



Messages

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Increasing Labor Pains (Part I)



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Increasing Labor Pains (Part I): Increasing Wage Differentials, and Increasing Retirement Ages

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Regional Wage Differentials further Increase, but Major Metropolitan Labor Markets (essentially the greater Tokyo area) are Still the Recommended Choice for Foreign Capital Investments



In February, 2007, the Ministry of Health, Labor and Welfare published a survey of wage levels by prefecture. The highest scheduled monthly earnings (not counting overtime, commutation at cost, and usually 4 to 6 months of summer and winter bonus payments) as of June, 2006 was 375,000 yen (US\$3,260 at 115yen/\$) in Tokyo. The average age was 40.2 years with 12.1 years of service. The lowest monthly pay level was in Aomori prefecture in the north part of Honshu (Japan's main island). The pay level here was 221,700 yen (\$1,928) with an average age of 41.6 years and 11.6 service years. This would make pay in Aomori only 59.1% of what it is in Tokyo. The figure for Tokyo was 4,900 yen (US\$43) higher than the previous year, while the figure for Aomori was 1,100 yen (\$10) lower than in 2005.

Average monthly earnings increased in 24 prefectures, mainly large metropolitan areas, but decreased in 23 prefectures and particularly in Aomori, the Okinawa islands, and Iwate (also in northern Honshu).

Foreign capitalized firms, especially if they are going to have an expat, or expats stationed in Japan, or home office visitors/specialists in and out of Japan, have always clustered their operations in Kanto, or the greater Tokyo, Yokohama area. Way fewer firms would happen to get started in the Kansai—Osaka, Kobe, Kyoto area, but even this was often regretted. In more recent years, with foreign capital suppliers serving the Japanese auto industry, some expat staff have found themselves

a bit isolated in the Nagoya area as well. Being in these areas, especially greater Tokyo, made sense, and continues to make sense, in terms of the expat and his or her family's life style, not the least of which is presence and choice of international schools, ease and distance to international airports, if not membership in international clubs such as the Tokyo American Club. Many Europeans and other expats also join there with their companies footing the bill.

Even more important than expat convenience/viability is the difficulty of attracting the good, international, foreign language speaking Japanese staff and managers that are needed. There is a reason the population of the large cities, especially Tokyo's 23 wards, has been increasing more than ever in recent years at the expense of the regional areas. Many of these towns and villages are little more than ghost towns, inhabited by very old ghosts at that. A foreign capitalized firm will have even more trouble bucking this trend than an indigenous local firm would have.

I read with interest that more firms are moving into rural areas of China, including some foreign firms. I guess the difference is that in that country wage differentials of several hundred percent make it even more attractive to seek this lower priced and very plentiful labor force. I suppose they are also primary manufacturing operations, without the same internationalized talent needs, and labor shortage that we face in Japan.

Mandatory Retirement Age on the Rise

In Japan, employers must enroll employees into the mandatory social security government retirement system. This is called 'kosei nenkin' or Employee Pension Insurance. The contributions are equally made by the employer (on top of the salary amount quoted to someone joining a firm), and by the employee by way of a deduction at time of monthly salary payment to the employee. The employer pays 7.144%, and the employee has deducted from his or her monthly salary the same 7.144%, for a total of 14.288%.

In addition to this, most companies provide for a corporate retirement allowance. This is not legally required, although once the retirement plan is defined in a company's Rules of Employment (ROE), unless the company changes the benefit and those ROE, the employer would have to provide this benefit. (ROE are legally required under labor ministry jurisdiction if a firm has over 10 employees. However, in practice, when a firm hires its first employee and wants to place him or her in the mandatory government social insurances, the social insurance office usually asks for a copy of the ROE.) Traditionally, this non-mandatory retirement benefit is paid out as a defined benefit plan (not a defined contribution plan) lump sum retirement allowance within some 30 days (or could be more) of retirement. The retirement allowance was traditionally based on months of base monthly salary times a number of months of salary depending on years of service. It was traditionally one month or a bit more of monthly salary for every year of service. It usually appears as a table at the back of the ROE. It usually goes up to 40 years of service, and might peak at 50 months of salary.

