Chapter I

Japanese Economy and Labor Situation

1 The Current Status of the Japanese Economy and Its Future Prospects

Overview: The "Lost Two Decades" after the Collapse of the Bubble and the Present State of the Japanese Economy

Taking a long-term view of Japan's economy, the real economy posted high growth of more than 5% in the second half of the 1980s. This high growth in the real economy was also reflected in financial and securities markets, as well as in the asset value of companies. With stock prices reaching an all-time high of ¥38,915 at the end of 1989, Japanese companies were acquiring foreign companies and assets, encouraged in part by the impact of the strong yen at a time when corporate mergers and acquisitions (M&A) were a major trend. In response to these moves, Japan was highly praised by other advanced nations as the world's number one. However, on reaching 1990, asset prices such as stock prices and land values immediately began to fall, and this decline was not stopped for a long time. Following this collapse of the so-called economic bubble, Japan entered a prolonged economic slowdown.

Thereafter, on at least three occasions to date, Japan has experienced deep recessions that could be described as the worst since the Second World War. Firstly, the decline in stock prices and land values that had been underway since 1990 eventually extended so far as to result in the bankruptcy of major financial institutions in November 1997, immediately after which a severe financial shrinkage began, which plunged Japan into a deep recession. Lending by financial institutions continued to decline sharply from 1998 and continued to fall for a long time, until a moderate increase reversed this process in mid-2005. Moreover, the unemployment rate (3.5% in November 1997) rose sharply in 1998, reaching 4.8% in June 1999, and the employment environment became more and more severe. In particular, with regard to the employment of those who had newly graduated from university, the period from graduation in around March 1994 to around 2005 is generally called the employment ice age, when it continued to be extremely difficult to find employment. The university graduate employment rate underwent a sustained decline from 66.6% for those graduating in March 1997, falling to 55.1% in March 2003.

The second recession occurred at the end of 2000 until the first half of 2002, when the financial shrinkage was still underway, caused by a worldwide recession in the field of semiconductors. Focusing primarily on electrical appliances, there was a major decrease in production in export-related areas of manufacturing industry; coupled with the deflationary effects of the financial shrinkage, this led to the unemployment rate beginning to rise from around May 2001, reaching 5.5% – the highest-ever rate – in June 2002 and again in August of that year. With regard to the job market for university graduates, as mentioned above, the job market for those graduating in March 2002 and March 2003 in particular was exceedingly harsh.

The third recession covers the period from September 2008, when the so-called "Lehman shock" (the bankruptcy of Lehman Brothers) took place, until the present day. From January 2002, the Japanese economy continued a moderate recovery (the period up to October 2007 alone became the longest since the war), and lending by financial institutions began to increase again from mid-2005, but from the end of 2007, in response to the worldwide economic slowdown, the economic situation became patchy. At this point in time, the Lehman Shock occurred. In Japan, exports of goods such as motor vehicles fell significantly, which led to a major decrease in production in machinery-related industries. This decrease in production swiftly spilled over into all industries, as a result of the interindustry-relation effect, becoming a very fast-paced recession that was the largest since the war, with the index of industrial production demonstrating a fall of 30% compared with the previous year toward the first half of 2009. In addition, as if to add insult to injury, the Great East Japan Earthquake occurred in March 2011, when the economy had not yet completely recovered from the Lehman Shock.

The Great East Japan Earthquake disaster initially caused catastrophic damage to production activity and employment in the Tohoku region; in particular, the suspension of operations by auto parts makers and others sparked a major supply shock to the Japanese economy and overseas markets. And although production subsequently made a quick recovery, thanks mainly to automobile manufacture, exports posted a year-on-year decrease for five successive months. Moreover, after the accident at TEPCO's Fukushima No.1 nuclear power plant, Japan's energy sources shifted significantly toward thermal power generation, leading to a massive increase in imports of crude oil and natural gas. As a result, Japan suffered a trade deficit for two successive years in FY2011 and FY2012 (Note 1).

From the second half of 2011, the yen reached a historically high value, triggered by the crisis of government debt in Greece and other southern European nations. This delivered a crippling blow to Japan's socio-economy, just as it was heaving under the weight of recovery and reconstruction measures after the Great East Japan Earthquake disaster. Although the economy had started to make a recovery of sorts after the disaster, this historically strong yen forced it back into recession for almost a year from the end of 2011.

Thus, over almost 20 years since the collapse of the bubble economy, Japan has been struck by a number of recessions. In recent years, apart from exceptions such as corporate profits, which have been achieving record highs, most economic indicators, including stock prices, GDP, capital investment, employee incomes and average wage levels, have either remained below the levels they were at in late 1997, when the financial shrinkage began, or are currently at levels below the 1997 levels after having exceeded them at one point. It is because of this that the period is referred to as the "lost decade" or the "lost two decades".

At the end of 2012, former Prime Minister Shinzo Abe was elected for a second term after a five-year hiatus. Now, at Abe's own initiative, the government set out an economic policy centered on "three pillars" (bold monetary policy, flexible fiscal policy and a growth strategy that encourages private investment), and is currently working to flesh out the specific content of this policy. Based only on the economic trends in the few months between the start of the new administration and the time of writing, the Abe administration's new economic policy – in tandem with the announcement of a plan for "an entirely new dimension of monetary easing" by the Bank of Japan's new Governor – has firstly brought a significant swing to a weaker yen on foreign exchange markets. The expectation that this will vastly improve corporate performance – particularly among export-related companies – has been welcomed by stock markets and triggered a rise in share prices, leading the economy toward a new phase.

Financial Shrinkage being a Major Reason for the Prolonged Recession

Why has the recession (lost period) lasted so long? Opinions may differ from expert to expert, but in this author's view, the biggest reason lies in financial shrinkage.

At the time in the 1990's, amidst the progressive introduction of current value accounting, the major fall in asset prices was detrimental to the assets (stock) not only of financial institutions, but also of ordinary companies, and in order to deal with the reduction of excessive debt, they were compelled to achieve cost reductions (flow adjustment) by cutting back production and employment. This was the occurrence of the so-called "three excesses" (capacity, employment, debt).

With regard to this mechanism, it is currently a well-known phenomenon, with the term "balance-sheet recession" having been coined, but in the early 1990s, when the fall in asset prices had only just begun, there was no awareness in Japan of what this might bring about. As the economic growth rate had not decreased by a particularly great amount, there was not even any awareness that an economic slowdown had begun. Triggered by a book written by an expert, in the autumn of 1992, when about two and a half years had passed since the fall in asset prices had commenced, people started to be aware that an economic slowdown had begun that was different from those experienced hitherto. The delay in recognizing the recession might also be one reason why it became so prolonged.

However, it did not stop here. As stated above, stemming from the failure of major financial institutions at the end of 1997, financing shrank over a long period of time. Finance is truly the lifeblood of economic activity: it is behind all production activities, with the provision of operating capital (discounting of bills), as well, of course, as finance for capital investment. As a result of this shrinkage, economic activity itself was forced to contract, and a succession of companies went bankrupt.

With regard to the cause of financial shrinkage, firstly, it is related to the structure in which, unlike in the USA (Note 1), Japanese financial institutions held a large quantity of cross-owned company shares. The major decline in stock prices and land values resulted in a swift, large-scale deterioration in the financial situation of financial institutions. In addition, it was caused by finance provided to companies rapidly becoming bad debts due to the prolonged recession, and also by an impact from moves toward international finance-institutional reforms, through which financial institutions at that time were forced to strengthen their equity ratio. As well as speeding up the recovery of debts from companies, in order to ensure that the inevitable asset deterioration was not aggravated, these financial institutions curbed new lending to a significant degree (Note 2).

The Economic Policy of the Government and the Bank of Japan and Structural Issues in the Japanese Economy

In response to these recessions, the government implemented a series of emergency economic measures. In addition to pump-priming government expenditure, the government used public funds (taxes) to introduce capital injections to financial institutions, in order to ensure that the deterioration of loan assets into bad loans and counter-measures to deal with this would not restrict the loan functions of these financial institutions.

Meanwhile, the Bank of Japan also promoted a zero-interest rate policy, particularly from the second half of the 1990s. After the turn of the century, it then promoted a policy of quantitative easing as a new financial policy (a measure to combat deflation) and provided commercial banks with vast amounts of liquidity.

After that, with a mild economic recovery underway, the Bank of Japan was seen to explore the possibility of an "exit policy", but up to the Lehman Shock, in the same way as the central banks of other advanced countries in the West, it adopted the unusual measure of widespread purchases not only of government bonds, but also of the securities of companies held by financial institutions, such as company bills, corporate bonds and CP, seeking to build up a supply of liquidity to the market.

