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**Dismissal Regulation in Japan**

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# Dismissal Regulation in Japan<sup>1</sup>

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<sup>1</sup> This chapter is based on a paper co-authored with Koichi Hamada titled “Kaikoken Ranyo Hori: Hanrei Hori to Keizai no Mekanizumu [The Doctrine of Abusive Dismissal: The Economic Mechanism of Case Law]” presented at the 2006 conference of the Japan Law and Economics Association held at the National Graduate Institute for Policy Studies (GRIPS), Tokyo. The author benefitted greatly from comments from the editors of this volume as well as Ken Togo, Fumio Ohtake, participants of the above-mentioned Japan Law and Economic Association conference, and participants of a workshop held at the University of Tokyo on November 27, 2007. The findings and data presented in this chapter largely draw on collaboration with Kyota Eguchi, Masato Hara, Junko Hirasawa, Ryoichi Imai, and Hisashi Okuno-Takeuchi in the preparation of the edited volume titled *Kaiko Kisei no Hou to-Keizai [The Law and Economics of Dismissal Regulation]*. The author is deeply grateful for their cooperation and their consent to use the material from the volume for this chapter.

## ABSTRACT

The purpose of this chapter is to take a closer look at the role of legal institutions and their impact on human capital accumulation using the Japanese case of dismissal regulation as an example. In the Japanese labor markets, so called the Doctrine of Abusive Dismissal has been thought to be responsible for controlling dismissal behaviors. With careful examination of court cases and statistics, this chapter shows, the Doctrine has grown out of industrial conflicts in the past and it has been useful in resolving disputes revolving around mass layoffs and, by fostering communication between management and labor regarding firms' business conditions, helped to smooth the rapid adjustment of employment in Japan. In other words, in order to achieve a relationship of mutual trust between employer and employees, the Doctrine created social norms encouraging the two sides to reach agreement within the workplace, firm, or organization. This guidance provided by the Doctrine contrasts with the direct constraints imposed on the contents of labor contracts by, for example, the Labor Standards Act.

## **1. Legal Institutions, Economic Growth, and Human Capital Investment**

Do legal institutions affect economic growth? Intuition suggests that indeed better institutions are likely to result in higher growth. Yet, there are plenty of historical examples which seem to present evidence to the contrary. On the one hand, the divergence between Japan and China during the 20<sup>th</sup> century, for instance, shows that legal institutions certainly changed the course of economic development. On the other, the economic convergence during the latter half of the 20<sup>th</sup> century between the United Kingdom, (West) Germany, and France, with their different legal traditions, suggests that legal institutions did not matter much for the achievement of economic growth.

In the world of economic theory, the basic growth model proposed by Solow (1956) implies that initial conditions do not affect an economy's final destination in terms of product per capita, which is determined by the rate of exogenous technological innovation. No matter what the legal institutions at the starting point, economies will eventually converge. In fact, Romer (1989) conducted empirical work that suggests that there is no correlation between a country's recent rate of economic growth and its level of national per capita income at the starting point, which supports the convergence hypothesis. Although this hypothesis of simple convergence has been largely rejected as more data have become available and statistical methods have improved, both the theoretical and empirical literature on economic growth suggest that the answer to the question posed at the outset – do legal institutions affect economic growth? – is not obvious when a situation conforming to the ideal of competitive markets is assumed.

A different perspective on this issue is provided by the economic historians Douglass North and Richard Thomas (North and Thomas, 1976)). Conducting a qualitative examination of economic growth in pre-modern Europe, they argue that the key for economic development is legal institutions, that is, the extent to which checks are imposed on the arbitrary exercise of power.

As an example, they pick the case of Spain and Portugal. During the 16<sup>th</sup> century, the two countries flourished and led the world into the Age of Discovery. Yet, their economic development slowed during the 17<sup>th</sup> century and they were eventually left behind by Britain in the 18<sup>th</sup> century. Although Spain and Portugal were able to gain tremendous wealth from trade and from their colonies, they never became leading international powers again. According to high school textbooks, the turning point was the defeat of the Spanish Armada

in 1588 at the hands of Francis Drake. North and Thomas, however, argue that it was the artisans in the wool industry that were responsible for the turn in fortunes. The wool industry was the most innovative industry of the day, but, North and Thomas argue, the unconstrained exercise of power by the rulers – including the collection of arbitrary taxes and the confiscation of private assets – led to an exodus of artisans from the Iberian Peninsula to England, where, following the Revolution of 1688, Parliament imposed constraints on the Crown. Political rulers were prevented from the arbitrary exercise of power. Legal institutions to protect private ownership provided incentives for investment in the industry and laid the foundation for the Industrial Revolution. Thus, explaining why the Industrial Revolution occurred at this particular time, in the 18<sup>th</sup> century, and in this particular place, England, North and Thomas provide a clear illustration of how legal arrangements affected the incentive for investment which resulted in different trajectories of economic development.

