

Dismissal regulations in Japan

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Introduction

Among international observers, there is some confusion about the strictness of dismissal regulation in Japan. Some say that it is almost impossible to dismiss regular employees in Japan. Others say that Japanese dismissal regulation is not as strict as in other developed countries. They show the data published by the Organisation for Economic Co-operation and Development (OECD) in 2013, according to which Japan ranks 25th among a total of 34 OECD countries in respect of 'Protection of permanent workers against individual and collective dismissals'.

I believe that both opinions are in a sense correct, but also incorrect. I am of the opinion that in comparison with American Law, where employment-at-will is a basic concept, Japanese dismissal regulation is stricter. In addition, in comparison with major European countries, Japanese law is more rigid in that it does not have any economic sanction, just the sanction of reinstatement, for unjust dismissal.

Recently, some economists have put forward the argument that Japanese dismissal rules should be more deregulated in order to cope with the economic necessity surrounding Japanese firms who are forced to compete with rival foreign firms in the globalized market. In addition, some labor scholars suggest that a monetary compensation system, if not thorough liberalization, should be introduced in the Japanese law.

1. Outline of the Japanese dismissal regulation

1.1 Freedom of dismissal principle of the Civil Code

Article 627 (1) of the Civil Code (CC) of 1896 provides that 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.

This provision guarantees not only the freedom of resignation to the employee, but also the freedom of dismissal to the employer. Formally, it is still in effect, but over the years, it has been modified profoundly by subsequent labor laws.

1.2 Statutory regulation

The Labor Standards Act (LSA) of 1947 maintained the freedom of dismissal of CC, but strengthened the requirement to give notice of dismissal: that is, Article 20 of

LSA provides that the employer must give at least thirty days' advance notice before dismissal or pay a substitutional allowance, except to temporary workers, for a term of employment of less than two months.

Furthermore, the Japanese laws prohibit certain specific types of dismissals. First of all, the employer shall not dismiss its employees during a period of incapability for work caused by occupational accidents, or during a period of statutory maternity leave.

Next, Article 3 of the LSA provides that employers shall not use the nationality, creed or social status of any workers as a basis for engaging in discriminatory treatment with respect to wages, working hours or other working conditions. This equal treatment provision applies to a dismissal carried out for discriminatory reasons.

The Labor Union Act of 1945 and 1949 prohibited the dismissal of union members as an unfair labor practice, for which a special administrative procedure is provided, modelled on the National Labor Relations Act of the United States of America.

Furthermore, the Act on Securing, Etc. of Equal Opportunity and Treatment between Men and Women in Employment, at the time of its revision in 1985, introduced a provision, according to which an employer may not dismiss an employee on the grounds of sex, marriage or pregnancy. Moreover, the Act concerning the welfare of workers who take care of children or other family members, including childcare and family care, provides that an employer may not dismiss or otherwise treat a worker disadvantageously by reason of said worker applying for or taking childcare leave or family care leave.

1.3 Abusive doctrine

Though some legal intervention in the area of dismissal has taken place, Japanese law had not had any provision that requires the just cause or justified motive of dismissal. In order to fill up the lacuna, in the 1950s, lower courts came to establish an abusive doctrine, according to which unjustified dismissal is invalid as an abusive exercise of the right prohibited by Article 1(3) of the CC. After the accumulation of such decisions in lower courts, finally in 1975 the Supreme Court (*Nippon Salt Manufacturing Co., Ltd* case of April 25, 1975) confirmed this doctrine, formulating 'a dismissal shall, if it lacks objectively reasonable grounds and is not considered to be appropriate from a social viewpoint be treated as an abuse of right and be invalid'. However, this case regarded the dismissal conducted by an employer in order to comply with the union-shop clause stipulated between the employer and the union to which the dismissed worker belonged. Certainly, this decision recognized the abusive doctrine, but at the same time confirmed

that the dismissal of an employer who was excluded from the union is objectively reasonable and socially appropriate.

In 1977, the Supreme Court confirmed once again an abusive doctrine of dismissal (*Kochi Broadcasting Co., Ltd.* case of January 31, 1977). This is a case of dismissal for the reason of misconduct. In this case, the Supreme Court ruled the invalidity of the dismissal, taking into consideration any possible favorable factors for the dismissed employee. This Supreme Court decision of 1977 made Japanese firms or workers and lower courts understand that the abusive doctrine was significantly strict towards employers.

