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## Journal of The Japanese and International Economies

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# Long-term effects of labor market conditions on family formation for Japanese youth

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### ARTICLE INFO

#### Article history:

Received 8 September 2010

Revised 28 August 2011

Available online 24 September 2011

#### JEL classification:

J12

J13

#### Keywords:

Fertility

Marriage

Unemployment rate

### ABSTRACT

**Hashimoto, Yuki, and Kondo, Ayako**—Long-term effects of labor market conditions on family formation for Japanese youth

This study aims to examine how each cohort's family formation is affected by labor market conditions experienced in youth in Japan. Although the deterioration in youth employment opportunities has often been blamed for Japan's declining fertility rate, the effect of slack labor market conditions on fertility is theoretically unclear. We estimate the effects of regional labor market conditions at entry to the labor market and contemporaneous conditions on fertility, controlling for nation-wide year effects and prefecture fixed effects, and find the following. First, high school-educated women who experienced a recession while entering the labor market are less likely to have children. In contrast, a recession rather increases fertility among college-educated women. When summed up, the aggregate impact of labor market conditions experienced in youth on fertility is weak. Second, the unemployment rate at entry to the labor market is positively correlated with the probability of having two or more children conditionally on having at least one child. Third, the contemporaneous unemployment rate is negatively correlated with marriage of women in the local labor market, although the correlation is weak and concentrated on the less educated group. *J. Japanese Int. Economies* **26** (1) (2012) 1–22. Japan Society for the Promotion of Science, 7-3-1 Hongo, Bunkyo-ku, Tokyo 113-0033, Japan; Faculty of Economics, Hosei University, 4342 Aiharacho, Machida-shi, Tokyo 194-0298, Japan.

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## 1. Introduction

In this paper we examine how Japanese women's fertility is affected by labor market conditions experienced in youth using the dataset of individual-level information on fertility history. As is the case in many developed countries, in Japan, the fertility rate has been falling for decades. At the same time, unemployment and non-regular employment among youth have been rising (Fig. 1). Because of the concurrence of these events, the deterioration of youth employment has often been blamed for the declining fertility rate (e.g. Yamada, 2007; Matsuda, 2009).

Economic theories, however, do not predict that deterioration in youth employment prospects necessarily leads to lower fertility rates. A recession can have a positive substitution effect because worse employment opportunities for women lower the opportunity costs of childbearing. Therefore, the observed negative correlation between the unemployment rate and the fertility rate in Japan might be a mere coincidence. Indeed, empirical studies using data from the United States have established that worse opportunities for women in the local labor market can actually *increase* marriage and fertility rates, implying that the positive substitution effect tends to dominate the negative income effects that derive from a deterioration of male employment opportunities (Butz and Ward, 1979; Schultz, 1994; Blau et al., 2000; Dehejia and Lleras-Muney, 2004; Kondo, forthcoming).<sup>1</sup>

In Japan, however, the fertility rate remains low in a recession, suggesting that the negative income effect dominates the positive substitution effect on fertility. We suppose that two important factors peculiar to Japanese labor market are in play for suppressing the demand for children by cohorts that faced a recession in their youth: less flexibility for inter-temporal substitution of labor supply and the persistent effect of a recession experienced at entry to the labor market.

The first factor is based on the thin mid-career job market. In Japan, most firms prefer to hire new high school or college graduates over mid-career workers, and they favor employees who have stayed at the firm since their graduation in internal promotions. Therefore, workers have incentives to remain as long as possible at the same firm, and quitting a job is considered as a serious disadvantage. If a woman quits a job due to marriage or childbearing, it is hard for her to find a fulltime regular job after a few years' break. As a result, a considerable number of women choose to keep their jobs over marriage and childbearing.<sup>2</sup> Furthermore, the number of non-regular workers on temporary contracts has increased rapidly among unmarried young women since the late 1990s. Since few of them can take even an unpaid maternity leave, it is even more difficult for them to keep their jobs while raising children. In fact, women on such non-regular employment tend to delay marriage and have fewer children (Nagase, 2002; Sakai and Higuchi, 2005; Kitamura and Sakamoto, 2007). Hence it is harder in Japan to adjust labor supply inter-temporally, and the positive substitution effect may be weaker.

Another important factor peculiar to Japan is that labor market conditions in the year of graduation have very persistent effects on employment and earnings for the affected cohort. As in many other countries, new school graduates are hit more severely by a recession than prim-aged workers because it is easier for firms to reduce hiring than firing incumbent employees. In addition, as described above, Japanese firms prefer to hire new school graduates and favor employees who stay at the same firm for long time, thus there are few opportunities for cohorts who enter labor market during a recession to catch up by changing their jobs. Consequently, the labor market conditions at graduation have very persistent effects on employment and earnings in subsequent years (Genda et al., 2010). Such a decline in permanent income may affect the total number of desired children and the number of people who will never have a child. Furthermore, earning capacity is an important factor that Japanese women care about when choosing a spouse,<sup>3</sup> thus, a persistent decline in income of young men

<sup>1</sup> At the individual level, Lindo (2010) finds that a husband's job displacement accelerates child bearing in the short run but it reduces the total fertility in the long run, using data from the United States. Furthermore, Huttunen and Kellokumpu (2010) find similar effects in Finland.

<sup>2</sup> Gutiérrez-Domènech (2008) finds that a high unemployment rate delays marriage and fertility of Spanish women and argues a similar mechanism; i.e. potential mothers care not only of their current employment status but also in their expected possibilities to work afterwards.

<sup>3</sup> It is often emphasized that the social norm in Japan expects men to support their spouse financially. According the Eleventh Japanese National Fertility Survey in 1997, women in Japan consider earning capacity one of the very important attributes of a prospective spouse.

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