The *kosei nenkin*, or Employee Pension Insurance used to be payable to employees at the traditional retirement age of 60. In recent years, the age that this is payable from the government has moved up to 65. A lot of people do not seem to know it, but from April 1, 2006 the retirement age 'basically' became 62. From April 1, 2007 it became 63, from April 1, 2010, it will become 64, and from April 1, 2013, 65 years old. I say 'basically', because in fine Japanese form, things are never quite what they may at first seem. For example, the retirement age could be kept at 60 in the Rules of Employment (ROE), as long as there are explicit written objective

and fair criteria for letting most (but not necessarily all) people work up to the above ages.

The authorities recommend that years of service toward the retirement benefit be capped at age 60, and that people be reemployed on term contracts. This testifies to the fact that the government authorities have always been mindful of the burdens and needs of companies as well as employees. If the government was going to force employers to keep people working longer by way of increasing the retirement age, the government (and of course the business interests that lobby the government), felt it was too much for employers to also have to be burdened with continuing corporate retirement liabilities. Adjustments in pay level can take place, as can the work assigned. The rational is that one should work longer, but the government certainly does not want to also force employers to maintain pay levels of older workers who may be losing their edge.

I think firms and the authorities have always been mindful that it is necessary to make room for younger people in the ranks of managers. In this sense, age discrimination is non-existent on such an issue in Japan. So this means that although companies essentially have to allow their employees to work up until the above extended retirement ages, the non-mandatory, non government corporate retirement benefit can be, and usually is closed out at age 60. The mandatory, government program of *kosei nenkin*, or Employee Pension Insurance, would continue to be payable by both the employer and employee, although these payable premiums would be at the lower salary level if salaries were lowered after age 60. In the administrative guidance of the government, they actually recommend and assume that this is what companies will do. The government, and Labor Standard Office also has no problem if pay levels of people are reduced at age 60, just because the person reached age 60. Actually, backed up by earlier administrative guidance, many firms adjust pay levels down at an earlier point when most employees reach age 55. This guidance was about 20 years ago when employers were encouraged to move the traditional 55 year old retirement age up to age 60.

So this is a pretty reasonable approach and system that should be good for employees who cannot get the government national pension until age 65 now, and employers who can flexibly utilize

older workers as the labor market tightens. And with the aging of the workforce, and decrease in population, there now is, and will continue to be, even more of a labor shortage in Japan. As wages rapidly go up in other Asian countries including China, and the Japanese realize they have been burned by transferring (knowingly or unknowingly) too much technology to places like China, manufacturing in Japan will become more attractive. Already some large plants are being built in Japan, or are slated to be built here, for example the first new auto plants in years. This would have happened less 10, or even 2 years ago.

However, if a foreign capitalized firm does not know of the above flexible and widespread application, does not have the right written and practiced policies, the increase in the retirement age could be more of a labor pain than it needs to be. I have seen countless clients that were not informed of these flexible applications by their local staff. So Japan may be unusual. Although the retirement age is going up above 60, that does not mean that pay levels have to be maintained above age 60. In fact in

most Japanese firms a quid pro quo for extended retirement ages is a salary cut. And certainly these firms do not allow years of service beyond age 60 to be calculated into their retirement benefits.

In many foreign capitalized firms, home offices, and expatriate foreign bosses may not know these things. In those cases, often Local Japanese managers keep their mouths shut, and do not go out of their way to educate their companies to the possibilities that would keep those companies more competitive with what Japanese employers are doing. I suppose the Japanese local staff directly affected cannot be blamed for hoping that salaries and retirement benefits will continue to rise beyond age 60. (I believe there is nothing wrong with salaries rising for some of your people over age 60. I also believe that people over 65 can do a good job, and at least in Japan, you do not have to worry about age discrimination when it comes to assigning them to an appropriate and fair pay level each year on those extension contracts.)