preventing the infringement of the individual right of workers.

Abusive Dismissal¹⁶² is an important element of the employment policy in Japan. The other policies dealing with the labor market also emphasize the protection of employment as its basic objective. For this purpose, the need for active intervention of the government in the labor market is explicitly stated.¹⁶³ In practice, the policies mentioned below are important.¹⁶⁴

First, private employment agencies had been strictly regulated, considering the problem of exploitation by intermediaries, which had often been a serious social problem before World War II.¹⁶⁵ Instead, Public Employment Security Office, a public agency, in principle, had monopolized placement and vocational guidance activities.¹⁶⁶ Second, unemployment benefits are provided to help unemployed workers.¹⁶⁷ Third, public measures have been taken for the development of the vocational abilities of workers.¹⁶⁸ Fourth, financial support is also offered to promote the employment of elders,¹⁶⁹ and handicapped people,¹⁷⁰ partly for the purpose of providing equal

¹⁶² For the doctrine of abusive dismissal, see *supra* notes 88- 109 and accompanying text.

¹⁶³ See Koyō Kankei Chōseihō [Employment Measures Law], Law No. 132 of 1966, arts. 1, 3, & 4.

¹⁶⁴ For the survey of the Japanese law of the labor market, see SUGENO, *supra* note 57, at 31-73.

¹⁶⁵ See *supra* note 56.

¹⁶⁶ See Rōdō Kijūnhō [Labor Standards Law], Law No.49 of 1947, art. 6.

¹⁶⁷ See generally Koyō Hokenhō [Employment Insurance Law], Law No. 116 of 1974.

¹⁶⁸ See generally SUGENO, *supra* note 57, at 48-51.

¹⁶⁹ See Koyō Hokenhō Shikoukisoku [Rule for Enforcement of Employment Insurance Law], Ministry of Labour Rule No. 3 of 1975, art. 104 (providing subsidies for certain employment of elders). For an

opportunities to workers. Fifth, the employment measures are designed to support depressed industries and areas.¹⁷¹

As the list of policies above shows, the support to the unemployed people and the subsidization for the protection of employment form the main body of the policies, reflecting its objective of promoting employment security. A conventional wisdom of neoclassical economics tells the latter as the type of policy that simply preserve the inefficiency of the market, thereby impeding competition.¹⁷² After 2000s, when firms began active employment adjustment, and the unemployment rate approached the 5% level,¹⁷³ Japan's employment policy is shifting its emphasis from protecting the

explanation of Japanese Law concerning employment of elders, see Noboru Yamashita, *Act Concerning Stabilization of Employment of Older Persons*, 4 JAPAN LABOR REV., no.3, at 71 (2007).

¹⁷⁰ In essence, Law for Promotion of Employment of Handicapped People provides that if a firm (only those usually employ more than 300 employees) employs handicapped workers less than certain percentage (1.8%) of total workers then the firm has to pay penalties. See *Shōgaisha no Koyō no Sokushintō ni kansuru Hōritsu* [Law for Promotion of Employment of Handicapped People], Law No. 123 of 1960, art. 53; *Shōgaisha no Koyō no Sokushintō ni kansuru Hōritsu Shikourei* [Ordinance for Enforcement of Law for Promotion of Employment of Handicapped People], Ordinance No. 292 of 1960, art. 18. In contrast, if a firm employs handicapped workers more than that percentage then it will be subsidized. See *Shōgaisha no Koyō no Sokushintō ni kansuru Hōritsu* [Law for Promotion of Employment of Handicapped People], Law No. 123 of 1960, arts. 49 & 50.

¹⁷¹ For present situation concerning regional employment, see Minoru Ito, *Measures for Supporting Regional Job Creation in Japan*, 5 JAPAN LABOR REV., no.1, at 85, 92-99 (2008).

