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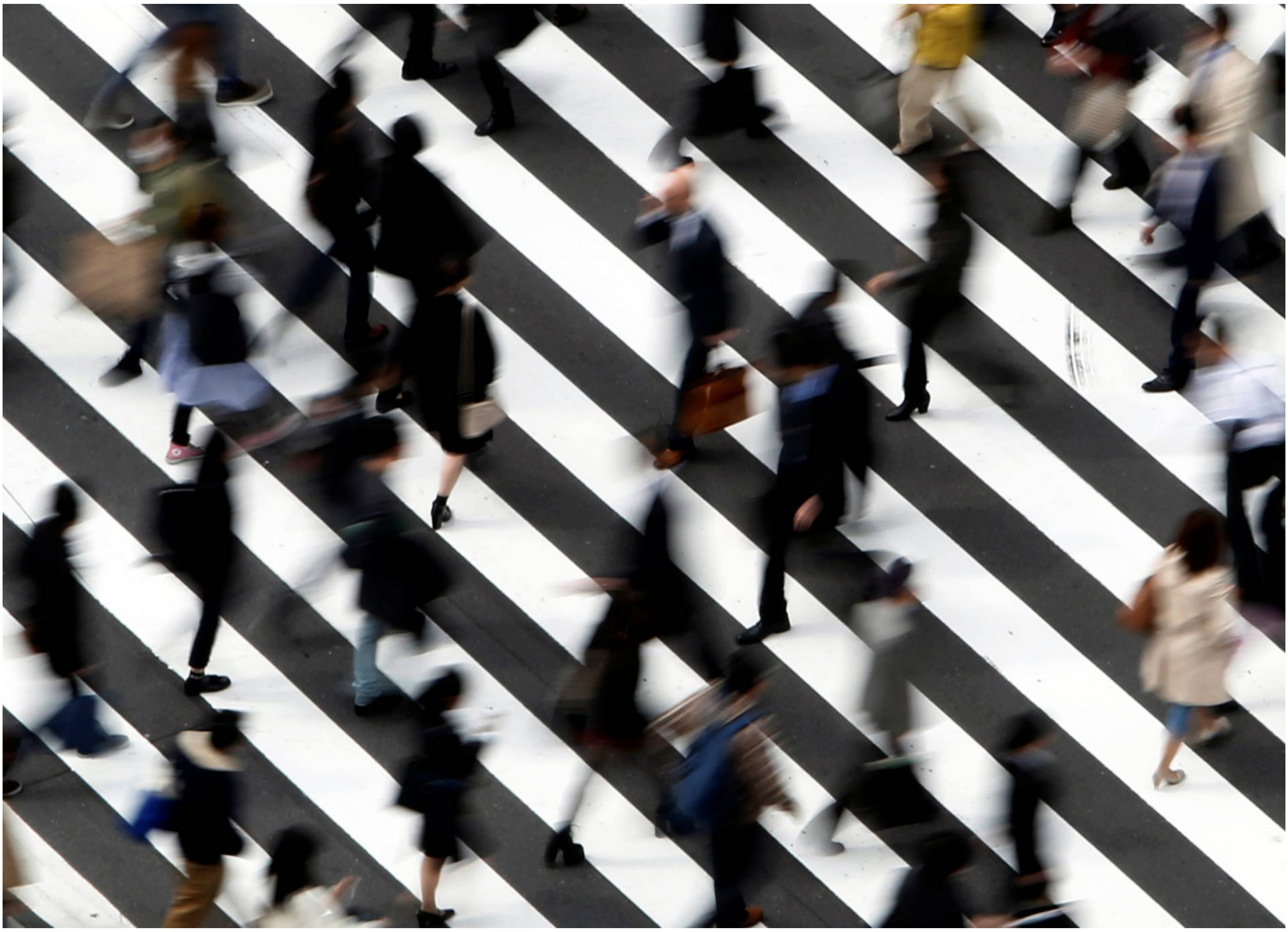
Unpacking Japan's great wage conundrum

With inflation running at a four-decade high, the world's third-largest economy's famously stagnant salaries are finally showing signs of rising. Can the momentum be sustained?



