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Japan’s jobs market on the way to modernisation

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ARTICLE

In Japan's labour market, an increase in people changing jobs is occurring in the middle of a growing labour shortage, and changing traditional features of Japanese corporate culture such as lifetime employment and seniority-based remuneration. Under the administration of Prime Minister Fumio Kishida, labour market reform is a major theme in Japan's growth strategy with increased government spending on the development of individual skills. This is steadily but surely changing the relationship between Japanese workers and their employers.

According to a 2018 Cabinet Office survey, about 10 per cent of mid-career and younger employees felt that it was beneficial to seek new jobs in order to better utilise their talents or were dissatisfied with their current position. A 2021 survey revealed that over 80 per cent of employees aged 25–44 expressed a desire to develop their careers independently.

By 2022, more than half Japanese companies had implemented systems allowing for side jobs and multiple occupations. According to a 2023 survey, 37 per cent of the working population was considering or planning a job change. More than half of those under 34 expressed a desire to change jobs. These data suggest that Japan's post-pandemic labour market is becoming much more dynamic.

This change can be explained by three factors — the government's labour market reforms, labour shortages and changes in the market such as rising wages and digital transformation.

The essence of the government's labour market reform is expanding 'job-based' employment — as distinct from Japan's traditional 'membership-based' system — that offers compensation commensurate with skills while facilitating reskilling and labour mobility. These policies aim to lift productivity and move Japan in what is thought to be the right direction.

But the changes are in fact fundamentally being driven by labour shortage.

Japan's working-age population is expected to decrease by nearly 15 per cent between 2025 and 2040. As of April 2024, the seasonally adjusted ratio of effective job openings to jobseekers for all occupations was 1.26, but in industries like construction, it exceeds five.

Both large and small businesses have a strong desire to hire, making securing talent a critical issue. Labour shortages are just beginning to bite and are expected to become even more severe. Labour shortages put jobseekers in a better bargaining position.

The changes are also explained by market shifts such as rising wages and an increased need for digital talent. Nominal wages have been rising since 2023 with the advent of inflation driven by rising energy prices and increasing geopolitical risk. Advances in digitalisation have boosted opportunities for higher wages through new technologies and increased competition from global companies for top talent.

These changes are now forcing Japanese companies to transform their business model. Over the past 30 years, most Japanese companies have defended their business by cutting prices, suppressing costs and wages and preserving employment. But companies now need to shift to a business model that raises wages, retains talent, increases added value and expands profits by appropriately increasing mark-up rates.

To secure the funds to invest in wage increases and investment in human capital, companies have to achieve sustainably high profits to bankroll them while also improving productivity. This also means that workers will likely shift towards companies with high productivity. If these changes are successful, they could lead to increased labour productivity on a macroeconomic level and contribute to the long-term growth of the Japanese economy.

The stock prices of Japanese listed companies have finally recovered to levels exceeding those seen 30 years ago. Unlike then, few view this level of stock prices as a bubble — rather, it reflects the expectation that Japanese listed companies can now undertake business model reforms aimed at raising capital returns that exceed long-term capital costs. The CEOs of prime market-listed companies are gradually prioritising long-term investment in intangible assets like human capital in response to requests from the Tokyo Stock Exchange in 2023 to consider stock prices and capital costs in their engagement with institutional investors.

This shift from an era of labour surplus to one of labour shortage requires new policy strategies. Individual reskilling needs support to ensure smooth labour mobility to companies and sectors with high labour productivity. Japan must also support corporate initiatives to adopt job-based employment suited to the new business model.

Creating an environment that facilitates business model reforms and corporate restructuring, including by supporting startups and mergers and acquisitions, is the challenge. Traditional labour market policy that emphasised the protection of long-term corporate employees will have to be replaced by the opposite: ‘active’ labour market policies that encourage higher wages and investment in human capital while making the labour market more dynamic.

COMMENTARY

The article explains Japan's plan to make the labour market more dynamic by encouraging "higher wages and investment in human capital." The government plans to address the "increase in people **changing** jobs," and labour market inefficiencies with many who are "dissatisfied with their current position." Hence, there has been a growing labour shortage: more jobs are available than workers. This led to the government's labour market reforms and **changes** in the market that stimulated higher wages and digital transformation. Accordingly, Japan's "active labour market policies" aim to smoothly help those of working age to find jobs that fit their skill sets for economic growth and adapt to the economic and structural **changes** in the country.

