

JAPAN ECONOMIC CURRENTS

A COMMENTARY ON ECONOMIC AND BUSINESS TRENDS

Changes in Attitudes Toward Work Among Japan's Young Generation

by Yoshihiro Toyoda, Works Institute, Recruit Co., Ltd.

Japan used to be proud of the fact that its employment market was the most stable and full in the world. But since the high-water mark of a 3.4 percent unemployment rate in 1997, it rose to 4 percent in 1998, and hit 5.4 percent last month. Especially worrisome is that the unemployment rate for young people (those between 15 and 24 years old) exceeded 10 percent, noticeably higher than other age brackets.

Rising joblessness among young Japanese is accompanied by two dramatic changes in their attitudes and behaviors toward work: (1) a soaring number of college graduates who do not have full-

time regular jobs, nor go to a graduate school, and (2) a widely accepted "freeter" employment style or lifestyle. (Freeter is a Japanese compound word invented from the English word "free" and the German word "arbeiter," or worker).

Drastic Changes in the Japanese Employment System During the Last Decade

Once the source of admiration, Japanese style management was supported by three fundamental employment principles: "lifetime employment," "seniority system," and "company union." In sustaining these mechanisms for many years, the practice of hiring new graduates en masse played an essential role: a constant inflow of newly hired young people enabled Japanese companies to maintain order within organizations and achieve stable growth, leading to their long-term prosperity.

But with the collapse of the Japanese bubble economy at the beginning of the 1990s, Japanese companies started to hire fewer new graduates. The number of job openings available to each new college graduate declined from

2.86 in 1990 to 1.08 in 1995. In this severe hiring freeze, often referred to as the "glacial period," some college graduates had no job offer at all upon graduation.

Increasing mid-career recruiting also contributed to reduced employment opportunities for new graduates. More companies became willing to recruit workers with some work experience from other companies, a practice once considered heretic in Japan's corporate culture.

Furthermore, changes in employers' focus from full-time regular employees to part-time or temporary workers, primarily in order to achieve cost reduction, negatively affected the job market for new graduates.

Coincidentally, the number of job applicants graduating from college has been rising sharply for the past 10 years. Currently, more than 430,000 students, compared to slightly more than 280,000 in 1990, are now looking for jobs. Graduates have been hit hard by a new reality: the college degree no longer guarantees employment.

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Primary Contributors for Soaring Number of New Graduates Without Further Full-Time Careers

While the employment rate among new college graduates has started to fall, the number of young people called Jobless New Graduates who have no full-time career started to soar (see Chart 1). Today, as many as 21.7 percent of Japanese college graduates are pursuing nontraditional paths that do not involve any full-time commitment, either in work or academics. An unbalanced demand and supply relationship is responsible for this phenomenon to some extent, but there are other factors at play: (1) accelerated job seeking activities and (2) changes in the types of employees who appeal to most companies.

Japanese companies, which now have fewer slots to fill, tend to start their recruiting activities early, in order to attract top students. But a majority of Japanese college students acknowledge that they do not know 'what they would like to do' or can identify 'in what area they can best utilize their talents.' In part, this is a systemic problem – Japanese colleges do not attempt to prepare their graduates for future careers, nor do they provide sufficient support for career planning. Not long ago, the failure of colleges to look ahead to the

work place was relatively unimportant because companies typically provided their own training to recruits. But now the same companies seek to hire 'students with clear vision and will' who can contribute to revitalizing the organization. Typically though, a majority of the students fail to pass job interviews because they give stereotyped answers to questions that probe their motivations.

Another factor is the role of the Internet in employment searches. Japanese students today tend to research the job market and companies on line. While this practice may enable a more efficient and systematic job search, it can limit students' abilities to gather first-hand information from college alumnae who are employed in targeted companies, possibly making it harder for them to find the best job match.

