



# Re-examination of wage, employment, and hours adjustments: what is crucial for differences in the adjustments?

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## Abstract

Manufacturing wage, employment, and hours adjustments are significantly different among developed countries, typically between Japan and the US. The problem of explaining the differences is closely related to that of what effect the extent of wage flexibility has on labor market adjustments. However, prevailing theories are invalid or incomplete for explaining the differences. The differences in the adjustments cannot be unrelated with institutional features of the labor market. Indeed, the extent of wage flexibility depends on the differences in the institutional features. Using a new model with such an idea, this paper theoretically re-examines the cause of the differences in the adjustments. The crucial causes are the characteristics of wage flexibility as well as the differences of the institutional features. The characteristics are that wage adjustment is discontinuous, infrequent, and has a lower limit in comparison with changes in demand. © 2001 Elsevier Science B.V. All rights reserved.

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## 1. Introduction

Manufacturing wage, employment, and working hours (per person) adjustments are significantly different among developed countries, typically between Japan and the US. According to Gordon (1982), in cyclical variations in demand, wage and working hours (per worker) are both more flexible, and employment is much more invariable in Japan than

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Table 1

Standard deviations of four-quarter percentage rates of change of manufacturing wage rates, hours, and employment<sup>a</sup>

	Nominal wages	Hours per worker	Employment
1963 (Q1)–1980 (Q3)			
US	1.69	1.09	4.05
Japan	4.84	1.98	2.03
1963 (Q1)–1972 (Q4)			
US	1.66	1.06	3.39
Japan	2.83	1.17	2.15

<sup>a</sup> Source: Gordon (1982, Table 1).

in the US (see Table 1). Furthermore, in Japan hours are first adjusted, and then employment adjusted if the hour adjustment is not enough. Empirical evidence after Gordon (1982) demonstrates that those differences remain unchanged.<sup>1</sup> The question of why such differences arise is still one of the important issues not only in labor economics but also in macroeconomics. It is closely related to the question of what effect the extent of wage flexibility has on labor market adjustments. However, prevailing theories to explain the above differences, e.g. the human capital theory and flexible wage theory, are invalid or incomplete, as stated later. In addition, the conclusions derived from both theories are different. This paper theoretically re-examines the cause of such differences in the adjustments as observed between a rigid wage country like the US and a flexible wage country like Japan, focusing on the process of a deep recession. In the paper, wage flexibility indicates the flexibility of nominal wage, and the flexibility of real wage is not explained. It is because empirical evidence for the difference in real wage flexibility is not so enough as in the case of nominal wage.

In the human capital theory the cost of on-the-job training plays a crucial role in explaining the inter-country differences about the adjustments. Hashimoto (1993) attributed the stability of employment in Japan to greater investments in firm-specific human capital in Japan than in the US, and flexible hours in Japan to its stable employment. Although these relationships appear to be valid, they are based on a supposition. Incidentally, the latter relationship is not always obvious in itself, since wage adjustment has a negative effect on hours, which may, in turn, offset the relationship. Fukao and Otaki (1993) analyzed the influence of training cost functioning as sunk cost on real wage, employment, and hours adjustments in the real business cycle model. They explained stable employment, flexible hours and real wage in Japan under the supposition that training cost is born more in Japan than in the US. Their analysis, however, includes a very

<sup>1</sup>For example, for the difference in wage adjustment, see Taylor (1989, pp. 139–143), the survey by Tachibanaki (1987), and Yoshikawa (1995, pp. 155–156). For that in employment adjustment, see Hashimoto (1993, pp. 153–154, 158), and Hart and Kawasaki (1999, pp. 125–127). As for that in hour adjustment, see Hashimoto (1993, pp. 153–154, 158), Ono (1981, pp. 24, 26), and Ohashi (1990, pp. 104–105). Exceptions are Abraham and Houseman (1989) and Hart and Kawasaki (1999), but they do not lead to confuting the evidence above, which is viewed as an accepted standard. As for the lagged response of employment adjustment after hour adjustment in Japan, see Part 1 in Ministry of Labor (1993, 1994, 1998, 1999).

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