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Elderly Employment in Japan

Policy for extending working life

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Main Points

- The world's leading industrialized nations as well as most Asian countries are all experiencing the aging of their populations. These countries are all confronted with a variety of problems which occur in aging societies, including how to handle the declining working-age population and rethinking the social security system. One possible answer lies in the labor force participation rate or employment rate of the elderly and how to increase it. Doing so could cancel out the decline in the working age population, at least to some extent. Moreover, income produced by the elderly would contribute to the support of domestic demand. If this is realized, it could help economies to avoid contracted equilibrium arising from both the supply and demand for labor. More elderly people continuing to work would mean more tax and social security payments, which would contribute to the relief of some of the pressure on the government's fiscal situation. This scenario should be applicable to all countries whose societies are aging, though the concrete policies and established practices for carrying out would of course differ. There are many possible variations on this central theme.
- Age discrimination ban supported by hiring practices based on specific job descriptions: The labor force participation rate of the elderly in Japan is high in comparison to other countries. The rate for men between ages 60 to 64 is over 70%, more than twice that of Italy or France. On the other hand, when the data is placed in a time series, this figure averages out to being flat over the past forty years. Considering the fact that the average lifespan and healthy life-span of the Japanese has grown recently, it seems that there is leeway for raising the labor force participation rate another level. As the most advanced nation in the world in terms of aging, Japan really ought to do so.

A pioneering effort in policy effecting this area is the revision of the Law Concerning Stabilization of Employment of Older Persons, which stipulates that corporations must ensure job security for employees up to age 65. The effects of this law have recently become apparent in statistics which show that the labor force participation rate of persons between the ages of 60 to 64 has stopped declining, while the unemployment rate for this age group has fallen as well. However, the majority of corporations make use of a re-employment system when extending employment, and there are many cases where employees undergo major wage cuts. One of the challenges for the future will likely be how to achieve growth in labor force participation without causing the elderly to lose the incentive to continue working.

¹ This is a shortened version of an earlier DIR report focusing on overseas economies entitled "Report on Elderly Employment" (issued in July 2015).

In the US and Europe, there are signs that governments are taking great pains to design systems which promote working longer by making the question of whether or not a person is working neutral to qualifying for social security payments. The biggest difference in Japan's approach in this case has been to initiate laws banning age discrimination. With the exception of women in Sweden and Switzerland between the ages of 60 to 64, the labor force participation rate of the elderly is lower in the US and Europe than it is in Japan, but there is a continuing growth trend in the rate being maintained in many countries. It is quite likely that the prohibition against age discrimination in employment has contributed to this fact.

However, it would be difficult to transplant the same legal framework to Japan as is. This is because the policy to set mandatory retirement at age 60 has also carried the role of bringing an end to the prevalence of the wage > productivity hypothesis triggered by long-term employment and the age-based remuneration system. Japan will have to do away with the established practice of raising wages based on age if it is ever to come up with an effective ban on wage cuts based on age.

The reason that the US and Europe have been able to establish a functioning ban on age discrimination is because they use hiring practices which focus on particular job descriptions (as opposed to Japan's lifetime employment system which hires young people just out of college based on university background and ability to pass a test). This allows them to avoid an overly large discrepancy between wages and productivity. This means that when worker productivity falls due to aging, wages also fall. However, compared to the situation in which wages are decreased merely because of age, it seems this would have less of a negative effect on the incentive to work. Moreover, on the corporation's side of things, this should not provide an employer with cause to insist that an employee retire if the employee is receiving a wage commensurate with their productivity.

 Getting people to work longer: In light of the above, disseminating hiring practices based on specific job descriptions to a certain degree in Japan stands an excellent chance of increasing the labor force participation rate of the elderly. Moreover, hiring practices based on specific job descriptions could also contribute to the overcoming of certain weak points in Japan's labor market, such as correcting the disparity between how regular employees are treated as opposed to irregular or outside labor, while at the same time invigorating the external labor market. This is because when hiring is based on specific job descriptions, labor performed by each person is evaluated according to objective principles which can be applied anywhere. However, it would be inappropriate to completely negate Japan's existing long-term or lifetime employment. The long-term employment system is founded on the principle that the hiring corporation places great importance on training and educating its own internal human resources, and it is difficult to sufficiently replace this with the external labor market alone. What the external labor market can do is to provide a supply & demand matching function in which the right people can be placed in the right jobs to a degree that exceeds the corporate framework, thereby improving the productivity of the labor market overall. This in no way takes away from the importance of the corporation as a means of training and educating human resources.

What is most important here is to seek for a new Japanese-style employment system which combines aspects of both hiring practices based on specific job descriptions and Japan's existing long-term employment system. From the viewpoint of promoting employment of the



elderly, this provides an increasing number of choices of how one would like to work, while at the same time increasing ones incentive to continue working. If the discrepancy between wages and productivity can be reduced as hiring based on job function becomes more prevalent in Japan, the number of corporations choosing to raise the age of mandatory retirement as a part of efforts to ensure job security, or even scrap the old retirement system, will likely increase.