Parental dependence is shifting too. In the past, once students graduated from college, they started working in full-time jobs; they had to be financially and/or physically independent from their parents or risk being harshly criticized. But social norms have substantially changed – many young people today continue to live with their parents after graduating from college, partly because of fewer children per household. In

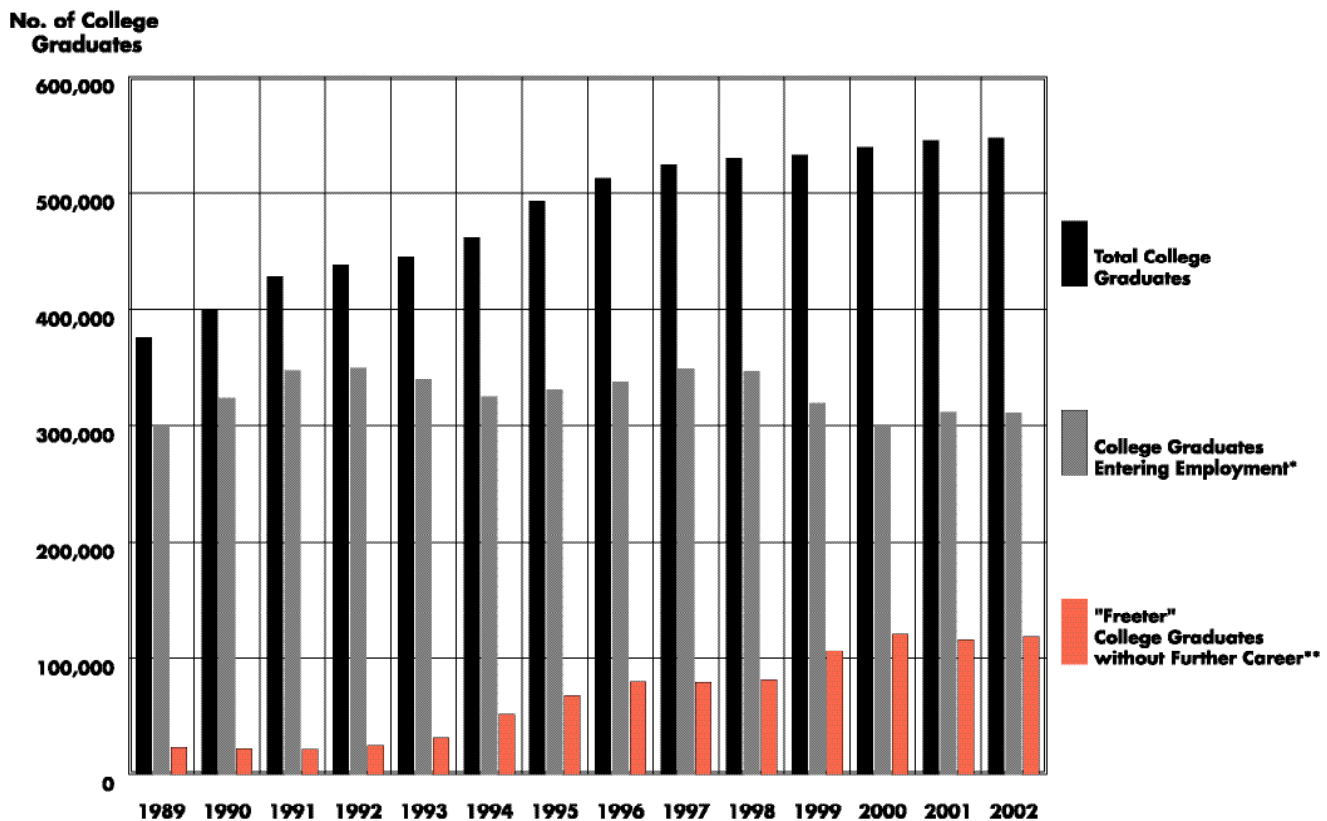
some cases, singles adults in their 30s still live with their parents.

Freeter as 'Lifestyle or Form of Employment'

Graduates without full-time career jobs have come to be called "freeters." As mentioned, freeter is a Japanese word coined in 1987 and originally connoted 'a young person, who does not hold a regular occupation to pursue his/her dream, living on part-time work.' At first the freeter phenomenon attracted much public and media attention as new the type of young Japanese who attempts to fulfill him or herself in an innovative way. But now freeters tend to be portrayed negatively as people who depend on their parents and take minimum part-time jobs' or 'those who live from mouth to hand, without any regular occupation.'

Freeters fall in three different groups: (1) recent high school and middle school graduates, (2) school drop-outs, and (3) former corporate employees. The freeter population doubled from 850,000 in 1987 to 1,570,000 in 1997, and currently is estimated to exceed 2,000,000 (Note 1). Although this figure accounts for only 5 percent of the total employed, and less than 10 percent of regular corporate or public employees, freeters dominate

"FREETERS" IN JAPAN



SOURCE: BASIC RESEARCH ON SCHOOLS BY MINISTRY OF EDUCATION, CULTURE, SPORTS, SCIENCE, AND TECHNOLOGY

* EMPLOYMENT: FULL-TIME WORK (US EQUIVALENCE TO FULLTIME PROFESSIONAL EMPLOYMENT).

