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# Shortage of Labor Threatens Japan's Corporations

## *Where have all the workers gone?*

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### Summary

- Many of Japan's corporations are experiencing a shortage of labor, and this problem is affecting corporate management in some very real ways. Most corporations handle the problem by increasing overtime hours. However, this approach will become more difficult once the new ruling which puts a cap on overtime hours goes into effect (Regulation with Penalties on the Limitation of Number of Overtime Hours Worked). Moreover, this development may lead to an intensification of competition to secure the necessary number of employees.
- In order to promote long-term growth, corporations need to move urgently on the problem of labor shortage. In this report, we examine the question of how or where corporations can find the workers they need (Where have all the workers gone?). Potential growth in the supply of labor, based on certain conditions, has been confirmed to be 430,000 men between the ages of 15 and 64, 1,860,000 women between the ages of 15 and 64, and 330,000 senior citizens age 65 and older. However, labor force participation on the part of these potential workers will not be possible without labor reforms on both the institutional level and on the level of social awareness. The number of hours worked per part-time worker have continued to decline in contrast to the growth seen in hourly wage. If this trend can be reversed by making changes to the marital deduction on income taxes in Japan, the number of man-hours in macro terms could attain major growth.
- There is also the question of how best corporations can retain existing employees. This requires the development of an employee-friendly work environment, and the improvement of labor conditions.

# 1. Labor Shortage and Corporate Activity

## 1.1 Introduction

Nowadays in Japan whenever the subject of employment comes up, one of the major themes is the shortage of labor. Chart 1 shows a factor analysis of the growth rate in Japan's real GDP based on labor productivity, employment, and man-hours. The findings in this chart indicate that labor input (employment x man-hours) contributes negatively to Japan's real GDP.

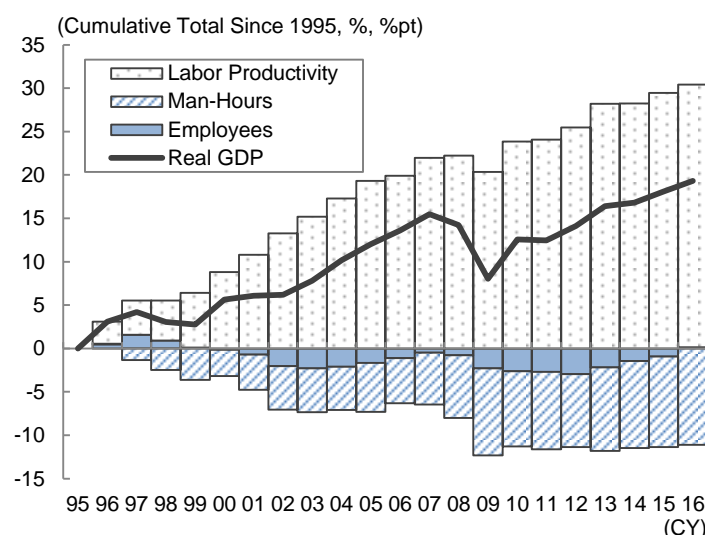
Since 2013, the problem of labor input having a negative effect on GDP has gradually been resolved, but it is still an essentially negative factor.

In order to ensure the Japanese economy's long-term growth in the future, it will be necessary to improve labor productivity. However, at the same time, it is important to increase labor input as much as possible in the future as labor productivity has been on the decline recently, and is expected to be reduced further by the Limitation of Number of Overtime Hours Worked.

The question of how to increase labor input despite the shortage of manpower is an important focus of this report.

Factor Analysis of Real GDP Growth Rate

Chart 1



Source: Cabinet Office, Ministry of Internal Affairs and Communications, Ministry of Health, Labour and Welfare; compiled by DIR.

## 1.2 Current Condition of Labor Shortage

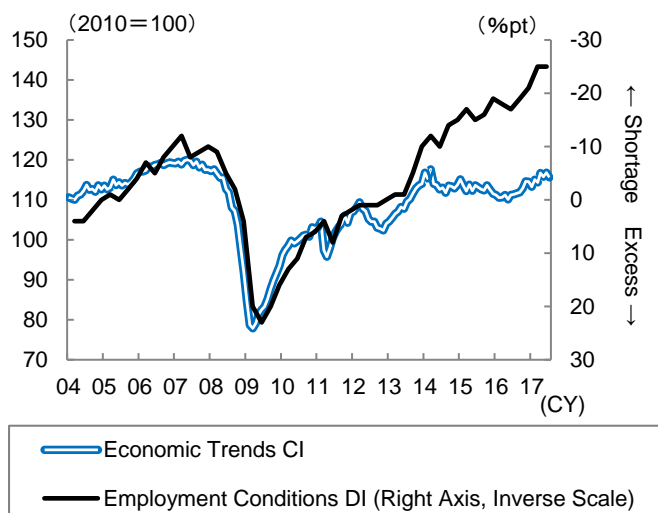
Taking a look at the most recent situation as regards the shortage of labor, we see that ever since the end of the bubble period (around 1991-92) the effective openings-to-application ratio has maintained a high level around the same as it was during Japan's period of high economic growth, reaching 1.48x in April 2017.

However, with the unemployment rate having fallen to 2.8% as of August 2017, Japan has almost reached a state of full employment. Hence employment (the total number of employed) is expected to grow at a moderate pace at best.

Behind the growing sense that there is a manpower shortage is the fact that the sense of a shortage is growing faster than economic improvement in recent years (Chart 2). Japan, with its ultra-low birthrate and aging society, can be said to have entered the era of serious manpower shortages.

Economic Trends and Shortage of Manpower

Chart 2



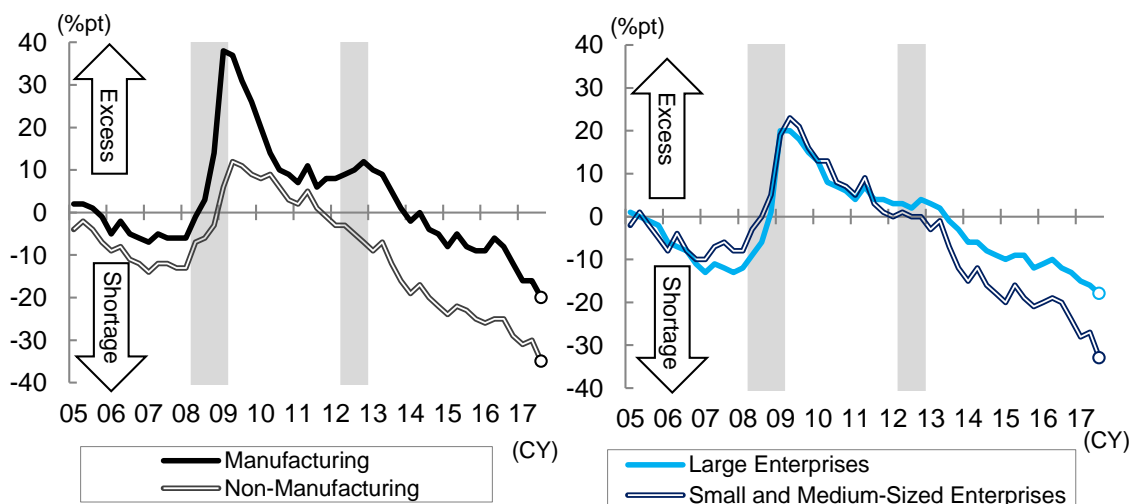
Source: Cabinet Office, Bank of Japan; compiled by DIR.