Japan's stubbornly static wages have been one of the greatest mysteries in the nation's shrinking labor market. | REUTERS

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Pressured by rising prices and a labor crunch, Atsushi Tanaka has succumbed to what the administration of Prime Minister Fumio Kishida has been pushing for: wage hikes.

In March, the president of a medical parts manufacturer will be raising the monthly salaries of his full-time workers by ¥15,000 ($114) while also increasing the hourly wage for his part-timers.

It wasn't an easy decision to make for Tanaka, whose family-owned company is based in Ibaraki Prefecture, northeast of Tokyo. Raw material prices have been rising and soaring energy costs have seen electricity bills double at his factories. With more than 100 full- and part-time staff on the roster, the pay hikes will cost Tanaka's firm, Sanetsu, an extra ¥20 million or so annually.

"It's the first time we've raised the base pay for all our employees at once by this much," says Tanaka, who took over the reins of the four-decade-old business from his father two years ago. "But it can't be helped under these circumstances."

With core consumer inflation hitting its highest levels in 41 years, there are signs that the world's third-largest economy's famously stagnant wages are finally starting to rise.

But in a country entrenched in a deflationary mindset and where job security has been prioritized over pay for decades, whether or not the momentum lasts depends on addressing structural and demographic issues hindering labor market flexibility and the willingness of smaller firms such as Tanaka's to bet on the long-term advantages of wage hikes.

(https://www.japantimes.co.jp/wp-content/uploads/2023/02/np_file_210308.jpeg)

Japanese firms have long been reluctant to pass on costs to budget-minded consumers, which in turn have led to wages being subdued. | BLOOMBERG

Deflationary mindset

Japan's stubbornly static wages have been one of the greatest mysteries in the nation's shrinking labor market, a puzzle that leaders past and present have tried and failed to solve.

Speaking to lawmakers in January ahead of the annual spring wage talks between labor unions and companies, Kishida asked firms to raise wages above the 4% inflation rate in an effort to fuel consumer spending and, by doing so, lift the economy still recovering from the pandemic.

“We will promote labor market reform in order to build a structure for sustainable wage increases on the foundation of the economic growth that has been steadily built up to date,” Kishida said. “First of all, wage increases that exceed price increases must be achieved.”

Outgoing Bank of Japan Gov. Haruhiko Kuroda, meanwhile, has been stressing the need to maintain the central bank’s ultraloose monetary policy until wages rise sufficiently and inflation sustainably hits its 2% target.

Japan is not the only developed country where real wage growth has been suppressed in recent decades. Nevertheless, its sluggish pace stands out. In dollar terms, the average annual pay in Japan stood at $39,711 in 2021, well below the Organization for Economic Cooperation and Development average of $51,607 and nearly unchanged since 1997, when it hit $38,395 before flattening out.

That was also the year of the Asian financial crisis following the burst of Japan’s asset price bubble in the early 1990s. As the economy tanked, labor costs increased and firms were forced to repress wages.

Up until the 2000s, however, Japan’s salary levels were still high by international comparison, says Hisashi Yamada, a senior economist at the Japan Research Institute. Wage hikes, meanwhile, also risked putting Japan at a competitive disadvantage with rising economies such as South Korea and Taiwan and encouraging a shift of production to China.

However, the environment changed during the 2010s as firms’ labor cost ratios began declining. At the same time, massive monetary and fiscal stimulus programs spearheaded by former Prime Minister Shinzo Abe and the BOJ saw the strong yen corrected and dollar-denominated wages fall. Annual wages in Japan have now slid below those of South Korea on a purchasing power parity basis.

(https://www.japantimes.co.jp/wp-content/uploads/2023/02/np_file_210310.jpeg)

Apparel giant Fast Retailing has said it would raise wages by as much as 40% for full-time employees from March. | BLOOMBERG

With the nation's lifetime employment model — that ensured generations of workers financial stability — crumbling, there's growing concern that wage restraint will induce an exodus of talented human resources overseas and, in turn, reduce the international competitiveness of Japanese firms, Yamada says.

"There's no more reason why wages shouldn't grow, but strangely they haven't — it defies economic logic," he says.