** CAREER: FULL-TIME EMPLOYEE OR STUDENT AT GRADUATE SCHOOL.

certain business sectors, such as convenience stores (52.3 percent) and restaurants (19.7 percent). In addition, freeters make up 10–20 percent of those employed in sales/service industries such as Japanese inns, hotels, other leisure facilities (19.2 percent) and retailers (12.8%) (Note 2).

A survey of freeters reveals that 51.6 percent work more than 40

hours a week, while those working fewer than 20 hours a week account for less than 10 percent.

Interestingly, 16.5 percent of freeters who work more than 40 hours per week reported that they perform work or have skills at the same level or above those of their peers who have worked regular jobs for more than 4 years (Note 3).

Note 1. Source: 'Data Book about Employment of the Young Generation', published by the Japan Institute of Labour. Freeters are unmarried people aged 15–34, who work part-time, excluding those who are not working at all.

Note 2. Research on Working People 2000 by Works Institute, Recruit Co., Ltd

Note 3. Research on Non-Traditional Employees 2001 by Works Institute, Recruit Co., Ltd

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Freeters thus play an essential role in the Japanese economy and provide a valuable and flexible source of labor. Social biases against freeters fail to appreciate their contributions.

Policy Recommendations

Stark demographic realities mean that Japan will soon face a labor shortage of young people. Clearly, more must be done to urge young people to consider and plan their careers more seriously, despite certain values enjoyed by freeters.

As explained, most Japanese college students start their job search without any clear vision about their life goals. It is essential that there be better communication between schools and work places in the earlier stage of education. Dramatic changes in school curricula to address this problem are also necessary. Companies should be encouraged to offer internship opportunities to students. Policymakers should study programs aimed at introducing work to children such as the 'National Take Your Child to Work Day' and 'Job Shadowing,' that are popular in the U.S.

Japanese public school teachers are notorious for being out of touch with the real world. More than improving teachers' skills or knowledge is needed, teachers,

who are alert to, and understand society itself and corporate world are crucial, so that Japan does not produce a mass of children who have little clue about the wider world around them.

More generally, Japan should strive to create a social system that promotes a wide variety of lifestyles including, but not limited to freeters, as well as methods to educate people differently. Unfortunately, the Japanese social system is still based on the traditional, rather obsolete concept: a full-time regular employee husband who supports the family with a stay-at-home wife.

Japan's current tax system and health insurance/pension system were all based on this somewhat outdated family model. As a result, in some cases, individual business owners are disadvantaged over corporate regular employees, while part-time workers typically earn much lower salaries than those of regular employees, regardless of ability.

Thus, to achieve job equality, a sea change in social attitudes is necessary. Many Japanese still cherish an illusion that a full-time regular position is always desirable, and other positions are merely backups. But to enjoy a flexible and innovative work force, a variety of

job options should be available to workers. This is precisely the time that Japan must completely change its views and values about different types of employment as being equal. Failure to embrace a new outlook will mean that Japan's bright employment future will remain a dream. ■

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A Bilateral “Social Security Totalization Agreement” is Needed Between Japan and the United States

by Valerie Ploumpis, Keizai Koho Center

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Interest in concluding a so-called “Social Security Totalization Agreement” between Japan and the United States has been alive for nearly twenty years.

As currently drafted, the proposal would eliminate – both for the employee and his or her employer – the current double taxation of social security contributions imposed when Japanese executives work in the United States and US executives work in Japan. If approved, the tax treaty would require that contributions for executives sent to the other country for five years or less be made only to the home country.

Starting in 1973, the United States has concluded such Social Security Totalization Agreements with twenty countries and is keen to expand its network of agreements with others. For its part, Japan has signed such agreements with the United Kingdom and Germany and is now focusing on such an agreement with the United States.

Formal negotiations aimed at concluding an agreement between the Japan and the United States commenced several years ago and in recent weeks, new efforts have been made to address outstanding issues.

What Would a Social Security Totalization Agreement Accomplish?

An agreement between Japan and the United States would benefit Japanese employers and Japanese expatriates working in the United States branch office (or subsidiary) of a Japanese company for periods of up to five years by relieving them of a double social security tax burden. Naturally, because bilateral tax agreements are reciprocal, the benefits would flow in the other direction – US companies with American nationals working in the Japanese branch office (or subsidiary) of an American company would benefit equally from a Totalization Agreement.