¹⁷² See, e.g., HARVEY S. ROSEN, PUBLIC FINANCE 303-10 (2d ed. 1988) (arguing that subsidies and differential tax treatment among production factors create deadweight losses to the overall economy).

¹⁷³ See MINISTRY OF HEALTH, LABOUR AND WELFARE, WHITE PAPER ON THE LABOUR ECONOMY 2005, at 3-4 (2005), available at <http://www.mhlw.go.jp/english/wp/l-economy/2005/dl/01-01.pdf>.

pre-existing employment to absorb the existing unemployment.¹⁷⁴ The drastic reform of the labor market law is now in progress, as will be shown in section IV. B.

IV. Economic Consequences of the Japanese Legal Policy on Labor Relations

A. The Relationship between Labor Relations and the Labor Law in Japan

The JEC and Japanese labor law developed in parallel after World War II. Is it then possible to state that the Japanese labor law enforced the establishment of JEC? As the basic principles of the Japanese labor law suggest, the legal system and its principles were influenced by Western society, particularly the U.S., after World War II.¹⁷⁵ Therefore, it is difficult to say that those laws enacted through the reform after the World War II themselves established the development of the JEC, which characterized the post-war Japanese employment system.

Furthermore, the Japanese labor law at least in part respects the autonomy of labor and management by establishing only the basic framework concerning industrial relations. There are not many laws that enforce or even point toward the JEC, and hence, it can be said that the labor laws only set the frame and the base of the autonomous negotiation under which the LTER had been developed spontaneously. In

¹⁷⁴ See ARAKI, *supra* note 21, at 31-32.

¹⁷⁵ See GOULD, *supra* note 30, at ch. 2 & 106-16.

other words, labor laws restricted freedom of contracting in some part by setting the minimum standards or by regulating the way of negotiation but the LTER is something that emerged within that restriction as a set of contracts (in the economical sense). This observation corresponds with our theoretical conclusion concerning the JEC in section II.B. that the LTER in Japan can be regarded as an implicit contract, which continues for a long period and which is self-binding between employers and employees. Let us review the details.

First, with respect to individual labor relations, the JEC possesses unique features in its promotion and payment systems such as broad discretionary power of management on the working conditions and personnel administration or flexible and reliable wage payment. As explained in section II.B, this is the feature of the Japanese LTER that has led to an increase in the productivity of workers and has provided incentives for them. Therefore, it is regarded as the most important part of the LTER by which Japanese firms keep their economy strong.

However, these features are not specified within the verifiable contract between worker and employer when the worker is hired. They are guaranteed by the work rule that is set autonomously through the agreement between employers and workers, and the legal intervention in this autonomy is not so affirmative but is

restrained.

One important exception is the area of employment protection, wherein the explicit regulation by The Doctrine of Abusive Dismissal was effective. Even in the case of adjustment dismissal, it is not clear whether the doctrine indeed directly reinforced the employment protection. As we explained in section III.C., this doctrine began with the adjustment of the judicial decision to the social norm of the LTER: it was rather long after the establishment of the custom of the LTER that this doctrine had its explicit regulatory effect due to the accumulation of precedents. In other words, the LTER was originally established as a social norm in Japanese employment society and the doctrine led the real economy only partially toward the protection of the LTER by legal enforcement.

The same is the case with regard to the Japanese labor union law. The long-term cooperative relationship between the Labor Union and management is a key aspect of the superiority of the LTER in Japan,¹⁷⁶ as was discussed in Part II.¹⁷⁷ For example, in the several recessions that Japan experienced since the Oil Shock, this consultation system has contributed to the improvement of the organization of firms

¹⁷⁶ See KOIKE, *supra* note 6, at 207-16; Kanemoto & MacLeod, *supra* note 42, at 145-46.