And indeed, all developed countries today have in place legal systems that provide protection for private property and a legal basis for financial and physical transactions. However, it is not only investment in physical assets that is important for economic development. As has been widely pointed out, another important source of economic growth is human capital accumulation, that is, increases in labor productivity, such as through experience, formal education, and vocational training. Thus, if we were to extend North and Thomas's argument on pre-modern Europe to industrialized societies today, one could argue that the legal protection of human capital also plays a crucial role in economic growth.

Of course, in the case of investment by workers in their own human capital, “confiscation” of such human capital would require physical constraints on workers and amount to slavery. However, when it comes to investment by one person in the human capital of another, a more realistic, economic, problem setting arises, since the realized value of such investment will depend on the effort of the person receiving the investment in human capital. That is, the latter can “confiscate” (or free-ride on) the investment of the former. Thus, without mechanisms to safeguard the investor's return from investment in human capital, it is unlikely that sufficient investment in human capital will be forthcoming. This is especially the case at early stages of development, when, due to poverty, workers have few resources to invest in human capital accumulation. Thus, it is important to establish mechanisms to ensure that those in a society with surplus funds in some way shoulder the costs of human capital accumulation of others.

## **2. The Role of Legal Institutions in the Labor Market**

The preceding considerations suggest that legal institutions have a role to play in providing the necessary incentives for human capital formation. However, finding the appropriate legal arrangements so that such investment in human capital is forthcoming is anything but straightforward. The use of direct coercion in this context is clearly in conflict with fundamental rights: someone who has invested in the human capital of another can neither force that person to perform a particular job assignment nor confiscate a portion of that person's salary simply because of the investment in that person's human capital. In other words, the investor does not have any ownership of that human capital. One theoretical possibility instead of such direct coercion therefore would be to use indirect coercion through a loan contract, where the recipient of the human capital investment borrows the funds from the investor. However, investments and loan contracts are generally different legal arrangements in terms of implementation, risk allocation, etc. For example, a loan contract has to fix ex ante the future return and the borrower faces various uncertainties. Moreover, with a loan contract, the borrower can use the funds for purposes other than investing them in his human capital. For these reasons, Becker (1993), for example, proposed the simple rule that to achieve efficient investment in human capital, workers themselves should bear the cost of investment in general human capital which is useful anywhere in the economy, while employers should bear the cost of investment in specific human capital which is beneficial only in a specific environment such as a specific firm or industry.

However, Becker's classic argument cannot be applied to joint investment in human capital. A widespread example of such joint investment is on-the-job training (OJT) where employers bear costs in terms of lower productivity during training, while employees need to make an effort to achieve higher productivity. Yet, typically, the size and share of the costs borne by the two parties is anything but clear and, should the employee leave the company (or be dismissed), it would be very difficult to determine how the employer should be compensated for the investment which is being lost. Thus, in the case of joint investment in human capital, it is difficult to find efficient contractual arrangements between employers and employees. In other words, the simple extension of civil or commercial law to labor market transactions does not provide a framework that safeguards the benefits of human capital investment. This is one of the reasons why labor law as an independent legal field separate from civil and commercial law has developed since the beginning of the 20<sup>th</sup> century.

The purpose of this chapter is to take a closer look at the role of legal institutions and their impact on human capital accumulation using the Japanese case of dismissal regulation as an example. Dismissal can be seen as a unilateral breach of contract by the employer, and dismissal practices affect, for example, workers' incentives regarding the amount of effort they devote to OJT, which in turn affect the efficiency with which the labor market operates.

The Japanese case offers an instructive example because joint investment in human capital through OJT plays a particularly important role. The rise in competitiveness of Japan's manufacturing industries since the 1960s is closely associated with the sharing of production information across occupations and investment in specific human capital through OJT. Human resource practices have also fostered a deep commitment of workers to their company. For instance, the so-called "Quality Control Circles" were formed through the voluntary participation workers after their regular working hours. Such "Quality Control Circles" provided workers with the opportunity to share productivity-enhancing information, such as improving design aspects of new products to achieve more efficient production. Since workers usually did not receive any payment for attending such circles, it is clear that they were not formed as part of written labor contracts.<sup>2</sup> Moreover, the information shared and the human capital accumulated through such OJT was likely to be of little use outside a specific firm. It is thus unlikely that workers would have been prepared to invest their own spare time in order to achieve productivity improvements without sufficiently credible employment protection.

Put differently, this means that Japanese manufacturing firms successfully managed to persuade employees that they would not be easily dismissed, leading to productivity gains that allowed firms to compete in international markets through the mechanisms just described and amply documented in numerous case studies by Koike (1983). This link between employers' commitment to long-term employment and high worker productivity has subsequently been confirmed in an empirical study by Kato and Morishima (2002) using microdata of a large survey. Moreover, studies examining the role of long-term employment from an international comparative perspective, led by the one by Hashimoto and Raisian (1985), have repeatedly shown that the return to tenure is much higher in Japan than in the United States and that long-term employment is much more common in the former than the latter. In addition, as for example shown in Bognanno and Kambayashi (2009), different from the United States, in Japan, wage losses from job change are strongly related to age and tenure. Although providing only indirect evidence, these findings are clearly consistent with the notion that employers in Japan have established a commitment not to dismiss workers easily, while workers voluntarily engage in productivity-enhancing activities.