However, despite these economic policies of the government and the Bank of Japan, the Japanese economy continued to experience low growth in the long term. It is believed that excessively low growth rates give rise to a vicious circle by causing the anticipated growth rate to decline, which brings about a structural stagnation in capital expenditure, as a result of which the low growth rate continues. In order to promote an internationally-competitive, technology-oriented nation, aggressive investment is essential (Note 3). Moreover, low growth not only causes increases in unemployment and wage stagnation, but also tears apart socioeconomic systems through such issues as the dissolution of employees' pension funds and health insurance unions by companies that cannot sustain the increase of costs due to the aging of the population, conjointly with operational deterioration resulting from low interest rates, or major decreases in the national pension scheme receipt rate.

Major issues can also be seen elsewhere in terms of the economic structure. The biggest issue is believed to be the delay in improving (reforming) the economic structure. This problem can be seen as being symbolic of the business strategy of Japanese companies against the strong yen and the resultant performance of the Japanese economy since the 1980s. With regard to the strong yen and the recession, many Japanese companies responded by transferring their production hubs overseas and implementing cost reductions and operational rationalization based on an approach of "selection and concentration". At that time, taking into consideration the fact that the rate of return on investment (investment efficiency) had been diminishing for a long time and that cost competition had become increasingly harsh due to the strong yen, this was rational behavior for companies. However, what remained as a result were an even stronger yen and the hollowing-out of domestic industry and employment. Rational behavior at the microeconomic level brought about even more deflationary tendencies and the contraction of domestic production at the macroeconomic level. What brought about the "fallacy of composition" was perhaps the fact that the government did not join together with the business community to create new industries and seek a strategic switchover in the industrial structure, and did not implement initiatives, either, that would lead to the development of projects that would attract businesses and investment from overseas utilizing yen being bought, although the government had such a plan. This is a problem that many experts have been united in pointing out.

Secondly, various labor problems will be taken up in detail in the chapters that follow, such as the hollowing-out of employment, the explosion in the number of non-permanent workers, long working hours concentrated at specific workers, and the long-term stagnation of wages; although they are problems that have emerged as a result of the deterioration of the economic situation, they themselves form one of the most serious economic problems facing Japan at present.

Thirdly, the economies of Japan's provinces are exhausted and stagnating. In combination with the deterioration of local government finances, it has also been affected by the fact that public investment has been on the decrease for a long time. The current state of the provincial economies is very serious and, as if to add insult to injury, the impact of the Great East Japan Earthquake is giving rise to even greater concern.

Finally, because a large quantity of government bonds were issued as part of the aforementioned fiscal stimulus, Japan's public bond balance increased dramatically from the 1990s onwards, reaching 1.98 times GDP in 2010 (incidentally, with regard to the figures for other countries, 0.93 times for the USA, 0.81 for the UK, 0.92 for France and 0.80 for Germany =OECD survey), giving Japan far and away the highest proportion among all advanced countries. Furthermore, government bonds account for more than 30-40% of the national budget in each fiscal year, and outstanding debt is rising further. The steep rise in the public bond balance is increasing the sense of anxiety about the future destabilization of government bond markets and whether it might not result in crowding out private capital investment funds.

Recent Economic Trends and the Future Outlook

Recent trends in the Japanese economy were introduced briefly in the overview explanation at the start of this chapter. To close the chapter, the recent economic situation will be summarized in slightly more detail.

The Immediate Post-Lehman Recession

In Japan, bank loans started to increase again from around the middle of 2005, when capital investments also turned the corner. By around the second half of 2008, GDP and capital investment were both approaching their levels before the financial shrinkage at the end of 1997. In employment, too, there were palpable signs of a long-awaited recovery; for example, the university graduate employment rate continued to rise significantly between 2006 and 2008 (both as of March 31). Then came the Lehman Shock.

The impact of the Lehman Shock dealt a severe blow to the global economy, including Japan. In Japan's case, however, the mechanism of the ensuing recession seems to have differed slightly from that in other developed nations, as explained below.

It all started with the failure of subprime loans (housing loans for low earners), the equivalent of a collapsed housing bubble, in the United States. Riding the prevailing global tide of financial instruments, these subprime loans had been securitized through complex combinations with a variety of securitized products, as a way of dispersing risk. These were then traded in large volume on the world's financial markets, ultimately leading to a loss of credit confidence that spread through the world's financial markets from around 2007. The downward spiral of confidence even affected blue chip securities, which began to lose value on the markets, until in September 2008, the major US investment bank Lehman Brothers went bankrupt. For a while after this, raging confusion on financial markets caused the entire financial system itself to cease functioning.

In other words, at the heart of the recession suffered by the US and Europe after the Lehman Shock lay financial shrinkage similar to that experienced by Japan from the end of the 1990s. For this reason, it is imagined that the deflationary effect on economic activity was both prolonged and relentless in the US and Europe. By contrast, Japanese financial institutions are thought to have held relatively small quantities of financial securities linked to US subprime loans. It would be fair to say, in fact, that hardly any shrinkage of finance (supply) was caused by financial institutions in Japan.

In that case, what made the recession in Japan increase in severity? The US recession had the effect of vastly reducing Japan's exports of automobiles and others, and this in turn caused a huge downturn in domestic production in Japan. Indeed, it was a recession caused by a fall in demand. Production output by Japan's auto manufacturing industry is relatively large, and in terms of its structure, it has strong input-output connectivity with many other industries and trades, with a broad base of supporting industries. For this reason, a decline in production due to falling export demand had wide-ranging implications for Japan's economy as a whole.

As will emerge in subsequent chapters, the Lehman Shock not only caused mass unemployment and redundancies, but also gave rise to many social problems. Firstly, many day laborers dispatched to manufacturing industries were laid off, but because workers who had moved out of company housing could not afford apartment rents, many of them started to camp out at Internet cafés and public parks in cities. This so-called "haken-mura" (temp workers village) problem later triggered a sudden increase in applications for livelihood support benefits, creating a huge political headache. Meanwhile, the employment environment for school leavers and young people had been expected to turn upwards, due to ongoing mass retirements by the "baby boomer" generation from 2007 onwards. However, the numbers hired fell sharply, ushering in another harsh employment environment.

The Impact of the Great East Japan Earthquake Disaster on Japan's Economy

Before the economy could fully recover from the Lehman Shock, the Great East Japan Earthquake disaster struck.

Worst hit by the disaster was the Tohoku region. Home to suppliers of materials and parts in the manufacturing industry, this region is a vital supporting framework for Japan as a nation of technology. The damage suffered by these manufacturers made it difficult for them to supply parts and other essential products to other companies, including some overseas, leading to suspended production and a drastic decline in utilization ratios. The Tohoku region is also one of Japan's most important centers for agriculture and fishery. The destruction of production sites and the ensuing radiation pollution caused a sharp fall in agricultural and fishery produce, or even halted shipments altogether. This not only confronted farmers in Tohoku with massive financial losses, but also led to confusion and significant impact on markets and ordinary households all over Japan.

With regard to production, domestic production suffered a historically large decrease in March 2011; the month-on-month decline of 16.2% was the worst for a single month since statistical records began. This just reveals how greatly suspended operations by auto part makers and others affected the supply of goods in the early stages after the Great East Japan Earthquake disaster.

After that, however, production recovered rapidly. It would be fair to say that such rapid recovery was brought about by the efforts of industries and individual companies, which supported each other in seconding employees to damaged affiliates and working hard to locate new sources of parts. Corporate bankruptcies in the Tohoku region increased at a heightened tempo for a while after the disaster, but since many of the affected companies were parts manufacturers and others supplying producers all over Japan, disaster-related insolvencies were spread across the whole country, rather than being concentrated in Tohoku. Furthermore, the SME Financing Facilitation Act, initially enacted as temporary legislation applicable with a time limit of one year, has so far been extended by about three years through two extensions by March 2013. This has assisted many small and medium enterprises. Thanks to these various supporting factors, domestic production activity appears not to have fallen into such a severe situation as was initially feared, and has thus been able to overcome the impact of the Great East Japan Earthquake disaster.

Where, then, did the problems occur? Firstly, in the international balance of payments. After the accident at TEPCO's Fukushima No.1 nuclear power plant, imports of crude oil and natural gas suddenly increased, causing the trade balance to fall into the red.

Moreover, the impact on agriculture, fisheries and dairy farming was by no means small, including their market conditions. As noted above, the Tohoku region is home to some of Japan's most important fishing grounds, and many of these were destroyed by the massive tsunami, or buried in rubble. Refrigeration and other facilities at fishing ports were also destroyed, making fishery activity impossible for a considerable time. At the time of writing, landed catches have yet to return to pre-disaster levels in a number of fishing ports. Meanwhile, shipments of rice, vegetables, beef, tea leaves and other produce were forcibly suspended whenever contamination by radioactive substances was discovered. They could only be resumed when the government declared them safe, in line with the Act on Special Measures Concerning Nuclear Emergency Preparedness. Even after resumption had been permitted, damaging rumors caused a protracted and ongoing slump, with wholesale prices for dressed carcasses falling to around half of the previous year's level. Combined with other damaging factors, this caused enormous economic hardship to farmers (Note 5).