¹⁷⁷ See *supra* notes 21-24 and accompanying text.

and industries while protecting employment.¹⁷⁸ Even during the long-run stagnation after the 1990s, this consultation system essentially succeeded in maintaining a cooperative relationship between labor and management while drastically restructuring firms.¹⁷⁹

Further, having been introduced immediately after the war with the U.S., it is noteworthy that the Japanese labor union law never forced, or even expected this form of labor union. The social and economic circumstances experienced by Japan after the war created the enterprise labor union,¹⁸⁰ as in the case of other JEC. It is possible to develop this custom only by strictly respecting the fundamental rule of “labor-management autonomy”.¹⁸¹

In summary, the Japanese legal system has made important contributions as a sub-system to the social enforcement of the JEC merely through setting a reasonable stage for the mutual agreement between labor and management. With the protection of the right of workers and the autonomy of parties guaranteed by the legal framework, labor and management autonomously adopted the system of JEC as a type of implicit

¹⁷⁸ See SUGENO, *supra* note 117, at 12 & 304-07.

¹⁷⁹ See ARAKI, *supra* note 21, at 166. Even today, the Japanese unemployment rate is approximately 5%.
See KŌSEI RŌDŌSHOU, *supra* note 138, at 15.

¹⁸⁰ See ARAKI, *supra* note 21, at 165-66.

¹⁸¹ *Id.* at 165-166.

contract in post-war Japan.

It may be noteworthy to mention a covert but important legal aspect for the establishment of the JEC. The Japanese legal system for minimizing individual labor disputes has greatly contributed to the efficient management by decreasing dispute costs to firms and protecting their power of discretion. At the same time, however, it seems that the high cost of litigation and the social pressure for pretrial agreements have made it difficult to bring lawsuit.¹⁸² It has been argued that a new system of individual dispute resolution, which is more accessible to individual workers, should be organized.¹⁸³

B. Adjustment of Labor Relations and Labor Law to the Structural Change of the Economy after the 1990s

Following the 1990s, the merit of the JEC diminished because of the active technological innovations. Firms are required to shed unwanted labor to cope with the long-run macroeconomic stagnation. Therefore, it was necessary to restructure the

¹⁸² See Kazuo Sugeno, *Judicial Reform and the Reform of the Labor Dispute Resolution System*, 3 JAPAN LABOR REV., no.1, at 4, 5-6 (2006) (indicating the backgrounds of small numbers of labor litigations in Japan).

¹⁸³ See, e.g., *id.* at 8-12 (discussing the need for reform of individual labor disputes resolution system). For labor tribunal system under Labor Tribunal Law (*Rōdō Shinpanhō*) of 2004, see Katsutoshi Kezuka, *Significance and Tasks involved in Establishment of a Labor Tribunal System*, 3 JAPAN LABOR REV., no.1, at 13, 16-27 (2006).

existing industries, and develop new industries that embodied new technologies by using the market mechanism, including the migration of labor force from old to new businesses and industries. As we will see below, while in some areas of the labor law, this reform was actually put into effect, the regulation of labor relations and labor market has been tightened in other areas leading to the aggravation of distortionary effects on the economy. This section discusses first the competition-promoting change and the next section discusses the efficiency-decreasing regulations.

The reform of the JEC by law was first put into practice by using its flexible legal structure. As pointed out in the previous section, the Japanese labor law does not reinforce or even push in the direction of an LTER as the typical employment relation in Japan. It allows for various types of labor contracts. In effect, the present labor contracts in Japan allow more specific and individualized contracts other than the LTER. The Japanese wage payment system based on seniority is also being reformed to reflect performance measures more directly.¹⁸⁴ As the awareness of laborers changes, they are willing to accept these changes.¹⁸⁵ This change allows for richer options for workers and will be efficiency enhancing in the present economic environment, where

¹⁸⁴ See KŌSEI RŌDŌSHOU [Ministry of Health, Labour and Welfare], HEISEI 19NEN-BAN RŌDŌ KEIZAI NO BUNSEKI [Analysis of Labor Economics 2007] 105-08 (2007) (indicating that making wage more reactive to workers' performance has become popular).