1. Raising the Labor Force Participation Rate

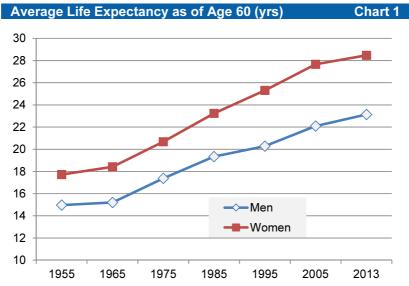
Improving incentives for returning to the work force through diversification of work styles

Effects and Limitations to Institutionalizing Extension of Employment

The necessity of raising the labor force participation rate of the elderly is an unavoidable issue for Japan. Doing so could cancel out the decline in working population caused by the unavoidable decline in population, at least to some extent. Moreover, income produced by the elderly would contribute to the support of domestic demand. Moreover, elderly people continuing to work would mean that their status would change from persons requiring support to that of persons who can provide support. This would contribute to the relief of some of the pressure on the government's fiscal situation.

This of course does not mean that virtually all elderly people ought to work. People should simply have more choices available to them, including retirement. For some people it would be physically difficult to work. Cases where it is difficult to take on a paying job due to home care responsibilities are expected to increase in the future as the population of elderly persons increases in the future.

In terms of physical ability to work, there is a major difference in people now in their sixties compared to the same age group in the past, which suggests that the labor force participation rate in this age range can and should be increased. The average life expectancy as of age 60 grew between 1980 and 2013 to 6.6 years for women and 4.8 years for men.² Even so, the labor force participation rate experiences a sharp decline after age 60. As of 1980, the labor force participation rate for men between the ages of 55 and 59 stood at 91.2%. The rate fell steeply to 77.8% for men between the ages of 60 to 64, a difference of 13.4% pt. As of 2013 this figure grew to 92.7% for the 55-59 age group while falling to 76.0% for the 60-64 age group, representing a difference of 16.7% pt. Considering the lengthening of the period during which a person is able to work based on the current physical capacity of the average elderly person, it seems odd that the labor force participation rate would experience such a sharp drop between ages 60 to 64. There must be some kind of factor which prevents growth in the labor force participation rate.



Source: Ministry of Health, Labour, and Welfare; compiled by DIR.

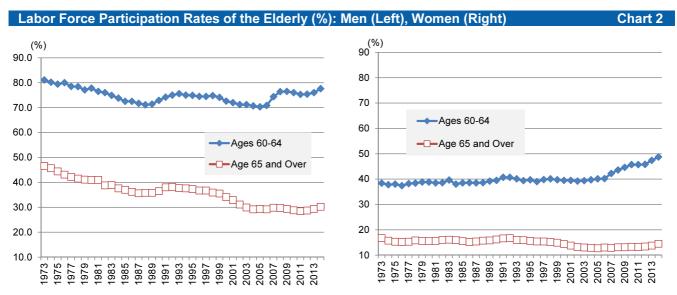
As of 2010 the healthy life-span was 70.4 for men and 73.6 for women.



The quickest answer to this question is the mandatory retirement system. This system determines when most people retire, and has been influenced by a recent revision in the Law Concerning Stabilization of Employment of Older Persons.

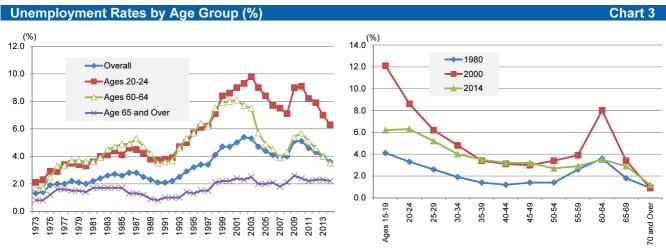
This law, revised in 2004, stipulates Measures to Promote the Employment of Middle-Aged and Elderly Persons, and requires corporations to adopt measures to ensure the employment security of employees up to age 65 (Measures to Ensure Employment Security for the Elderly). According to these measures, social security payments are to begin at age 60 and then raised in stages through age 65. It requires business owners to use any one of the following approaches: (1) Raise the age of mandatory retirement, (2) Introduce a continued employment system (re-employment of persons who have undergone mandatory retirement), or (3) Abolish mandatory retirement. In further revisions implemented in 2012, stronger punitive provisions were included. Corporations are now prohibited from screening employees for selection under the continued employment system for persons up to age 65 (in other words, they must accept all those who apply for the program). The corporate names of violators will be publically announced.

These revisions to the system have been relatively effective. The labor force participation rate of persons in the 60-64 age group, especially men, is now in a mid to long-term declining trend due to the decline in sole proprietorships, meaning a decline in the percentage of workers running their own businesses or in family businesses. It is quite possible that revisions to the Act for Stabilization of Employment of Older Persons was the major factor responsible for halting this tendency in 2007 and increasing the labor force participation rate amongst both men and women of the same age group.



Source: Ministry of Internal Affairs and Communications; compiled by DIR.





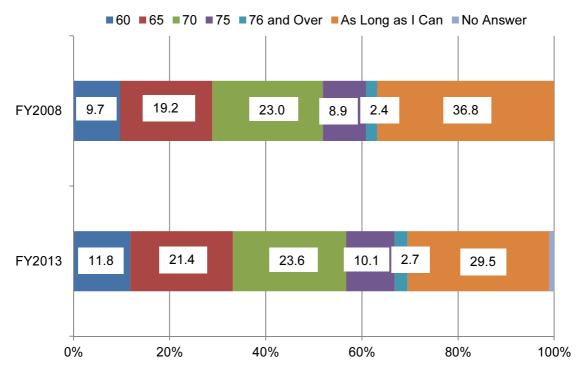
Source: Ministry of Internal Affairs and Communications; compiled by DIR.