The Current State of Japan's Economy under "Abenomics"

As briefly mentioned in the overview at the beginning, the policies espoused by the Abe administration from the end of 2012, in tandem with bold monetary easing by the Bank of Japan, have at the time of writing caused a significant swing toward a weaker yen and higher share prices.

What is actually going on in Japan at the moment? At least as far as this author is concerned, the aims of the economic policy set out by the new Abe administration appear to have had a positive impact on forward sentiments by investors and the public (known in economics as "expectation"). This in itself is of immense significance. This is because, as stated above, Japan has experienced repeated recessions and a long period of continuously low growth over the last 20 years or so. As a result, the sentiment that there could not possibly be a major leap forward or growth in the economy for the foreseeable future (i.e. an extremely low expected growth rate) has taken a firm hold within the national consciousness. Private capital investment, the driving force behind economic growth, has been stagnant over the long term. This is partly because the cooling down of expectation has made investors and companies feel pessimistic about future business prospects and put a brake on investment. It is also because there was a certain amount of "capital flight" overseas.

The economic policy of the Abe administration–based on the three central pillars of bold monetary policy, flexible fiscal policy and a growth strategy that encourages private investment–has been dubbed "Abenomics". While it has had a positive impact on people's expectations, Abenomics has sparked a degree of controversy among economists. Firstly, the Abe administration has asked the Bank of Japan to boost inflation, as if deflation were the cause of recession. In response, the Bank of Japan, under its new Governor, recently decided to instigate a 2% rise in consumer prices by two years from now (Note 6). But did deflation really cause the recession? Based on the rationale that deflation arises from economic activity, this economic policy would appear theoretically flawed. Secondly, is it actually possible to inflate prices through financial policy alone? An important point here is that quantitative easing itself has already been promoted for some considerable time. Even if not a "new dimension", private company bonds, CPs and other financial instruments not conventionally bought by the BOJ have been purchased in large volume as an "exceptional measure". As detailed in Note 7, the base money supply has grown to considerably large proportions. As far as this author is concerned, whether it will after all lead to an increase in capital demand by private companies, and particularly an increase in capital investment, seems an important point; this very point, one feels, will define whether Abenomics will be successful or not.

The economic policy of the Abe administration is now entering a decisive phase in determining whether it will be successful or not. Attention will be on the outcome of the "three pillars" from now on (Note 8).

Notes:

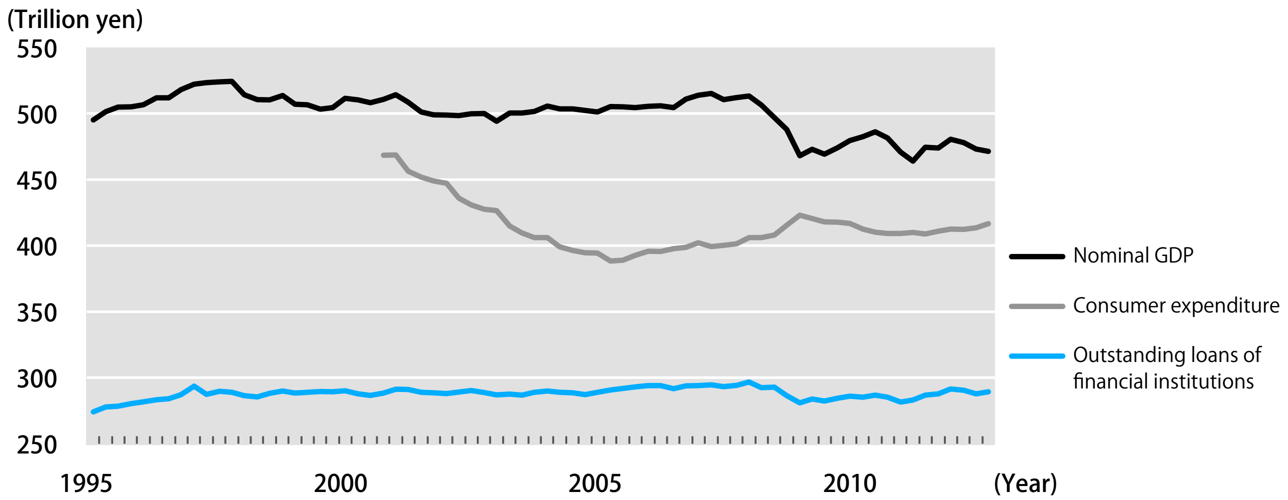
1. In Japan, the surplus in the income balance, one of the components of the current account (the balance between outgoing and incoming revenues between domestic firms and overseas subsidiaries, affiliates, etc.), has vastly expanded since around 2004. Since FY2005, it has exceeded the surplus in the trade balance, another component of the current account. As this situation is still continuing today, the current account has not fallen into the red even if the trade balance has gone into deficit recently.
2. In the USA, as early as 1933, immediately after the Great Depression, the Glass–Steagall Act was enacted, prohibiting commercial banks from investing in company shares, which was one of the causes of the depression, to achieve the separation of duties by bank type.
3. The outstanding loans of financial institutions continued to decrease from late 1997 to mid-2005. Usually, a decrease in stock data is an extremely abnormal economic phenomenon.
4. The economist J. A. Schumpeter argued in his Theory of Economic Development, the original of which was in German translated under this title in the English version, that creative destruction and innovation have an important role to play in economies. In addition, at the same time, he emphasized that credit creation is vital to innovation. In relation to this paper, which also refers to financial shrinkage, this will be a crucial point that we ought to recall.
5. A word should be added on the state of recovery and reconstruction after the Great East Japan Earthquake disaster. At the time of writing, it is already two years since the disaster struck. Although the government and affected local authorities have completed their initial disaster response measures, the reconstruction effort has yet to start in earnest. This situation was partly affected by problems in the government's administrative procedures and structures. In some more serious cases, the affected authorities were unable to formulate plans for reconstruction promotion and development stipulated by the government, because they had no employees capable of working out a blueprint and concept for reconstruction needed to start the reconstruction work. This has consequently delayed the reconstruction effort as a whole. On the other hand, delays have also arisen in some local authorities ravaged by the massive tsunami because it is taking time to secure candidate land for relocation to higher ground. Thus, the reconstruction work is generally taking much longer than expected, and the disaster-affected residents are also unhappy with delays in the recovery effort. Following the explosion at TEPCO's Fukushima No.1 nuclear power plant in Fukushima Prefecture, meanwhile, residents living near the plant were forced into temporary evacuation to avoid radiation exposure, but some of these still do not know when they will be able to return to their homes. This is further hampering the progress of countermeasures.
6. At the same financial policy decision meeting at the beginning of April 2013, it was also decided that the balance of base money supplied to the market by the Bank of Japan (see Note 7 below) would be doubled over the next two years. This would be done by expanding the objects of government bond purchase from previous levels (by including bonds with more than two years left to maturity, but sometimes also 10-year, 20-year and other very long-term bonds), and purchasing risk assets such as ETFs (index-linked exchange-traded funds) and REITs (real estate investment trusts) owned by private financial institutions, among other moves. At a press conference after the meeting, the new Governor is said to have termed these decisions collectively as "an entirely new dimension of monetary easing".
7. As one instrument of financial policy, base money (the sum of the balance of bank notes issued by the Bank of Japan and reserves deposited by commercial banks in the Bank of Japan (current deposits)) has itself been "piled up" at quite a high tempo over the last few years (see Table 1; the rate of increase was more than 6 % year-on-year from the beginning of 2009 and more than 5 % from the second half of 2010 following the renewed economic slump, and has continued to post two-digit increases since the Great East Japan Earthquake disaster in March 2011). However, the balance of deposits in commercial banks (M2, M3, etc.) has only increased by around 2%. The basic reason for this is that, even if financial institutions allocate their increased capital specifically to purchasing government bonds, etc., the increased capital is not being linked to loan for capital investment and operating capital for private companies.
8. As far as the author is concerned, the priority should above all be on fiscal discipline. If the market were to lower its valuation of Japanese government bonds, it would cause huge write-downs and asset deterioration in private financial institutions, and the financial shrinkage starting in 1997 could be repeated. However, an important point that most clearly distinguishes this situation from that one is that even the Bank of Japan now owns massive volumes of government bonds exceeding 100 trillion yen. If the government bond market were to fall significantly, the Bank of Japan would also suffer a certain appraisal loss. This would almost certainly cause mass confusion on financial markets, and in that situation, would the Bank of Japan be able to adequately fulfil its given role as the ultimate provider of finance? Partly to avoid this kind of situation, ensuring the greater soundness of fiscal discipline is just as important to Japan's economy today as flexible fiscal policy, if not more so.

