

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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Cambridge University Press
052164240X - Internal Labor Markets in Japan
Kenn Ariga, Giorgio Brunello and Yasushi Ohkusa
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KENN ARIGA, GIORGIO BRUNELLO AND
YASUSHI OHKUSA



Cambridge University Press
052164240X - Internal Labor Markets in Japan
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PUBLISHED BY THE PRESS SYNDICATE OF THE UNIVERSITY OF CAMBRIDGE
The Pitt Building, Trumpington Street, Cambridge, United Kingdom

CAMBRIDGE UNIVERSITY PRESS
The Edinburgh Building, Cambridge CB2 2RU, UK <http://www.cup.cam.ac.uk>
40 West 20th Street, New York, NY 10011-4211, USA <http://www.cup.org>
10 Stamford Road, Oakleigh, Melbourne 3166, Australia
Ruiz de Alarcón 13, 28014 Madrid, Spain

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First published 2000

Printed in the United Kingdom at the University Press, Cambridge

Typeface 10/12pt Times System 3B2

A catalogue record for this book is available from the British Library

ISBN 0 521 64240 X hardback

Cambridge University Press
052164240X - Internal Labor Markets in Japan
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To our families

Contents

| | |
|---|------------|
| <i>List of figures</i> | viii |
| <i>List of tables</i> | x |
| <i>Preface</i> | xiii |
| Introduction | 1 |
| Part I Features of Japan's internal labor markets | 11 |
| 1 Internal labor markets in search equilibrium | 13 |
| 2 Demand and supply of skills in a corporate hierarchy | 35 |
| 3 Measuring occupational and internal labor markets | 68 |
| 4 Earnings and seniority in internal labor markets | 96 |
| 5 Recruitment and promotion in Japanese firms | 121 |
| 6 Product market competition and internal labor markets | 169 |
| Part II Recent changes in wage and employment structures | 187 |
| 7 Institutional changes in Japanese internal labor market | 189 |
| 8 Changes in the employment and wage structure of Japanese firms, 1976–1996 | 207 |
| 9 Changes in Japanese earnings profiles | 226 |
| 10 The impact of growth and business cycles on Japanese corporate hierarchies | 242 |
| Epilog | 268 |
| <i>References</i> | 271 |
| <i>Index</i> | 281 |
| | vii |

Figures

| | <i>page</i> |
|-----|-------------|
| 2.1 | 49 |
| 2.2 | 54 |
| 3.1 | 77 |
| 3.2 | 79 |
| 3.3 | 81 |
| 3.4 | 91 |
| 4.1 | 110 |
| 4.2 | 110 |
| 4.3 | 117 |
| 4.4 | 117 |
| 4.5 | 118 |
| 4.6 | 118 |
| 5.1 | 132 |
| 5.2 | 137 |
| 5.3 | 138 |
| 5.4 | 139 |
| 5.5 | 139 |
| 5.6 | 140 |
| 5.7 | 141 |
| 5.8 | 141 |

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 Kenn Ariga, Giorgio Brunello and Yasushi Ohkusa
 Frontmatter
[More information](#)

| List of figures | ix |
|--|-----|
| 5.9 Kaplan–Meier survivor estimate: promotion to at least rank 9 from initial rank 0 | 142 |
| 7.1 Total hirings and graduate hirings, 1975–1995 | 194 |
| 8.1 Employment and output growth, manufacturing | 209 |
| 8.2 Employment and output growth, distribution | 210 |
| 8.3 Employment and output growth, finance | 211 |
| 8.4 Relative wages, manufacturing | 211 |
| 8.5 Relative wages, distribution | 212 |
| 8.6 Relative wages, finance | 213 |
| 8.7 Span of control, manufacturing | 214 |
| 8.8 Span of control, distribution | 215 |
| 8.9 Span of control, finance | 215 |
| 8.10 Relative wages and spans of control | 216 |
| 8.11 Promotion and growth | 220 |
| 8.12 Promotion rates, by firm size | 221 |
| 8.13 Promotion rates, by industry | 221 |
| 8.14 Promotion, by age | 222 |
| 9.1 Unconditional wage–tenure profiles, large firms | 235 |
| 9.2 Unconditional wage–tenure profiles, medium-sized firms | 235 |
| 9.3 Unconditional over conditional profiles, large firms | 236 |
| 9.4 Unconditional over conditional profiles, medium-sized firms | 236 |
| 9.5 Wage–experience profiles, large firms | 237 |
| 9.6 Wage–experience profiles, medium-sized firms | 237 |
| 10.1 Cyclical indicator, manufacturing | 258 |
| 10.2 Cyclical indicator, distribution | 259 |
| 10.3 Cyclical indicator, finance | 259 |

Tables

| | <i>page</i> |
|---|-------------|
| 1.1 Comparative statics | 28 |
| 2.1 Numerical example of market equilibrium | 55 |
| 2.2 Simulated wages | 56 |
| 2.3 Regression using simulated log wages | 57 |
| 3.1 Means and correlation matrix for two alternative measures of ϕ | 75 |
| 3.2 Cumulative distribution of $\phi_{22.5}$ | 76 |
| 3.3 Average age, seniority, occupational tenure, firm size, and relative earnings, different ranges of $\phi_{22.5}$ | 77 |
| 3.4 Average age, seniority, occupational tenure, share of large firms, and relative earnings, top 20 occupations, ranked by value of $\phi_{22.5}$ | 78 |
| 3.5 Average age, seniority, occupational tenure, share of large firms, and relative earnings, bottom 20 occupations, ranked by value of $\phi_{22.5}$ | 80 |
| 3.6 Summary statistics | 84 |
| 3.7 Earnings profiles interacted with $\phi = \phi_{22.5}$ | 85 |
| 3.8 Earnings profiles interacted with $\phi = \phi_{22.5}$ | 88 |
| 3.9 Earnings profiles interacted with $\phi = \phi_{22.5}$, blue-collar occupations | 89 |
| 3.10 Estimated values of the marginal impact of a higher ϕ on the slope of the wage–seniority profile | 90 |
| 4.1 Weighted means and standard deviations, Japan, 1994 | 105 |
| 4.2 Estimated earnings equations, Japanese men | 106 |
| 4.3 Estimates of the rank function, by instrumental variables | 107 |
| 4.4 Estimates of the rank function, using the ordered probit model | 108 |
| 4.5 Estimated earnings growth caused by tenure, Japanese men | 109 |