Revisions to the law also contributed to reducing the unemployment rate amongst persons aged 60 to 64. As shown in Chart 3, the unemployment rate for the 60-64 age group was especially high in the past. This is something unique to Japan, and was most obviously the outcome of the mandatory retirement system. However, this problem has now been resolved for the most part. In recent years, the unemployment rate for the 60-64 age group has been at pretty much the same level as the overall unemployment rate. The number of cases where members of this age group leave work in large numbers and then face difficulty in finding new employment has declined significantly. These results should be plenty reason to give high marks to the revisions to the Act for Stabilization of Employment of Older Persons.

Changes brought on by revisions to the law affirm the major influence that the mandatory retirement system had on the labor force participation rate (as well as the incentive to work) of the elderly. The huge impact of the mandatory retirement system, which regulated the labor force participation rate of middle-aged and elderly persons, becomes apparent in the decline in sole proprietorships which do not have a retirement system, as well as the overall decline in the labor force participation rate of the elderly.

If this is the case, it would be inappropriate to minimize the effects of the revisions to the Act for Stabilization of Employment of Older Persons, but at the same time, the employment problems of the elderly are not completely settled because of this one development. One issue which remains is the fact that the revisions to the law are merely a means of delaying real change. There is a very good chance that the problem of the declining labor force participation rate and high unemployment previously experienced in the 60-64 age group will simply reemerge for persons aged 65 and over, now that the problem has been resolved for the former age group.

Chart 4 indicates that Japan's elderly have a strong desire to work. The question, "How long do you want to work (up to what age)?" put to people in 2013 received the following responses: "Until age 60" (11.8%), "Until age 65" (21.4%). Nearly 70% of respondents answered that they would like to work until they are very old.



Source: Cabinet Office (2013 Survey on Participation of the Elderly in Regional Society); compiled by DIR. Note: Response to the question "Up to what age do you want to work?" - "As long as I can" is abbreviated from its complete form "Forever, as long as I can work"; figures in the chart represent the percent share of all respondents (%), and Fiscal Year.

The revisions to the Act for Stabilization of Employment of Older Persons focus only on the 60-64 age group, and are basically neutral in regard to the question of the labor force participation rate of persons over the age of 65. Hence the question of how to raise the labor force participation rate of persons over the age of 65 as well as holding down the unemployment rate of this age group is likely to become an issue for policy in the future. The most direct effect likely to arise from this situation would be to come up with policy against age discrimination similar to what has been done in the US and Europe. Under such a policy, corporations would be forced to adopt a policy which ensures employment security for the elderly. To do so, the mandatory retirement system would be abolished. However, taking this step is difficult in Japan because of the long-term employment system which assumes age-based pay. This issue will be discussed further in a later section of this report.

Inducing the Incentive to Continue Working

The second problem associated with the Act for Stabilization of Employment of Older Persons is that it does not provide incentive to the elderly to continue working.

According to the Ministry of Health, Labour and Welfare's General Survey on Working Conditions (6,140 companies surveyed in 2014, number of responses 4,271), an overwhelming 81.8% of corporations set retirement age at 60. In a small percentage of cases this may be due to the revisions to the Act for Stabilization of Employment of Older Persons, which includes a provisional measure till the year 2025 according to which employment may be secured until age 65 while provisions are implemented in stages up to the year 2025. However, rather than extending retirement till age 65, most corporations make use of an employment extension policy³ or a re-employment system.⁴ Of the

³ A system by which a company continues to employ an individual even when said individual has reached the age of mandatory retirement according to the mandatory retirement system set up by the company.

⁴ According to this system, an employee is re-employed after having retired, having reached the age of mandatory retirement.



corporations surveyed which have established a mandatory retirement policy, 72.1% also make use of a re-employment system.

According to an older survey, Survey on Employment Conditions of Elderly Persons (Ministry of Health, Labour and Welfare, 2008), 60.0% of elderly persons employed under a re-employment system were given non-regular or contract employee status, while only 32.9% retained the status of regular employee. Moreover, there was a large number of cases where wage levels fell considerably below what the employee had been receiving at the time they reached the age of mandatory retirement. Of the total number of respondents to the survey, 21.8% received an increase in wages or wages remained the same, while 23.6% received 80-90% of their former wage, 34.8% received 60-70% of their former wages, and 16.1% made only 40-50% of their original wages.

As is made evident in Chart 5, Non-Regular Employment by Age Group, age 60 appears to be the cutoff point where regular employment gives way to non-regular employment. In comparing two points on the graph – the years 2002 and 2012, we can see that the revisions to the Act for Stabilization of Employment of Older Persons is a factor in raising the percentage of non-regular employment amongst the elderly.⁵

The same chart also indicates a disparity in type of employment between men and women. It appears to be mainly men who travel the road from regular employee up to age 60, then the shift to non-regular employment after reaching the age of 60, followed by a decrease in wages. In the case of women, with the exception of the younger years (below the age of 34), the ratio of non-regular employment is over 50%. Then over the age of 60, the older the age the more the non-regular employment ratio increases. Although this tendency has now improved in comparison to the past, an M-curve persists in the labor force participation ratio by age group. This suggests that it is nearly impossible for a woman to regain the status of regular employee once she has temporarily left the work force. Moreover, as will be covered in more detail later in this report, the wage profile by age group for women tends to remain flat. Women workers seem to exist completely outside the traditional age-based wage system. Considering the need to raise the level of Japan's overall labor force participation rate in order to increase the supply of labor, increasing women's incentive to work is essential. In order to do so, making serious efforts to remove the disparity between men and women in type of employment is an unavoidable issue. This means of course the disparity between regular and non-regular or contract employees.



