

# How the Rapid Growth of Non-Regular Employees Will Impact the Next Round of Employment Adjustment

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*We predict the next round of employment adjustment will largely bypass regular employees and impact the rapidly growing segment of non-regular employees. In the worst case scenario, the pace will surpass previous adjustments and lead to an employment rate of 10% by 2010. The proposed ban on temp staff workers in the manufacturing sector would hurt more than help by limiting opportunities for new hiring. We recommend a policy that enhances re-employment opportunities through occupational training and better job matching, and at the same time expands the safety net of employment insurance.*

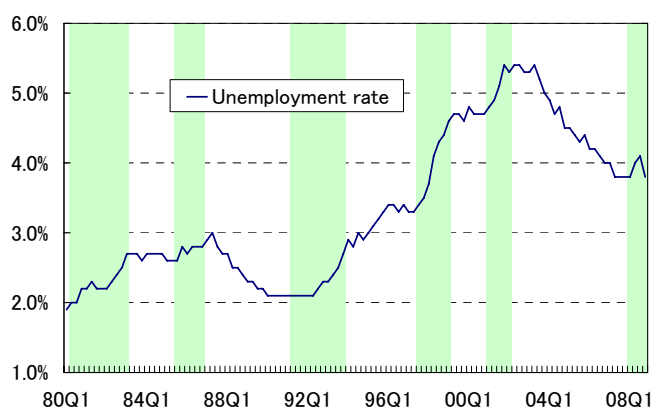
## 1. The Deteriorating Job Situation

### 1. The Economy's Sharp Downturn in Autumn 2008

The surge of oil prices until summer 2008, followed by the recent sharp downturn of U.S. and other overseas economies, have caused Japan's economy to steadily contract since its October 2007 peak. Although relatively mild at first, the recession accelerated from September 2008 when the Lehman Brothers collapse triggered a global financial crisis.

The job situation has also deteriorated, with media reports appearing almost every day about employers who reneged on promises to hire new graduates, laid off more workers, or slashed their temporary staff workers. The unemployment rate, which had leveled off through autumn 2008, surged 0.7 point in the two months from November, reaching 4.4% in December.

Exhibit 1 Unemployment Rate



Note: Shaded areas denote recessions.

Source: Statistics Bureau, Ministry of Internal Affairs and Communications, *Labour Force Survey*.

However, considering that unemployment rarely fell below 4% in the long expansion from 2002, the current level is not unusually high (Exhibit 1). Compared to a year ago, payroll employment at yearend 2008 decreased by only 70,000 jobs, while the unemployment rate fell only 0.6-percentage point. By comparison, the U.S. economy lost almost 3 million jobs in 2008 and saw the unemployment rate surge to 7.2% at yearend from 4.9% one year ago.

### 2. Why Unemployment Lags Behind the Economic Cycle

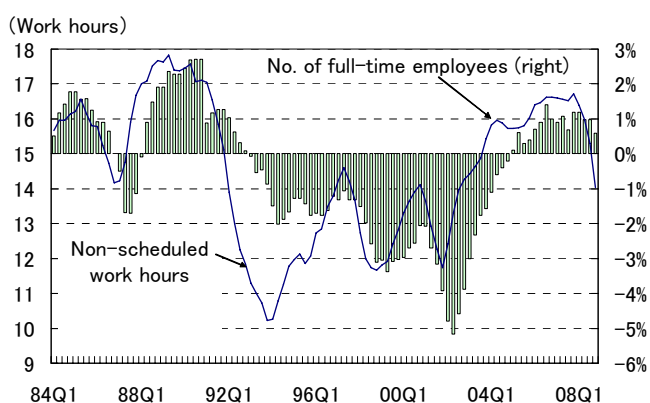
In the current recession, the unemployment rate did not start to rise until one year into the recession. This pattern is similar to previous recessions, wherein the unemployment rate showed no appreciable increase at first, and began surging upward after a lag. In fact, in the previous two recessions, the unemployment rate peaked only after the economy had bottomed out and started to recover.

This lag of the unemployment rate behind the economic cycle occurs due to the way employment adjustment unfolds in phases. When companies start decreasing production in an economic downturn, they first reduce labor input by shortening overtime hours (non-scheduled work hours).

Only after this phase plays out do they start to cut employment.

