

Key topic**Measures Required to Achieve Sustainable Wage Hikes: MHLW's White Paper on the Labour Economy 2023**

In Japan, while labor productivity has been increasing to a level comparable with other countries, real wages have remained almost flat due to changes in companies' distribution of profits, bargaining power between labor and management, and the composition of employees. The Ministry of Health, Labour and Welfare (MHLW) published the White Paper on the Labour Economy 2023 and stated that the increase in wages has a positive effect on consumption on a macro level. Toward achieving sustainable wage hikes, it pointed out that measures should be taken, such as passing cost increases to prices, improving an environment to promote business start-ups, facilitating the conversion of non-regular workers to regular workers, and implementing the principle of equal pay for equal work.

I. Current status and issues of wages**1. Wage trends****A gap between growth in nominal labor productivity and growth in nominal wage**

The white paper first reviewed the trends in productivity and wages over the past 50 years. Nominal labor productivity and nominal wage, for which the effect of price fluctuations is not taken into consideration, continued to increase almost consistently from 1970 until the first half of the 1990, but their growth slowed down from around the middle of the 1990s. Since then, the growth in nominal wage did not keep pace with the growth in nominal labor productivity, leaving a gap between them. According to international comparison, both nominal wage and nominal labor productivity per

capita have been growing since 1996 in countries such as the United Kingdom and the United States, whereas they have been going sideways in Japan (Figure 1). In real terms, labor productivity has been increasing to a level comparable with other countries, but real wages have remained almost flat. In all industries, the growth in nominal wage in Japan has not been as large as in other countries (Figure 2).

It is said that Japanese wages are less sensitive to labor productivity but more sensitive to the unemployment rate. An increase in nominal labor productivity per capita by 1% led to an increase in nominal wages per capita by around 1% in the United States but an increase only by 0.4% in Japan. On the other hand, when the unemployment rate increased by 1 percentage point, nominal wage per capita decreased by 0.3 percentage points in the United States but they decreased by around 1.1 percentage points in Japan. The white paper explained that in Japan, although it should be noted that wages are not reduced as much as a productivity decline, the growth in wages did not keep pace with the growth in productivity during the phase of productivity growth, when compared with the United States. It also pointed out that while the sensitivity of the wage growth rate to the employment situation is high, the wage growth rate has been kept at a low level along with the unemployment rate.

Factors that pushed down the real wage growth rate

To see the background to the changes in wages per capita, the white paper broke down these changes into those in terms of "hourly productivity," "labor

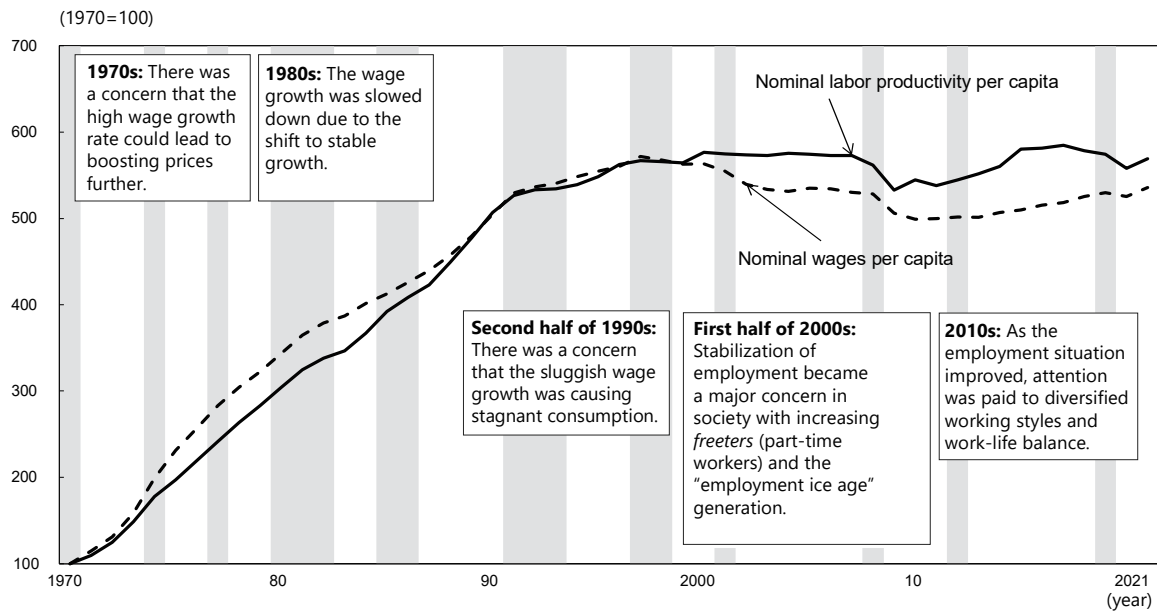


Figure 1. Trends in nominal labor productivity and nominal wage per capita (1970–2021)