What has been hindering a spike in payrolls, then, is likely to be Japan's decadeslong deflation and a deeply ingrained deflationary mindset.

Japanese firms have long been reluctant to pass on costs to budget-minded consumers, which in turn has led to wages being subdued. That has led to the proliferation of ¥100 shops and cheap fast food joints, for example. Even amid the early stages of the pandemic, when costs began rising, stimulus measures such as cash handouts and zero-interest loans saw inflation barely budge.

But the combination of higher energy and raw material prices, the war in Ukraine and the weaker yen are finally forcing a change.

Cooking oil, frozen foods, diapers, highway tolls and electricity bills, to name a few, have all gone up and further widespread price hikes for more than 10,000 products are on the horizon this year. This has put the brakes on domestic consumer spending, with the most recent government data from December showing household spending having fallen 1.3% from a year earlier.

The key, then, for what Kishida describes as a "virtuous cycle of growth and distribution," is for firms to invest in wages so consumers can open their wallets.

"There are companies with strong earnings and impressive business performances, while corporations' internal reserves have hit record highs," Yamada says.

“We’re entering a phase in which businesses need to raise prices and wages to remain competitive and maintain employee motivation, and some are already doing so,” he says. “But not all can adapt and act immediately, and that risks polarization.”

Bigger is better?

A growing list of Japan’s largest corporations is moving ahead to ramp up payrolls.

Apparel giant Fast Retailing, known for its casual clothing line Uniqlo, said it would raise wages by as much as 40% for full-time employees starting in March. Beverage behemoth Suntory Holdings is also hiking salaries, along with a score of major financial institutions such as Nippon Life Insurance and Sumitomo Mitsui Banking.

The movement is not just limited to full-time employees. Aeon, Asia’s largest retailer, said it will raise hourly wages by 7% on average from March for its 400,000 or so part-timers working in supermarkets and other stores operated by 147 domestic units. The firm is known for hiring the largest pool of part-timers in Japan.

“Our workers are the bedrock of our business, and are also members of local economies,” says Kazuhiro Yoshida, a spokesperson for Aeon. “It’s important to maintain their standard of living and to spur economic activity while also securing skilled workers.”

(https://www.japantimes.co.jp/wp-content/uploads/2023/02/np_file_210306.jpeg)

Retailing giant Aeon has said it will raise hourly wages by 7% on average from March. | REUTERS

But whether the trend can include small and midsize firms that account for 99.7% of all businesses in Japan remains unclear.

These companies employ around 70% of the working population and are responsible for a large portion of economic output. They are the cornerstone of the service sector and play a critical role in the manufacturing and export supply chain, but are also the ones bearing the brunt of soaring expenses and a chronic labor shortage in a shrinking, aging population.

Pay hikes at these firms, economists say, are crucial in preventing rising prices from dampening consumer spending.

According to a survey taken in December by Daido Life Insurance, however, only 34% of around 9,000 small and midsize firms that participated in the questionnaire said they would be willing to offer wage hikes. Among them, just 15% are prepared to provide salary hikes above the 4% consumer inflation rate.

In an ominous sign of what may lie ahead, market research firm Teikoku Data Bank said in its January report that the number of firms that went bankrupt due to not being able to retain their employees is increasing.

Among the 140 firms in the report that went belly up last year due to staff shortages, at least 57 were directly due to workers resigning.

"A virtuous cycle in which rising prices trigger an increase in labor market fluidity and push up wages may finally be arriving," Teikoku Data Bank wrote in its report, citing recent moves for wage hikes at major corporations. "However, the ability to raise wages is limited to large companies with strong earnings, industry leaders with high market shares and price control advantages, and companies that create added value with proprietary technologies."

Takayasu Otomo, a researcher at Teikoku who worked on the report, says that means there will likely be more smaller firms that can't afford to dole out better salaries to retain talent, leaving them further behind the competition.

"It's something that needs to be closely watched," he says.

Labor crunch

Sonoko Fukui's very first paycheck as a caregiver at a nursing home for older residents came to around ¥130,000 after tax — about the price of a mid-range laptop.

That was 17 or 18 years ago. She was straight out of vocational school and living with her parents in Aomori Prefecture.

