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Japan's declining labor share attributed to conditions in growing service industries

Economists have been trying to figure out why the share of income taken by workers has been declining in many economies. While global growth has continued to make the pie bigger, the share of that pie dished out for labor has shrunk in many places.

It's an important issue, since greater inequality is usually the result when workers are getting less of the pie but the owners of the businesses they work for are taking home a bigger slice.

This phenomenon has been evident in Japan for longer than in many other countries. And according to a recent working paper for the Asian Development Bank Institute, the reasons why the share of labor income has been declining in Japan differ from the explanation that most likely covers the experience in other developing countries.

In Japan, the share of income taken by labor began declining in the 1970s and over the next three decades declined by about 10 percentage points, from a high just under 80% of income generated in the economy. It declined again in the late 1990s.

Unlike what has been seen in many of the other developed economies, however, labor's share of income remained fairly steady in the manufacturing sector in Japan. Elsewhere, global competition and automation have been driving down the share of income taken by workers in manufacturing.

In Japan, labor income share has primarily dropped in services.

The working paper, which studied Japanese data on 84 industries from 1970 until 2012, found that the trend was especially apparent in services which do not need specialized training. In the so-called low-knowledge-intensive services, labor's share of income has dropped at the same time as that part of the economy has been expanding faster than any other.

That sector now accounts for more than 50% of the total hours worked in Japan.

The authors point to a number of factors that have led to the trend in Japan.

Changes to both the makeup of businesses in Japan, and the nature of work and workers, have contributed to the issue.

Rewind 40 years and the Japanese economy back then was generally one in which big manufacturing companies employed workers for life and services were provided by "mom and pop" or family-run enterprises.

Since then, manufacturing has shrunk as a share of the economy and fewer workers are employed by the same company for their entire career. But today's manufacturing sector is not unrecognizable from that which existed 40 years ago.

The situation is different for services, and especially services in the low-knowledge-intensive sector. Back then, many were run as family businesses. For example, in the corner store, retail shop or restaurant, most if not all of the work was done by the owners.

Self-employed or family-owned business accounted for 25.5% of the service industry in 1970. Just 10% of them are now in that category. In the low-knowledge-intensive sector, the proportion dropped even more sharply; from 30% to 11%.

Instead of being family run, many of these businesses are now part of large chains owned by huge corporations. Those companies can set employment policy across hundreds of stores or restaurants. Instead of asking the owner directly for a raise, a worker now deals with layers of managers who dictate corporate policy to thousands of employees.

That worker may not even be on the job long enough to ask for a raise. While the service industry has been growing fast, so too has the use of so-called "non-regular" workers. These are workers who are hired when needed and their pay and benefits are often just a fraction of what regular workers receive.

In non-knowledge-intensive services, workers can be switched in and out without much fuss.

Another major change to the workforce in Japan is that women are now a bigger part of it. About 40% of the hours worked in non-knowledge-intensive services are done so by women. Forty years ago, it would have been rare to see a woman doing the job.

The authors suggest that if authorities want to help offset the declining labor share trend in Japan, they could look at measures that might tilt the situation some way toward workers in the low-knowledge-intensive sector.

They add that measures could also be taken to slow the increasing concentration of ownership in the sector so that the owners don't have even more bargaining power over those they employ.

This podcast was based on *Institutions, Deindustrialization, and Functional Income Distribution in Japan*, a working paper for the Asian Development Bank Institute by Kyoji Fukao, professor of economics at the Institute of Economic Research of Hitotsubashi University and Cristiano Perugini, associate professor at the University of Perugia.

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