Source: Ministry of Internal Affairs and Communications (Employment Status Survey); compiled by DIR. Unit: %

⁵ According to the Labor Force Survey, the ratio of non-regular employment amongst the middle-aged and elderly grew continuously between the years 2013 and 2014.

Meanwhile, when a woman who has left work reenters the labor market, most have no other choice but to accept a position as a non-regular employee. While non-regular employment is generally the way the external labor market works, it seems that with the system of regular employment still around, the external labor market cannot function sufficiently. Similarly, when an elderly person reaches age 60 (the age at which most corporations set mandatory retirement), it becomes extremely difficult to maintain the status of regular employee when seeking work via the external labor market. Most workers face a major decrease in wages after they reach age 60.6

There is another more recent survey regarding wages paid to the elderly which was carried out by the Tokyo Metropolitan Government Bureau of Industrial and Labor Affairs. This survey focuses on city government offices located throughout the Tokyo metropolitan area: Fact-Finding Survey on Continued Employment of the Elderly (2013). According to this survey, comparative wages of individuals continuing employment in contrast to time of retirement were as follows: up to 50-60% of original wage 23.3%, up to 60-70% of original wage 22.6%, up to 70-80% of original wage 15.3%. Persons receiving less than 50% of their original wage were 11.7%. Meanwhile, 68.8% of individuals continuing employment according to the survey worked an average of 35-40 hours per week. Most persons surveyed were full-time employees (this point is worth noting).

Similarly, the Fact-Finding Survey on Work Performed by the Elderly Continuing Employment published by The Japan Institute for Labour Policy and Training indicates that wages of continuing employees tend to decrease significantly. Meanwhile, in a survey of employees regarding Job Satisfaction after Continuation of Employment, most responses were positive: 5.6% were extremely satisfied, while 55.6% were generally satisfied. On the other hand, responses regarding level of satisfaction with wages after continuation of employment were as follows: only 2.5% were extremely satisfied, while 26.2% were generally satisfied. Meanwhile, on the negative side, 25.0% were completely unsatisfied and 35.6% were not very satisfied. Negative responses greatly outnumbered the positive responses.

The situation of older workers shifting from regular to non-regular employment also exists in Europe and the US. However, it tends to be a longer process in which workers will move gradually from fulltime to part-time as they grow older and approach retirement. A major characteristic of Japan is that wages drop when the employee shifts to non-regular employment status. Plus in most cases employees are working full-time. As is suggested in the above surveys, the low level of satisfaction regarding wages after shifting to the status of continued employment acts as a factor discouraging workers from continuing employment after having reached the age of mandatory retirement, and may also be a factor in keeping the labor force participation rate in check. The fact that there are few choices available in how to work is the cause of Japan's external labor market lacking fluidity. It is also why many elderly workers end up choosing non-regular full-time positions. According to an OECD report, ⁷ Japan, the US and Australia all have a high ratio of older men who work long hours. The report indicates that there is a general tendency toward "rigidity in arranging work hours, preventing the elderly from working longer, and resulting in older workers shifting from full-time work to not working at all, ultimately bringing about a 'cliff edge' approach to retirement."

⁶ Another possibility is that wages decline dramatically for employees under the re-employment system after reaching age 60 because at the point when the surveys mentioned in this report were carried out, the age at which payment of social security benefits begins had been raised at that time. The provisional measure associated with the raising of the age at which payment of social security benefits begins lasts until 2025. Therefore, in many cases, the age at which employees face major wage cuts is delayed until age 65.

⁷ Aging and Employment Policies, OECD (2006)

⁸ "Longer" meaning a longer period of time, not number of hours.



The revisions to the Act for Stabilization of Employment of Older Persons does not provide answers to these problems. This is also a limitation of the approach to extending employment through the use of re-employment systems.

As was mentioned earlier, the revisions to the Act for Stabilization of Employment of Older Persons came about in response to the raising of the age at which payment of social security benefits begins. The age at which payment begins for both the fixed portion of social security benefits and the earnings related portion of the pension plan have been raised in stages from age 60 to age 65. For men, payment of the fixed portion changed in 2013, while for women the change will be complete by 2018. Meanwhile, the earnings related portion will change in 2025 for men and in 2030 for women. The main reason for raising the age at which payment of pensions begins is the stringent finances of the government pension system. Hence, considering the need to increase the incentive of the elderly to continue working, this change can be considered permissible. As the world's most advanced country in aging, there is most likely little chance that Japan will be able to settle long-term on the age of 65 for beginning pension payments. The age for pension payments in England will be 68 by the year 2046, while in Germany it will be raised to 67 by the year 2029. Amongst the advanced nations, even the US, which has the slowest rate of aging, has decided to raise the age at which social security payments begin to 67 by the year 2027.

The place where Japan has room for improvement in its pension system from the viewpoint of promoting work amongst the elderly is the old age pension for those still working. This system was established as a special measure added onto the pension system, which assumes retirement as the prerequisite to receiving payments. The system has been changed as appropriate from the viewpoint of providing incentive to the elderly to work longer, as well as the need to cut back on payments in consideration of future generations. In recent years, it is the former which has received more attention. In 2004 it was revised so that 20% of pension payments to elderly individuals who are still working are cut, regardless of the amount of wages and pensions they are receiving. The older version of the old age pension for those still working was abolished altogether.