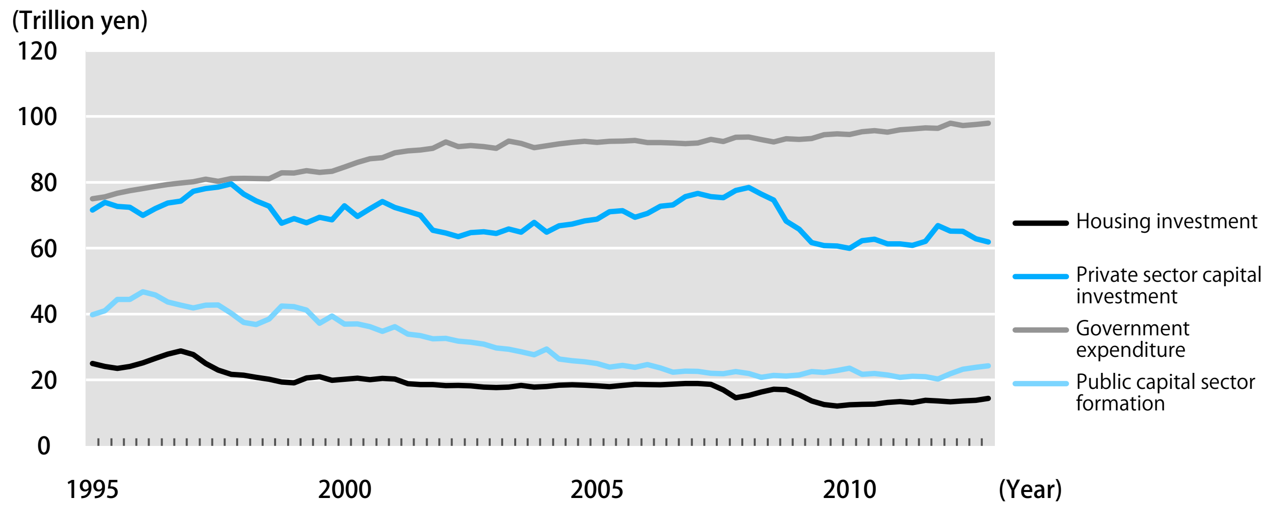
   Three points should be mentioned in this regard. Firstly, there have been media reports of ongoing confusion in the government bond market over the last few weeks. This demands some scrutiny. Is it merely, as reported in the media, a case of confusion because, for example, the structure of pre-maturity terms for government bonds subject to bidding is different to what it used to be? Or is it a sign that this "new dimension of monetary easing" by the central bank is no longer welcome, from the viewpoint of various financial institutions? The new Governor has apparently asserted a stance of valuing "dialog" with the market, and it will be indeed being challenged.

Secondly, there are also media reports that, given the current ultra-low interest rates, issues of corporate bonds have been increasing over the last month or two, mainly among large corporations, or that more companies are considering making issues. In itself, this situation is very similar to that back in early 1987, when many companies suddenly started promoting equity finance (raising capital by issuing new shares). At the time, the capital raised was appropriated to buying land and shares. This time, as well as having learnt the lessons of the asset bubble, cross-holding of shares between companies has been vastly reduced, while capital procurement based on corporate bonds is unlike that based on shares. For these reasons, the situation will probably not develop in the way it did back then. Nevertheless, still other media reports suggest that many large corporations took advantage of the historically strong yen to carry out mergers and acquisitions (M&A) of overseas companies, while the recovery of corporate earnings over the last few years has helped large corporations to pay off a lot of their interest-bearing debts. In light of this, a matter of keen interest is how the capital raised through bond issues will be used.

Thirdly, talk of the trade balance going into deficit is somewhat worrying in connection with the government bond market. A negative trade balance causes a decrease in currency supply coming into the country. For this reason if none other, under the situation that financial institutions may feel less inclined to purchase government bonds, for example, it is not beyond possibility that, seen overall, this could cause a squeeze on capital entering the government bond market.

Figure I-1 Developments in GDP, Capital Investment and the Outstanding Loans of Financial Institutions (All Nominal Values)

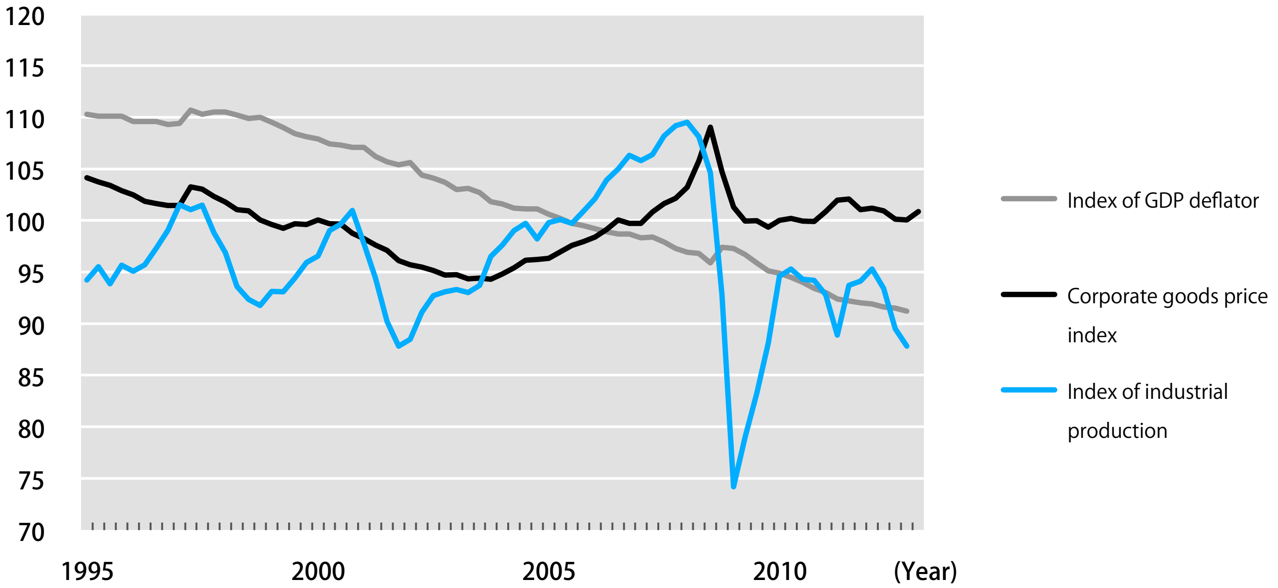




Note: Nominal GDP and each component element are seasonally-adjusted figures for each quarter. The figures for outstanding loans of financial institutions were compiled from the three-monthly average of the monthly data. In addition, it was not possible to obtain data for the outstanding loans of financial institutions before the October-to-December period 2000 on the Bank of Japan website.

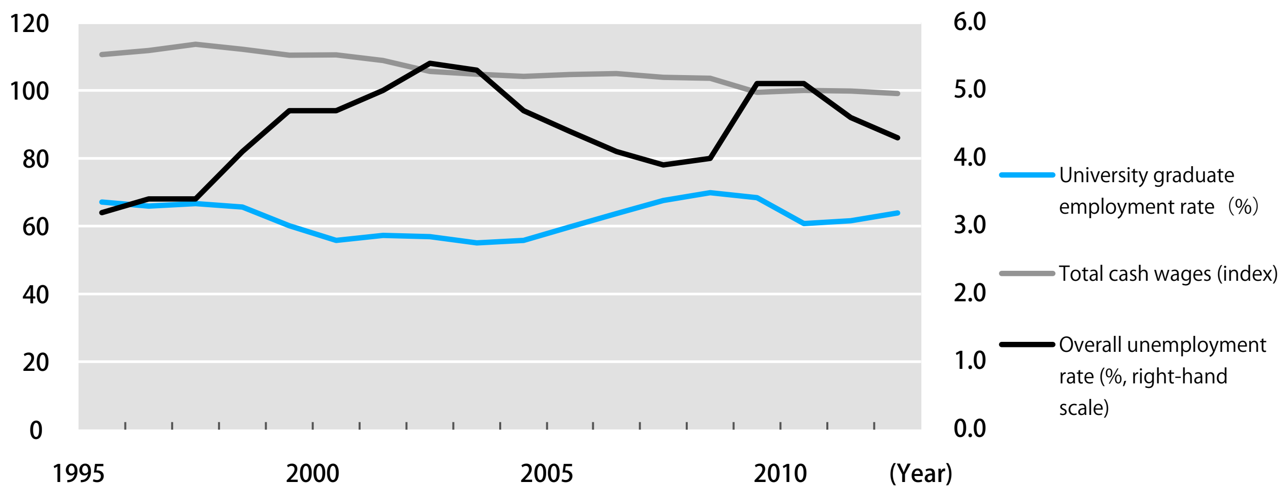
(Continued)