Looking at the breakdown of statistics on the shortage of labor, we see that the sense of a shortage of manpower is strongest amongst small to medium-sized enterprises and the non-manufacturing industry (Chart 3). The question is whether the problem of the shortage of manpower is affecting the actual business activities of corporations. If this is the case, then from the viewpoint of ESG criteria, which are important to ensure long-term growth, the question of dealing with the problem of the increasingly serious shortage of labor should be urgent business for Japanese corporations.

In this report, we examine the effects of the labor shortage on corporations, and what the possible means to resolving that problem might be.

Employment Conditions DI

Chart 3



Source: Bank of Japan, Cabinet Office; compiled by DIR.

Notes: 1) Employment conditions DI = excess – shortage.

2) The circles represent the future estimate. Shaded areas represent periods of recession.

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### 1.3 Effects of Labor Shortage on Corporations

When we examine macro statistics, we can confirm that the shortage of labor is indeed becoming serious, but what exactly are corporations doing about it?

The Japan Institute for Labour Policy and Training performed a survey covering 12,000 corporations with more than thirty employees asking about the labor shortage situation as of end December 2015. More than half (52.1%) of respondents stated that they were experiencing a shortage of manpower at that time.

Of those responding that they were experiencing a shortage of manpower, two-thirds said that the shortage of labor was effecting business operations in some way. Concretely speaking, said effects included the following: Unable to keep up with growth in demand (45.4%), difficulty in passing down technology and know-how (41.5%), has become a hindrance to business operations (37.0%), personnel expenses growing due to increase in recruitment wages, improvement of benefits and care for existing personnel, and increase in overtime (36.6%).

This survey indicates that corporations are having an actual experience of shortage of manpower, and that the shortage is effecting business operations a real way.

This survey looks into conditions as of the end of December 2015, and examining more recent macro statistics shows that the shortage of labor has grown all the more serious. Since the time the survey was taken even more corporations are experiencing problems due to the manpower shortage, and we estimate that the effects on business management have also grown.

## 2. Corporations Threatened with Variety of Risks

### 2.1 Overtime Increases due to Shortage of Labor

The survey mentioned previously also asked corporations experiencing a shortage of manpower about how this shortage was effecting day-to-day business at the corporation's place of business. Conspicuous amongst the responses were the following: Increase in overtime and decrease in number of vacation days taken (69.8%). This suggests that the shortage of manpower is being handled by virtue of increasing the work hours of employees.

However, this approach will likely become more difficult in the future. One of the developments associated with work style reform is corrective measures regarding prolonged work hours, including stricter overtime regulations.

### 2.2 In the Future, Increasing Overtime Hours will no longer be an Option

As mentioned above, work style reform includes efforts to correct the issue of long working hours. This includes the introduction of a new ruling – the Regulation with Penalties on the Limitation of Number of Overtime Hours Worked. There is a risk that this new ruling could place corporations in a situation in which the manpower shortage becomes increasingly serious.

Although there are exceptions to the rule, the new regulations would place a cap on overtime with the upper limit set at 45 hours per month or 360 hours per year. In some cases a company's labor contract may stipulate that hours may be increased to 720 hours per year.

One exception to the limitation on overtime is highly paid professionals (the Advanced Professionals System). With the inclusion of exceptions the new ruling will become a part of amendments to the Labor Standards Act to be submitted to the legislature with implementation expected in April 2019 at the earliest.

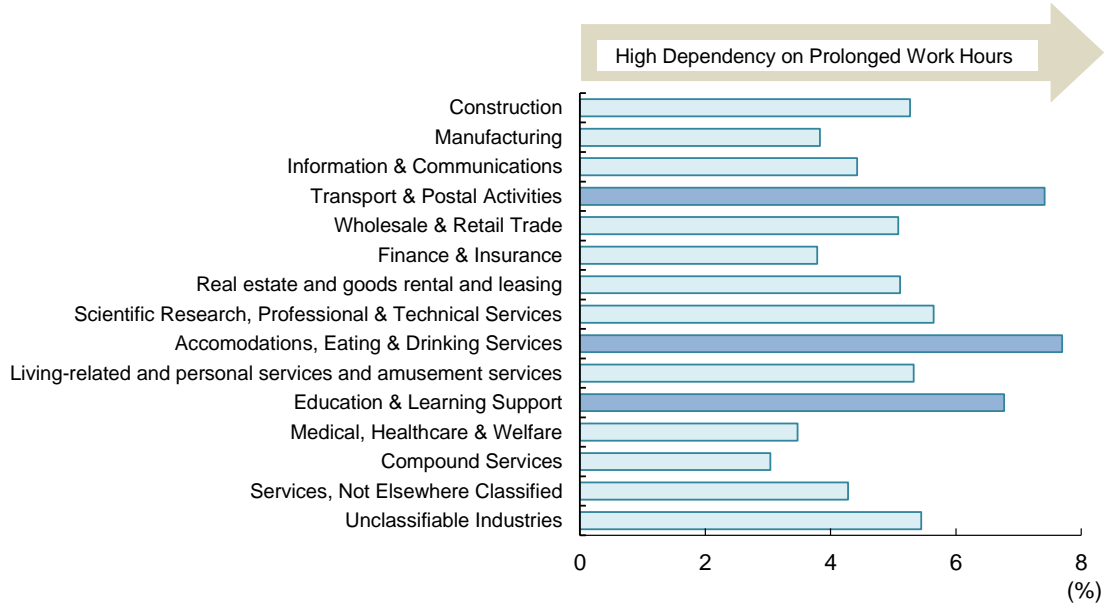
According to estimates based on a labor force survey, overtime hours exceeding 60 hours per month total just under 400 million hours per month. This estimate includes overtime hours of drivers, the construction industry, and other industries which have been given a deferment in regard to the new regulations, as well as professions falling under the definition of "advanced professions". Hence this figure should be taken with a certain grain of salt. However, the estimate does tell us that there is a considerable number of work hours expected to be affected by the new overtime regulations.

Once the Regulation with Penalties on the Limitation of Number of Overtime Hours Worked goes into effect, corporations will have to redistribute work hours restricted by the ruling to other workers including new workers. In order to compensate for overtime hours which have been cut, corporations will require another 2,480,000 new fulltime workers, but there is very little margin for an increase in the labor force participation rate. However, there is not much hope of gaining a significant increase in employment beyond what we have now. With things as they are, competition to secure the necessary number of employees is expected to intensify in the future. At the same time, there is a limit to the supply of labor at this time. Therefore finding ways to increase labor productivity is also a matter of urgent business of Japanese corporations.

The new regulations on overtime are expected to have an especially large effect on industries and companies which have a high dependence on prolonged work hours. Next we take a look at which industries fit this description. There appears to be a wide variety of industries in this list, with many differences between them (Chart 4). Industries with a high level of dependency on prolonged work

hours include transport & postal activities, accommodations & eating and drinking services, and education & learning support. Changes in how these industries handle their businesses are now being sought.

**Percentage of Total Working Hours Accounted for by Overtime Hours Exceeding 60-Hrs Per Month** Chart 4



Source: Ministry of Internal Affairs and Communications; compiled by DIR.  
 Note: Data from year 2016.