In this context, examining the role of dismissal regulation in Japan can provide important clues regarding the formation of institutional arrangements that safeguard investment in human capital. In addition, such an examination also provides a starting point for future research on why and how labor markets differ from markets for goods and services.

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<sup>2</sup> See case studies for the 1960s and 1970s in Koike (1977). Such practices continued even in subsequent decades, as shown in case studies by Aoki, Koike and Nakatani (1989) and Inoki and Koike (1987; 2004).

### 3. Dismissal Regulation in Japan and the Doctrine of Abusive Dismissal

This section provides an overview of the establishment of dismissal regulation in Japan in order to understand the legal constraints it imposes on economic agents.

Japan's legal tradition since the 19<sup>th</sup> century is largely based on continental European law, particularly German law, and as such is mainly based on the statutory law system. However, because statutory laws do not cover all possible contingencies, statutory laws, just like in other countries, are complemented by judicial precedents set by the courts. Japan's labor law is similarly subject to such a dual legal framework. On the one hand, the Labor Standards Act sets clear national minimum standards, specifying, for example, in Article 32 that "an employer shall not have a worker work more than 40 hours per week, excluding rest periods" and that "an employer shall not have a worker work more than 8 hours per day for each day of the week."<sup>3</sup> On the other, there are few specific statutes governing procedures concerning the conclusion, change, or termination of labor contracts. To make up for this lack of legislation, Japanese courts have gradually constructed their own case laws since 1945. The most important are the case laws for dismissing employees, the Doctrine of Abusive Dismissal (Kaikoken Ranyo Hori).<sup>4</sup>

Although there has been some academic debate on whether the Doctrine has impeded economic activity by imposing excess costs on employers (see, e.g., Ohtake et al., 2002), there is little empirical evidence to determine whether it has actually interfered with employment adjustment. One of the main reasons for this is the lack of data.<sup>5</sup> But another reason is how the Doctrine should be interpreted in terms from the perspective of economics. Economists implicitly assume that the Doctrine represents a monetary tax on employers (or severance transfers from employers to employees). But from a legal perspective, the Doctrine merely provides a social norm, since employers can adjust their number of employees without any additional payment as long as they follow the Doctrine. Thus, the Doctrine imposes additional costs in some cases but not in all. To reconcile the two perspectives, legal and economic, it is useful to examine how the Doctrine was established and what role it has played in actual disputes.

Based on the principle of contractual freedom, Japan's Civil Code allows the dismissal of

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<sup>3</sup> Translations of Japanese laws, unless otherwise noted, are from the following Ministry of Justice website: <<http://www.japaneselawtranslation.go.jp>>.

<sup>4</sup> Some of the case laws have been included in the Labor Contract Act newly legislated in 2007.

<sup>5</sup> Considering the long-term employment naturally delays the employment adjustment and the Doctrine covers all over Japan equally, it is difficult to identify the effect of the Doctrine apart from the effect of long-term employment.



employees at any time, if the contract is open-ended. Article 627 states:

“(1) If the parties have not specified the term of employment, either party may request to terminate at any time. In such cases, employment shall terminate on the expiration of two weeks from the day of the request to terminate.”

Thus, with regard to the termination of labor contracts, the Civil Code imposes only procedural conditions (i.e., two weeks notice), but no substantial conditions, such as compensation, etc. What is noteworthy, moreover, is that the Civil Code makes no distinction between termination of employment by the employer (dismissal) or by the employee (resignation).

Although Article 627 of the Civil Code has not been changed since its enactment in 1896, changes in the economic and political environment have led to the addition of supplementary regulations on the termination of employment by employers. For example, according to the Labor Standards Act of 1947, workers suffering from a job-related illness and women on maternity leave cannot be dismissed (Article 19), and an employer wishing to dismiss an employee must give at least 30 days advance notice or, when not giving 30 days notice, pay the average wages for a period of at 30 days (Article 20).

The Act on Securing, Etc. of Equal Opportunity and Treatment between Men and Women in Employment (sic) of 1985 prohibits, in Article 6, discrimination against workers on the basis of sex with regard to dismissal, while Article 7 of the Labor Union Act of 1949 states:

“The employer shall not [...] discharge or treat in a disadvantageous manner a worker by reason such worker’s being a member of a labor union, having tried to join or organize a labor union, or having performed justifiable acts of a labor union [...]”

Leaving the world of pure contractual freedom of the Civil Code behind them, these labor laws restrict employers’ conduct with regard to the discharge of employees. However, it is important to note that these statutes protect workers in specific situations (e.g., when suffering a job-related illness, being on maternity leave, engaged in union activity, etc.) and do not provide general dismissal rules.