However, the mechanism by which pension payments are decreased as wages rise is still in place. It would be preferable for this approach to be changed as well, so that there would be zero penalties for the elderly who choose to continue working. If this results in increasing the labor force participation rate of the elderly, pension premium payments would increase as well. Even so, abolishing the old age pension for those still working does not necessarily mean that pension financing will not get worse in the future.

Pension and social security systems in Europe and the US tend to be more oriented toward promoting working longer. Much like Japan, in the US, social security payments are decreased when an older person having reached the age where payments can be received continues working and therefore is receiving a wage. However, this system was abolished in 2000. The focus is of course to increase the incentive of the elderly to continue working.

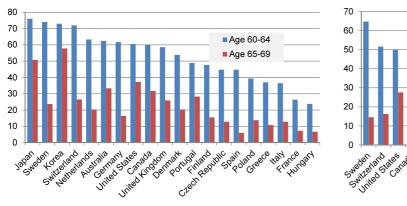
⁹ Fiscal recalculation revealed that premiums would rise excessively for later generations unless the age at which benefit payments begin is raised.

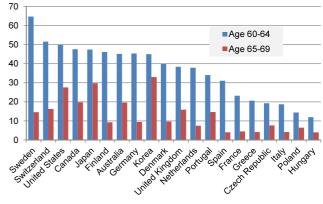


Still Room for Raising the Labor Force Participation Rate

The labor force participation rate of the elderly in Japan ranks high in an international comparison. This is especially the case for men. The labor force participation rate for men as of the year 2013 showed Japanese men between the ages of 60 and 64 to be 76.0% in comparison to the OECD average of 57.4%. Meanwhile, the 65-69 age group was at 50.7% in comparison to the OECD average of 31.4%. The labor force participation rate of women in Japan was not as high as it is for men, but it also exceeded the OECD average (ages 60-64: OECD 38.9%, Japan 47.4%; ages 65-69: OECD 18.6%, Japan 29.8%).

Labor Force Participation Rate of the Elderly: An International Comparison (Left: Men, Right: Women) Chart 6





Source: OECD; compiled by DIR. Note: Figures for the year 2013. Unit: %

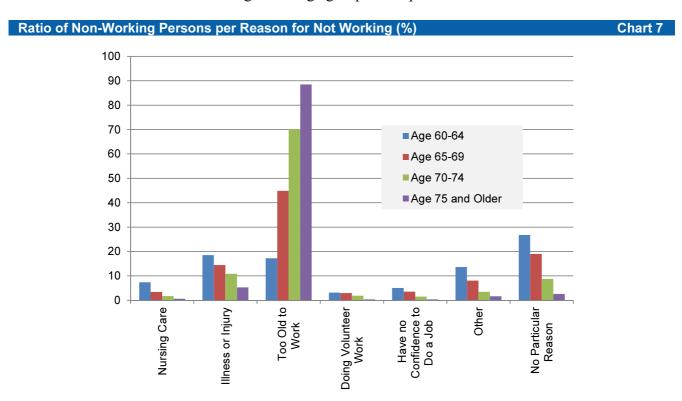
One reason for this high labor force participation rate and one which is often pointed out is the low income replacement rate of Japanese pensions. According to the OECD publication Pensions at a Glance 2013, the income replacement rate of Japanese pensions (median value) is 37.5%, considerably below the OECD average of 57.9%. There are two major factors driving down Japan's overall income replacement rate. One is the fact that the only public pension system covering self-employed persons is Japan's national pension plan, and the other is the low absolute level of this system's benefits. The labor force participation rate for men ages 65-69 in South Korea is even higher than Japan's. There too the income replacement rate of the pension system is low at 43.9%, and the ratio of self-employed individuals to overall employment as of the year 2013 is extremely high at 27.4%. (The ratio of selfemployed individuals to overall employment in Japan according to the OECD is 11.5%.) This is thought to be a factor in pushing up the labor force participation rates of the middle-aged and elderly.

The fact that the elderly in Japan have a high labor force participation rate in comparison with other countries does not necessarily mean that there is no room to raise it further. As was demonstrated earlier in this report in Chart 4, nearly 70% of Japan's elderly have the desire to work till the age of 70 or longer. A the same time, it would be short-sighted to insist that the labor force participation rate for the 70-74 age group has to be at the 70% level. However, it is also possible to understand this statistic as meaning that the high rate of the desire to work on the part of the elderly has not been fulfilled.

According to the Ministry of Internal Affairs and Communications 2012 Employment Status Survey, there was a total of 35,190,000 persons aged 15 and over who responded that they do not want to work. Of this number, 3,040,000 were aged 60-64, while 4,080,000 were in the 65-69 age group and 4,870,000 were aged 70-74. Meanwhile, those who responded that they would like to work but are not now seeking employment totaled 610,000 for the 60-64 age group, 600,000 for the 65-69 age group, and 510,000 from the 70-74 age group.



This is a fairly large group and could become the source of growth in potential labor force participation rate as well as growth in the number of people holding jobs. Of course the population which responded that they do not want to work or that they would like to work but are not now seeking employment includes elderly persons who are ill or require nursing care, but this number is not necessarily that large. The most common reason given for not working amongst unemployed persons in the 60-64 age group was "no particular reason" (26.8%), while illness or injury accounted for 18.5%, and being too old to work accounted for 17.2%. The number of respondents choosing "too old to work" increases as the age group becomes more advanced, hitting 44.9% for the 65-69 age group. The next most common reason for not working in this age group is "no particular reason" at 19.0%.