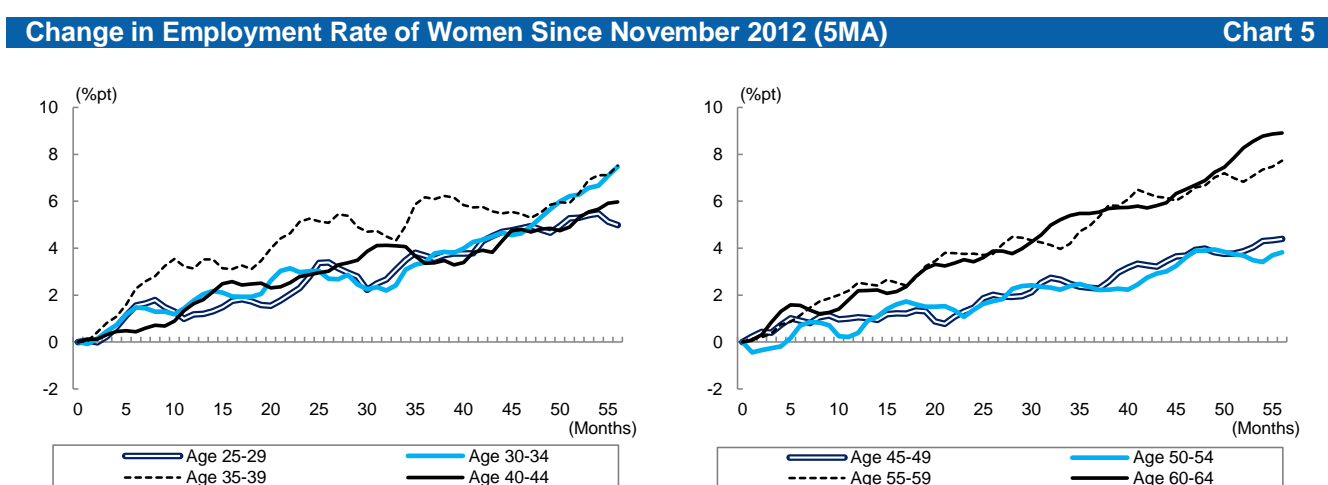
### 3. Where are the Workers?

Amidst all the concern with the shortage of labor, is there any chance the supply of labor can grow further? Next we consider potential growth in the supply of labor focusing on four factors: (1) women, (2) men, (3) the elderly, and (4) part-time workers.

#### 3.1 Women

As Japan enters the era of ultra-low birthrate and aging society, the working age population is in a declining trend, but some progress is being made in labor force participation amongst women and the elderly, and this is contributing to some growth in the number of employed.

Just how much is the employment rate of women growing? Chart 5 shows changes in the employment rate by age group during the current economic growth period (from November 2012 to present). This chart indicates that the employment rate has seen major growth in the case of all age groups.



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

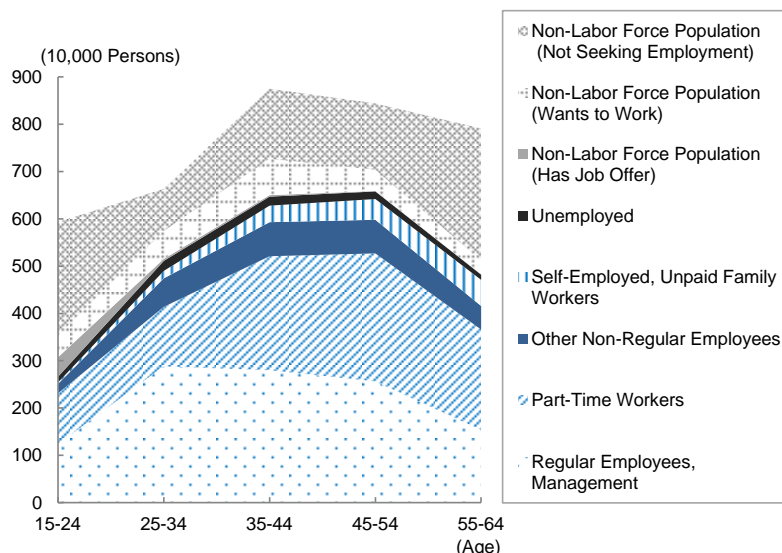
Meanwhile, Chart 6 shows the employment situation of women by age group. One of the most obvious sources of potential growth in the supply of labor is of course women who are not currently working, but who would like to work.

This includes both the unemployed and those who are members of the non-labor force population, but who want to become employed. The difference between the unemployed and members of the non-labor force population who want to become employed is the question of whether or not one is seeking employment. There are many reasons why an individual may want to become employed yet is not actively seeking employment. It would be rash to suggest that all you have to do if you are a member of the non-labor force population who wants to become employed is to work. But keeping this in mind, when we look at the statistics on women between the ages of 15 and 64 who wanted to become employed but were not actively seeking employment as of the year 2016, we find that, omitting those not seeking employment due to health reasons or because they were still attending school, there was a total of 2,630,000 women including the unemployed. This is the equivalent of 10.6% of women between the ages of 15 and 64 who were employed.

Furthermore, when we examine the details of the non-labor force population which wants to become employed, we see that reasons stated for not seeking employment include suitable type of work most likely does not exist (570,000), childbirth and childcare (860,000), and caregiving/nursing care (140,000).

In the future, work style reform may provide for a wider variety of approaches to work, making it possible to care for children or provide nursing care and work at the same time. It is therefore possible that a certain portion of this population which wants to work but is not currently seeking employment will eventually enter the labor market.

**Women's Employment Status by Age Group (2016 Average)** Chart 6

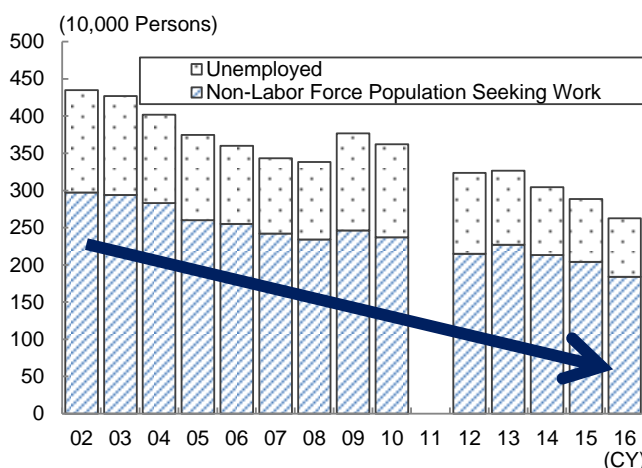


Source: Ministry of Internal Affairs and Communications; compiled by DIR.

If the current non-labor force population which wants to become employed (between the ages of 15 and 64 excluding those not seeking employment due to health reasons or because they are attending school) were to enter the labor market assuming the unemployment rate is at 2.8%, the number of employed would grow by 1,860,000 persons.

However, getting to this point is not as easy as it sounds. Chart 7 indicates that the unemployed population and the non-labor force population which wants to become employed are on the decline. Potential growth in the supply of labor coming from women's participation in the work force has continued to exhibit major growth, but is expected to near its limit in the short-term. Major growth in the number of employed will most likely not be possible without labor reforms on both the institutional level and on the level of social awareness.

**Women Age 15-64 Unemployed Population and Non-Labor Force Population Which Wants to Work** Chart 7



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

Notes: 1) Data for the year 2011 was lost due to The Great East Japan Earthquake.