¹⁸⁵ See ARAKI, *supra* note 21, at 70-73.

technical progress, and the diversification of labor force such as female-labor, middle-aged and older workers, and foreigners deepen rapidly. The general theory of labor contract within the Japanese labor law is sufficiently broad to cope with this possible change.

In the area of labor market law, more explicit reforms are currently in progress. To cope with the rapid change in the economic environment, the Japanese labor law has recently begun to emphasize the activation of the external labor market by the deregulation of the private employment agency business¹⁸⁶ and public support to the vocational training provided to the unemployed.¹⁸⁷ The law for subsidizing employment in depressed industries has been abolished¹⁸⁸ and instead a subsidization policy related to newly created industries such as those pertaining to information, environment, medicine, and welfare industries was implemented.¹⁸⁹ At the same time, unemployment

¹⁸⁶ For the deregulations concerning workers dispatch, see *supra* note 82 and accompanying text.

¹⁸⁷ See KŌSEI RŌDŌSHOU, *supra* note 138, at 223-28 (explaining measures for vocational training).

¹⁸⁸ Tokutei Fukyou Gyoushutō Kankei Rōdōsha no Koyou no Antei ni kansuru Tokubetsu Sochihō [Law on Special Measures Concerning the Stabilization of Employment in Specified Depressed Industries], Law No. 39 of 1983 was abolished in 2001. This abolition was a part of reform of labor market law in 2001 which in turn was in line with the deregulation policy of Japan after bubble economy.

¹⁸⁹ Koyō Taisakuhō [Employment Measure Law], Law No. 132 of 1966 was amended. This amendment was also a part of the reform in 2001. See KAZUO SUGENO, SHIN-KOYŌ SHAKAI NO HŌ [Employment System and Labor Law] 88-93 (Supplemented ed. 2004). In this reform, law regarding regional employment was also amended. See Ito, *supra* note 171, at 88-91 (explaining policy and legal changes concerning regional employment after 2000).

benefits are enhanced in order to provide a safety net to cope with increasing unemployment.

It can be said that the present employment policy in Japan not only uses the JEC to protect employment but also supports the adjustment ability of the external labor market mechanism and tries to integrate these two previously distinct policies to establish full employment.

C. Potential Sources of Economic Distortion by Legal Regulations on Japanese Labor Relations

In some other areas, the direction of the present Japanese labor law emphasizes the direct regulation of the labor relations rather than respecting the autonomy. This seems in contrast to the required deregulation to recover the efficiency of the economy and has resulted in considerable welfare cost since the 1990s.

First, the regulations of wages are likely to reduce the efficiency of the economy. One such direct legal restriction is the minimum wages legislation,¹⁹⁰ wherein a considerable amount of resource allocation waste has been created for allocating labor for small business and part-time workers.¹⁹¹ With respect to workers covered in the

¹⁹⁰ For law regarding minimum wages, see *supra* note 131 and accompanying text.

¹⁹¹ See RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 322-55 (7th ed. 2007) (discussing the welfare implications of the legal regulation on minimum wages).

LTER, a more significant regulation of real wages was the result of the reduction in working hours. According to a recent influential empirical research, some significant part of the slowdown of the Japanese economy in 1990s can be explained by this regulation.¹⁹²

The equal opportunity regulation for male and female workers and a similar regulation for protecting foreign workers will be further tightened in the near future. In its procedural aspect, the recent development of the judicial reform in Japan intends to expand the capacity of the judiciary, including an increase in the number of lawyers and more accessibility to the use of litigation.¹⁹³ With this reform, more labor-related disputes will be contested and the right-consciousness of individual employees will be enhanced in the near future. One of the aims of this reform is to establish individual rights and the rule of law more firmly in Japanese employment society. It should be admitted, however, that economic efficiency would be sacrificed by decreasing the discretionary power of employers for disciplining workers.