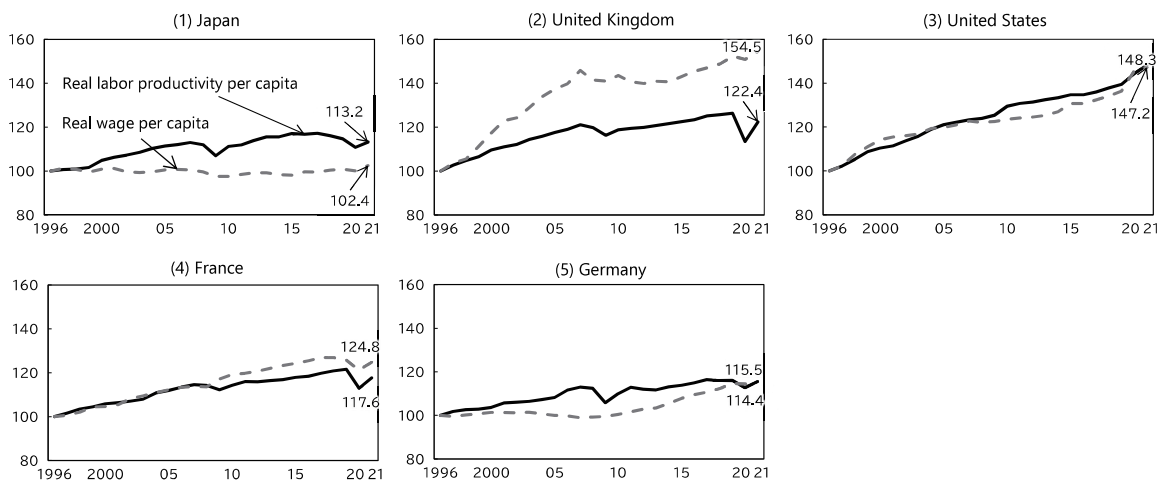


Figure 2. International comparison of nominal labor productivity and nominal wage per capita (1996=100, international comparison)

hours,” and “labor share.” Japan achieved growth in real labor productivity per hour by around 20% as in the case of the United Kingdom, France, and Germany. The white paper pointed out that this may be due to the ongoing downtrend of commodity prices. As the factors that pushed down the real wage growth rate, the white paper indicated the deterioration of trade terms, in addition to the decrease in labor hours and the decline in labor share.

It also pointed out that the decrease in labor hours is largely due to the increase in the percentage of part-time workers.

A significant decline in the labor share over the past 20 years

The white paper defined the labor share as “compensation of employees per employee divided by the GDP per worker” and compared the trends in

Japan and in other countries. It is necessary to be careful in comparison because the values of the labor share depend on the definition. See the column at the end of this article for the labor share according to various definitions.

The labor share in Japan has been constantly on a declining trend. The decline in the labor share in Japan during the period between 1996 and 2020 was large among OECD countries. The most recent level of the labor share in Japan was lower than other countries. By industry, the labor share was at a low level in “finance and insurance,” “accommodations, eating and drinking services,” and “public health and hygiene, social welfare and care services.” Based on the analysis on these points, the white paper stated that it is important to continue efforts to increase productivity to increase wages.

2. Background to sluggish wage growth

The white paper analyzed the background to the sluggish wage growth in Japan in terms of five factors. The first factor is the changes in distribution of profits by companies. The white paper pointed out that companies’ internal reserves have been increasing due to the increase in added value, explaining that the background factor for this trend is companies’ deep uncertainty over the future.

The second factor is the changes in bargaining power between labor and management. The white paper indicated the decline in the unionization rate and the rise in the percentage of labor markets where employees are concentrated in a particular company (concentration of business control in each labor market). When labor markets in Japan were divided into about 4,400 by subcategory in industrial classification and by prefecture, the percentage of labor markets where the concentration level was particularly high increased over the four years from 2012 to 2016. As the market concentration intensifies, companies have more bargaining power, causing a downward pressure on wages. Meanwhile, as the unionization rate increases, workers have more bargaining power, causing an upward pressure on wages.