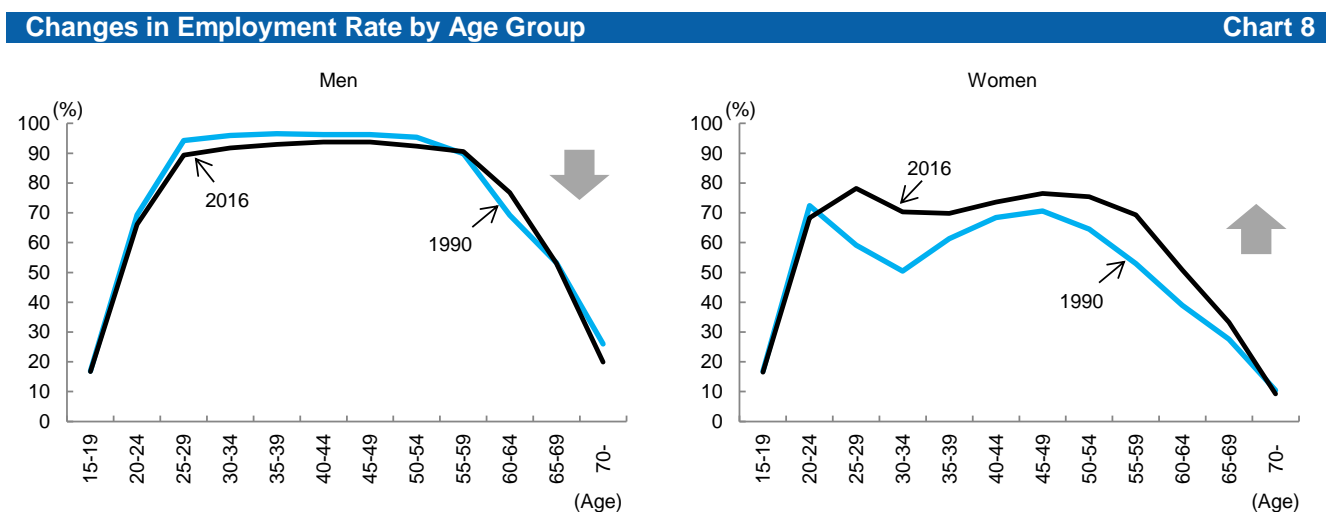
2) Non-labor force population seeking work excludes persons not working due to health issues and persons attending school.



### 3.2 Men

In considering the potential growth of the labor force, what first attracts our attention is women. However, what is happening with the men hiding in their shadows.

Chart 8 compares employment rates by gender and age group during the bubble era (1990) and the year 2016. The graph here indicates that there has been major growth in employment for women in all age groups (age 25-69), especially in the area known as the M-shaped curve where traditionally women's employment rate would temporarily fall off during the childbirth and childcare years. However, looking at the data for men, we see that the employment rate has continually been low for all age groups up to age 59 ever since the bubble era.



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

Why are the benefits of recent years of economic improvement not spreading sufficiently to men? One possible cause is that the effects of Japan's "employment ice age" (the period just after Japan's economic bubble burst between the mid-1990s and the mid-2000s when it was especially hard for job seekers) are still being felt.

A study carried out by Ohta, Genda and Kondo (2007) analyzes the cohort effect of the labor market. According to this study, "the cohort effect in the labor market refers to the lasting impact on employment conditions, such as wages and job separation, of a group of people of the same age, gender, and educational background that is created by supply and demand in the labor market at the time of graduation and that group's population size." The results of the study found that "rising unemployment rates at the time of graduation left graduates unable to find employment immediately after graduation or thereafter, increasing the likelihood that they would obtain provisional employment or remain unemployed altogether. A trend toward declining annual incomes was especially noticeable among high school graduates." Although the employment ice age has passed, certain aspects of its influence remain indefinitely, much like a glacier which can take years to melt.

The cohort effect is felt not only by men, but also by women. However, recent developments, such as the promotion of women's social contribution, meant that forces stronger than the cohort effect, mainly the entry of more women into the labor market, caused the remnants of the employment ice age to melt away as far as women were concerned.

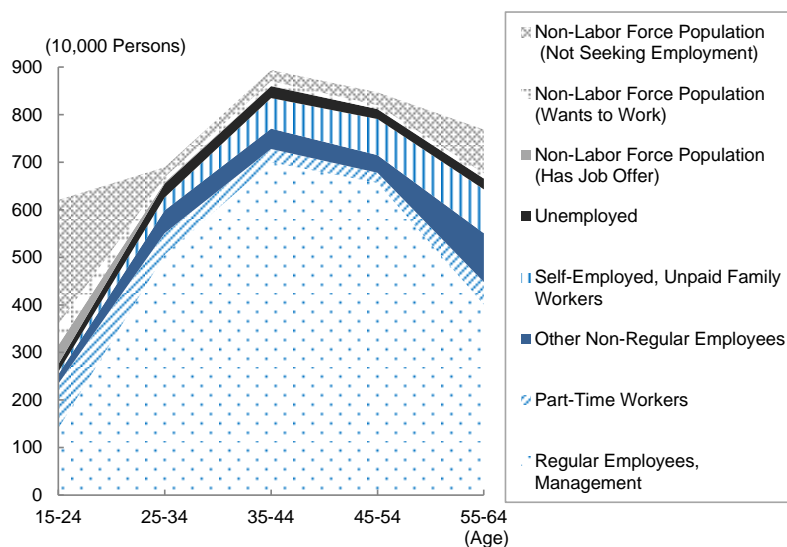
On the other hand, the ice has not melted in the case of men. It is almost as if men in their prime, who were at one time the prime movers in Japan's economy, have disappeared from the labor market. But

looking at it the other way around, it could also mean that there is still room for potential growth in the supply of labor as far as men are concerned.

So how much potential growth is there? Chart 9 shows the employment situation for men by age group.

Men's Employment Situation by Age Group (2016 Average)

Chart 9



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

Men between the ages of 15 and 64 who wanted to become employed but were not actively seeking employment as of the year 2016, excluding those not seeking employment due to health reasons or because they were attending school, totaled 1,350,000 including the unemployed. This is the equivalent of 4.3% of men between the ages of 15 and 64 who were employed.

Furthermore, when we examine the details of the non-labor force population which wants to become employed, we see that reasons stated for not seeking employment include suitable type of work most likely does not exist (90,000), and caregiving/nursing care (30,000).

If the current non-labor force population of men that want to become employed (between the ages of 15 and 64 excluding those not seeking employment due to health reasons or because they are attending school) were to enter the labor market assuming the unemployment rate is at 2.8%, the number of employed would grow by 430,000 persons.

Members of the non-labor force population seeking employment which answered that they are not seeking employment because suitable type of work most likely does not exist are likely those who have given up seeking work after having continually searched for work but to no avail. These individuals have lost the will to continue the job seeking process (referred to as discouraged workers by the OECD).

The reason these individuals are unable to find jobs is often because they did not have the opportunity to attend training programs at their past employment. These people therefore lack the technical skills that prospective employers are seeking. In other words employee mismatch occurs as regards what corporations are seeking in their recruitment efforts. This indicates that more job training opportunities are needed, as well as better job-placement services.

### 3.3 The Elderly

Next to women, the group which is most promising as a new source of labor supply is the elderly. In the Japan of the ultra-low birthrate, society is gradually coming to expect that everyone should work as long as they are still healthy.

In recent years attitudes towards employing the elderly have changed from one of “it can’t be helped because of the shortage of manpower” to a more positive one which believes that “employing the elderly is good for corporation”.

For instance, there are an increasing number of companies who hire elderly employees to service elderly customers since someone of the same age group has a better idea of the elderly customer’s needs. Doing so will eventually lead to expansion of profits. Developments such as this are helpful both from the viewpoint of the employer and that of the elderly employed.

Next we consider how much potential growth in the supply of labor we can obtain from the elderly. Chart 10 shows the employment situation for the elderly.