In 2003, when the LSA was revised, the case law rule of abusive doctrine of dismissal was codified. Then this rule was transferred from the LSA to the Labor Contract Act (LCA) when the latter was enacted in 2007. Now the abusive doctrine is incorporated in Article 16 of the LCA. This provision applies to all kinds of dismissal, personal dismissal or economic dismissal, individual dismissal or collective dismissal.

2.1 Problems of Art.16

Art.16 of the LCA has been criticized in some respects. First, the terms used in the provision, 'objectively reasonable ground' and 'socially appropriate', are so ambiguous that the judge has very wide discretion for judgement on the validity of dismissal. Such legal circumstances have deprived both parties of predictability.

However, it should be noted that as for economic dismissals since the latter half of the 1970s, lower courts have formulated four factors to be considered in deciding the abusiveness of such dismissal.

- (a) What was the economic necessity of reducing the workforce?
- (b) To what extent did the employer make efforts to avoid dismissal in attaining the reduction? (*ultima ratio*)
- (c) Was the method of selecting the employees to be dismissed appropriate?
- (d) How and to what extent did the employer inform and consult on dismissal with trade unions or employees to be dismissed?

Nevertheless, it is not clear how the judge should consider these four factors to reach a conclusion on the validity of each dismissal. In this sense, there remains the problem of unpredictability also in the case of economic dismissal.

The prominent Japanese economist, Naohiro Yashiro, professor at Showa Women's University, indicates several problems regarding this legal dismissal regulation from an economic viewpoint. In particular, he emphasized that it is difficult for employers to estimate the possible costs of dismissal beforehand, so that employers

are likely to be discouraged to employ permanent workers. As a result, the share of temporary workers whose employment can be easily terminated has been rising. He said also that appealing to the court is too costly for many workers in small and middle firms, who are not usually union members.

Second, the judges tend to interpret and apply an abstract and ambiguous rule prescribed by Art.16 of the LCA favorably to the dismissed employee. In my opinion, it is not because Japanese judges have a pro-labor stance, but as dismissed employees are usually in peril of poverty and socially disadvantaged, the judges tend to think that they are worthy of protection. In this way, dismissal regulation has come to be interpreted strictly towards employers.

Third, Art.16 provides, as mentioned above, that a dismissal, if it is abusive, should be invalid. In the process of the dismissal dispute, the employer has no option to terminate an employment relationship by payment of a monetary compensation; in other words, he is compelled to accept a continuation of the relationship. Such a provision is too rigid, and according to some people, a symbol of scarce flexibility of the Japanese labor market.

3 Legal analysis on dismissal regulation

3.1 Inquiry into the basis of dismissal regulation

According to the traditional concept of labor law, the subordinate position of a worker is inherent in a labor contract. In particular, a dismissal is the decisive cause of such subordination. Consequently, it is taken for granted that the dismissal should be regulated.

However, as we can easily discern from the evolution of dismissal legislation, freedom of dismissal has been a legal principle for a long time and it was not until the 1970s that legal intervention began in this sphere – earlier in the case of some European countries i.e. 1966 in Italy.

In Japan, the case law had developed an abusive doctrine, using general clauses of the CC in order to find a proper resolution of dismissal dispute through a case-by-case approach. Under some background circumstances, Japanese judges limit employers' right of dismissal.

First, regular employees usually had a legitimate expectation regarding the stability of the employment relationship. Once hired with a labor contract of indefinite term, employees believe that they have acquired a 'tenure' and that they have the right to continue to work, so long as they want, until they reach a mandatory retirement age – practically equivalent to pensionable age. In these circumstances, dismissal was

regarded as a betrayal on the part of the employer and had to be limited.

Second, employers try to utilize their regular employees as efficiently as possible in return for stability of employment. It should be noted that in Japan, the wage system of regular employees has traditionally been seniority-based. Their job description was very often not specified, so they were expected to be engaged in various jobs, complying with their employers' orders. This can explain the high flexibility of the internal labor market in Japan.