Looking at the historical relationship between scheduled work hours and number of employees in manufacturing, we find that when non-scheduled work hours exceed (or fall below) approximately 15 hours per month, the number of employees starts to rise (or fall) after a short lag (Exhibit 2). Notably, in the two post-bubble expansions from October 1993 and January 1999, the economy slowed down before non-scheduled work hours reached the 15-hour threshold, and as a result employment failed to grow. However, in the longest postwar expansion from 2002, non-scheduled work hours soared above 15 hours, spurring employment to grow from 2005.

**Exhibit 2 Non-Scheduled Work Hours and No. of Employees (manufacturing sector)**



Note: Data covers establishments with 5 or more employees from 1990, and establishments with 30 or more employees before 1990.  
Source: Ministry of Health, Labour and Welfare, *Monthly Labour Survey*.

Thus when manufacturing production began to decline in early 2008, non-scheduled work hours stood at the highest level since the bubble economy era. As a result, labor input could be sufficiently reduced by trimming non-scheduled work hours. However, after production plummeted in autumn 2008, non-scheduled work hours plunged well below 15 hours, reaching 11.6 hours in December (seasonally adjusted). Thus we are now in the initial phase of employment adjustment, and can expect to encounter a full-fledged adjustment ahead.

## 2. Full-Fledged Employment Adjustment is Approaching

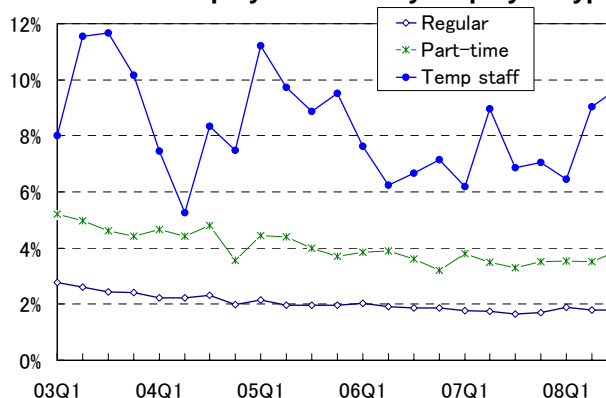
### 1. The High Unemployment Rate of Non-Regular Employees

Due to the fast growth of non-regular employment in recent years, the prevailing consensus holds that when employment adjustment becomes full-fledged, the pace of adjustment will be much faster than in the past.

Employment has always been unstable for non-regular employees, regardless of the economy's condition. In fact, by type of employment, the unemployment rate of regular employees (in the past year, the number of regular employees who became unemployed, divided by the total number of regular employees) has been remarkably stable at around 2%. By comparison, the unemployment rate has hovered at around 4% for part-time workers, and fluctuated widely around 10% for temporary staff workers (Exhibit 3). This is because the majority of temp staff workers become unemployed when their contract period ends.

The non-regular employment ratio, or proportion of part-time, temp staff, and other non-regular workers in all employees (excluding directors), more than doubled in the past two decades from 16.4% in 1985 to 33.5% in 2007 (Exhibit 4). Until 2000, part-time workers comprised the core of non-regular employees. However, spurred in part by deregulation of the temp staff industry, temp staff workers have contributed greatly to the surge of the non-regular employment ratio.

**Exhibit 3 Unemployment Rate by Employee Type**



Note: Unemployment rate = No. of unemployed workers by type in past year / (No. of unemployed and employed workers by type in past year)  
Source: MIC Statistics Bureau, *Labour Force Survey (Detailed Tabulation)*.

Led by temp staff workers, non-regular employment has contributed significantly to the recent growth of number of employees. The problem is that being relatively easy to adjust, non-regular workers are likely to bear the brunt of employment adjustment in an economic downturn.

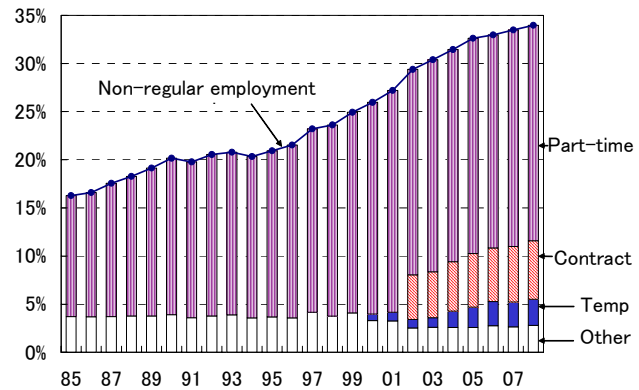
## 2. Employers are Already Reducing Non-Regular Employees

According to the *Comprehensive Survey of Diversification of Employment Type (2007)* by the Ministry of Health, Labour and Welfare, the primary reasons that employers cite for hiring non-regular employees are: to reduce wage costs (40.8% of respondents); to accommodate fluctuating work demands during the day or week (25.9%); to secure employees with expertise (24.3%); because regular employees cannot be secured (22.0%); to adjust employment in response to business conditions (21.1%); and to reduce non-wage labor costs (21.1%; Exhibit 5).