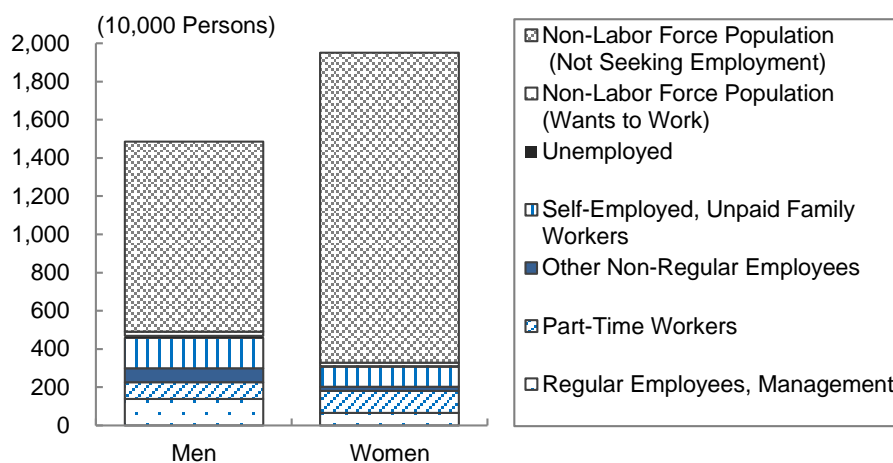
As of the year 2016, elderly persons aged 65 and older who wanted to become employed but were not actively seeking employment, excluding those not seeking employment due to health reasons, there was a total of 480,000 elderly persons including the unemployed. This is the equivalent of 6.3% of elderly persons aged 65 and older who were employed.

If the current non-labor force population aged 65 and older (excluding those not seeking employment due to health reasons) were to enter the labor market assuming the unemployment rate is at 1.9%, the number of employed would grow by 330,000 persons.

However, despite the fact that employing the elderly is being promoted, the reality is that in comparison to people who are now in their productive years (the working generation) it is more difficult for the elderly to find employment. There is a certain fixed percentage of employee-job mismatch which occurs during the process of job-seeking which is due to the advanced age of the job-seeker. Approximately half of unemployed persons aged 65 and older pointed to the problem of employee-job mismatch as the reason they could not find work. This points to a need for job-placement services oriented toward the elderly

Employment Situation of Persons Aged 65 or Older (2016 Average)

Chart 10



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

The Japan Institute for Labour Policy and Training performed a survey focusing on people in their 60s in 2015. Findings indicate that for persons in their sixties who do not continue to work after reaching compulsory retirement, it is difficult to gain re-employment once they have become distant from work. In order to further promote the employment of the elderly in the future, the key may lie in the question of how the elderly can continue to work beyond traditional retirement age.

### 3.4 Part-Time Workers

#### *Work time gets cut back when hourly wages increase*

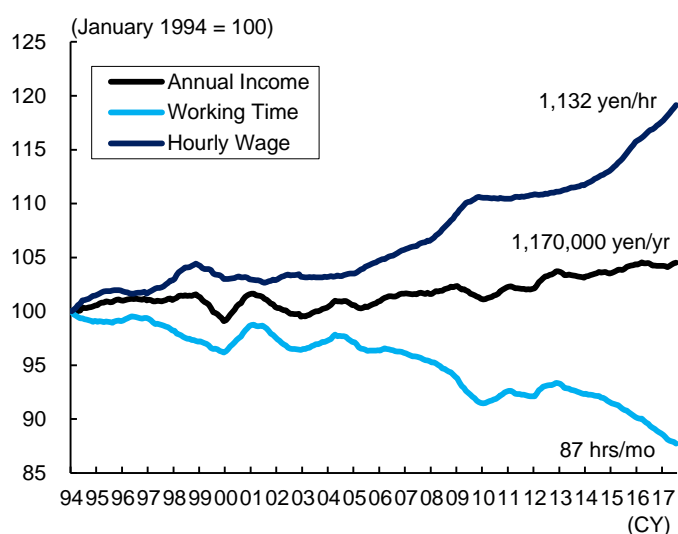
In this section we examine the question of working hours (man-hours) per part-time worker from the viewpoint of potential growth in the supply of labor.

Currently approximately 30% of workers in Japan are part-time workers. When we consider the way in which part-time workers work, we find that there is one very characteristic phenomenon. Chart 11 shows changes in the hourly wages of part-time workers, along with working time (man-hours) and annual income. Here we see that in contrast to growth in the hourly wages of part-time workers, working time is on the decline. Meanwhile, annual income continues to mark time.

What this graph suggests is that part-time workers are adjusting their working time, thereby holding down their annual income. Behind this phenomenon lies a problem which is often discussed – that of the marital or spousal deduction on Japanese income taxes, which acts as a barrier to becoming more fully active in the labor market on the part of married women.

Annual Income, Working Time, and Hourly Wages of Part-Time Workers

Chart 11



Source: Ministry of Health, Labour and Welfare; compiled by DIR.  
Note: 12-month moving average.

#### *Marital deduction acts as barrier*

The marital deduction can be declared on a taxpayer's Japanese income tax and local city tax if the taxpayer's spouse has an income below a certain fixed amount. The marital deduction has been seen as being problematic since it is considered to be a factor in holding down the number of man-hours worked by part-time workers who tend to be mostly women. Some movement toward rethinking this deduction was seen in tax reforms carried out in FY2017 (Chart 12).

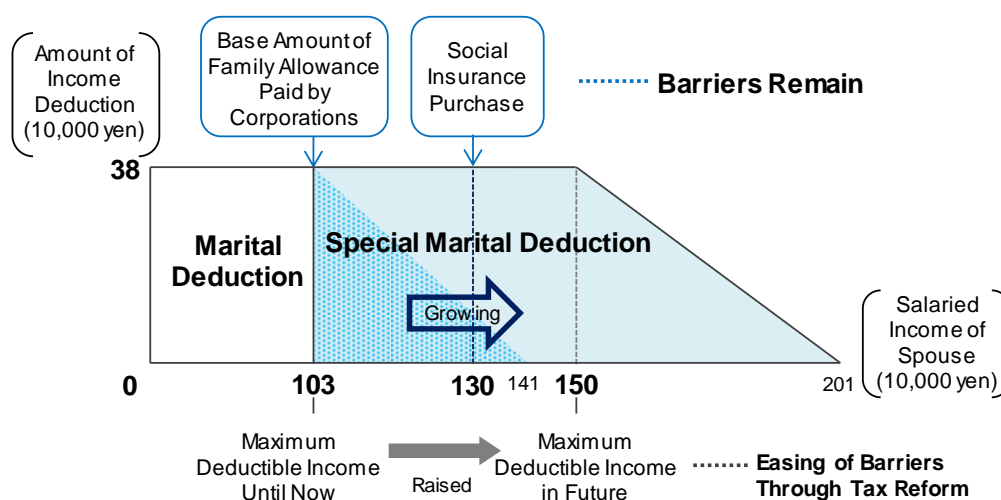
Concretely speaking, this was a change to the special marital deduction approved by the cabinet according to which the maximum deduction on annual income of a spouse was raised to 1.5 million

yen. In effect, this lowered the tax barrier somewhat to women working more hours, but the problem as such remains.

There are still other major barriers in place, first and foremost being the spousal or family allowance paid to employees by corporations. Most corporations in Japan provide a spousal or family allowance which is contingent on application of the marital deduction on the employee's income tax. However, the recent change in the tax system was for the special marital deduction, not the main marital deduction. Hence the standard for payment of the corporate family allowance does not automatically change. The standard amount paid for the family allowance by most corporations remains at 1,030,000 yen, and this acts as a barrier to women working more hours.

The Marital Deduction: Barrier to Employment

Chart 12



Source: Produced by DIR based on various laws and ordinances.

Notes: 1) This chart does not take into consideration income limits for the marital deduction and special spousal deduction based on the income of the member of a married couple with the highest income.

2) Social insurance barrier is 1,056,000 yen for persons employed by corporations with 501 or more employees meeting certain set terms.