Figure I-2 GDP Deflator, Corporate Goods Prices and Industrial Production Indices (Seasonally Adjusted for Each Quarter)



Note: GDP deflator and industrial production indices are based on 2005 average = 100; corporate goods price index is based on 2010 average = 100

Figure I-3 Labor-related Indicators



Note: In the index for total cash wages, 2010 average = 100

Table I-4 Trends in the Trade Balance, Share Prices, the Yen Exchange Rate and Other Indicators after the Great East Japan Earthquake Disaster

	Trade balance (100 million yen)		Nikkei stock average (month-end closing price; yen)	Yen rate (Tokyo Inter-bank, central rate vs US $, monthly average	Corporate bankruptcies (year-on-year; %)	Base money (year-on-year; %)	Money supply (M2) (year-on-year; %)
		Exports (y-o-y change; %)					
2011.1	- 3,994	2.89	10,237.92	82.63	2.85	5.5	2.3
2	7,203	9.71	10,624.09	82.53	- 8.49	5.6	2.4
3	2,368	- 1.36	9,755.10	81.79	- 9.32	16.9	2.6
4	- 4,120	- 12.66	9,849.74	83.35	- 0.62	23.9	2.7
5	- 7,713	- 9.78	9,693.73	81.23	9.67	16.2	2.7
6	1,299	- 1.02	9,816.09	80.51	- 5.53	17.0	2.8
7	1,418	- 2.26	9,833.03	79.47	5.12	15.0	3.0
8	- 6,903	4.15	8,955.20	77.22	0.52	15.9	2.7
9	3,723	3.01	8,700.29	76.84	- 10.18	16.7	2.7
10	- 2,089	- 2.74	8,988.39	76.77	- 5.63	17.0	2.8
11	- 5,889	- 3.06	8,434.61	77.54	3.85	19.5	3.0
12	- 1,468	- 6.95	8,455.35	77.85	- 8.85	13.5	3.2
2012.1	- 13,897	- 8.49	8,802.51	76.97	- 2.56	15.0	3.1
2	953	- 1.95	9,723.24	78.45	10.41	11.3	2.9
3	- 12	7.29	10,083.56	82.43	- 0.10	- 0.2	3.0
4	- 4,371	11.13	9,520.89	81.49	- 7.53	- 0.3	2.6
5	- 8,049	11.56	8,542.73	79.70	5.08	2.4	2.2
6	1,122	- 1.46	9,006.78	79.32	- 12.59	5.9	2.3
7	- 3,761	- 7.45	8,695.06	79.02	- 2.28	8.6	2.3
8	- 6,636	- 5.25	8,839.91	78.66	- 12.18	6.5	2.4
9	- 4,747	- 10.54	8,870.16	78.17	0.59	9.0	2.4
10	- 4,513	- 5.98	8,928.29	78.97	6.07	10.8	2.3
11	- 8,508	- 4.04	9,446.01	80.87	- 3.40	5.0	2.1
12	- 5,723	- 6.89	10,395.18	83.64	- 4.74	11.8	2.6
2013.1	- 14,798	6.76	11,138.66	89.18	- 10.20	10.9	2.7
2	- 6,713	- 3.31	11,559.36	93.21	- 12.09	15.0	2.9
3	- 2,224	0.33	12,397.91	94.75	- 19.62	19.8	3.1

2 Recent Features of the Labor Situation in Japan

Trends in the Japanese economy since the collapse of the bubble

After falling into recession with the collapse of the bubble in the 1990s, Japan's economy came out of recession by eliminating the "three excesses" (equipment, employment and debt) in the early 2000s, following a period of severe restructuring. The economy then expanded for 69 consecutive months from February 2002, outstripping the 57-month growth recorded during the economic boom in the late 1960s to reach a new record high. Nevertheless, the real growth rate in GDP (gross domestic production) during this period remained low at 2%. This was markedly lower than the 10% registered during the period of high growth, revealing a certain lack of vigor in the economy.

The global financial crisis triggered by the collapse of the US investment bank Lehman Brothers in autumn 2008 caused a major contraction in the Japanese economy, which recorded two straight years of negative real growth in GDP in fiscal 2008 and 2009. In the meantime, the economy was starting to correct itself, albeit somewhat weakly, with a recovery in exports from around spring 2009.

But just then, the Great East Japan Earthquake struck the Japanese archipelago on March 11th, 2011. Besides the immediate damage, other problems including interrupted parts supplies, the nuclear reactor accident and restrictions on the power supply cast a dark cloud over the Japanese economy. And although the economy subsequently returned to the path of recovery, progressive currency appreciation from summer 2011 and the global economic slowdown caused by the European debt crisis inevitably made the pace of that recovery extremely lethargic.

In the General Election at the end of 2012, the Liberal Democratic Party returned to power at the head of a coalition government, and embarked on an economic policy founded on bold monetary easing. The markets reacted to this policy, dubbed "Abenomics" after the name of the Prime Minister, and the Japanese economy suddenly turned to currency depreciation and rising share prices. However, a counterreaction to this started in June 2013, when share prices fell sharply. The policy of monetary easing is merely "the first shot"; the search is on for a "growth strategy" that will put the economy on track for real growth. At the same time, the future direction for employment and labor to meet this growth has also surfaced as a focal point of concern.

Trends and characteristics of the employment situation

Looking back over the employment situation during this period, the problem of unemployment was aggravated by major financial collapses in 1997, causing the overall unemployment rate to post a record high of 5.5% in April 2003 and an equally high level of 5.3% in calendar year 2003. The unemployment rate improved during the subsequent economic recovery and was trending in around the 4% range between 2004 and 2008. However, the storm of global recession triggered by the Lehman shock brought an unprecedentedly sharp deterioration in employment, taking the unemployment rate back to the 5% level for two straight years in 2009 and 2010.

The Great East Japan Earthquake of March 2011 caused considerable setbacks to employment and labor in the three affected prefectures of Tohoku, where the total number employed fell from the previous figure of 2.75 million to 2.60 million at one point. And although the government's employment support and job creation measures are starting to improve the situation, there is nevertheless concern over the impact of a population exodus; problems of mismatches in occupations, gender and other factors have also emerged.

The national unemployment rate has been gradually improving from the aftermath of the

Lehman shock, registering 4.5% in 2011 and 4.3% in 2012.

Upheaval in the Japanese-style Employment System

Perceptions of the "Japanese-style employment system", founded on the practice of long-term employment, went through a major upheaval during this period.

The context for this goes back to the time of the oil crisis in autumn 1973. The crisis brought an abrupt end to the "golden sixties" enjoyed by leading capitalist states, and western nations sank into a combined morass of "stagflation" (stagnation + inflation). In contrast to these, however, Japan continued steady growth throughout the 1970s and 80s, eventually becoming the biggest trading nation in the world. At the conclusion of the "Plaza Accord", an agreement on currency adjustment designed to address Japan-US trade friction, Japan was enjoying an unprecedented bubble of prosperity. To unravel the secret of Japan's economic prosperity, in such stark contrast to the stagnation of the west, experts in various fields, in both Japan and abroad, focused their attentions on "Japan research" in the 1980s. In the process, interest leapt on the Japanese-style employment system, with its central pillars of long-term employment, wages based on seniority and in-house unions.

However, this bubble of prosperity burst, taking the Japanese economy into a protracted slump in the 1990s. This changed everything, and from then on the Japanese-style employment system came under fire from all sides. The traditional system was now nothing more than a millstone holding up the "structural reform" of Japan's socio-economy. As this kind of sentiment suddenly took shape, reform of the Japanese-style employment system and its core principle of long-term employment, as well as labor relations, wage policies, labor policies and others connected with it, came to be seen as an indispensable task for "structural reform".

But what exactly was the much-discussed Japanese-style employment system? In short, it could be interpreted as the employment practice of training and using regular employees over the long term in the internal labor market. It was developed during the period of high economic growth and became established in the 1970s.

Various employment-related systems then sprang up to fit this internal labor market. On the assumption of guaranteed employment until retirement age, new graduates were regularly hired, employees were rotated through "flexible relocation" with no specified job contents, and training was done on the job. A system of seniority, whereby wages and promotions were based on the accumulation of work performance ability, was made the cornerstone of personnel and wage management. Even in a recession, companies made every attempt to avoid releasing regular employees, preferring measures such as transferring or re-training surplus personnel, or disadvantageous changes to labor conditions.

In collective labor relations, meanwhile, industrial unions independent of companies were the mainstream in Europe, but failed to take on in Japan, where in-house unions suited to the internal labor market took the leading role.