The third factor is the changes in the composition

of employees in terms of employment status and age group. These changes have different effects on wages depending on the period. Looking at how these changes affected the average wage, during the period between 1996 and 2019, the increase in the number of part-time workers consistently had a negative effect on wages. During the period between 1996 and 2012, the increase in the number of employees aged under 60 had a strong negative effect on wages. During the period between 2012 and 2019, the increase in the number of employees aged 60 or over had a strong negative effect on wages.

The fourth factor is the transformation of the Japanese employment practice, which is characterized in that wages for regular employees in large companies take on the characteristic of living wages under the life-long employment system and are based on seniority, increasing according to the length of service. If many people still work under such employment practice and the tenure-wage profile is flat, this may have a downward effect on wages on a macro level. Has the Japanese employment practice changed? To see the situation of employees in long service, the white paper focused on regular employees who entered the company at a young age and continue to work for the same company, so-called *haenuki* employees.

The proportion of *haenuki* employees among regular employees, which has been on a declining trend over a long term, was about 30% of regular employees with a high school degree and 60% of regular employees with a university degree in 2021. The tenure-wage profile of *haenuki* employees was notably flat among employees with a university degree or higher education in large companies. This may be due to the decline in the percentage of employees with a university degree or higher education who have been working for the same company for 16 years or more (aged around 40), particularly among those in managerial positions. Employees who have worked for long enough to become managers may be held back in promotion because managerial positions available to them are limited due to the aging of the workforce in the company. The white paper indicated that the sluggish

wage growth due to the delay in promotion among regular employees with a university degree was observed for large companies where the characteristics of the Japanese employment practice are noticeable.

The fifth factor serving as the background to the sluggish wage growth is diversification of workers' needs. The composition ratios of workers have changed. While the percentage of males aged under 60 significantly decreased, the percentage of females under 60 increased. The percentage of males and females aged 60 or over also increased. However, most women and elderly people who are seeking jobs wish to find jobs as clerical workers and carrying workers or cleaning workers, which are offered relatively low wages. This may have led to pushing down the wages for these jobs due to the decline in the job openings-to-applicants ratio. According to the analysis of the conditions desired by job seekers, while wage is still the most important condition, other conditions such as days-off and job relocation are now also considered as important. The white paper analyzed that as job seekers give more weight to work conditions other than wage, the degree of importance of wage declines relatively, which may result in putting a downward pressure on wage.

II. Economic impact of wage hikes

1. Impact on companies and workers

A wage increase has a positive impact on companies and workers. The white paper pointed out that wages offered for job seekers affect the status of job applications. For example, if the lower limit of the offered wage is higher by 5% or more than the minimum wage, the number of applicants introduced to full-time jobs within three months increases by about 10%. Wage hikes also have an effect of decreasing the job separation rate. According to the MHLW Survey on Employment Trends, 2021, in relation to the question about the reason for quitting the previous job, "low wage" accounted for a high percentage along with "poor working conditions" and "personal relationships at the workplace," if involuntary reasons (e.g., the mandatory retirement, termination of the term of contract, reasons on the

part of the company) and personal reasons are excluded. When the Japan Institute for Labour Policy and Training (JILPT) asked the companies that gave their employees across-the-board pay raises (888 out of 2,450 respondents) about the effects of pay raises they recognized, about 40% mentioned "increase in motivation among the existing employees" and labor 20% mentioned "decline in the separation rate" (JILPT 2024). In view of such survey results, the white paper pointed out the possibility that wage hikes may have a positive impact on workers' motivation for work and personal development.

2. Impact on economy

The white paper indicated that wage hikes have a positive impact on consumption on a macro level. According to its analysis, regular pay for full-time workers has a strong impact on the rate of consumption growth expected when elements such as the amount of wage and the number of workers increase by 1%. The white paper also pointed out the effect of an increase in the amount of wage or salary in increasing production and employment. Specifically, it showed an estimate that a 1% wage increase for all workers will increase the production amount by about 2.2 trillion yen, employment by about 160,000 persons, and compensation of employees by about 500 billion yen.