As these results indicate, companies hire non-regular employees primarily to reduce labor cost and facilitate employment adjustment.

Companies are already reducing non-regular employment in response to rapidly deteriorating business conditions. According to the MHLW survey of the job termination status of non-regular workers (completion of temp staff employment period or subcontract period, termination of contract,

**Exhibit 4 Non-Regular Employment Ratio**



Sources: MIC, *Labour Force Survey Special Survey (February Survey)* for data to 2001; *Labour Force Survey (Detailed Tabulation)* for data from 2002 onward. For 2008, shows average value from January to September.

**Exhibit 5 Reason for Hiring Non-Regular Employees**

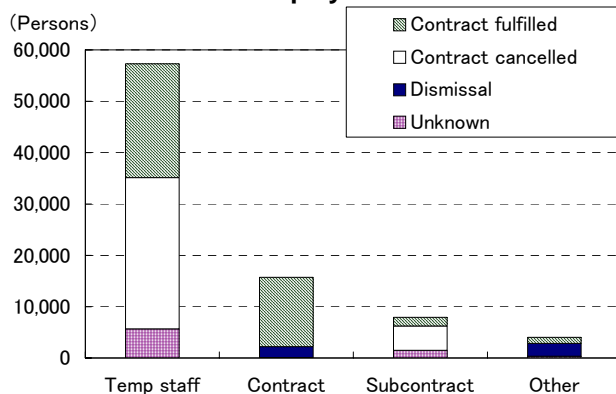
(Multiple response; percent)

	Reduce wage cost	Adjust to daily/monthly demand changes	Secure skilled workers	Secure experts	Could not hire regular workers	Adjust to business cycle	Reduce non-wage cost
Non-regular employee	40.8	31.8	25.9	24.3	22.0	21.1	21.1
Contract	28.3	4.5	38.3	43.6	18.2	15.6	8.1
Shokutaku contract	20.5	3.4	41.9	35.4	10.9	2.2	5.2
Temp staff	18.8	13.1	35.2	20.2	26.0	25.7	16.6
Seasonal	27.2	29.2	21.9	22.9	14.7	23.5	15.4
Part-time	41.1	37.2	11.8	12.7	17.6	18.0	21.3

Note: Shows results for the top 7 of 13 reasons cited in the survey.

Source: MHLW, *Comprehensive Survey on the Diversification of Employment Types*.

**Exhibit 6 Termination Status of Non-Regular Employees**



Source: MHLW, *Status of Non-Renewal of Contracts of Non-Regular Workers* (January 26, 2009).

and dismissal), in the latest release on January 26 found that in the six-month period from October 2008 to March 2009, approximately 125,000 persons either lost or are slated to lose their jobs. The number was approximately 30,000 persons in the November 25 release, and 85,000 persons in the December 19 release. Thus from November to January, the number of non-regular employee job terminations has grown fourfold. By employment type, temp staff workers comprise the majority at 68.7% of the total, and dismissals exceed contract completions (Exhibit 6).

However, since the survey data is compiled by local labor bureaus and public

employment stabilization offices nationwide based on questionnaires sent to companies, it does not necessarily reflect overall labor market trends. For this, we refer to the *Labour Force Survey (Detailed Tabulation)*, which contains data on number of employees by employment type. In the latest data for July-September 2008, regular employees continue to decline significantly, while non-regular employees are actually growing (Exhibit 7). However, since the survey data does not reflect the recent downturn in job conditions, we must wait for the October-December 2008 data or later data to confirm whether non-regular employment has decreased.

When the previous employment adjustment occurred in the late 1990s, regular employees were targeted while non-regular employees continued to grow in number. The next round of employment adjustment, which will target non-regular employees, will be a new experience for Japan.