Even government employment policies were rooted in measures designed to keep employees within the embrace of companies as far as possible. When business contraction became inevitable owing to recessions and the like, the government would mainly use "employment adjustment subsidies" to subsidize companies' costs in maintaining employment through leave of absence, training or secondment of employees.

Under the pressure to reform, the Japanese-style employment system based on these features went through violent upheavals, while at the same time "distortion" arising from the reforms also surfaced. Since then, there has been an ongoing debate on the future direction of employment and labor, as one of the top priority issues facing Japanese society today.

Expansion of Non-regular Labor and the Problems of Young Workers

From the mid-1990s onwards, companies rigorously cut back on their numbers of full employees earmarked for career development, and started to make broader use of non-regular employment. This was one of the measures they took to reduce overall personnel costs.

In 1995, the Japan Federation of Employers' Associations (as it was then; amalgamated with the Japan Federation of Economic Organizations in 2001 to form the present Japan Business Federation) published a report entitled "Japanese-Style Management in the New Age". Today, this report is accorded the status of a "historical document", as an indicator of the expansion of non-regular employment. The report divides company employees into three types. Employees under the practice of long-term employment were called the "long-term accumulated ability utilization type", and these were seen as continuing to form the nucleus of corporate human resources. However, the report suggests that numbers of employees in this type will be narrowed down through rigorous selection, and instead, ratios of employees in the other two types (i.e. the "advanced specialist ability type" and the "flexible employment type") will be expanded. Moreover, personnel and wage management for these will differ from those applied to workers under long-term employment.

As if to coincide with the publication of "Japanese-Style Management in the New Age", employment formats have become increasingly diverse since then. The ratio of non-regular employees to all persons in employment rose rapidly from 20% in 1995, and has today reached a level in excess of 35%.

A serious issue, however, is the rise of the non-regular employment format known as "freeters". These are young people who are unable to find employment as full employees, as companies suddenly reduced their intake of new graduates amid the protected recession, and instead drift aimlessly on the labor market. The biggest problem facing these young freeters is that, as they are excluded from the opportunities for vocational ability development available to regular employees, they have no hope of improving their skills even after working for a long time. Thus they have few opportunities to engage in work at a more advanced level, and as a result have no prospects for increasing their income in the future. Unlike in western countries, opportunities for vocational training of workers in Japan are mainly provided within companies. In terms of accumulating vocational ability, exclusion from this in-house training has such negative consequences as to be life-defining.

In Japan, the unemployment rate of young people, traditionally low, has deteriorated since the middle of 1990. A widening of the income gap between young age groups is beginning to be conspicuous, and there are now concerns that it will become established and will further expand. Because many non-regular workers lack the financial means, they tend to marry late or not at all. As such, the expansion of non-regular labor has come to be regarded as a factor obstructing measures to combat the declining birth rate and population aging - identified by the Japanese government as its most important policy target.

The Correlation between "Guarantees" and "Constraints"

There is no shortage of problems facing regular workers, either. Against a background of personnel cuts, many regular workers are compelled to work long hours, a trend most conspicuous amongst males in the prime working ages between 30 and 40. Karoshi (death from overwork) and mental health disorders, fomented on the hotbed of long working hours, have long been established as social problems in Japan. But the problems do not end there. Male workers have less time to spend on housework and child rearing, and instead, the burden of chores falls on the shoulders of their partners.

The ratio of childcare leave taken by female workers is gradually rising, and has passed 80% recently. However, the proportion of women quitting their jobs to have babies has reached 60%. Therefore, if the total number of female employees due to give birth is taken as the denominator, the rate of taking childcare leave in real terms is only just over 30%. Considering attempts to improve the efficiency of home life, female workers will inevitably think twice about the working style of regular workers, with the strong constraints it involves. When it comes to marriage and raising children, they are pressed by a choice between two options - whether to continue working in regular employment, or not.

Regular workers enjoy the strong support of their employers in terms of employment guarantees, but on the other hand, cannot easily refuse overtime orders or re-assignments against the company's wishes. Firm guarantees of employment are therefore counterbalanced by a large degree of constraint by the company. In other words, they can be said to have strong "guarantees" but also strong "constraints". By contrast, non-regular workers are rarely forced to work overtime or to change the location of their work. However, their employment guarantees are so weak as to be incomparable with those of regular workers. In other words, they can be said to have weak "guarantees" but also weak "constraints". Regular and non-regular working styles are clearly divided from each other by the barrier of this correlation between guarantees and constraints.

The very nature of employment practices lies behind the decrease in rates of marriage and childbirth, and there is a growing perception that a reform of employment practices is also necessary for the sake of measures to combat the declining birth rate. Measures for working people, liberating them from choosing between the two options of regular or non-regular employment and making their employment terms continuous, are being brought to the table for discussion, as is the creation of schemes to make it easier for workers to move between the two formats.

Labor Policies of "Abenomics"

As part of its "Abenomics", the LDP-led coalition government formed at the end of 2012 compiled a "Labor Policy for Growth" in June 2013. It includes plans to create a manual on "limited full employees" (limited to specified jobs and regions) in mid-FY2014, with a view to spreading this format. This is an attempt to expand schemes for full employees within a separate framework from conventional full employees, with their strong degree of constraint, and could be seen as a proposal to open up the bottleneck of the choice between regular and non-regular work. Labor unions do not in principle oppose the creation of this scheme in itself. Nevertheless, they warn that the scheme of "limited full employees", while weakening the "constraint" from companies, has the associated characteristic of creating full employees with weaker "guarantees", and that "this could become a trigger for easing regulations on dismissal and making it easier to dismiss full employees".

"Abenomics" reveals an attitude of shifting the fulcrum of policy from "maintaining employment" to "promoting job changes". It stresses the need to shift labor from mature industries to growth industries, and sets out to reduce the "employment adjustment subsidy" used to support companies that protect employment during a recession, increase "labor mobility support subsidies" paid to companies that transfer employees using private-sector employment agencies, and reverse the budget scales of these two.

In any case, this is an issue touching on the very core of the Japanese-style employment system, and debate continues, while reviewing the course of "reform" since the mid-1990s.

Reform and Revision of Wage Systems

The "Japanese-Style Management in the New Age" report by the Japan Federation of Employers' Associations advocated a revision of wage systems for full employees as an important means of reducing a company's "total personnel costs", alongside the diversification of employment formats. Since then, the number of non-regular workers has grown but there has been continuous downward pressure on the wages of regular workers, through the medium of revised wage systems. As the specific content of reform, particularly noteworthy examples include the introduction of wage systems reflecting performance and outcomes, the reduction or abolition of regular pay rises, and linkage between corporate performance and bonuses.

One conspicuous characteristic of the period of economic expansion after the protracted recession was that, while large corporations continued to earn record profits, improvements to workers' wages were slower to materialize. It was described as "economic recovery with a hollow ring". The fruits of economic growth were not reinvested in the lives of ordinary workers, and as a result, consumer demand showed no growth. Apart from capital investments, economic recovery has a strong tendency to be led by increased exports. When the global financial crisis struck in autumn 2008, the Japanese economy should already have overcome its own financial crisis; nevertheless, this very dependency on exports could be seen as the reason why Japan suffered a bigger blow than expected, in comparison with other countries.

For "Abenomics" to achieve its policy effect of launching a recovery in the real economy, it will require an expansion of household consumption, which accounts for 60% of gross domestic expenditure. Just before the round of wage negotiations in spring 2013 (the 2013 *shunto* or "spring offensive"), Prime Minister Abe asked the heads of business organizations to increase workers' wages, as they are the wellspring of consumption. This was a highly unorthodox approach for the government, which normally remains neutral in labor negotiations, and was given considerable media coverage as a result.

That notwithstanding, changes to wage systems, which started in earnest from the beginning of the 2000s, have caused a lot of confusion in sites of employment. In many cases, they have had a negative effect on employee incentives. The "excessive introduction" of performance and outcome-linked pay has provoked a barrage of criticism that "teamwork in the workplace has worsened" and "the evaluation of conditions and processes is being neglected", among others. Moves to correct this trend have also been notable.

In any case, one thing for certain is that progress has been made in the "personalization of wages" reflecting the individual worker's performance, outcomes and working attitudes in pay and conditions.

The Transformation of the *Shunto* System

The *shunto* system, a uniquely Japanese system of deciding wages, could be called the showpiece of the postwar labor movement. In most European countries, labor and management negotiate wages for sectors and industries in regional or national units. In Japan's case, this is basically done between labor and management on an individual company basis. Instead, individual company unions form alliances in different industries, and the unions in each industry start pay rise negotiations at around the same time. This has the effect of forming and spreading agreed rates of pay rises. After its beginnings in 1956, this *shunto* system rode the wave of high-level economic growth to grow and become established, resulting in standardized wage levels for workers and contributing greatly to the expansion of domestic demand in the Japanese economy. The *shunto* system also served as a springboard to accelerate high-level growth.