The only way to remove this barrier is for corporations to review their own standards. In fact, the Japan Business Federation (Keidanren) has encouraged its members to review their standards for payment of the family allowance. This is one example of movement towards a rethinking of the family allowance centering on large corporations. However, it is expected to take some time for this movement to spread more widely. Hence the 1,030,000 yen barrier is expected to remain for a while.

Meanwhile, even if corporations review their standards for payment of the family allowance, there are still other barriers in place. This brings us to the second issue, that of social insurance. According to the current system, once the spouse's annual income exceeds 1,300,000 yen (or in the case of large corporations 1,056,000 yen if certain conditions are met), the spouse can no longer be covered by the principal breadwinner's social insurance. The spouse must pay into Japan's national health insurance and national pension plan on their own. This is known as the 1300,000 yen (or 1,060,000 yen) barrier. Of course, there are positive things to say about a spouse buying social insurance on their own, but when considering the fact that once the spouse's income reaches 1,300,000 yen they will have to pay around 183,000 yen in social insurance annually, it makes more sense to adjust working hours and stay below the amount for maximum income.

In the recent review of the tax system the amount of the special marital deduction was raised, but the overall mechanism of the marital deduction did not change. In addition, issues remain such as the corporate spousal or family allowance and the social insurance issue. Hence the effect on how part-

time workers approach their work is considered to be minimal. The current situation in the labor market requires major structural reform, not minor stopgap measures such as this.

### *Working time of part-time workers to become key in the future*

As was mentioned previously, since 1993 when statistics on the working time of part-time workers first began, working time has continually declined in contrast to growth in wages. If working time per person for part-time workers was at the same level as it was in 1993, working time in the macro sense (working time per person x number of part-time workers) would grow by 170 million hours per month. This is the equivalent of around 40% of the amount of working time to be cut back by the new overtime regulations explained in section 2.2 of this report.

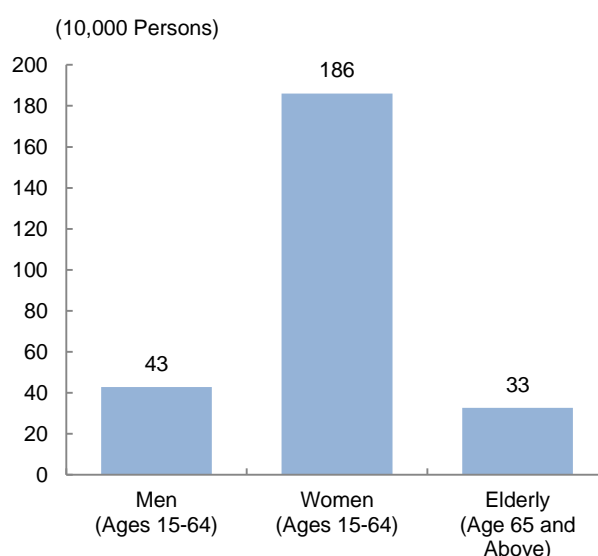
Furthermore, if working time per person for part-time workers was at the same level as it was in 1993, working time per person would grow by 11 hours per month. In reality of course it would not be easy to return the situation to what it was in 1993. However, due to the seriousness of the shortage of labor, the question of how much working time per person for part-time workers can be increased is the key to the future of the labor market.

## 3.5 Potential Growth in the Supply of Labor

So far in this report we have examined the question of how to increase labor input despite the shortage of manpower by looking at several factors, including (1) men, (2) women, (3) the elderly, and (4) part-time workers. Next we consider questions regarding potential growth in the supply of labor.

First, in terms of the number of potential workers there may be at this time, if people who are not currently participating in the labor market but who would like to work (excluding those not seeking employment due to health reasons or who are attending school) were to begin labor force participation, assuming the unemployment rate is at a fixed level, the number of employed would grow by 430,000 persons for men between the ages of 15 and 64, 1,860,000 for women between the ages of 15 and 64, and 330,000 for elderly persons aged 65 and above (Chart 13). Totaling the above groups brings us 2,620,000 potential workers.

**Potential Growth in Labor Supply (Estimated Number of Workers)** **Chart 13**



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

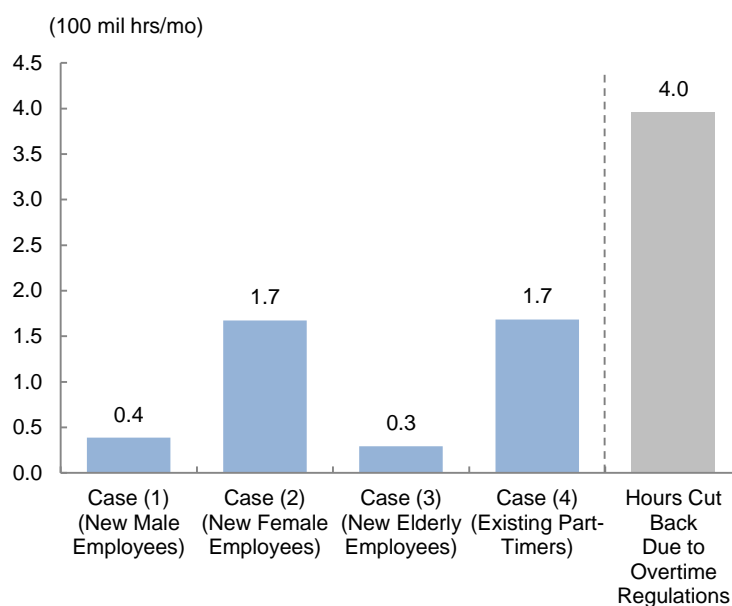
Note: Estimates assuming non-labor force population that wants to work (excluding those not seeking work due to health reasons or attending school) enters the labor market assuming fixed rate of unemployment: (1) Men between ages 15 and 64 with unemployment at 2.8%, (2) Women between ages 15 and 64 with unemployment at 2.8%, (3) Elderly age 65 and above with unemployment at 1.9%. Data from year 2016.

Furthermore, there is the question of potential growth in volume (man-hours). Here we look at four hypothetical cases: (1) New male employees between the ages of 15 and 64 as estimated in Chart 13 are part-timers who work 90 hours per month, (2) New female employees between the ages of 15 and 64 as estimated in Chart 13 are part-timers who work 90 hours per month, (3) New elderly employees aged 65 and above as estimated in Chart 13 are part-timers who work 90 hours per month, and (4) Existing part-time workers put in working time along the lines of man-hours per month recorded in 1993.

According to our estimates, potential growth in the supply of labor would be as follows: Case (1) men 40 million hours per month, Case (2) women 170 million hours per month, Case (3) the elderly 30 million hours per month, and Case (4) 170 million hours per month. If the numbers estimated for cases (1) – (4) were all to be achieved, we would see a total of hours per month in work time which would pretty much offset the number of overtime hours lost due to the new overtime regulations (Chart 14).

In order to achieve growth in the supply of labor in the future, the problem must be approached from both the quantitative and qualitative sides (both number of workers and hours worked per person). This means (1) encourage labor force participation by persons who would like to work but who have currently not entered the labor market, and (2) increase the number of hours worked per person for current part-time workers.

**Potential Growth in Supply of Labor (Estimated Hours) Chart 14**



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

Notes: Case (1) New male employees between the ages of 15 and 64 as estimated in Chart 13 are part-timers who work 90 hours per month.

Case (2) New female employees between the ages of 15 and 64 as estimated in Chart 13 are part-timers who work 90 hours per month.

Case (3) New elderly employees aged 65 and above as estimated in Chart 13 are part-timers who work 90 hours per month.

Case (4) Existing part-time workers put in working time along the lines of man-hours per month recorded in 1993.