III. Toward achieving sustainable wage hikes

1. Situation of wage hikes at companies

More than 90% of the companies raised wages

The white paper analyzed the wage policy for raising wages in a sustainable manner and the effect of such a policy. How many companies and what kind of companies raised wages for their employees? Based on the abovementioned JILPT 2024 ("Survey on Companies' Wage Determination" conducted in January to February 2023, asking the situation as of December 2022), the white paper reviewed how companies' economic prospects and cost pass-through are related to wage hikes, and the circumstances in which companies determine wages.

Among the surveyed companies, more than 90% raised wages and more than half increased regular pay and summer bonus per employee. The companies that experienced an increase in terms of the total sales, operating income, ordinary income, and labor productivity over the past three years tend to give their employees across-the-board pay raises or temporary pay raises, when compared to the companies that experienced a decrease in terms of these factors. Furthermore, the percentage of companies that gave across-the-board pay raises or temporary pay raises was higher among the companies that presented a prospect of increase in the total sales and other factors than among the companies that presented a prospect of decrease.

Positive correlation between cost pass-through and wage hikes

According to JILPT 2024, while only slightly more than 10% of the surveyed companies were able to pass through more than 80% of their cost increases to prices, the companies that were not able to achieve a cost pass-through accounted for as much as 30%. The higher the degree of cost pass-on, the higher the percentage of enterprises that have achieved across-the-board pay raises or temporary pay raises. As the reason for not being able to achieve a cost pass-through, the percentage of “the sales would decrease if prices were raised” was the highest at about 34%. The white paper maintained that it is important to encourage companies to pass through cost increases to prices appropriately and develop a climate and environment in society that facilitate wage hikes by companies, so that companies will sell and purchase goods and services at fair prices.

Positive correlation between the business start-up rate and the wage growth rate

A positive correlation was observed between the business start-up rate and the labor productivity growth rate as well as between the business start-up rate and the wage growth rate. The white paper stated that although these correlations do not always represent cause-and-effect relationships, there is a possibility that the initiative to create an environment

where start-up companies that are expected to promote innovations can actively start and develop business will drive productivity, resulting in wage increases. Compared with OECD countries, Japan’s business start-up rate is low. Although simple comparison is difficult due to the difference in the definition, looking at the long-term trends, the business start-up rate was most recently around 10% in the United Kingdom, France, and the United States, and 7% even in Germany, where the rate is comparatively low. The business start-up rate has remained at a lower level in Japan, slightly less than 5% in 2021. The white paper pointed out the possibility that this may be attributed to Japanese societal trends. It is necessary to build a mechanism where starting business will not be disadvantageous.

New companies may tend to raise wages as they have high growth prospects and need to secure workforce as their urgent task. The white paper analyzed the results of JILPT (2024), and the web survey conducted by Venture Enterprise Center, Japan, targeting venture companies, and pointed out that start-up companies tend to be active in increasing wages due to their high needs for securing human resources. Focusing on the regular pay growth rate per employee among the companies which have achieved an increase over the three years for at least one of the three following factors of total sales, operating income or ordinary income, the percentage of companies with a regular pay growth rate of 5% or higher was larger among companies in business for less than 15 years rather than other companies (JILPT 2024).

Higher probability of annual income growth over the previous job two years after the job change

Both the number of people seeking job changes and people changing jobs have been increasing since 2013. How will wages change after the job change? Using the Japanese Panel Study of Employment Dynamics conducted by the Recruit Works Institute, the white paper analyzed the long-term wage increase or decrease after the job change and the impact of the job change on wage increases. The white paper clearly indicated that the probability of wage

decreases is high immediately after the job change, but two years after the job change, annual income is more likely to significantly increase compared to when remaining in the previous company. It also pointed out that the conversion of non-regular workers to regular workers leads to annual income growth and makes workers realize self-development more strongly.

