# WHY IT'S GOOD TO BE YOUNG IN JAPAN

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*At the Japan Society event "The Sun Also Rises?: Japan's Potential in the Post-Crisis Global Economy," we heard panelists talk about how they thought that Japan could incentivize growth in productivity. One area of note was that Japan's largest industrial employer shifting from seniority-based pay to pay for performance was a very big step.* **The Seniority-Based Systems of Lifetime Employment** If you are working in America and you're very good and also lucky, you could have a shot at ultimately ending up in the boardroom. In Europe, under a similar set of circumstances, you could find yourself running a region or division. But what happens to those who are very good and very lucky in Japan? In truth, not much…unless they've also worked at the company for a very long time. Japan's seniority-based wage system fits within the context of the idea of "lifetime employment." Employees in this system start with a standard basic wage and then receive an increase in pay for each year of service. If an employee leaves and joins another firm, he or she automatically starts at the lower end of the wage scale at the new firm. The reality of the system is that a) there is very little incentive to change companies, and b) younger workers could be underpaid initially but then be rewarded in later years even if their productivity is declining.[1] **The Bottom Line Problem:** What is the incentive for younger workers to do their best and push themselves to be more productive in their early years? In a word: money. **Introducing Pay-for-Performance** In an effort to incentivize increased productivity, especially among Japan's younger workers, we've seen evidence of some companies either adopting or examining merit-based pay: • **Toyota:** Toyota has been the quintessential example of a firm benefiting in the Abenomics environment, and as the largest weight in the (Tokyo Stock Price Index (TOPIX)[2], it is always front and center. Toyota's new compensation arrangement is designed to attract young talent—focused on exactly what we heard at the panel discussion. It will apply to about 40,000 workers—approximately 60% of its total workforce—aged between 18 and 65. Employees will be evaluated, and wages adjusted, twice a year.[3] • **Hitachi:** This has been a long conversation for Hitachi, which started in 2003 but wasn't characterized by any real follow-through. The key here is not necessarily what Hitachi itself is doing but rather how true adoption of this new type of employee compensation could encourage other firms to follow suit.[4]

• **Japan Post[5] :** Japan Post Group is led by state-owned Japan Post Holdings Co., which controls postal, banking and insurance units as well as a post office network operator. An average postman may see performance pay rise by up to 13% or fall by up to 6%. The key: improving employee morale.[6] **2015: A Year of Big Raises** While the shift from seniority-based to merit-based compensation is of central importance, it's also worth noting that thus far in 2015 we have seen some big compensation increases at Japanese firms. A critical goal of Abenomics is ending deflation, specifically by increasing consumption within Japan's economy. Prime Minster Abe is doing all he can to encourage Japanese corporate leadership to raise wages [7]. Toyota, Honda, Nissan, Hitachi, Panasonic and Toshiba are six examples of large companies that agreed to give their employees large pay increases this year[8]. This, combined with how one of the panelists cited during his talk how fiscal policy with the raised consumption tax from 5% to 8% in April 2014 was a net drag on economic growth—but now with postponement to April of 2017—any evidence of drag from fiscal policy should dissipate. The addition of low oil prices to this equation could lead to a further improvement in the consumption picture. **It's Good To Be Young in Japan** Japan is a land of opportunity for the young. In addition to the fact that the typical college student in Japan graduates with no debt (an amazing statistic in and of itself for those of us who were typical college students in the United States), there simply aren't enough of them. Looking through an economics lens, you want to be where there is scarcity because the market must pay a premium for that scarcity. In theory the demand for young, educated Japanese youth will drive incomes and productivity up. While the road is by no means easy, there are reasons to be excited about Japan's prospects as the country takes proactive steps in a positive economic direction. Read the *Japan Society Series*. *As of March 31, 2015 the WisdomTree Japan Hedged Equity Index held 5.81% of Toyota; 1.05% of Hitachi; 3.02% of Honda; 3.11% of Nissan; 0.76% of Panasonic and 0.68% of Toshiba.* [1]Source: "The Seniority Wage System (nenko joretsu)," Cross Currents—Learn About Japan,

2003. [2]Source: Bloomberg, with TOPIX constituents measured as of 3/31/15.[3]Source: Abinaya Vijayaraghavan, "Toyota to Move to Merit-Based Pay for Factory Workers: Nikkei," Reuters, 1/26/15.[4]Nyshka Chandran, "With Small Steps, Japan Wages Move towards Merit System," CNBC, 9/26/14. [5]Japan Post was a private company as of 3/31/15 and was, therefore, not eligible to be held in any WisdomTree Indexes. [6]"Merit, Not Seniority, to Pay at Japan Post," The Japan Times, 6/7/12. [7]Jonathan Soble, "Japan's Businesses Respond to Abe's Push for Higher Wages," The New York Times, 3/18/15.[8]Soble, 2015.

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## DEFINITIONS

**Productivity** : Measure of efficiency that details how much output is obtained per unit of input.

**Abenomics** : Series of policies enacted after the election of Japanese Prime Minister Shinzo Abe on December 16, 2012 aimed at stimulating Japan's economic growth.

**Tokyo Stock Price Index (TOPIX)** : A free float-adjusted market capitalization-weighted index that is calculated based on all the domestic common stocks listed on the Tokyo Stock Exchange First Section.

**Deflation** : The opposite of inflation, characterized by falling price levels.

**Fiscal Policy** : Government spending policies that influence macroeconomic conditions. These policies affect tax rates, interest rates and government spending, in an effort to control the economy.