Source: Ministry of Internal Affairs and Communications (2012 Employment Status Survey); compiled by DIR.

The number of non-working elderly persons appears to be concentrated largely in the "too old to work" category - in other words those with no clear reason not to work such as those in the category of illness or injury and nursing care. It is therefore possible to conclude that many people in this category are potential members of the labor force and merely require the incentive to work. If we assume, hypothetically, that at least half of those responding "too old to work" and "no particular reason" could become members of the labor force, then the labor force participation rate for the year 2012 would rise from 60.5% to 67.0% for those aged 60-64 and from 38.2% to 54.3% for the 65-69 age group.

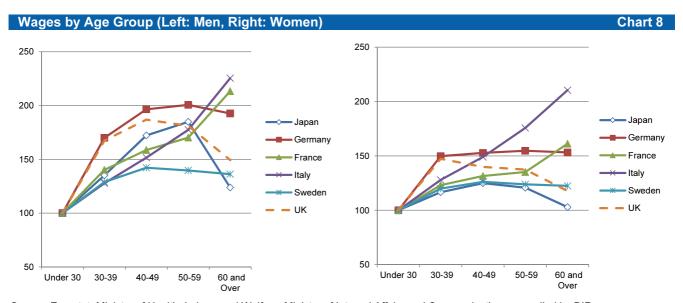
The Seniority-Based Wage System and the Demand for Elderly Workers

So just what kind of demand might there be for elderly workers. Even if there is still plenty of room for growth in the labor force participation rate of the elderly as suggested in the previous section, employment of the elderly will not increase unless there is more demand.

The key to resolving this issue is striking the right balance between wages and productivity of the elderly. As was mentioned earlier in this report, the revision of the Law Concerning Stabilization of Employment of Older Persons has led to a decline in the unemployment rate for the 60-64 age group. However, corporations which are obligated to provide job security for employees up to age 65 tend to do so by using a re-employment system, which tends to lead to major wage cuts for elderly workers. The main factor behind this kind of corporate behavior is the existence of the seniority-based wage

system. According to this system, employee wages are kept at a level below actual productivity while employees are still young. Then as they grow older, the extent of the disparity gradually shrinks. Once employees reach middle-age, they begin receiving a wage which is set above actual productivity. The balance between wages and productivity is achieved over the long term. This type of wage system is an integral part of Japan's long-term or lifetime employment system. Corporations using the senioritybased wage system must then set the age for mandatory retirement at 60. The role of mandatory retirement is to bring a final stop to the wage-productivity imbalance (productivity < wage). Therefore, for the majority of Japan's corporations, the option of delaying retirement or doing away with the mandatory retirement system is a difficult one. While Japan's employment system is gradually changing, this logic is still considered to be valid by quite a large number of corporations.

One can observe the phenomenon of wages rising as employees get older to a greater or lesser degree in most countries. Productivity increases as employees accumulate experience, and this legitimizes growth in wages for older employees. This means of rationalizing the phenomenon is widely used. Though there are some major economies in the EU such as Sweden where the equal pay for equal work system has taken hold making its wage profile for men nearly flat, in the case of Germany and the UK, the wage growth curve suddenly spikes for employees in their forties and fifties.



Source: Eurostat, Ministry of Health, Labour and Welfare, Ministry of Internal Affairs and Communications; compiled by DIR. Note: Hourly wage used for Europe, regular base wage used for Japan. Index set with 100 as under age 30.

Generally speaking, if wages for older employees were high, then demand for older people in the work force would be suppressed. As is indicated in Chart 8, the wage profile of men aged 60 and over in Japan and the UK is noticeably lower than that of men in their 50s. Germany and Sweden are also somewhat on the low side, but in France and Italy, wages for men aged 60 and over are clearly higher than other age groups. On the other hand, the employment rates for older people are higher than the OECD average in these countries, with Japan at the top of the list followed by the UK, Germany and Sweden, while the minor difference in employment rates between the 55-59 age group and the 60-64 age group is consistent with the wage profile. In comparison to these four countries, France and Italy are characteristic in the major decline in employment rate after age 60.

However, this inverse correlation between wages and employment rate (or the demand for older workers) does not necessarily mean that a one-sided causal relationship exists running from wages to employment rate. In France and Italy early retirement is the norm, and older people who do choose to continue working often do so because the cost of leaving work is extremely high. In many of these cases the individual has a high income, and this tendency may be the reason that statistics from these countries show workers over age 60 to have higher wages. In this particular case, therefore, higher



wages in this age group explains at least in part why the employment rates for older people are low in these countries.

Be that as it may, in the case of Japan, the high employment rate and low wage of older people (in other words the extent of the drop from peak level) are considered to be inseparable. If that is the case, then raising the wages of employees over the age of 60 in hopes of increasing the incentive of older people to work and thereby increasing the labor force participation rate of the elderly would most likely be difficult.

At the same time, there is no reason to assume that there is no way out of this dilemma. The important point here is the balance between wages and productivity. As we have seen, wages tend to peak when workers are in the 40s and 50s in many of the EU member nations as well. The reason that it is Japan whose wage system is called age-based or based on seniority is because age or length of employment at one company is the very basis by which wages are raised. This does not mean that when a particular individual's wage is being determined that it is done so from the viewpoint of obtaining a balance between wage and productivity. It is simply because Japan's typical work pattern does not correspond to specific job functions, but rather assumes a long-term employment relationship during which time an employee will be regularly shifted between different job functions and assigned to different work locations. The purpose of frequent job rotation is the company's way of ensuring that an employee will obtain the knowledge and skill set thought to be unique to their business. Mastery of a particular job function from the very beginning is not expected. Hence a match between productivity and wage at the early stages of employment would be impossible. However, in the course of accumulating the knowledge and skills associated with a particular business, differences in productivity per individual begin to appear within the framework of the lifetime employment system.