As a result, Japanese courts have gradually established their own case laws. These require a legitimate justification for regular dismissals, or otherwise the dismissal may be regarded as an abuse of the individual’s rights and judged invalid. This case law is called the “Doctrine of

Abusive Dismissal.” This Doctrine distinguishes two categories of dismissal, depending on the reason. The first is “normal dismissal” where an employee is dismissed for specific individual reasons, while the second is “economic dismissal” where there are no individual reasons for dismissal but rather the dismissal is due to the employer’s circumstances. No-fault layoffs usually fall under the second category.

In the case of “normal dismissals,” the Supreme Court decided in 1975 that

“even when an employer exercises its right of dismissal, it will be void as an abuse of the right if it is not based on objectively reasonable grounds so that it cannot receive general social approval as a proper act.”<sup>6</sup>

Two years later, the Supreme Court stated again that

“even where there are normal reasons for a dismissal, an employer does not always have the right to dismiss. If, under the specific circumstances of the case, the dismissal is unduly unreasonable so that it cannot receive general social approval as a proper act, the dismissal will be void as an abuse of the right of dismissal.”<sup>7</sup>

Thus, even if a worker is dismissed for individual reasons, the unilateral termination of an open-ended labor contract by the employer must satisfy additional conditions, that is, the dismissal must be “objectively reasonable” and “socially acceptable.” In addition, the courts, by using their authority to request an explanation (*shakumeiken*), can require the defendant (i.e., the employer in a dismissal case) to prove that the unilateral termination does not constitute an abuse of rights. Because it is difficult for employees to verify the employer’s behavior and/or intent, this reversal of the burden of proof in practice is one of the most important aspects of the Doctrine.

The meaning of “objectively reasonable” and “socially acceptable” of this Doctrine is illustrated most clearly by referring to the leading case on economic dismissals, which is the Tokyo High Court case *Shimazaki v. Toyo Sanso* from 1979,<sup>8</sup> with the Supreme Court specifying the following four assessment criteria four years later:

- (1) The employer must provide a reasonable explanation to the court of the need to reduce the number of workers.

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<sup>6</sup> Judgment of April 25, 1975, *Ichikawa v. Nihon Shokuen Seizo Co.*, Supreme Court, vol. 29, *Minshu*, pp.456-458. Translation from Sugeno (1992), p.402.

<sup>7</sup> Judgment of Jan. 31, 1977, *Kochi Hoso Co.*, Supreme Court, vol. 268, *Rodo Hanrei*, p.17. Translation from Sugeno (1992) p.402.

<sup>8</sup> Judgment of Oct. 29, 1979, *Shimazaki v. Toyo Sanso*, Tokyo High Court, vol.30, *Ro Minshu*, p.1002.

- (2) The dismissal must be the last resort to adjust labor input.
- (3) The selection of the persons to be discharged should be proper.
- (4) The dismissal procedure should be reasonable.

These four criteria are sometimes referred to as the Doctrine of Economic Dismissal in order to distinguish them from the two simple conditions of “objectively reasonable” and “socially acceptable.” However, they do not specify what kind of employer actions will be deemed acceptable by the courts. A detailed examination of actual judgments in layoff cases between 1975 and 1984 is provided in Kambayashi and Hirasawa (2008a), which seeks to clarify which actions of employers the courts did or did not recognize as acceptable behavior.

Generally, the interpretation of the first criterion regarding the necessity of reducing the number of workers is that the layoffs must be carried out with sufficient consideration of business needs. Up until the first half of the 1980s, as the Doctrine evolved, judgments were based on “whether or not the firm would go bankrupt without an adjustment of the number of employees.”<sup>9</sup> Since the latter half of the 1980s, with the Doctrine having matured, the courts have tended to leave it up to employers to decide the need for adjusting the number of employees, but have examined whether the reasoning used by employers was logically consistent.

The second criterion that dismissal must be the last resort means that dismissals are justified only when other methods of labor adjustment are not available. Textbooks on labor law suggest that courts will examine efforts to avoid layoffs such as the solicitation of voluntary retirements, a halt on new recruitment, or transferring workers to other positions, and determine whether these efforts on the whole satisfy the second criterion. However, on which basis courts actually assess such efforts in practice is still ambiguous. Let us consider as an example the treatment of solicitations for voluntary retirement. Under Japan’s life-time employment system, solicitations for voluntary retirement appear to be a common way to avoid dismissals and therefore appear to be a good example. In Kambayashi and Hirasawa (2008a), we examined 54 court cases in the period from 1975 to 1984 concerning economic dismissals. In 16 of these 54 cases, the courts rule that the dismissals were invalid because employers did not make sufficient efforts to avoid dismissals. However, in 8 of these 16 cases, the firms actually did solicit voluntary retirements, meaning that such solicitation is not sufficient to meet the last-resort criterion. On the other hand, there were 34 cases in which employers did not solicit voluntary retirements. In 15 of these 34 cases, the courts accepted the employers’ justification of the layoffs. And in 12 of these 15 cases, the courts explicitly