¹⁹² See Fumio Hayashi & Edward C. Prescott, *The 1990s in Japan: A Lost Decade*, 5 REV. ECON.

DYNAMICS 206 (2002) (suggesting that the strengthened legal restrictions on working hours significantly contributed to the slowdown of the macroeconomic performance of the Japanese economy in the 1990s).

¹⁹³ See Shihō Seido Kaikaku Shingikai [The Justice System Reform Council], SHIHŌ SEIDO KAIKAKU SHINGIKAI IKENSHO: 21 SEIKI NO NIHON WO SASAERU SHIHŌ SEIDO [Recommendations of the Justice System Reform Council : For a Justice System to Support Japan in the 21st Century] (June 12, 2001) (the basic summary of the idea of the judicial reform in Japan). The English version of this recommendations are available at http://www.kantei.go.jp/foreign/policy/sihou/singikai/990612_e.html.

Let us consider the economic effect of the Japanese employment security more in depth. We consider, first, the effect on the allocation of labor among various firms and industries, and second, the effect on the accumulation of firm-specific human capital. If we consider the frictionless neoclassical competitive labor market, the effect on the allocation of labor is neutral to resource allocation including the unemployment rate, since the strict protection of workers is completely offset by the reduction of wage rates.¹⁹⁴ However, it is sometimes difficult to make such adjustment smoothly. For example, when firms are required rapid restructuring because of the unexpected change of the economic environment, firms are usually constrained by labor law not to make drastic reduction of wages. In such cases, firms are required to hire unwanted high-cost labor so that the allocation of labor should be distorted by the employment protection.

Next, if we consider the effect on the firm-specific human capital, there is a widespread belief that employment protection enhances the incentive of workers to make such investment.¹⁹⁵ In reality, this argument does not hold true, since the workers protected by the employment protection law have no incentive to make such an effort,

¹⁹⁴ See Edward P. Lazear, *Employment -at-will, Job Security, and Work Incentives*, in EMPLOYMENT, UNEMPLOYMENT AND LABOR UTILIZATION 39, 46-52 (Robert A. Hart ed., 1988).

¹⁹⁵ See, e.g., Hiroyuki Chūma, “*Kaikoken Ranyou Hōri*” no Keizai Bunseki [Economic Analysis of “Doctrine of Abusive Dismissal”], in KAISYAHŌ NO KEIZAIGAKU [The Economics of Corporate Law] 425, 444-50 (Yoshiro Miwa et al. eds., 1998).

since their job is legally protected without any effort.¹⁹⁶ So, a punishment was rather necessary for the workers who did not accumulate firm-specific human capital.

In the absence of a method other than dismissal for this punishment, it is true that employment protection destroys that innate efficiency in the JEC discussed in section II.B., wherein the long-term relationship between the enterprise and union makes possible the efficient accumulation of firm-specific human capital as a reputation equilibrium. However, it is possible to punish the workers by a reduction in wages or a step-down of offices and positions or by suspending the expected promotion of the employee. In this case, the employment protection policy is again neutral to resource allocation. As we discussed above, the regulations on working conditions, such as regulations against discriminations and work time regulation are being strengthened after the 1980s. In view of these extended limitations on the discipline of workers, tight employment protection is more likely to be a factor in diminishing the efficiency of the Japanese labor relations in the accumulation of firm-specific human skills.

All in all, the overall development of regulations on working conditions and employment seems to have made it more difficult for firms to restructure, and for labor market to allocate labor force among various industrial sectors more appropriately,

¹⁹⁶ See Lazear, *supra* note 194, at 54-56.

impeded the accumulation of skills of workers, and barred new industries from entering the market due to the increase in labor cost. As its consequence, more unemployment and the substitution of regular workers with part-time workers occurred, particularly in the younger generation.

Main empirical researches on the effect of employment protection on the labor market performance confirmed the above conjecture: i.e. that employment protection causes a negative effect on the labor market.¹⁹⁷ Given these empirical contributions, it seems to us that the strengthening of the employment security that developed after the 1970s in Japan caused welfare loss to the Japanese economy.