2. Impact of policy measures on wages

The minimum wage hike has an impact on part-time workers

The white paper analyzed the impact of policy measures on wages from two perspectives: the minimum wage hike and the implementation of the principle of equal pay for equal work under the Act on the Arrangement of Related Acts to Promote Work Style Reform. It reviewed the distribution and transition of workers working for nearly the minimum wage among full-time workers and part-time workers, respectively. Among full-time workers, the percentage of workers working for the minimum wage plus 50 yen or so has been increasing but not significantly, and no major change has been seen in the distribution of wages. On the other hand, among part-time workers, the percentage of workers working for the minimum wage plus not more than 100 yen has been increasing over a long term. Particularly since 2015, the percentage of workers working for the minimum wage plus 20 yen has increased significantly. In accordance with the minimum wage hike, the percentage of part-time workers working

for nearly the minimum wage has significantly increased recently. As a result, the minimum wage hike had a greater impact on the wages of part-time workers than before. The white paper performed a simulation regarding the impact of the minimum wage hike on the distribution of wages among part-time workers, using the data for the period between 2012 and 2021. The simulation indicated the possibility that the future minimum wage hike will increase the percentage of part-time worker working for the minimum wage plus not more than 75 yen. It also indicated the possibility that the minimum wage hike of 1% will increase the wage among the bottom 10% of part-time workers by around 0.8% and will also increase the wage among the middle group by 0.7%.

The principle of equal pay for equal work may fill the gap between the hourly pay for regular workers and that for non-regular workers

The white paper indicated by statistical data that a gap tends to widen between the hourly pay for regular workers and that for non-regular workers, along with the increase in the length of service. It also indicated the analysis results that the implementation of the principle of equal pay for equal work may have filled the gap by around 10% between the hourly wage for regular workers and that for non-regular workers. It also pointed out that the implementation of this principle may have resulted in an increase of 5% in the percentage of employers that paid a bonus to non-regular workers.

Column

Labor Share According to Various Definitions

The labor share is an indicator of the share of the value added received by workers out of the value added obtained through production activities. In Japan, there are several measurement methods depending on how value added generated by companies and how the share received by workers are defined. This column introduces following five definitions.¹

Definition 1

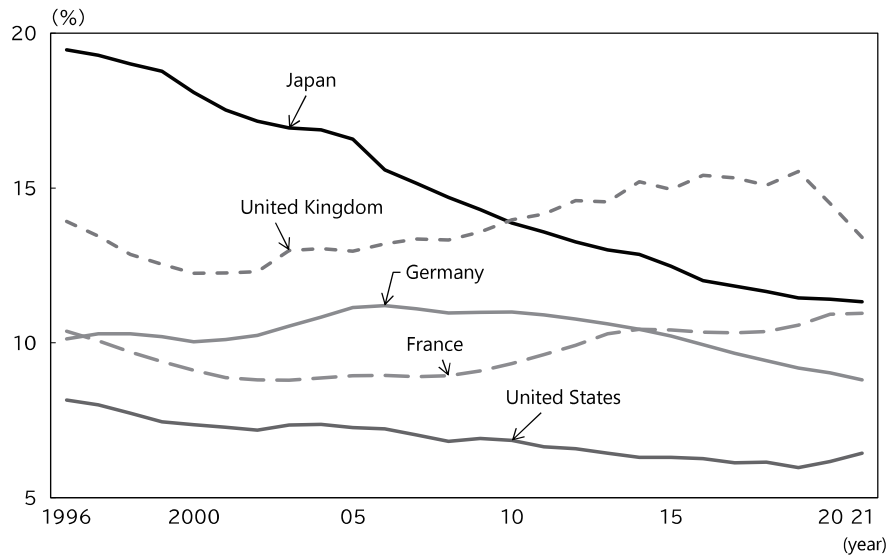
$$\text{Labor share} = \frac{\text{Labor cost}}{\text{Labor cost} + \text{Net operating income} + \text{Interest expense and discount expenses} + \text{Taxes and dues} + \text{Rent on movable and immovable property}}$$

Definition 1 is widely used in past *White Papers on Labour Economy* and *Annual Reports on Japan's Economy and Public Finance*. Using the “Survey for the Financial Statements Statistics of Corporations by Industry” by the Ministry of Finance, “labor cost + net operating income + interest expense and discount expense + taxes and dues + rent on movable and immovable property” is used in the denominator as the sum of value added generated by the company. The numerator is labor cost (including executive compensation) as the distribution of value added to workers. This definition allows us to confirm the distribution of value added to workers in private companies. However, international comparison in this definition is often difficult due to differences in statistics and other data from various countries. In addition, there is the question of whether it is appropriate to exclude self-employed workers. (hereinafter the “self-employed workers”), from the analysis of distribution in the first place.