| List of tables | xi |
|--|-----|
| 4.6 Means and standard deviations, Japan and the United Kingdom, 1979, manufacturing and finance | 114 |
| 4.7 Estimated earnings equations, Japanese and British men | 115 |
| 4.8 Estimates of the rank function, by instrumental variables | 115 |
| 4.9 Estimated earnings growth caused by tenure, Japanese and British men | 116 |
| 5.1 Ranks and positions in the Japanese firm | 129 |
| 5.2 Allocation to initial rank | 134 |
| 5.3 Percentage promoted to a given rank who started from a rank lower than 3 | 136 |
| 5.4 Log rank tests of the null hypothesis that survivor functions do not vary with type of recruitment | 137 |
| 5.5 Promotion patterns for the cohort hired in 1979, college graduates or more | 143 |
| 5.6 Percentage of employees promoted to rank i , 1979–1994 | 145 |
| 5.7 Hirings and survivors among college graduates, by year of recruitment, 1972–1994 | 148 |
| 5.8 Summary statistics, full sample | 151 |
| 5.9 Estimates of model (5.1)–(5.2), by age cohorts, employees with less than college education | 153 |
| 5.10 Estimates of model (5.1)–(5.2), by age cohorts, employees with at least college education | 154 |
| 5.11 Weibull hazard model, firm D | 161 |
| 5.12 Weibull hazard model, firm E | 162 |
| 5.13 Probit estimates of the probability of promotion to a higher rank, firm B and firm C | 163 |
| 5.14 Key features of the four firms | 164 |
| 6.1 Summary statistics | 173 |
| 6.2 Inter-industry comparisons | 174 |
| 6.3 Regressions of tenure and average wages in individual firms, 1972–1994 | 176 |
| 6.4 Estimates of augmented production functions, using <i>iniw</i> | 178 |
| 6.5 Estimates of augmented production functions, using <i>yslop</i> | 179 |
| 6.6 Estimates of augmented production functions, using growth rates | 180 |
| 7.1 Changes in mandatory retirement age, 1976–1997 | 192 |
| 7.2 Age composition of employment, 1975–1995 | 197 |
| 7.3 Distribution of firms, by major institutional change, reported in <i>Rousei Jihou</i> , 1979–1998 | 198 |
| 7A.1 Cases reported in <i>Rousei Jihou</i> , 1979–1998 | 205 |
| 8.1 Changes in relative wages, 1976–1996 | 212 |
| 8.2 Changes in spans of control, 1976–1996 | 214 |

| | | |
|-------|---|-----|
| xii | List of tables | |
| 8.3 | Changes in average age, 1976–1996 | 217 |
| 8.4 | Changes in average tenure, 1976–1996 | 217 |
| 8.5 | Average five-year promotion rates, by industry and firm size | 219 |
| 8.6 | Promotion premia, by rank, 1980s and 1990s | 223 |
| 9.1 | Weighted means and standard deviations, large firms, 1980 and 1994 | 230 |
| 9.2 | Weighted means and standard deviations, medium-sized firms, 1980 and 1994 | 231 |
| 9.3 | Estimated earnings equations, Japanese men | 232 |
| 9.4 | Estimates of the rank function, by instrumental variables | 233 |
| 9.5 | Estimated earnings growth caused by tenure, Japanese men, 1980–1994 | 234 |
| 9.6 | Estimated unconditional earnings growth caused by net experience, Japanese men, 1980–1994 | 234 |
| 9.7 | Age groups and cohorts, 1976–1996 | 239 |
| 9.8 | IV estimates of (9.3), 1976–1996 | 240 |
| 10.1 | Effects of technological progress, growth, and supply shocks | 248 |
| 10.2 | Relative wages and growth, pooled cross-sections | 252 |
| 10.3 | Relative wages and growth, data aggregated over age groups | 253 |
| 10.4 | Span of control and growth, data aggregated over age groups | 253 |
| 10.5 | Promotion rates and growth, pooled cross-sections | 253 |
| 10.6 | Promotion rates and growth, data aggregated over age groups | 254 |
| 10.7 | Cohort effects on average wages | 255 |
| 10.8 | Rank-specific wages and the cyclical indicator, <i>GAP</i> | 261 |
| 10.9 | Rank-specific wages and the cyclical indicator, <i>GAP</i> , data aggregated over age groups | 262 |
| 10.10 | Rank-specific wages and the cyclical indicator, <i>GAP</i> , by tenure group | 263 |
| 10.11 | Rank-specific wages and the cyclical indicator, <i>GAP</i> , by tenure group, data aggregated over ranks | 264 |

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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Kenn Ariga, Giorgio Brunello and Yasushi Ohkusa
Frontmatter
[More information](#)

xiv **Preface**

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, Keiji 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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Frontmatter
[More information](#)

Preface

xv

financial support of the Italian Ministry of Universities and Research, the Italian National Research Foundation, the University of Udine, the Inamori Foundation, the Japanese Ministry of Education, and the Nihon Shoken Shorei Zaidan.

Last but not least, we are grateful to Ashwin Rattan of Cambridge University Press for his help throughout this venture.