At present, Japanese expatriates sent to the United States and their employers are subject to US Social Security (FICA) taxes even if they do not remain in the US long enough to be eligible collect their social security benefits upon retirement.

As a technical matter, one-half of the social security tax is imposed on the employee and one-half on the employer. But often the full burden is borne by the employer because the employee also makes contributions in Japan.

Case Study

To illustrate the current system, assume that a Japanese company transfers a Japanese executive to work in its US branch or subsidiary. Assume also that this Japanese employee earns \$150,000 in wages while working in the United States. The total FICA tax that will be imposed on the Japanese executive's wages, each year, consists of:

- * The OASDI (social security pensions) portion is calculated only on the first \$84,900 of the executive's wages. Since the wages of the hypothetical employee exceed this amount, the withholding tax would be limited to $\$84,900 \times 12.4$ percent, or \$10,527.
- * The Medicare (health insurance for senior citizens) portion, calculated on all wages earned by the executive, would be $\$150,000 \times 2.9$ percent, or \$4,350.

Thus, in addition to the pension and health insurance contributions made to the home country for wages paid to the Japanese executive working in the United States (as is typically the case), the employee and employer would also be required to pay to the United States an additional \$14,877 per

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year with respect to that one Japanese executive. Worse, these US social security contributions are frequently made without any benefit accruing to the Japanese employee upon retirement.

If a typical Social Security Totalization Agreement were signed between the US and Japan, however, a Japanese employee temporarily assigned to the United States (or a United States employee temporarily assigned to Japan) for a period of five years or less (a “Short-Term Expatriate Employee”) and their employers would be exempt from the social security taxes or contributions imposed by the host country (in the example above, the United States), as long as taxes or contributions were continued to be made to the home country (in the example above, Japan) as most do now.

For expatriate employees sent abroad for longer periods, a typical Social Security Totalization Agreement provides that only the host country, and not the home country, may tax or require contributions. Regardless of the duration of an assignment, social security taxes or contributions would be paid to only one country. In the example of the Japanese executive above, if the assignment were expected to last for more than

five years, the employee and the employer would only pay FICA taxes in the United States for the period the Japanese executive was assigned in the United States.

A Social Security Totalization Agreement between Japan and the United States would therefore create significant annual savings. The wages of the Japanese executive in the first illustration above would be exempt from FICA (an annual tax savings of \$14,877), and instead, the Japanese executive and his or her employer would only be subject to Japanese social security contributions on those wages earned in the United States.

Another benefit of Totalization Agreements is that they reduce the time requirements for employees’ eligibility to receive social security benefits, with benefits paid on a pro-rated basis. A Japanese worker who pays social security in the United States for as few as six quarters, for example, would be eligible for pro-rated benefits. Absent such an agreement, the Japanese citizen would have to pay social security taxes for at least 40 quarters to become eligible for United States benefits. Reciprocal rules, of course, would apply to United States expatriates who make social security contributions in Japan.

Issues Still Under Negotiation

Still to be resolved by Tokyo and Washington is the issue of whether a Short-Term Expatriate Employee from the United States to Japan who (along with his or her employer) is exempt from making contributions for pensions, would also be exempt from making contributions for health care.

Consistent with many other agreements it has signed, the United States is seeking such an exemption. Specifically, the United States is prepared to exempt Japanese Short-Term Expatriate Employees both from OASDI and Medicare taxes. Japan’s health care system, however, is fundamentally different from that of the United States – it provides universal medical insurance and covers all working people. As a result, it has never granted such an exemption and it may take some time to obtain the necessary consensus to expand the scope beyond pensions.

There are other issues still to be resolved, but it is understood that they are less problematic.

US Procedure For Implementation

Once an agreement is reached with Japan, the procedure in the United States to implement it in law would be straightforward: the

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'Heads Up on Hot Topics Affecting the US and Japan' "Sarbanes-Oxley: Implications for Foreign Companies."

by Michael Fine, Esq.

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Since the enactment of the Sarbanes-Oxley Act last summer, compliance with the new law's corporate governance and other reforms has dominated the boardroom at most large companies – foreign as well as domestic.