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<sup>9</sup> Several judgments use the exact same phrase. Examples include the Judgment of Dec. 24, 1975, *Hamada v. Omura-Nogami Co.*, Omura Branch, Nagasaki District Court, vol. 98 *Hanrei Jiho*, p.813, and the Judgment of April 25, 1979, *Kawamoto et al. v. Hosokawa Seisakujyo Co.*, Sakai Branch, Osaka District Court, vol.48, *Rohan*, p.331.

stated that the employer had satisfied the last-resort criterion without any solicitation of voluntary retirements. Thus, the solicitation of voluntary retirements is not always necessary to meet the last-resort criterion. In sum, although the solicitation of voluntary retirement is probably the most common way to avoid dismissals under Japan's life-time employment system, court rulings do not provide an unambiguous indication as to how important such efforts are.

Next, the purpose of the third criterion is said to be the elimination of arbitrary dismissals. In actual cases, employers that, for example, had chosen to lay off married female employees with two or more children<sup>10</sup> or used no criteria whatsoever<sup>11</sup> were defeated because the selection of the persons to be dismissed was deemed to be not proper.

Finally, the fourth criterion implies that employers have to explain the necessity of layoffs to workers and/or unions with or without collective agreements. In actual cases, the courts essentially judged efforts to have been insufficient only when employers did not explain the reasons for layoffs at all.

Overall, the Doctrine of Economic Dismissal provides some guidance with regard to acceptable employment adjustment procedures. Yet, there remains some ambiguity with regard to the strictness with which the specific criteria are applied. Although in economics, dismissal regulations are typically treated as a tax and the effects assessed using statistical data and estimation techniques, the approach chosen here to examine the economic effects of the Doctrine of Abusive Dismissal is to analyze its role in actual dispute resolution.

#### **4. Leading Cases in the Doctrine of Abusive Dismissal**

One of the most important roles of courts is, of course, to resolve disputes, and case laws are the result of such resolutions. With regard to the Doctrine of Abusive Dismissal, court decisions have been examined and polished, by thirty years of scholarship, into the legal principles outlined in the preceding section. However, it is also instructive to examine how these principles were arrived at and the conflicts that the courts had to resolve in the process. The following are brief summaries of some of the leading cases that have contributed to the Doctrine of Abusive Dismissal.

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<sup>10</sup> Judgment of Sep. 12 1975, *Umezū et al. v. Koparu Co.*, Tokyo District Court, vol.17, *Hanrei Jiho*, p.789.

<sup>11</sup> Judgment of April 25, 1979, *Kawamoto et al. v. Hosokawa Seisakujo Co.*, Sakai Branch, Osaka District Court, vol.48, *Rohan*, p.331.

The first leading case is that of *Ichikawa v. Nihon Shokuen Seizo Co.*, in which the employer dismissed a worker who had been expelled from the union. The reason for the expulsion from the union was serious political disagreements within the union. Informed that the plaintiff had been expelled from the union, it was quite natural for the employer to dismiss the expelled worker, because there was a union shop agreement between the employer and the union. The worker went to court not to contest the expulsion from the union but the dismissal from the firm; that is, the defendant in this case was not the union but the employer. After examining the case, the court decided that the expulsion from the union had been unfair; therefore, the dismissal based on the unfair expulsion from the union was held void. To arrive at this decision, the court invoked the fundamental principle of the Civil Code (Article 1) that “no abuse of rights is permitted,” and concluded that even when an employer exercises his right of dismissal (dismissal based on the union shop agreement in this case), this will be void as an abuse of right if “it cannot receive general social approval as a proper act.” And in this particular case, it was clear that the true cause of the dispute was the conflict among workers.

The second leading case is that of *Kochi Hosoo Co.*, in which a broadcasting company dismissed a radio announcer because he had been late for work twice within two weeks and as a result the company had to skip, once completely and once partly, its ten-minute news program. The court questioned several officers in relation to the two missed broadcasts and it emerged that the person charged with ensuring the announcer got up had also been late and that, moreover, there had been other occasions in the past not involving the plaintiff when broadcasts were missed. However, the plaintiff was the only person in the company who had been dismissed. Thus, the court ruled that the dismissal was unfair because there was no reason why only the plaintiff should have been dismissed but none of the other employees. In sum, the court concluded that if, in the specific circumstances of a case, the dismissal is “unduly unreasonable so that it cannot receive general social approval as a proper action, the dismissal will be void as an abuse of the right of dismissal.”