### 3. Previous Employment Adjustments Limited Only the New Hiring of Regular Employees

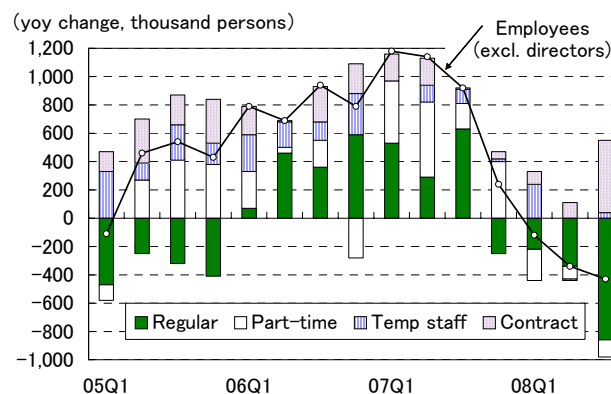
To see how employment adjustments were conducted in the past, below we examine trends by employment type (Exhibits 8 and 9).

The change in number of employees from the previous year is determined by the number of newly hired employees (including conversion from other employment types) and number of separations (unemployed persons and those leaving the labor force). Payroll employment increases when new hiring exceeds job separations. For example, even if separations rise, the total number of employees can still increase if newly hired employees increase by more.

The new hiring rate, or number of newly hired employees divided by total employees in the previous year, and separation rate, or number of separations divided by total employees, for non-regular employees both ratios exceed 10% are far higher than for regular employees. Thus while non-regular employees are more prone to become unemployed or leave the labor force, a large proportion of them also find new employment.

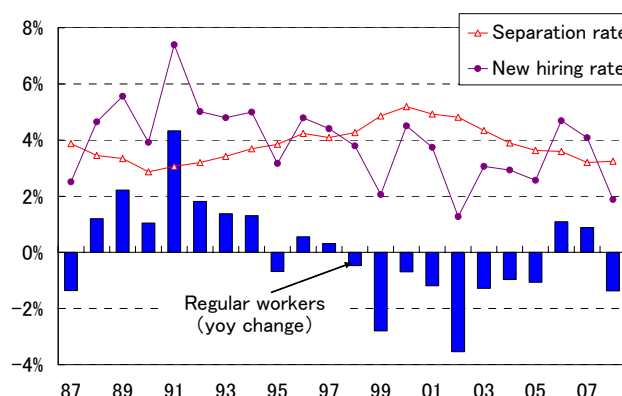
Moreover, compared to the relative stability of the separation rate, the new hiring rate is volatile and significantly affects the change in number of employees. Despite a declining separation rate from 2001 to 2005, the number of regular employees continuously fell from 1998 to 2005 due to the low new hiring rate. For non-regular employees, although the new hiring rate has

**Exhibit 7 Number of Employees by Type**



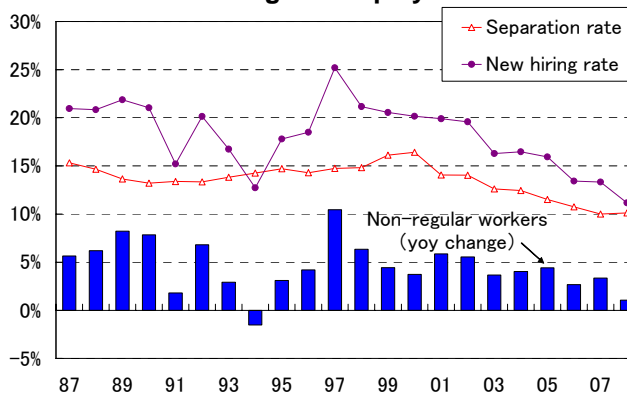
Source: MIC Statistics Bureau, *Labour Force Survey (Detailed Tabulation)*.

**Exhibit 8 Factor Analysis of Change in Number of Regular Employees**



Sources: MIC, *Special Labour Force Survey (February Survey)* for data through 2001; *Quarterly Labour Force Survey (Detailed Tabulation)* for data from 2002 onward. For 2008, shows average value from January to September.

**Exhibit 9 Factor Analysis of Change in Number of Non-Regular Employees**



Sources: MIC, *Labour Force Survey Special Survey (February Survey)* for data to 2001; *Labour Force Survey (Detailed Results)* for data from 2002 onward. For 2008, shows average value from January to September.

consistently exceeded the separation rate, a plunge in the new hiring rate in 1994 caused the number of employees to decrease.

Although employment adjustment is often associated with aggressive restructuring efforts involving layoffs, contract terminations, and early retirement, past experience indicates that it has actually aimed to limit hiring of new graduates and mid-career employees.