That amount has barely budged. According to the results of a survey released in 2016 by Aomori's elderly welfare association, the most common starting salary for a certified care worker in the prefecture was between ¥140,000 and ¥150,000 a month before tax.

"Wages and the cost of living are lower in the countryside so it's hard to compare, but I recall that my friends in Tokyo working part-time jobs were earning more than I did," says the 37-year-old caregiver who now resides in the capital's Bunkyo Ward.

Along with nurses and child care workers, caregivers are among the most sought after occupations in the world's most rapidly aging nation, but also among the more lowly paid. And Japan's seniority-based wage system isn't helping, especially in a grueling job with a high turnover rate.

According to the health ministry, the average monthly wage for both sexes in 2020 was ¥293,000 for nursing home workers, ¥303,000 for child care workers and ¥394,000 for nurses. That's compared to the all-industry average of ¥352,000.

(https://www.japantimes.co.jp/wp-content/uploads/2023/02/np_file_210307.jpeg)

Nobuko Nagase, a professor at Ochanomizu University, says structural incentives are needed to prod some segments of the country's workforce toward higher paying jobs. | COURTESY OF NOBUKO NAGASE

Complicating the issue is how their wages rely on subsidies coming from tax revenue and nursing care insurance premiums. Kishida, for his part, has been pushing for better treatment of employees in the medical and welfare sectors, where many female, so-called nonregular workers are employed.

In response to the economic strain resulting from the protracted recession the country experienced following the bubble's burst, the nation's leaders have pushed for reform across the labor market.

These deregulations led to corporate cost-cutting and a growing pool of nonregular workers, or those hired on a part-time or temporary basis who typically earn much less. They now account for more than a third of the country's workforce and have been cited as one of the reasons for bringing down overall salaries.

"Most caregivers at elderly homes I've worked at are nonregular workers, and many are older — some even in their 70s," Fukui says. "They come and go, and care facilities are always scrambling for staff to keep their operations running."

Demographic dilemma

With its working-age population shrinking, the government has been prodding more women and older people to join the workforce to offset a fall in productivity.

While advancements have been made, there still lacks structural incentives to drive them toward higher paying jobs, says Nobuko Nagase, a labor economics professor at Ochanomizu University.

The tax and social security system favors low-earning homemakers, giving married women an impetus to limit their paid employment, she says. Of the 27 million women in employment in 2020, for example, 14.3 million were nonregular workers, most being part-timers.

“There’s a deep-rooted belief in Japan that husbands should be breadwinners and wives should stay home to look after the kids,” she says. “But that model is cracking, and there are fewer women desiring to be housewives.”

In the long run, the wage conundrum plaguing Japan is a harbinger to a larger demographic issue the nation will have to face in the decades to come.

Last year, over-75s accounted for 15% of the population for the first time, while those over 65 hit a record-high 29.1%.

The government estimates the share of the elderly population to reach 35.3% by 2040. By then, the nation will likely face a shortage of 960,000 medical and welfare service workers.

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Takuya Hoshino, an economist at the Dai-ichi Life Research Institute, says low wages and employment instability are linked to the country’s low birthrate. | COURTESY OF TAKUYA HOSHINO

Meanwhile, the number of newborns was the lowest ever in 2021, at 811,622. With a stubbornly low birthrate, social security costs are bound to balloon for the working age population in the years ahead.

“Low wages and employment instability are linked to the low birthrate, as it hinders the incentive for workers to want families,” says Takuya Hoshino, an economist at the Dai-ichi Life Research Institute.

"When people are concerned about their livelihood, they tend to shy away from taking further financial risks in the form of getting married and having children," he says.

Case in point: Fukui, the caregiver, is in a relationship but has no plans to tie the knot or have children.

"It's difficult to commit to these things when your lifestyle is rather unstable," she says.

Fukui now works at a retirement care facility in the capital three days a week, and spends the weekends selling flowers from a small space she rents in her neighborhood at a discounted rate.

"I've always wanted to be a florist," Fukui says. But earning a decent profit from arranging a bunch or two is getting harder in these inflationary times.

"Even the price of flowers is rising," she says.

KEYWORDS

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