However, this system differs in essence from the style of systematic negotiation and forming agreements laterally across companies. Since the 1990s, the labor market has changed dramatically from the state of labor shortage pertaining until then; there has been conspicuous variation in corporate performance, even within the same sector, and with the advance of "personalized wages" following the reform of wage systems, the function of the *shunto* system in forming and spreading agreed rates of pay rise has weakened. Instead, "the theory of companies' ability to pay" has been thrust to the fore as a determining factor affecting pay rise trends.

The transformation of the *shunto* system has also served to accelerate the "widening gap" between workers.

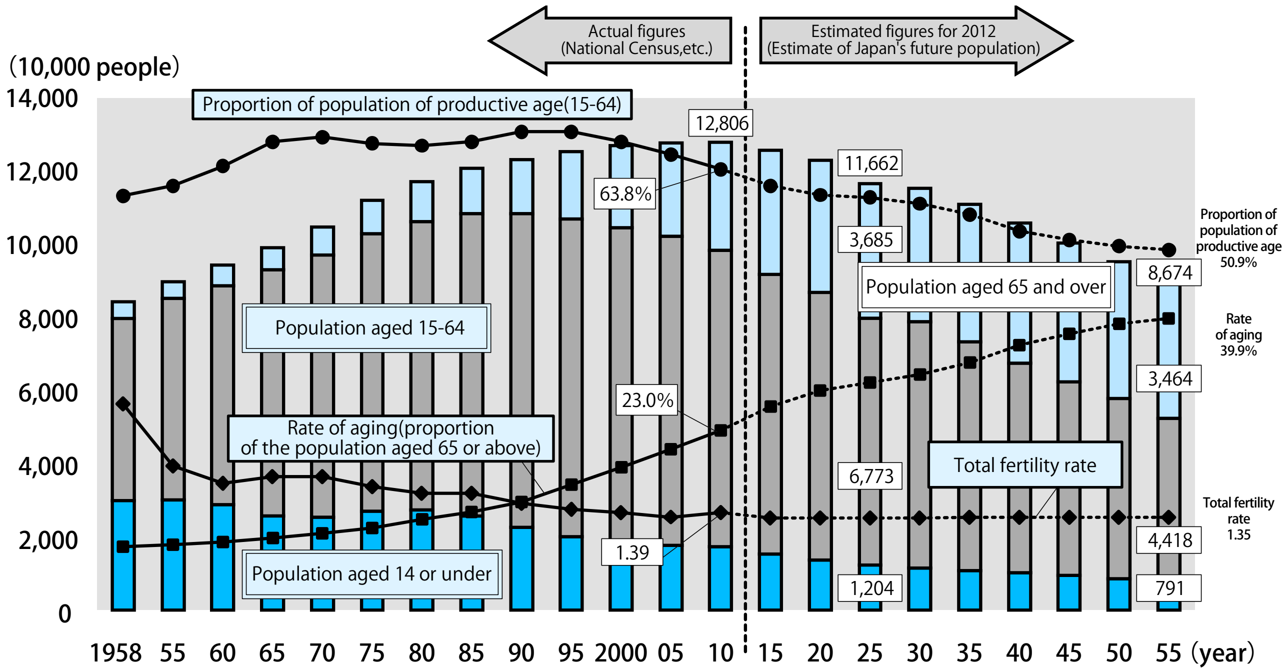
Reconstructing the System of Collective Labor Relations

There is also pressure to reconstruct the system of collective labor relations. The unionization rate of labor unions continues to fall; in 2003 it slipped below 20%, and by 2012 had fallen to 17.9%. In Japan, where individual company unions are the norm, the overwhelming majority of unions limit their members to regular employees, and despite the dramatic increase in non-regular workers, they are decidedly slow to join unions. From the beginning of the 2000s, various unions have started to unionize non-regular workers, thanks to encouragement by national centers, and signs of positive results are starting to be seen. Nevertheless, the unionization rate of part-timers is still only in the 5% range.

Japan's labor legislation consists of a two-tiered structure, whereby minimum working conditions are decided by law, and working conditions above this level are decided through labor negotiations. Besides non-regular workers, many workers in small and medium enterprises do not belong to labor unions either; in the case of small companies with less than 100 employees, the unionization rate is only about 1%. In Japan's case, moreover, it is very rare to find cases of labor agreements being applied beyond the range of union members, as seen in Germany, France and other European countries. The rate of application of labor agreements to the general workforce is extremely low. Labor negotiations have to be instigated to raise minimum working conditions above the levels determined by law, but for many workers, even that is out of the question. The essential content needed for deciding working conditions has been hollowed out, and the provisions of labor legislation have become little more than a façade.

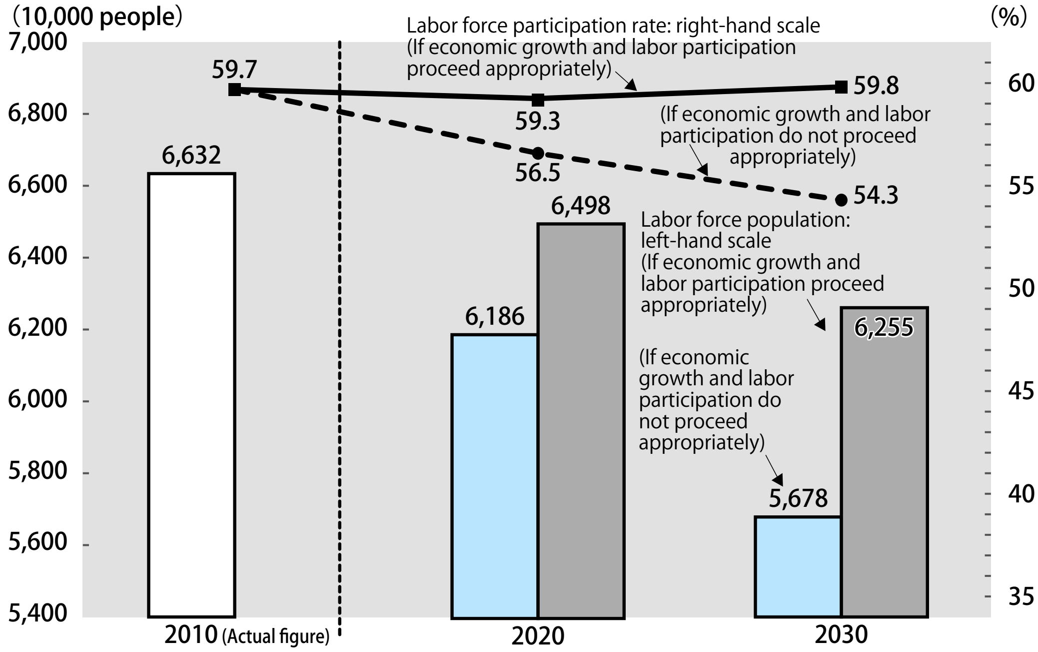
So what can be done to create a system of collective labor relations that also reflects the interests of non-regular workers? Japan is now at the stage where this should be discussed, together with the future directions for labor union legislation, taking account of new laws for employee representative systems found in European countries.

Figure I-5 Trends in Japan's Population



Source: Ministry of Internal Affairs and Communications, ***Population Census and Population Estimates***
National Institute of Population and Social Security Research, ***Population Projections for Japan (Jan. 2012 estimates): Medium Fertility (Medium Mortality) Projection*** (population as of Oct. 1 each year)
Ministry of Health, Labour and Welfare, ***Vital Statistics***