Speaking at the Keizai Koho Center's newest program series, "Heads Up on Hot Topics Affecting the United States and Japan," on October 15, guest speaker Michael Fine, a partner with Powell Goldstein Frazer & Murphy LLP, said that while full implementation is still months away, foreign companies that are listed on US stock markets ("foreign issuers") would have to comply with at least some reforms. While Sarbanes-Oxley remains a "moving target," Fine explained, one major reform (CEO certifications) has already been applied to foreign issuers and others could follow.

The new law, which many consider the most significant securities reform in 60 years, "is aimed at restoring investor confidence and market stability in the wake of the spectacular implosions at Enron, WorldCom and other companies." The impact of Sarbanes-Oxley, Fine said, could be sweeping. Key reforms of

particular concern to foreign issuers include:

- A new oversight board for audit firms (which could limit the ability of issuers to use foreign accounting firms for SEC filings);
- Mandated auditor "independence" rules (which could limit non-audit services available from an issuer's audit firm);
- Required "independent" audit committees (which could force significant changes to corporate governance structures);
- Mandatory CEO/CFO certifications for SEC filings (making these officials personally responsible for effective controls as well as accuracy in financial statements);
- More rigorous conflict rules for top executives (including a ban on "personal loans"); and
- Heightened reporting requirements for lawyers (for corporate as well as outside counsel).

The potential impact for foreign companies is broad because Sarbanes-Oxley makes no distinction in most areas between U.S. and foreign "issuers." Fine explained that the SEC historically

has tried to "accommodate" foreign concerns and modified rules to avoid conflicts or inconsistencies with home country regulation and practice. The SEC will again try to minimize friction, but in the current political and economic environment may find this harder in some areas.

Fine speculated that foreign-coverage decisions would be made on an issue-by-issue basis, rather than through a blanket exemption from all Sarbanes-Oxley reforms. He also thought it possible (although controversial) for distinctions to be made in some areas (such as accounting firm registration exemptions) based on different home country practices.

Fine identified several steps that foreign issuers should be considering. He said there would be a greater-than-usual opportunity to help shape rules for foreign issuers, because this area received so little attention during the legislative debate. Helping U.S. regulators to better understand home country practice, he thought, would be especially important. Fine also suggested that companies look closely at their internal controls programs, noting that much could be learned from recent advances in U.S. practice. ■

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proposed agreement would be transmitted by the President to both Houses of Congress, along with a report on the estimated number of individuals who will be affected by the agreement and the effect of the agreement on estimated income and expenditures. If neither the House nor the Senate votes to disapprove the proposal, the bilateral agreement would become effective on the later of the date provided in the agreement or within 60 “session days.”

A Japan-US Social Security Totalization Agreement is Needed

The result of a Social Security Totalization Agreement would be immediate savings to Japanese employers that send their Japanese employees to work in the United States. Without a Totalization Agreement being concluded between Japan and the US, Japanese employees and employers will continue to be subject to double taxation, and their employees will continue to be denied the corresponding

benefit for those additional taxes paid when they retire.

Given the number of Japanese companies, and Japanese expatriates, in the United States, conclusion of a Social Security Totalization Agreement between Japan and the US would result in a considerable amount of tax savings for Japanese businesses. ■

Valerie Ploumpis is the Associate Director of the Keizai Koho Center's office in Washington, DC.

Dear Readers:

We are pleased to announce that the Keizai Koho Center US office will soon launch our new website. And, to provide better service to our readers, we will begin to transfer publication of our monthly newsletter, “*Japan Economic Currents*,” from a paper format to a down-loadable, searchable electronic version within the next couple of months.

The KKC homepage will feature a wide range of bilateral economic data (GDP, balance of payments, trade, finance, foreign direct investment etc); a sweep of US-Japan economic relations 1970 to the present; information about Japanese politics (government reform, Japanese political parties); analysis of Japanese society today (aging society, industry issues, labor and health care matters); a “What’s New?” section; our publications; a profile of Keizai Koho Center activities; and updated information about the September 11th “Japan Relief Fund.”

As always, we look forward to hearing your comments and suggestions.

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Keizai Koho Center (KKC) is an independent, non-profit organization designed to promote the understanding of Japan's economy and society at home and abroad. Its financial resources are derived entirely from the private sector.

KKC fosters a deeper understanding of Japan's basic social structure. Furthermore, it conducts public affairs activities to improve the Japanese people's recognition of Japan's global role.

The views expressed in this newsletter are of the contributors and do not necessarily represent those of the Keizai Koho Center.