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Kenn Ariga, Giorgio Brunello and Yasushi Ohkusa
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Internal Labor Markets in Japan

Japanese labor market practices have attracted considerable attention in the West, for two reasons. First, innovative human resource management (HRM) is responsible for the development of competitive industrial sectors. Secondly, inner flexibility of the labor market has produced low unemployment and wage flexibility. This study provides a thorough investigation of the distinctive features of Japanese internal labor markets (ILM) and occupational labor markets (OLM), closely analyzes important changes in ILM, and considers future developments. It combines a mixture of descriptive and theoretical/econometric work and builds on the authors' well known previous research in this area. The volume also contains a detailed case study and the econometric analysis of the HRM-policies used by a large Japanese firm. Although the focus is on Japanese ILM, international comparisons are made throughout, mainly with reference to Europe and the United States.

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KENN ARIGA, GIORGIO BRUNELLO AND
YASUSHI OHKUSA

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Preface

In the past few years, economists have shown an increased interest in the theoretical and empirical analysis of the organization of labor within (mainly large) firms, and in the working of internal labor markets. Advances in the theory of contracts and in agency theory on the one hand, and the increased access to personnel data on the other, have been instrumental to these new developments.

At the same time, the emergence of a dominant Japanese economy on the international economic scene during the 1980s and its relatively good performance in the wake of the two oil shocks attracted considerable interest about the working of the Japanese labor market, both because of Japan's innovative human resource management (HRM) practices and because of the persistently low unemployment rate.

This book tries to bring together these two research threads by focusing on Japanese internal labor market (ILM). Japan is an interesting case, because a well known stylized feature of the Japanese way of organizing labor, especially but not exclusively in large firms, is the importance of long-term employment relationships, steep earnings profiles, and substantial investment in (firm-specific) human capital. All these features are typical of internal labor markets.

Part I of this book (chapters 1–6) looks at important features of Japanese internal labor markets (promotion, earnings profiles, rent-sharing) and tries to relate them to macroeconomic developments such as the slowdown in the rate of economic growth of the Japanese economy and the progressive ageing of its labor force.

Internal labor markets are not immutable organizations, and are sensitive to long-run economic changes. With the burst of the asset-prices bubble in the early 1990s, the Japanese economy entered a period of prolonged stagnation and approach the new millennium with increasing unemployment and slow or even negative economic growth. What are the implications of these dramatic changes in economic performance for the

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organization of Japanese internal labor markets? Part II of this book (chapters 7–10) tries to answer this question by combining a qualitative analysis of case studies with an empirical investigation of the evolution of the wage and employment structures in large and medium-sized Japanese firms.

This book is the outcome of almost 10 years of joint work by the three authors. Our venture started when Professor Masahiko Aoki at Stanford University introduced Brunello to Ariga in Kyoto. On top of our intellectual debt, we owe a great deal to Professor Aoki for pushing us in the right direction. Ohkusa joined our project within a few years, first as a graduate student, and rapidly became an indispensable member. Part of this research has been published in *Economica, Industrial Relations, The Journal of Economic Behavior and Organization, Labour Economics, The International Journal of Industrial Organization*, and *The Journal of the Japanese and International Economies*. The chapters that draw from published research have been substantially rewritten and updated, and may be considered as almost completely new.

During the span of this research we have benefitted from comments and suggestions from many people, including Yukiko Abe, Masahiko Aoki, Bruce Chapman, Hiroyuki Chuma, Ronald Dore, Mary Gregory, Bertil Holmlund, Hideshi Itoh, Takao Kato, Kazuo Koike, Claudio Lucifora, David Marsden, Alan Manning, Michael McAleer, Paul Milgrom, Naoki Mitani, Yoshifumi Nakata, Iwao Nakatani, Steve Nickell, Yoshihiko Nishiyama, Hiroyuki Odagiri, Konosuke Odaka, Isao Ohashi, Soichi Ohta, Fumio Ohtake, Keijiro Otsuka, Canice Prendergast, Marcus Rebick, Takehiro Ryoji, Ronald Schettkat, Paul Sheard, David Soskice, Haruo Shimada, Hideo Suehiro, Toshiaki Tachibanaki, Tsuyoshi Tsuru, and Guglielmo Weber. We are also grateful to Noriko Kinoshita for her excellent secretarial help.

A special thought goes to Tsuneo Ishikawa, a teacher and a friend, who inspired and encouraged us during this research project. Unfortunately, he passed away in June 1998, but his memory is very strong in our hearts.

Almost all the material covered in the book has been presented at seminars or conferences in Japan, the United States, Europe, and Australia. We are grateful to audiences at these events for helpful criticism and suggestions.

The idea to write this book started in the Italian Alps. We were able to get together in the same country at different stages of the research and we are grateful to IGIER Bocconi, ISER Osaka, and The Nissan Institute of Japanese Studies in Oxford for hospitality. We also acknowledge the

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