In the US and Europe, where employment tends most often to be based on particular job functions or descriptions, it is relatively easy to avoid major discrepancies in wage level and job performance. The wage profile to an appreciable extent reflects the productivity of each age group. Therefore, it would rarely be necessary to lower the wage of an employee simply because of having reached retirement age at age 60. The problem with Japan is the steep gradient of the wage profile in an age-based wage system. In other words, variation in wages amongst middle-aged employees is too small in comparison to variance in employee productivity. This is the reason for major wage cuts once workers reach age 60. The mandatory retirement age of 60 is set as a means of at least partially resolving this discrepancy.



Diversification of Work Styles

The problem with this wage system is that even if an employee is more productive in comparison to wage level, said employee will still have to accept a wage cut once they reach a certain age. The higher an employee's productivity, the more the motivation to continue to work will likely decrease if said employee's wages are cut a uniform amount merely because of age. The withdrawal of resources from the labor market is clearly a loss for society, and there is a danger that said loss will continue to expand as the aging of Japan's population progresses.

Just one look shows clearly how this state of affairs can be remedied. The automatic raising of wages based on age (or length of service) alone should be stopped, and the discrepancy between productivity and wage reduced as of that point based on an evaluation of each individual employee. However, it would be difficult to pursue wage-productivity consistency while maintaining a form of employment where a company's unique knowledge and skill-set is obtained by employees over the long-term through frequent job rotation. Rather, this would require a wider dissemination of employment based on specific job descriptions. Japan's employment system is already changing, and it is assumed that employment based on specific job descriptions will increase as a part of this process. The most preferable situation would actually be the dissemination of employment based on specific job descriptions where more individuals are hired on as regular (or permanent) employees, as opposed to irregular labor.

The desired effect is not merely to reduce the disparity between wages and productivity. As hiring practices change from focus on company-specific skills to specific job descriptions in which experience and capabilities of individual employees become the focus, there will also be a better chance that the external labor market will be invigorated as well. This is because when hiring is based on specific job descriptions, labor performed by each person is evaluated according to objective principles which can be applied anywhere. As was mentioned earlier in this report, Japan already has an external labor market, which provides a certain amount of fluidity or mobility for irregular labor. However, external mobility of regular employees is scarce. This explains why the ratio of irregular employment is high for women, as well as why women's wage profile is flat. If reform can be brought to this situation, the cost of leaving one's job will decrease. This is because it would become easier to obtain the status of a regular employee when seeking a new job in the external labor market. This would in turn raise the level of mobility in the external labor market to a higher level, giving birth to a positive cycle. When the cost of leaving a regular job is especially high it reduces the fluidity or mobility of the external labor market, while this effect in turn helps to maintain the high cost of leaving a regular job. In other words, it produces a closed or negative cycle which repeats itself over and over. The dissemination of employment based on specific job descriptions would provide more breathing room and a way out of this closed (negative) cycle.

Using a system of employment based on specific job descriptions is also beneficial to corporations. The payment of wages significantly exceeding actual productivity can be avoided, and it is easier to maintain employee incentive to work when wages more closely correspond to productivity. As Japan's society increasingly ages, this latter point is expected to become even more important.

According to the Japan Productivity Center's Survey Regarding Japanese-Style Employment and Human Resources, there is an increase in corporations which have introduced a new category into their wage (base pay) composition. This is the value of the particular job function or job responsibilities (i.e. compensation by job classification). The question here is simply whether or not the corporation should take into consideration job function or responsibilities as one of the factors determining wage. It does not mean that employment based on specific job functions or descriptions is increasing. However, setting wages so that they reflect job function or responsibilities means that the number of corporations that are aware of the benefits of avoiding the discrepancy between wages and productivity is

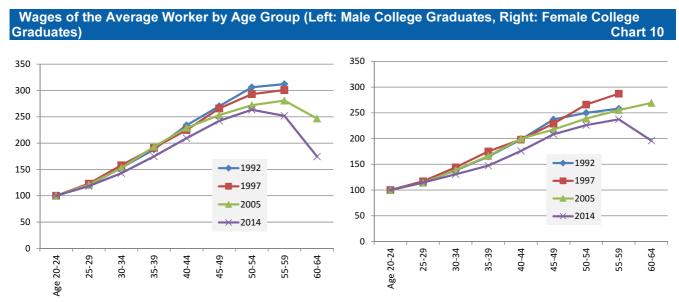


increasing. This also suggests that there are an increasing number of corporations having experience in introducing wages based on particular job functions even though said system may only be partially used. This is the result of the globalization of management which has brought with it more experience in setting up wage systems for use at overseas offices, as well as the hiring of foreign workers (usually highly skilled workers) at domestic offices.