Definition 2

$$\text{Labor share} = \frac{\text{National income}}{\text{Compensation of employees}}$$

In Definition 2, the labor share is calculated by dividing compensation of employees by national income. International comparison in this definition is easy because compensation of employees and national income are published in the national accounts of each country. However, there are some problems, such as the fact that the denominator, national income, includes the value added generated by self-employed workers, while the numerator, compensation of employees, does not include the income earned by self-employed workers. The number of self-employed workers in Japan has been declining at a faster rate than in other countries (Figure 3). Therefore, in recent years, the labor share measurement has been higher than when the number of self-employed workers was relatively large.



Source: Prepared by the MHLW (Office for Policy Planning and Evaluation for the Director-General for Policy Planning and Evaluation) based on OECD. Stat.

Figure 3. Percentage of self-employed workers in all workers (International comparison)

Definition 3

$$\text{Labor share} = \frac{\text{Compensation of employees} / \text{Number of employees}}{\text{National income} / \text{Number of workers}}$$

Definition 3 defines the labor share as the quotient of compensation per employee and national income per worker. Compensation of employees in the numerator is divided by the number of employees, and national income in the denominator is divided by the number of workers. The effect of the declining share of self-employed workers in all workers can be corrected. It should be noted, however, this method assumes that the value added per capita produced by employees and produced by self-employed workers are the same.

Definition 4

$$\text{Labor share} = \frac{\text{Compensation of employees} / \text{Number of employees}}{\text{GDP} / \text{Number of workers}}$$

Since national income does not include depreciation (consumption of fixed capital, which is evaluated as a distribution to capital in the long term), one could use gross domestic product (GDP) instead of national income as the denominator. In order to maintain international comparability while taking this point into account, Definition 4 defines the labor share as the ratio of compensation of employees per employee divided by GDP per worker. However, as in the case of Definition 3, there are assumptions and limitations regarding self-employed workers.

Definition 5

$$\text{Labor share} = \frac{\text{Per-capita compensation of employees} \times \text{Number of employees} + \text{Per-capita income of self-employed workers} \times \text{Number of self-employed workers}}{\text{GDP}}$$

In order to confirm the extent to which the value added generated by the Japanese economy as a whole is distributed to all workers, including the self-employed workers, in consideration of various limitations, this column attempts to estimate the labor share, taking into account income of self-employed workers as well as income of employees, as Definition 5. The average annual income per capita of self-employed workers is taken from the *Labour Force Survey (Detailed Tabulation)* of the Statistics Bureau of the Ministry of Internal Affairs and Communications. However, although the survey asks about income from all jobs during the year, income is not an actual amount, but rather the option selected from the annual income categories.² Therefore, here we estimate the median³ of each category as the mean.⁴

As described above, there are various ways to measure the labor share,⁵ and it is not that only one of them is correct. International comparison should be made with caution as the standard varies widely depending on the definition. In looking at the labor share, it is important to confirm its long-term trend while considering the characteristics of each measurement method.

Notes

1. This column is an edited translation of the column that appeared in the white paper (MHLW 2023), 93–95.
2. The annual income categories in *Labour Force Survey (Detailed Tabulation)* are as follows: “No income,” “Less than 500,000 yen,” “500,000 to 990,000 yen,” “1,000,000 to 1,490,000 yen,” “1,500,000 to 1,990,000 yen,” “2,000,000 to 2,990,000 yen,” “3,000,000 to 3,990,000 yen,” “4,000,000 to 4,990,000 yen,” “5,000,000 to 6,990,000 yen,” “7,000,000 to 9,990,000 yen,” “10,000,000 to 14,990,000 yen,” and “15,000,000 yen or more.” Respondents (individuals) are asked to select one of these categories. Note that self-employed workers are supposed to apply operating income (sales minus necessary expenses), not sales.
3. In the case of “15,000,000 yen or more,” 15,000,000 yen is considered as the median value because the median value cannot be measured.
4. Specifically, the ratio of the average income of employed persons to that of self-employed workers is estimated from the median of each age group and the number of workers using *Labour Force Survey (Detailed Tabulation)* for the period from 2002 to 2021. This ratio is then multiplied by per-capita compensation of employees (compensation of employees divided by the number of employees) to estimate per-capita compensation of self-employed workers. Since “annual income from work” is available from the 2002 survey, the ratio of income of employed persons to that of self-employed workers is assumed to be the same as in 2002.
5. For more information on multiple definitions and other details, see JILPT 2022.

Reference

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