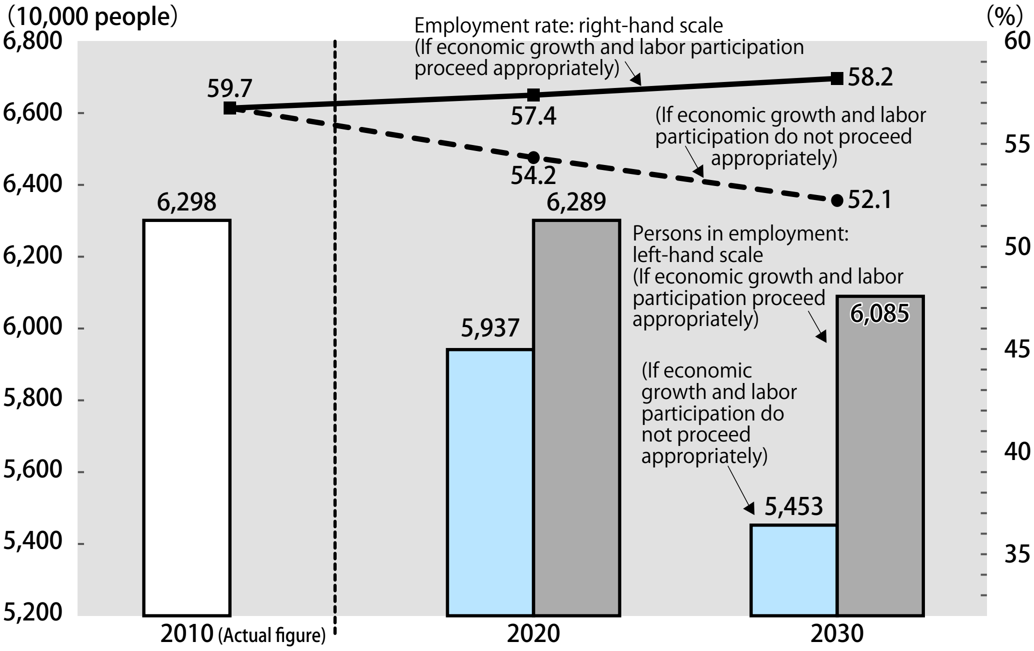
Figure Ⅰ-6 The Outlook for the Labor Force Population and the Labor Force Participation Rate



Sources: Actual figures for 2010 – Ministry of Internal Affairs and Communications, ***Labour Force Survey***, calculated from intercensal adjusted figures based on (new) standard population
Figures for 2020 and 2030 – JILPT estimates

Note: Estimates are made by JILPT using the National Institute of Population and Social Security Research, ***Population Projections for Japan (January Estimates): Medium Fertility (Medium Mortality) Projection***

Figure I-7 The Outlook for Number of Persons in Employment and the Employment Rate

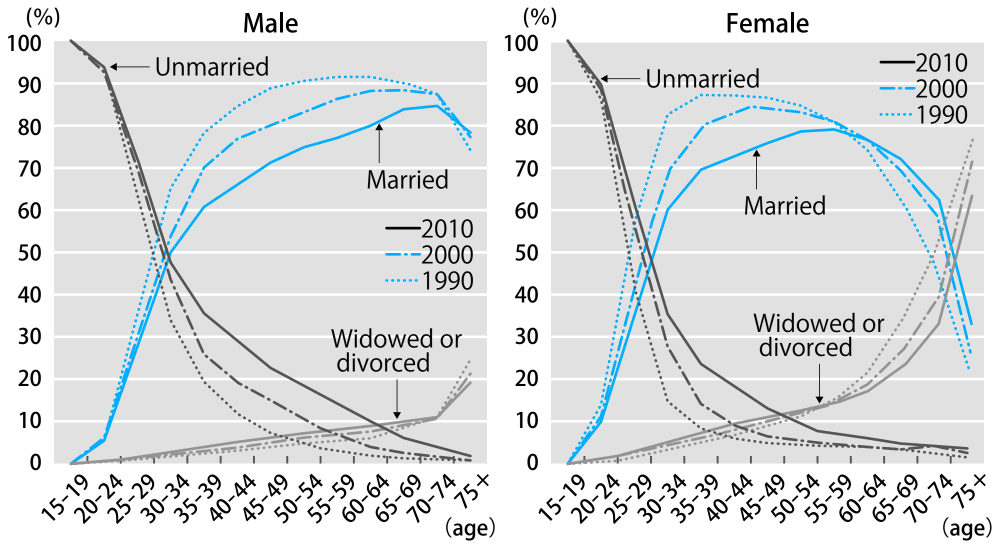


Sources: Actual figures for 2010 – Ministry of Internal Affairs and Communications, ***Labour Force Survey***, calculated from intercensal adjusted figures based on (new) standard population
Figures for 2020 and 2030 – JILPT estimates

Note: Estimates are made by JILPT using the National Institute of Population and Social Security Research ***Population Projections for Japan (January Estimates): Medium Fertility (Medium Mortality) Projection***

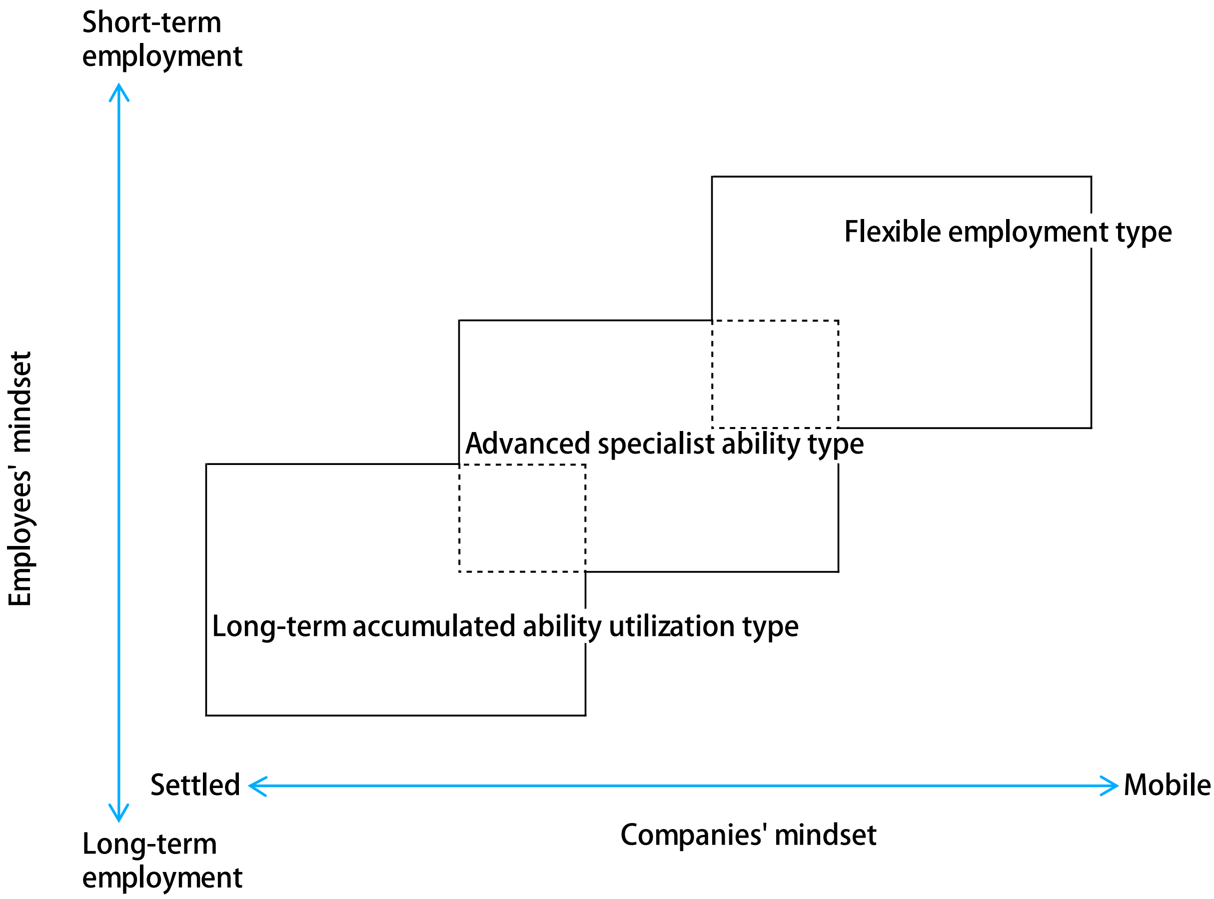
Figure I-8 Trends in the Unmarried Ratio by Age Group

The unmarried ratio is rising in all age groups for both males and females. For example, the unmarried ratio for males aged 30-34 was around 30% in 1990 but has now risen to around 50% .



Source: Compiled with reference to Ministry of Internal Affairs and Communications, ***National Census 2010***

Figure I-9 Classification of Employees by Employment Format



Main content of conditions by employment format

	Long-term accumulated ability utilization type	Advanced specialist ability type	Flexible employment type
Employment format	Open-ended contract	Fixed-term contract	Fixed-term contract
Target personnel	Management, career-track, core workers in skilled divisions	Specialist divisions (planning, sales, R&D, etc.)	Non-career track Skilled divisions Sales divisions
Wages	Monthly or annual salary Ability-related Incremental	Annual salary Performance-related No increments	Hourly pay Job-related No increments
Bonuses	Fixed rate + performance-based slide	Allocation by results	Fixed rate
Retirement pay, pensions	Points system	None	None
Promotions and upgrades	Promotion to management Upgrade of professional qualifications	Performance evaluation	Conversion to higher post
Welfare measures	Comprehensive livelihood measures	Livelihood support measures	Livelihood support measures

Source: "Japanese-Style Management in the New Age" Report
Japan Federation of Employers' Associations, 1995