The Effect of Labour Shortages in Japan

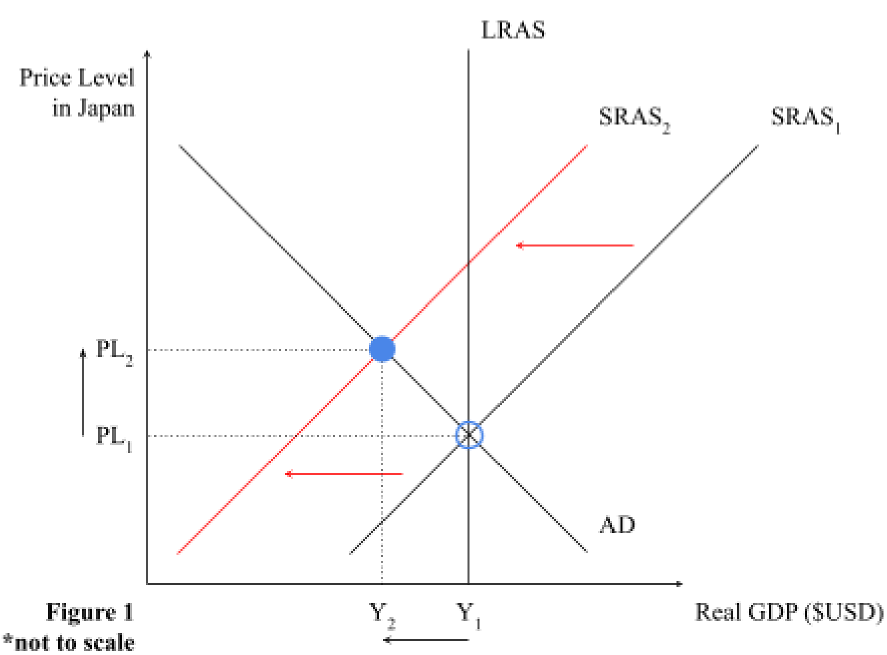

Figure 1
***not to scale**

Figure 1 illustrates a decrease in the short-run aggregate supply (SRAS) with rising wages and higher costs of production, increasing the price level from PL_1 to PL_2. The cost-push inflation is attributed to Japan's labour shortages: frictional unemployment where 37% of the workforce were planning a job **change** and thus temporarily out of work, underemployment where 10% of younger employees were overqualified in their position, and the decrease in the working-age population. Consequently, this stimulated higher wages to attract workers and retain talent to "compete with global firms," which began with the structural **change** of Japan's traditional "membership-based" employment to a job-based system raising labour expenses. This prevented companies from further investing due to the higher costs, which lowered output levels (Y_1 to Y_2). The new equilibrium is below the economy's potential GDP at the long-run aggregate supply (LRAS), causing a temporary recessionary gap.

The Effect of Labour Market Reforms in Japan

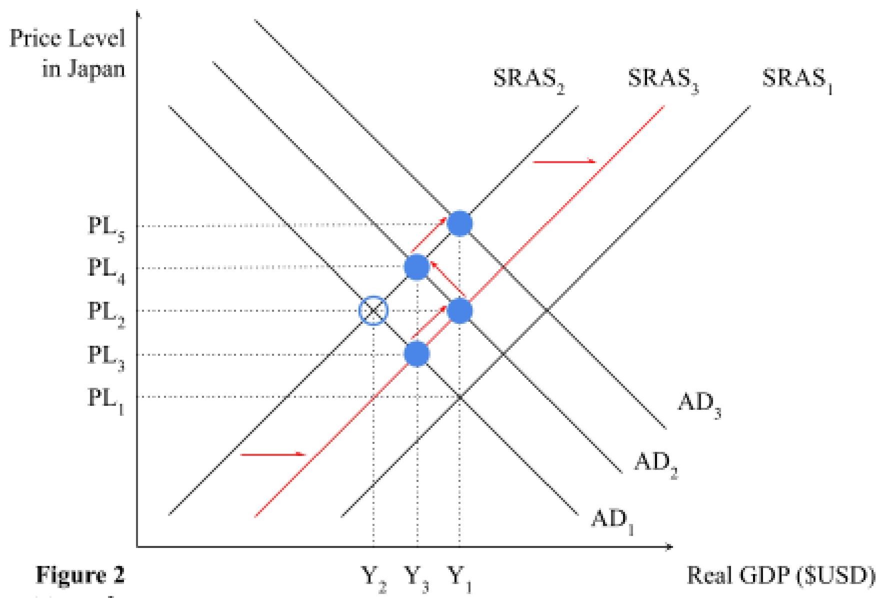

Figure 2
***not to scale**

Accordingly, Japan's labour legislation strengthened jobseekers' bargaining power, reducing prior unemployment levels with better job opportunities. This economic growth is further stimulated through labour market reforms and upskilling. Particularly, Japan's supply-side policy focuses on investments in "human capital" and the "development of individual skills" through education and training. The increase in labour productivity benefits corporations as they can maintain global competitiveness and reduce turnover rates, decreasing labour shortages. Figure 2 illustrates the higher output levels and increases $SRAS_2$ to $SRAS_3$.