| Categories Included in Base Pay Composition Chart 9 | | | | | | |
|---|----------------------------|----------------------------------|-----------|----------------------------|----------------------------------|-----------|
| | Management | | | Non-Management | | |
| | Age or Years of Service | Job Function or Responsibilities | Job Skill | Age or Years of Service | Job Function or Responsibilities | Job Skill |
| 2000 | | 43.9 | 82.4 | 72.8 | 24.9 | 87.0 |
| 2001 | 32.2 | 49.9 | 67.0 | 73.2 | 32.9 | 76.7 |
| 2003 | | 53.4 | 60.6 | | 34.3 | 69.3 |
| 2005 | | 61.0 | 57.5 | | 40.9 | 70.1 |
| 2007 | 33.5 | 72.3 | 74.5 | 61.9 | 56.7 | 80.9 |
| 2009 | 27.3 | 70.5 | 69.9 | 59.1 | 51.1 | 80.7 |
| 2012 | 22.7 | 79.2 | 65.6 | 48.1 | 58.4 | 77.3 |
| 2013 | 25.6 | 76.3 | 69.2 | 62.3 | 58.0 | 81.1 |

Source: Japan Productivity Center (14th Survey Regarding Japanese-Style Employment and Human Resources, 2014); compiled by DIR. Note: Figures represent the percentage of corporations which have introduced each of the listed items.

Looking at this chart, it appears that the ground has already been prepared in Japan for the gradual dissemination of employment based on specific job descriptions. Another positive factor is that in recent years, the seniority curve for the average worker has become more moderate. This actually may be the result of the increase in making use of job function at least in part in determining wage. Once the seniority curve becomes flat, the benefits of an employee's remaining at the same corporation until retirement will decrease. Or put in another way, the cost of leaving one's job will decrease. This future development is also expected to contribute to invigorating the external labor market.



Source: Ministry of Health, Labour and Welfare (Basic Survey on Wage Structure); compiled by DIR. Note: Index set with 100 representing age 20-24.

However, it is not necessarily desirable to completely scrap Japan's existing employment system in favor of employment based on specific job functions, since Japan's traditional lifetime employment places great importance on training related to the corporation's unique capabilities. As has been mentioned earlier in this report, the employment system which places importance on the unique capabilities of the corporation is an integral part of Japan's long-term employment. The benefits of



training and cultivation of human resources made available by the long-term employment system are difficult to ignore.

There are many corporations in Japan including OJT which place great importance on development of its own human resources, one of the assumptions here being that the employment relationship is longterm. If that assumption were to weaken or disappear altogether, corporations may begin to think twice about investing in the nurturing of human resources. Corporations placing priority on procuring experienced "industry-ready" human resources on the external labor market rather than cultivating or training their own human resources in-house would naturally increase. The result could actually end up being the inability to produce those same "industry-ready" human resources, instead creating the danger of the entire country's lapsing into a situation where there are barriers to improving the quality of labor. The external labor market provides the function of matching supply with demand, placing the right people in the right jobs, and has the potential of improving productivity for the country overall. However, it does not directly improve the quality of labor. Meanwhile, the general assessment is that Japan's university education does not provide sufficient job training, and changing this situation (completely aside from the question of whether or not a change of this sort would be desirable) would likely take a very long time.¹⁰

Therefore, the most realistic outlook for the future of Japan's employment situation is that even as employment based on specific job functions gradually becomes more widespread, the traditional lifetime employment system, which places greater importance on training related to the corporation's unique capabilities, will remain as the major form of employment, though still just one choice among many. Meanwhile, this gradual change will contribute to the external labor market's taking on not only the function of matching supply with demand, but providing training of human resources as well.

But there is another reason why the dissemination of employment based on specific job functions is important. It is because it will encourage the institutionalization of the concept of equal pay for equal jobs. And it is through this process of change that one of the conditions required to improve the poor working conditions associated with irregular employment can be established. The existence of this situation has been pointed out by the OECD as one of the major weaknesses of Japan's current economy. Moreover, increasing the incentive of the elderly to continue working after having reached mandatory retirement hinges on the ability to resolve the problem of the elderly falling into just this problem – being forced to accept irregular employment after retirement.

A good starting point for establishing an employment system based on specific job functions while at the same time retaining Japan's traditional long-term employment would be the diversification of work styles. This would help to improve the incentive to continue working for a longer time on the part of the elderly, while at the same time encouraging a decrease in the 'cliff edge' approach to retirement. It could also contribute to the improvement of the labor force participation rate.

Diversification of work styles does not mean that the elderly are expected to change jobs frequently – it would be difficult to imagine such a state of affairs. As was discussed earlier in this report, the dissemination of employment based on specific job functions holds the possibility of invigorating the external labor market, but it is more likely the younger generation which will make use of the greater range of choices that will become available due to this development. The direct impact on the elderly is more likely to be the fact that wage level will become the guideline for productivity, and this should reduce the risk of elderly workers having to face the threat of a wage cut based only on age. If the type

¹⁰ Even if the increase in use of an employment system based on specific job functions or job descriptions does not occur across the board in Japan, it could still lead to a partial reduction in the corporation's in-house training and education functions. If this is the case, then it will undoubtedly become necessary to establish human resources training and education systems outside the corporate framework. This could be done at existing universities and other educational institutions, or through some sort of publicly run job training.



of job is one where productivity naturally declines as the worker ages, then it will be easier for an individual to accept that fact, and should not become a factor leading to decline in motivation to continue working.

As for corporations, there will be less incentive to reduce the pay of employees who have reached a level of productivity commensurate with their wage solely on the basis of age. The dissemination of employment based on specific job functions may also lead to an increase in the number of corporations which choose to either raise the mandatory retirement age or do away with mandatory retirement altogether as a means of securing stable employment for the elderly.