Finally, the third leading case to be taken up here is *Shimazaki et al. v. Toyo Sanso*. This case is a typical example of no-fault layoffs caused by technological progress. The company operated in an industry, the gas industry, whose competitiveness had gradually declined during the 1960s and 1970s because of technological changes. The managers decided to close one of its factories and dismissed almost all of the employees working there. The employees argued in court that the company could have avoided layoffs by transferring employees to other factories in the same company which were still expanding in those days. The district court followed the employees’ argument and decided that the layoffs were void. In contrast, the high court did not regard the employer under any obligation to transfer workers and concluded that the layoffs were effective. It is in this ruling that the Tokyo High Court

presented the four criteria outlined above that should be satisfied for no-fault dismissals. The ruling was subsequently approved by the Supreme Court. However, in an interesting twist, even after the Supreme Court decision, the actual dispute continued for ten more years and ended in a settlement, in which the two parties agreed that, although the courts had been ruled that the dismissals were effective, the layoffs had been unjustified and that half of the plaintiffs (6 persons) would be reinstated under their original job titles in the company.

In Kambayashi and Hirasawa (2008b), we tried to shed light on the details of the case through direct interviews with the plaintiffs. The study shows that the main reason for the dispute was a split in the union. Specifically, the union was split into two factions, with the minority faction having its base in the factory that was to be closed – something that was not observable to outsiders. In the interviews, the plaintiffs indicated that there was a strong sense that they had been singled out for “political” reasons and therefore decided to go to court. Unfortunately, Toyo Sanso employed the union shop system and the minority faction could not withdraw from the union. Because negotiations between the firm and the union were all conducted by members of the majority faction, the minority faction did not have an avenue for direct negotiations with the firm and the only place to resolve grievances was the courts. However, the courts were unable to bridge the rift, since in examining the negotiation process between the firm and the union, they did not distinguish between minority and majority union factions. Ultimately, by force of circumstances, the only issues addressed in the courts were whether it would have been possible to transfer these employees and similar questions. The main issues of the dispute, however, were how to re-establish direct communication between the company and the minority faction and the sense among those in the minority faction that they were being laid off for “political” reasons. Thus, the courts failed to address the true issues and, as a result, the court ruling did little to resolve the actual dispute.

The disputes in these three leading cases essentially focused on industrial relations and the fair and equal treatment of employees. Especially when there were multiple unions (or union factions) within the same firm, as was common during the 1970s, it was quite natural for employers to try to expel extreme groups from the firm. Under these circumstances, disputes could become quite severe and end up in court when employees suspected that layoffs were not motivated by genuine business reasons and were not implemented in a fair and equitable manner but instead were based on “political” reasons and implemented in a discriminatory fashion. In sum, the Doctrine of Abusive Dismissal arose from industrial relations conflicts.

These observations are confirmed in Kambayashi and Hirasawa (2008a). As mentioned earlier, the study focuses on 54 cases of layoffs between 1975 and 1984. Of these, 34 cases (64 percent) were in the manufacturing sector, 13 cases (25 percent) in the service sector, 5

cases in educational institutions, and 4 cases in the health and welfare field. This sectoral distribution of the cases chosen more or less reflects the pattern of industrial disputes overall.

The 54 cases involved 469 employees in total, so the average number of employees per case is 8.7. However, the number of plaintiffs varied quite substantially, with 21 cases (39 percent) being single plaintiff cases, while 11 cases had more than ten plaintiffs. The biggest dispute was the case of *Hiroshima Glass Kogyo Co.*, in which 128 plaintiffs participated. To put these figures in perspective, it is useful to compare them with more recent ones reported in Kambayashi (2008). Examining 55 Tokyo District Court cases between 2000 and 2004, this study finds that the average number of plaintiffs in these cases was 2.1, and 37 cases, or 67 percent, were single plaintiff cases. Comparing this with the 8.7 plaintiffs per case and the much smaller percentage of single plaintiff cases (39 percent) for the cases between 1975 and 1984 suggests that the earlier cases had a strong element of collective conflict.

The subject matters of the cases also indicate that the disputes were of a collective interest nature. Of the 54 cases between 1975 and 1984, 28 cases (52 percent) were brought for “unfair labor practices.” Article 7 of the 1945 Labor Union Act enumerates various types of acts that are prohibited as unfair practices. For example, employers can neither discharge a worker “by reason of such worker’s being a member of a union” nor “refuse to bargain with the representatives of its employees without proper reasons.” The fact that those cases were brought for “unfair labor practices” indicates that the underlying disputes were based on collective action. Thus, during the period when the Doctrine of Economic Dismissal evolved, roughly half of all no-fault dismissal cases were based on collective action. On the other hand, of the 55 Tokyo District Court cases between 2000 and 2004, only 8 cases (15 percent) were brought for “unfair labor practices.”

One way to interpret the four criteria of the Doctrine of Abusive Dismissal is that they are intended to foster communication between employers and labor unions rather than to provide concrete norms to guide behavior. In fact, as shown in Kambayashi and Hirasawa (2008a), since the 1980s, labor-management relations have generally improved, and in addition to the decline in left-wing radicalism, better communication between management and employees, in particular the sharing of information on business circumstances by management, plays a role. This means that employees are better informed with regard to the business circumstances facing the employer and are therefore less likely to interpret layoffs as politically motivated or arbitrary. With effective communication between management and labor, mass layoffs are less likely to become a source of discord. In fact, as shown in Muramatsu and Kambayashi (2008), mass layoffs since 1997 have not resulted in severe disputes between dismissed workers and employers.

