

## Tuning the hybrid

Nov 29th 2007

From The Economist print edition

### Corporate Japan has devised a new industrial model, but further reform is still needed

HOW much has corporate Japan changed in the past decade? A great deal, say optimists, who point to all the things that are different; not enough, say pessimists, who point to everything that has stayed the same. Both are right. In recent years Japanese companies have emerged from the gloom of the 1990s with the help of a new industrial model that combines elements of the old Japanese way of doing things with some carefully chosen bits of American capitalism.

As our special report in this issue argues, the result is a hybrid, an effort to achieve the best of both worlds—rather as a Toyota Prius combines the range of a petrol engine with the energy efficiency of an electric motor. Many Japanese companies now provide merit-based pay and share options, for example, but not to the extent that American firms do. There is more shareholder activism and more mergers and acquisitions, but activists and acquirers are expected to be polite. And although the older salarymen get to keep their jobs for life, the young are less inclined to offer to “bury their bones” at the company that first hires them, and are keener on playing the market and moving around.



All of this is to be welcomed, and much of it has been made possible by a steady flow of reforms. But the emergence of the new hybrid model has been accompanied by the worrying creation of a two-tier labour market. The share of “non-regular” workers—which includes temporary, part-time and contract workers—has risen from 19% in 1989 to 33% today. Non-regular workers generally earn less than half as much as “regular” workers do, and are denied the generous perks and social-insurance coverage that such insiders receive.

During the 1990s companies placed a greater emphasis on non-regular workers, often reducing or freezing the hiring of regular workers, in order to reduce costs. But this tactic poses a long-term threat both to companies and to the economy as a whole. Non-regular workers receive little training, so that Japanese firms run the risk of ending up with a cohort of unskilled, middle-aged non-regular staff. And their low pay is one of the factors that has helped to hold down domestic consumption, making the Japanese economy's moderate recovery in recent years heavily dependent on exports—something that is now the cause of great concern, particularly as demand overseas for Japanese goods weakens.

Japan prides itself on being an egalitarian society. In a survey carried out in 1987, 75% of the population identified themselves as middle class. By last year the figure had fallen to 54%, and the number of people who identified themselves as below middle-class had risen from 20% to 37% over the same period. Worries over rising inequality were cleverly exploited by the opposition in the upper-house elections this summer, which led to the downfall of the prime minister, Shinzo Abe. His successor, Yasuo Fukuda, has pledged to continue along the path of reform while addressing inequality.

The best way to do that would be to focus on further reforms to the labour market, and in particular to reduce the lavish employment protection granted to regular workers, which is one of the reasons why firms hire non-regular workers instead. At the same time, business needs to extend some social-insurance schemes to cover non-regular workers, and improve conditions for non-regular workers with such things as better child-care provision and more training.

### **And the rest will follow**

Some companies have already responded to Japan's moderate recovery by shifting some non-regular workers into regular positions. Other firms should be encouraged to do the same. As well as addressing inequality, this could help to boost consumption. Reducing the protection offered to regular workers would make corporate restructuring easier. And better terms for non-regular workers would encourage more women to enter the workforce and more older people to keep working in semi-retirement, both of which will be necessary as Japan's population ages and the workforce starts to shrink. Entrepreneurship would benefit, too. At the moment anybody in a regular job who has an idea for a new company has a very strong incentive to shelve his idea and stay put. The labour market is, in short, the point at which Japan's various problems overlap, and where further reform is now most urgently required.