### 3. Scenarios for Unemployment Rate Increase and Policy Issues

#### 1. Three Scenarios Based on Adjustment of Non-Regular Employees

As seen by the scale of decline of the manufacturing index from the peak, which already exceeds that of the first oil crisis, the present recession will trigger a deep employment adjustment even by historical standards. According to economic forecasts released by private institutions in December 2008, real GDP will decrease -1% on average in fiscal 2008 and 2009. However, judging from the recent deterioration of conditions, forecasts are likely to be downgraded further. Negative GDP growth has not occurred in two consecutive years since fiscal 1997 and 1998 (-0.0% and -1.5% respectively). However, the cumulative decline of GDP is expected to surpass this and reach a record level.

The coming employment adjustment and increase in unemployment rate will likely outpace previous adjustments. Of particular concern is the impact that the unprecedented adjustment of non-regular employees will have on the unemployment rate.

Assuming that the coming adjustment of non-regular employees is done in the same way as previous adjustments of regular employees, we ran three simulations to see how far the unemployment rate, which is at 4.0% in 2008, would rise by 2010. Looking back at previous adjustments of regular employees, adjustment paces peaked in 1999 for the separation rate (rising from 4.3% to 4.9%), and in 2002 for the new hiring rate (falling from 3.7% to 1.3%). Thus in the coming two-year adjustment of non-regular employees, we assume the adjustment pace of the separation rate and new hiring rate will match these previous highs.

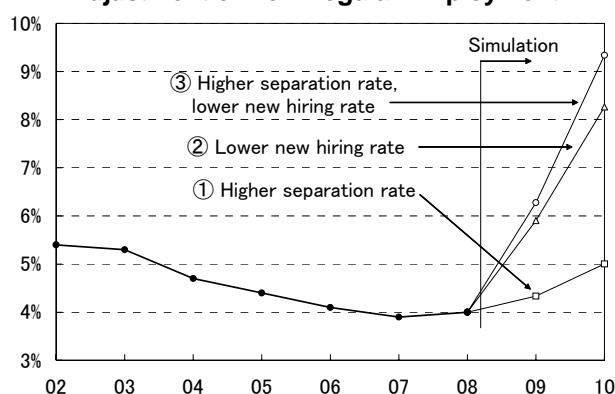
In Scenario 1 (separation rate increase), the unemployment rate rises from 4.4% in 2009 to 5.1% in 2010. In Scenario 2 (new hiring rate decrease), the unemployment rate surges to the previous high of 6.0% and continues upward to 8.3% by 2010. In Scenario 3 (separation rate increase and new hiring rate decrease), the unemployment rate surges to 9.4% by 2010, causing job losses for 920,000 regular employees and 3.25 million non-regular employees (Exhibit 10).

All three scenarios suggest the unemployment rate's rise will be caused more by a declining new hiring rate than an increasing separation rate.

However, if the economy should recover during the two-year adjustment period, it could halt the rise of the unemployment rate.

On the other hand, the economy could deteriorate to the point that regular employees (whom we assume will continue to decline at the current pace) become targeted for full-fledged adjustment. Indeed, the pace of adjustment could even exceed our worst case assumption. In the next two years, the unemployment rate will likely exceed the record high of 5.5%.

**Exhibit 10 Unemployment Rate Increase Due to Adjustment of Non-Regular Employment**



Sources: MIC, *Labour Force Survey Special Survey (February Survey)* for data to 2001; *Labour Force Survey (Detailed Results)* for data from 2002 onward. For 2008, shows average value from January to September.

## **2. The Need to Expand the Safety Net**

Amid the social issue of massive layoffs of temporary staff workers in the manufacturing industry, debate has intensified to strengthen regulation of temporary staff workers and ban their use in manufacturing. However, we believe that stricter regulation is not the solution. While the ban on employment of temporary staff workers would obviously prevent some loss of jobs, it is inconceivable under current economic conditions that employers would instead hire regular employees. The likely outcome is that non-regular workers would simply lose these job opportunities.

As we explained, the severity of employment adjustment will depend less on the increase of new job losses than on the decline of new hiring. Although more labor market regulation could help suppress new job losses, it threatens to dampen new hiring and thus lead to more long-term unemployment among currently unemployed persons. Instead, policies should aim to enhance re-employment opportunities through occupational training and reducing the mismatch between job seekers and available jobs.

In addition, since non-regular employment is less secure form of employment non-regular employees comprise one-third of the total, it is crucial to revise the safety net particularly with regard to employment insurance, which still remains limited to regular employees. While the government eased the eligibility requirement for employment insurance from an expected employment period of one year to six months, many workers still remain uncovered. A further reduction of the expected employment period, reduction of the required scheduled work hours (currently at least 20 hours per week), and easing other eligibility requirements, it is essential to expand the scope of the safety net.