## 5. Recent Rulings by the Tokyo District Court and Article 18-2 of the Labor Standards Act

The analysis in the previous section suggested that the main function of the Doctrine of Abusive Dismissal was to encourage communication between management and labor to achieve “relational fairness” between employers and employees. However, recent years have seen a number of rulings by the Tokyo District Court that have deviated from earlier rulings, and it is interesting to have a closer look at these cases.

Between 1998 and 2000, the Tokyo District Court issued several rulings which seem to depart from the traditional interpretation of the Doctrine of Abusive Dismissal. For example, in the case of *Kadokawa Bunka Shinko Zaidan*, the judge stated that because employers are essentially free to dismiss workers, the onus lies on the plaintiff to provide evidence proving the abusive of rights, and concluded that the dismissals were justified.<sup>12</sup> This stands in clear contradiction to the principle of reverse liability of the Doctrine of Abusive Dismissal. On the other hand, in the case of *National Westminster Bank*, the court argued that

“[t]he so-called four criteria for economic dismissals provide a classification of factors to be taken into consideration when determining whether a dismissal that can be thought to fall into the category of economic dismissals constitutes an abusive dismissal; they do not give rise to legal requirements in the sense of having the legal consequence that each criterion must be met; rather, each decision on abusive dismissal must be based on a comprehensive consideration of the specific circumstances of each individual case.”<sup>13</sup>

Legal circles in Japan, accustomed to the traditional interpretation of the Doctrine, were surprised by these decisions. The Labour Lawyers Association of Japan (Nihon Rodo Bengodan), for instance, condemned these decisions as changes to the Doctrine of Abusive Dismissal. The decisions were also widely reviewed in legal journals, with many scholars criticizing their inconsistency with previous rulings.

Apart from the legal arguments, it is also worth considering how the challenge to the Doctrine of Abusive Dismissal by the Tokyo District Court can be interpreted from an economic point of view. One possible explanation for the rulings is that the Tokyo District

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<sup>12</sup> Judgement of November 29, 1999, Tokyo District Court, *Rohan*, no.780, p.67.

<sup>13</sup> Judgement of January 21, 2000, Tokyo District Court, *Rohan*, no.782, p.23. Author’s translation.



Court was reacting to recent changes in Japan's labor market and tried to reshape the Doctrine.

Because it is too early to interview the plaintiffs, defendants, and judges of these cases, it is necessary to rely on indirect evidence from various statistical sources. The first observation from such statistical sources is that there has been a continuous decrease since the 1980s in collective disputes. According to the *Survey on Labour Disputes*, the estimated unionization rate decreased from 30.8 percent in 1980 to 25.2 percent in 1990 and 21.5 percent in 2000. The number of collective disputes, which in 1980 had stood at 4,376, also decreased, to 2,071 in 1990 and 958 in 2000, even though Japan experienced a prolonged period of unprecedented economic malaise during the 1990s. These figures illustrate that the collective labor movement in Japan has been in decline. The second observation is that Japan's economic structure has changed. The *Population Census* shows that the share of production workers among employed persons decreased from 36.4 percent in 1980 to 35.1 percent in 1990 and further to 32.9 percent in 2000. In contrast, the share of office workers increased from 29.8 percent in 1980 to 34.4 percent in 1990 and 35.5 percent in 2000, overtaking the share of production workers. Thus, many of the labor disputes in the manufacturing sector that made up a large proportion of court cases when the Doctrine of Abusive Dismissal was established are unlike to arise today, and many of the cases arising today are likely to differ from those 30 or 40 years ago.

The third observation is that human resource management practices have gradually changed. In the past, the typical labor contract at a Japanese company was open-ended and almost perfectly incomplete. Based on such a "carte blanche," the employer assigned the employee to various positions and jobs. On the other hand, the employee accumulated wide-ranging firm-specific human capital through the experience and OJT acquired in each position. More recently, however, many companies have started to introduce specific career ladders within a certain position and job. The *General Survey on Working Conditions*, for example, indicates that the share of companies which have introduced such specific career ladders increased from only 7.1 percent in 1981 to 19.5 percent in 2002.

These changes in the labor market mean that the content of dismissal cases filed in courts is likely to have changed considerably since the original cases in which the Doctrine of Abusive Dismissal was developed. In fact, examining dismissal cases filed with the Tokyo District Court between 2000 and 2004, Okuno and Hara (2008) find examples of cases that do not clearly fit the existing dichotomous distinction between "economic dismissals" and "normal dismissals," implying that the traditional distinction in Japanese legal scholarship may be becoming meaningless. In addition, the favorable start of the recently introduced

industrial tribunal system shows that, in disputes involving individuals, disagreements between employer and employee regarding the true reason for dismissal do not play as large a role as in collective disputes. Rather, the main point of contention in individual disputes often appears to be financial issues given the dismissal (Muramatsu and Kambayashi, 2008). And in such cases, the usefulness of the Doctrine of Abusive Dismissal, which was established to resolve collective disputes between management and labor, may be limited (Kambayashi, 2009). Based on these considerations, it could be argued that the dissenting rulings by the Tokyo District Court may represent a rational response to recent labor market changes and the fact that the focus of cases has shifted from collective disputes to individual disputes revolving around questions of financial compensation.