## 4. What Can Corporations Do?

Up to this point we have examined the issue from the viewpoint of the question of potential growth in the supply of labor in a time of a serious shortage of labor. There is also the question of how best corporations can retain existing employees. This is a very important in order to ensure long-term growth. It requires the development of an employee-friendly work environment, and the improvement of labor conditions. In this section we examine the questions of (1) diversity management and (2) improvement of labor conditions (giving more employees regular employee status).

### 4.1 Diversity Management

In terms of numbers, much progress has been made in the social advancement of women. Here we examine how current conditions have changed from the viewpoint of gender diversity.

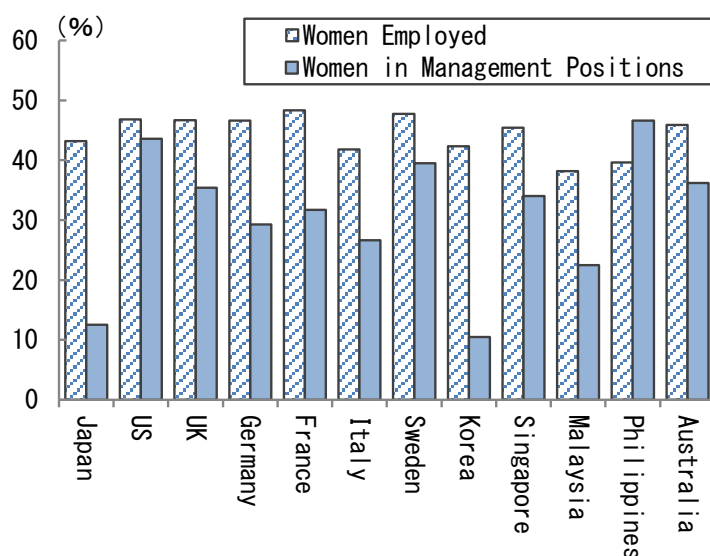
Chart 15 shows the proportion of women in employment, along with the proportion of women in management positions. Here we see that as far as the proportion of women in employment goes, Japan can hold its own against the other advanced nations, but when we come to the proportion of women in management positions, Japan falls way behind the other advanced nations. The Abe administration has announced a target of having the proportion of women in leadership positions reach 30% by the year 2020. However, if one looks around at the current reality, reaching that target looks to be extremely difficult.

In a DIR research report by Mariko Kawaguchi (2013), factors preventing diversity from progressing in Japan are pointed out as follows: “the biggest problem is that policy has focused more on work-life balance. Hence positive action has been insufficient.”

There are three steps to diversity management: (1) support both work and child-rearing equally, (2) rethink work style of all employees in order to achieve work-life balance, and (3) take positive action to develop and promote women in management. Handling of step (2) in diversity management is insufficient in many Japanese corporations and stands in the way of step (3) taking positive action in the form of policy.

Proportion of Women in Employment and in Management Positions (2015)

Chart 15



Source: Produced by DIR based on “Databook of International Labour Statistics 2017”, issued by The Japan Institute for Labour Policy and Training.

Note: Figures for Australia from 2014.



The insufficiency of how Japanese corporations have approached work-life balance policy lies in the fact that it focuses overly much on women’s issues since in reality they carry the heaviest burden in child-rearing. Policy then becomes more of a welfare policy for women rather than a means of encouraging both men and women to develop better work-life balance.

When considering diversity management, corporations must firmly adopt the awareness that work-life balance and positive action means more than merely preferential treatment for women. Rather, it is for creating a better work environment for both men and women, which ultimately improves the value of the corporation itself.

## 4.2 Will this Speed Up Improvement of Labor Conditions?

### *Will the number of regular employees increase in the future?*

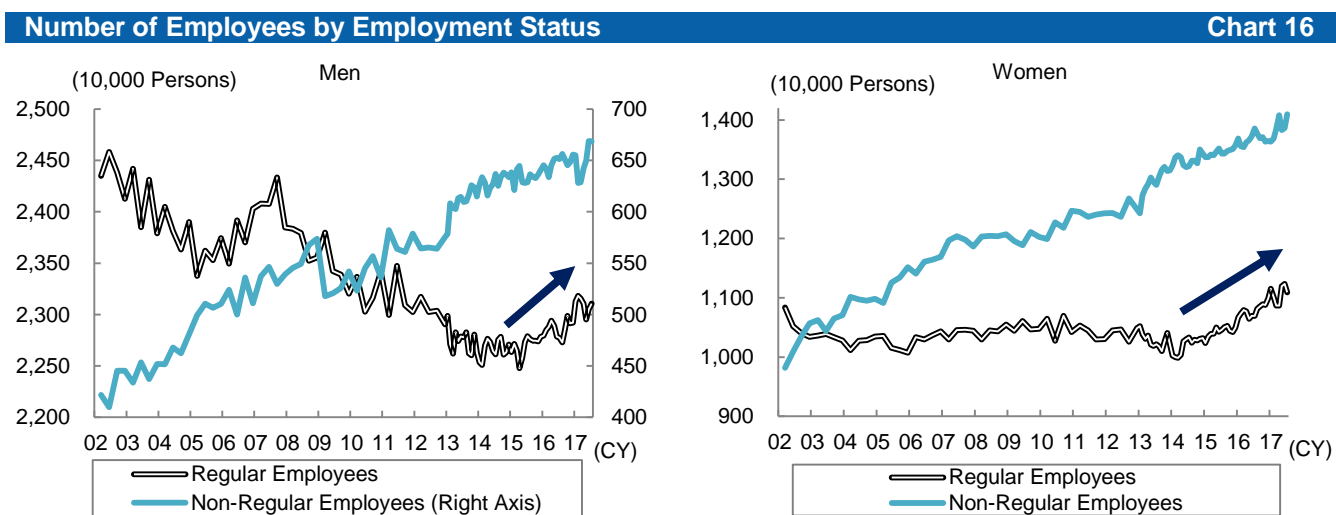
With the seriousness of the shortage of manpower, it will likely become more necessary for corporations to improve labor conditions as a means of retaining personnel. Some corporations are promoting non-regular employees to regular employee status as a policy for dealing with the problem of shortage of manpower.

Will efforts such as those mentioned above lead to growth in the number of regular employees? In this section we examine the current status of the regular / non-regular employee question. In addition, we will look at the effects of new policy and discuss the future of the labor market in light of the increase in regular employee status.

### *Regular employees and non-regular employees*

First we consider change over time in the number of regular employees versus the number of non-regular employees. For some time now, the number of non-regular employees has been on the rise in Japan, while the number of regular employees has continued to decline. But recently, the situation has changed. As was explained previously, the worsening condition of the shortage of manpower has brought a change in this tendency, with the number of male regular employees moving into a growth trend since 2015 and the number of female regular employees in a growth trend since 2014 (Chart 16).

The question now is whether this trend will continue. In conclusion, there is a very good chance that the pace of growth in the number of regular employees will accelerate from April 2018. This is very much related to The Revised Labor Contracts Act implemented in April 2013.



Source: Ministry of Internal Affairs and Communications; compiled by DIR.  
 Note: Data from 2012 is quarterly, and monthly from 2013 and beyond.

### ***The indefinite term rule of The Revised Labor Contracts Act***

Non-regular employees are normally on a contract with a fixed period, such as six months, one year, or some other agreed upon period. Approximately 30% of people working under this type of employment with a fixed period renew their contracts and continue to work for the same company for more than five years. Many people live with the constant fear that their employment might suddenly come to an end, wondering what they will do if their contract is not renewed. This state of anxiety forced upon contract workers became an issue several years ago.