V. Conclusion

This article discussed the functions of the Japanese labor law in relation to the Japanese system of labor relations, which we refer to as the JEC. We first selected the characteristics of the JEC as compared with Western countries. In the LTER that prevails in Japan, workers must follow orders from the employer with respect to OJT

¹⁹⁷ See, e.g., Edward P. Lazear, *Job Security Provisions and Employment*, 105 Q.J. ECON. 699, 706-17 (1990) (empirically showing that the employment protection policy not only increases unemployment but also creates the tendency to replace the permanent positions of workers with part-time workers.); James Heckman & Carmen Pages-Serra, *The Cost of Job Security Regulation: Evidence from Latin American Labor Markets*, 1 ECONOMIA 109 (2000) (empirically showing that employment regulation decreases the employment rate, especially for the younger generation).

and other personnel affairs, enterprise order and discipline. They also accept subjective merit ratings by the employers. Employers are, in turn, committed to the permanent employment of workers and appropriate payment of wages for their efforts, without depending on the managerial environment. This efficient outcome is characterized by a high level of accumulation of firm-specific intellectual skills to attain high productivity and low unemployment.

Since this system is in principle realized as a self-enforcing social equilibrium, it is not enforced directly through the Japanese labor law. However, in several aspects, the Japanese labor law has served as a subsystem to support this efficient social equilibrium. First, Japanese employers are, by law, allowed more discretionary freedom for controlling laborers than the employers in the West. This facilitated the capability of employers to reassign workers and increase investment in firm-specific skills through OJT. The limited access of workers to litigation also served to protect this system. Second, the rights of the workers are strongly protected to guarantee a favorable position in the collective bargaining with management and this made it possible to guarantee an appropriate reward to the employees who made sufficient effort in the accumulation of firm-specific human capital. Third, labor-management autonomy remains broad with regard to dispute resolution, so that legal regulation and

arbitration are not actively pursued. This principle made it possible to realize the efficient reputation equilibrium through the long-term relationship between unions and employers.

At present, it is unclear whether the JEC will prevail in the future. If it is not the case, one possibility is that Japanese firms may not protect this custom by reneging on the payment of the workers' effort, pursuing short-run profit. Then, the JEC will be transformed into a neo-classical competitive market system. Although we regard it as less efficient than the JEC in its successful state, it might be the case that the labor market allocation of human resource may be even superior to that by an internal labor market in the present economy, wherein technical innovation is active and the diversification of labor force is developing, since firm-specific human capital is relatively less important in this type of economic situation. If this is the case, this transition is favorable for the efficiency of the overall economy. In this case, however, appropriate legal measures should be considered as a safety net for workers who belonged to the LTER but were reneged on the payment for their efforts.

Another possibility is that Japanese workers may demand more comfortable working conditions, while protecting the legal regulations on employment security. In this case, Japanese employment society will converge to an economy with lower

productivity and a higher unemployment rate, as observed in European countries.

In any case, as long as the JEC is the product of the labor-management autonomy, which was not directly enforced through law, it is unlikely for the law to have a decisive power for its protection in the future. However, it is important that the law should not have a negative efficiency effect through inappropriate legal intervention in labor relations.

For example, it does not seem necessary to regulate working hours to harmonize with “World Standards” through legal enforcement. For the sake of efficiency, it is much more reasonable to leave the matter to the individual agreement between workers and employers. At the same time, employment security measures should not be chosen to preserve the unproductive sector of the economy, impede the development of new and productive industries, and to rescue unwanted or unmotivated workers. Given the need to extend the regulation on the working conditions, particularly with respect to equal opportunity policies for sexes, ages, nationalities, and rapid technical innovation, the relaxation of the protection of employees is necessary for the discipline of laborers and spectral adjustment in Japanese employment society in the near future.