These reforms promote labour mobility, allowing workers to find jobs that "better utilise their talents" for higher income, thus encouraging consumption. These **changes** are also reflected in the stock prices of Japanese corporations having “recovered to levels exceeding those seen 30 years ago,” highlighting renewed investor confidence in the expectation that Japanese companies will “reform models aimed at raising capital returns,” increasing AD_1 to AD_2.

Amidst these **changes**, companies are “forced to transform their business model” by advancing their digitalization and technology to compete with global firms. While this “boosted opportunities for higher wages” to retain skilled workers, it decreased $SRAS_3$ to $SRAS_2$ with higher costs of production, reducing output. This creates short-term uncertainty for lower-income workers concerning inflated prices, especially for individuals who “desire to **change** jobs,” reinforcing the previous rates of frictional unemployment. Corporations then need to increase wages to attract workers, which increases income and consumer confidence, shifting AD again. Altogether, these reforms lead to long-term sustained inflation in a wage-price spiral.

The Effect of Expansionary Fiscal Policy in Japan

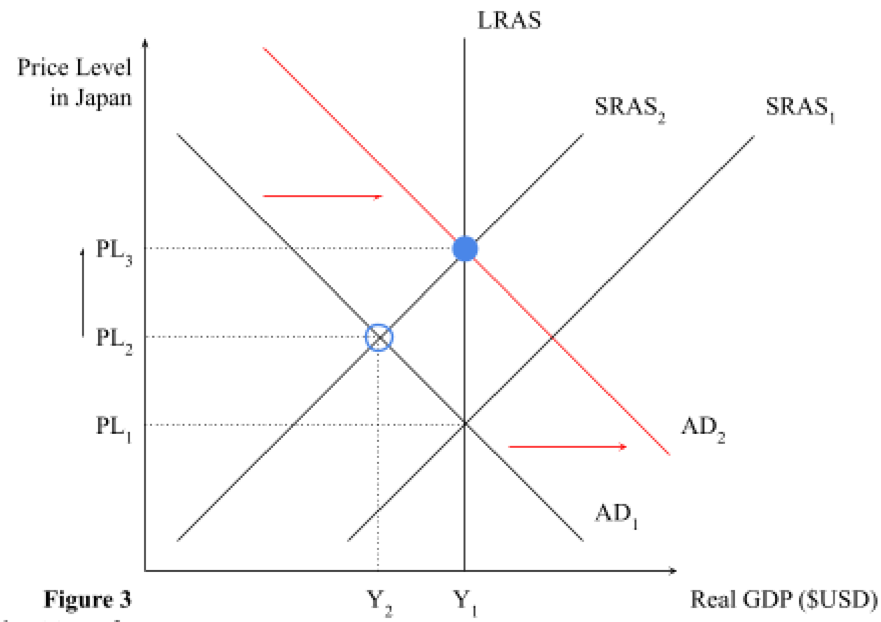

Figure 3
***not to scale**

To address the recessionary gap, the government could alternatively lower corporate taxes or implement direct cash transfers as expansionary fiscal policy. This increases consumption, and investment, while avoiding persistent inflation that significantly affects the purchasing power of lower-income households and the unemployed.

The additional capital from lowered taxes could allow businesses to sustain profits with reduced pressure to increase prices to cover labour and production costs. The tax cuts could free up resources for private investment, which incentivizes corporations to expand by hiring workers, and reducing unemployment. This supports Japan's market modernization: it adapts to the **changes** of competitive global companies by investing in new technologies while reducing labour shortages. However, helping corporations incurs an opportunity cost. For instance, the government could spend on direct cash transfers to support consumer confidence by increasing their disposable income and providing relief for higher wages, while also supporting Japanese startups and their investments.

Both increase AD in Figure 3 with higher output and price levels, addressing the recessionary gap and avoiding long-term inflation of labour market reforms in Figure 2. Wage-price spiral has greater inflationary pressures that undermine long-term economic growth, whereas fiscal policy of lowering corporate taxes reduces the financial burden for companies needing to "retain talent" leading to long-term labour productivity; direct cash transfers also prevent lower-income workers from **changing** jobs to seek higher wages.

To conclude, "Japan's labour market on the way to modernization" adapts to the **changes** in the market through higher wages and investments in human capital. However, this poses long-term challenges that can lead to a severe inflation of price levels. Rather, a better alternative to address labour shortages without the effects of a wage-price spiral, is expansionary fiscal policy on lowering corporate taxes or direct cash transfers, which prevents long-term inflationary pressures.