Because of this problem, the Revised Labor Contracts Act which went into effect in April 2013 stipulates that “Where an employee on a fixed term contract has had a total period of continuous employment of five years or more with one employer, that employee will now be entitled to apply for an indefinite term employment contract (“Permanent Contract”).” However, the change applies only to fixed term contracts beginning after April 2013. Some large corporations have already made the switch to permanent contracts in advance, in some cases taking the form of changing an employee’s status to regular employee, but in the case of small to middle-sized corporations, making a complete switch to permanent contracts is expected to occur in April 2018, five years after the revision took effect.

The indefinite term rule is being handled by corporations in three different ways: (1) changing status of non-regular employees to that of regular employees, (2) changing fixed term contracts to indefinite term contracts, and (3) terminating contracts before they get to the five year point.

#### ***How corporations are dealing with the change***

According to a survey performed by the Japan Institute for Labour Policy and Training in 2017, responses to the question of how corporations were handling the indefinite term rule were as follows: around 60% responded that they would switch to indefinite term contracts in some form, while around 8% responded that they would manage fixed term contracts including those up for renewal in a way so as to avoid said contracts exceeding a period of five years (i.e. they would terminate contracts as of that point). On the other hand, around 30% of corporations responded that they were as yet undecided or that they did not know. This indicates that as of one and a half years before the change, many corporations had not yet dealt with it.

Another point which should be noted is the percentage of corporations who replied that they would consider the appropriateness of each employee on a fixed contract and switch to indefinite term contracts where appropriate before the five year term is up. The percentage is 25.0% in the case of fulltime workers and 16.2% in the case of part-time. Percentages have grown even though the survey expanded its coverage last year to include small to medium-sized corporations. It appears that the number of corporations changing to indefinite term contracts in advance of the arrival of the five year limit is growing as the time for the indefinite term rule to go fully into effect draws near.

Of those corporations which answered that they would switch to indefinite term contracts, which method will they take – (1) change status to regular employee or (2) change fixed term contracts to indefinite term contracts?

According to the survey mentioned above, 43.1% of corporations which responded said that as far as fulltime employees are concerned, they would find some means of changing their employment status to that of regular employees, while 37.3% responded that they would change contracts to indefinite term contracts. Meanwhile, as regards the handling of part-time employees, 24.4% of corporations responding said that they would change part-timer status to that of regular employees, while 50.6% said that they would simply change contract periods to indefinite term. As far as part-timers are concerned, there are considerably fewer corporations willing to give regular employee status.

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*Will these changes encourage an increase in the number of regular employees?*

There are still many corporations which have not yet decided how they will handle changes in the labor law, hence there is an element of the unknown, but based on these results, we can say that as far as fulltime employees are concerned, the number of corporations which will be changing employee status to regular employee after April 2018 is fairly large. The Ministry of Health, Labour and Welfare is encouraging the change of employee status to regular employee, including employees whose current status is “limited” (this refers to a wide variety of employees whose work status limits them to specific work, limited working hours, or duties), and is offering subsidies to corporations which are changing the status of non-regular employees to that of regular employee.

At the same time, there are people who have chosen the status of non-regular employee on their own. This is often the case with women. So there are those cases where an employee does not wish to be changed over to regular employee status. The indefinite term rule specifies that the switch to regular employee status occurs based on a formal application or request from the worker. The change does not take place without the expression of the worker’s desire to do so. This means that in actual practice, there may not be as many people changing over to regular employee status as some corporations are imagining. But even with this factor, we still see a large movement toward growth in the number of regular employees in the future due to the indefinite term rule.

However, some issues still remain. According to a survey performed by the Japanese Trade Union Confederation, 84.1% of fixed term contract workers do not have knowledge of the full contents or details of the indefinite term rule. As was mentioned above, the indefinite term rule requires that the worker file an application or request to make the switch to the status of regular employee. Hence in order for this to work as intended, the new rule and how it works must first become common knowledge.

## 5. Conclusion

Ever since the end of the bubble period (around 1991-92), the effective openings-to-application ratio has maintained a high level around the same as it was during Japan's period of high economic growth, while the unemployment rate has remained extremely low at 2.8%. Most of Japan's corporations have a direct experience of the shortage of labor, and this shortage is having an effect on business operations.

Most recently, the larger number of corporations have handled the problem of the manpower shortage by increasing overtime hours. However, this approach will become more difficult in the future. A new ruling which puts a cap on overtime hours (Regulation with Penalties on the Limitation of Number of Overtime Hours Worked) is expected to go into effect by April 2019 at the earliest. The new regulation on overtime is expected to have an especially negative effect on industries and companies which have a high dependence on prolonged work hours. Moreover, this development may lead to an intensification of competition to secure the necessary number of employees.

Under these conditions, how or where can corporations find the workers they need? The most obvious source of potential growth in the supply of labor is people who are not currently working but who would like to become employed. If people who are not currently participating in the labor market but who would like to work (excluding those not seeking employment due to health reasons or who are attending school) were to begin labor force participation, assuming the unemployment rate is at a fixed level, the number of employed would grow by 430,000 persons for men between the ages of 15 and 64, 1,860,000 for women between the ages of 15 and 64, and 330,000 for elderly persons aged 65 and over.

There are many reasons why an individual may want to become employed yet is not actively seeking employment. It would be rash to suggest that all you have to do if you are a member of the non-labor force population who wants to become employed is to work. Labor force participation on the part of these potential workers will not be possible without labor reforms on both the institutional level and on the level of social awareness.

For instance, in the case of women, the reason many are not seeking employment is because of childbirth and childcare, or they are involved with caregiving and nursing care. In the future, work style reform may provide for a wider variety of approaches to work, making it possible to care for children or provide nursing care and work at the same time.

In the case of men, the non-labor force population which is seeking employment is influenced by Japan's "employment ice age". The reason these individuals are unable to find jobs is often because they did not have the opportunity to attend training programs at their past employment. These people therefore lack the technical skills that prospective employers are seeking. In other words employee mismatch occurs as regards what corporations are seeking in their recruitment efforts. This indicates that more job training opportunities are needed, as well as better job-placement services.

In the case of the elderly, approximately half of unemployed persons aged 65 and older are unable to find jobs because of the problem of employee-job mismatch. This points to a need for job-placement services oriented toward the elderly. Furthermore, for persons who do not continue to work after reaching compulsory retirement, it is difficult to gain re-employment once they have become distant from work. In order to further promote the employment of the elderly in the future, the key may lie in the question of how the elderly can continue to work beyond traditional retirement age.

Another important point when considering the question of potential growth in the supply of labor is working time per person for part-time workers. The extent to which working time per part-time worker can be increased in the future is a key point. The number of hours worked per part-time worker have

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continued to decline in contrast to the growth seen in hourly wage. If working time per person for part-time workers was at the same level as it was in 1993, working time in the macro sense would grow by 170 million hours per month. This is the equivalent of around 40% of the amount of working time to be cut back by the new overtime regulations.

Up to this point we have examined the issue from the viewpoint of the question of how much can the supply of labor be increased in a time of a serious shortage of labor. There is also the question of how best corporations can retain existing employees. This is a very important in order to ensure long-term growth. It requires the development of an employee-friendly work environment, and the improvement of labor conditions.

Japan still has many issues when it comes to the question of gender diversity. When considering diversity management, corporations must firmly adopt the awareness that work-life balance and positive action means creating a better work environment for both men and women, which ultimately improves the value of the corporation itself.

Finally, with the shortage of manpower, many corporations are promoting non-regular employees to regular employee status as a policy for dealing with the problem of retaining personnel. This tendency is being encouraged by the new “indefinite term rule” in the revised labor law, and it is highly possible that this may speed up the changeover of employee status to regular employee in the future.

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