What is even more interesting, though, is that there have not actually been more rulings in the courts deviating from the Doctrine of Abusive Dismissal in the past decade or so. The reason for this is the revision of the Labor Standards Act in 2004, which now formally includes the Doctrine of Abusive Dismissal in the form of Article 18-2, which states:

“A dismissal shall, where the dismissal lacks objectively reasonable grounds and is not considered to be appropriate in general societal terms, be treated as a misuse of that right and invalid.”

Although the article was added only in 2004, the debate in the years leading up to this is likely to have affected court decisions. When discussion on the article began, the original proposal prepared by the government contained an additional sentence, stating:

“An employer may dismiss a worker where his right to dismiss is not restricted by this Law or other laws.”

However, this part of the proposed article was deleted during deliberations in the Diet, as it was feared to have the declaratory effect of encouraging dismissals.

One of the foci of Diet deliberations was the burden of proof. As seen in Section 3, under the Doctrine of Abusive Dismissal, it is incumbent on employers to prove that a dismissal was not abusive. In the original government proposal, however, the burden of proof lay with employees who need to show that a dismissal was abusive. The Diet agreed that the purpose of legislation was not to change the case law but to widen it, and deleted the sentence, adding instead that “this new article shall not change the practice in the courts.” If the original proposal had been enacted, the dissenting rulings of the Tokyo District Court might have been the leading cases of the “modified” Doctrine of Abusive Dismissal. As it happens, however,

the Diet deliberations further clarified that the enactment of the Doctrine did not alter the practice of the case laws. This confirmation of the case laws is likely to have affected subsequent rulings by the Tokyo District Court, since, in fact, no further dissenting rulings can be found following the amendment.

## **5. Concluding Remarks**

As the preceding discussion has shown, the Doctrine of Abusive Dismissal has grown out of industrial conflicts in the past. As such, it may have been useful in resolving disputes revolving around mass layoffs of earlier decades and, moreover, as shown in Muramatsu and Kambayashi (2008), by fostering communication between management and labor regarding firms' business conditions, may have helped to smooth the rapid adjustment of employment in Japan after 1997, which did not result in severe labor disputes. On the other hand, though, the Doctrine of Abusive Dismissal may not always be useful in mediating in individual dismissal cases, which have increased since the 1990s. The dissenting rulings by the Tokyo District Court could have been the leading cases in the adaptation of the Doctrine to changes in the labor market. However, the revision of the Labor Standards Act, which has turned the Doctrine into law, as well as the deliberations in the Diet, have rigidly fixed the application of the Doctrine and may reduce its flexibility of interpretation to adjust to changing circumstances.

The examination of the establishment and application of the Doctrine of Abusive Dismissal in Japan raises two further points. The first concerns the flexibility of case law. It is generally said that while case law has the disadvantage of being slow to respond to changing circumstances, it has the advantage of imposing a stable legal order independent from political vicissitudes. This is why we often find that legal protection of financial investments has been stronger, and financial development faster, in the Anglo-Saxon countries than in Continental Europe.<sup>14</sup> In addition, it could be argued that the example of Japan's Doctrine of Abusive Dismissal shows that case law also has the advantage of greater flexibility, especially when relevant circumstances are in a gradual transition, because each ruling must be sensitive to marginal changes, which contrasts with political decisions, which are likely to reflect the average change.

The second point concerns labor regulations to safeguard the accumulation of specific human capital. In order to achieve a relationship of mutual trust between employer and employees, the Doctrine created social norms encouraging the two sides to reach agreement within the workplace, firm, or organization. This guidance provided by the Doctrine contrasts

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<sup>14</sup> See Acemoglu et al. (2001) and Glaeser and Shleifer (2002).

with the direct constraints imposed on the contents of labor contracts by, for example, the Labor Standards Act. Such direct intervention in the labor market with regard to the price and quantity of labor – through minimum wages and statutory working hours – may be effective in developing countries, where the primary aim is to ensure a minimum level of worker welfare. However, uniform regulation by administrative fiat is unlikely to automatically lead to cooperation at the workplace and informal investment in specific human capital. Especially when circumstances are uncertain and labor contracts are essentially incomplete, it may be better to encourage micro-level spontaneous agreements between stake holders than to take a prescriptive top-down approach.

Given these considerations, a further examination of Japan's Doctrine of Abusive Dismissal can offer instructive insights in assessing the appropriate role of the legal framework in labor markets.

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