The Japanese skill training system of regular employees is characteristic in two respects: one is the firm-specific character and the other is frequent job rotations. As for the firm-specific character, such a skill itself has been thought to strengthen competitiveness of each firm, in that it can distinguish itself from other firms. As for frequent job rotations, it can be explained by the typical way of thinking of Japanese firms. According to it, Japanese firms tend to ask their regular employees to contribute to the interest of firms for a long time; it means that a regular employee is expected to become a generalist, not a specialist of a specific job. Of course, also in Japan, specialized abilities are important for business, but such abilities are destined to become obsolete when technological innovations inevitably happen. Therefore, when Japanese firms demand highly specialized abilities, they try to utilize non-regular employees, whose contract is fixed-term, instead of assigning regular employees to be engaged in the jobs that need such abilities.

However, such training and job style leads to diminution of employability of regular employees. Because the accumulated generalist skills of regular employees are estimated relatively high so long as they continue to work in the same firm. That is why expelling regular employees from the firm by dismissal brought about serious damage to them.

Third, under such a training system, the skill of individual employees depends much on how their employers succeed in developing the ability of their employees. Under such a situation, possible incapacity of an employee would be attributable not to the employee, but to the employer, who would have failed to train the employee. In this situation, Japanese employers in fact are required to make an effort to utilize as much as possible the employee, even though his/her capacity for one or more jobs turns out to be insufficient. If such effort had not been sufficiently made by the employer before the dismissal, the judge would be very reluctant to affirm the validity of the dismissal.

As for economic dismissal, in European countries it is not regarded as arbitrary dismissal if it is conducted collectively; therefore, regulation for this type of dismissal is mainly procedural: in this procedure, the employer should make efforts to reduce the

damage of the dismissed workers through a social plan established after consultation with trade unions. On the contrary, in Japan more emphasis is laid on the fact that economic dismissals are not attributable to employees. Consequently, employers should make efforts to avoid a dismissal itself, instead of reducing the damage caused by a dismissal.

Fourth, the stability of employment in Japan, where it is often called lifetime employment, has been so profoundly diffused in Japanese employment practice that unemployment was never a serious issue earlier. In fact, the unemployment rate in Japan had been notably low, from 2.0 to 3.0 percent until 1995. In those days, Japanese government did not need to promote an active labor market policy. It means that it was extremely difficult for dismissed workers to find new employment opportunities, even if the dismissal rarely occurred.

3.2 The problem of unpredictability

Even though I explained some characteristics of the Japanese employment system and the necessity of regulation of dismissal, it may be difficult to ignore the defects caused by the unpredictability of Article 16 of the LCA. That is why various proposals for the reform of Article 16 had been put out, above all, from among economists. These proposals are intimately related to the changing economic environment with which Japanese firms have been faced.

First, the market in which businesses operate has been so globalized that international competition of firms has become increasingly fierce. This will necessitate the expulsion of less productive employees.

Second, the number of foreign shareholders increasingly sensitive to the rent in the short term has been increasing. Japan, which would be considered a country in which it is very difficult for employers to implement lay-offs of redundant employees in the economic downturn, would be less attractive for foreign investors.

Third, as many economists are arguing, dismissal regulation has the side effect of bringing about an increase in prolonged unemployment. Dismissal regulation could make firms reluctant to increase the number of regular employees even when the demand for workforce increases due to good economic conditions. Firms are afraid that when the economic downturn comes, they may suffer from surplus personnel. Additionally dismissal regulation could be a deterrent for the restructuring of firms in an economic crisis.

Fourth, atypical workers such as part-time and fixed-term workers, which in Japan are called non-regular employees, had functioned as a buffer-stock of economic

fluctuation: this temporarily utilized workforce is indispensable for maintaining the 'lifetime employment' that Japanese regular employees enjoyed. However, after some recent labor legislations aiming at strengthening the protection of atypical workers, the cost of such workers has increased significantly. It means that atypical workers no more function as buffer-stock, and it might necessitate employment adjustment of regular employees in the economic downturn.

These grounds for deregulation of dismissal rules are fairly convincing. Nevertheless, it is difficult to eliminate unpredictability of dismissal rules, because the law that should apply generally and comprehensively cannot establish unambiguously clear rules for dismissal, taking into consideration the fact that dismissal can happen in innumerably different situations.

Anyway, labor law scholars in Japan unanimously disagree with the introduction of the American 'employment at will' principle in Japanese law, even if some economists proposed it energetically. In this perspective, the most realistic reform of dismissal law is not to deregulate substantive rules, but to modify sanctions. In this way, the monetary compensation sanction for abusive dismissal has come to attract the attention of some labor law scholars and economists.

4 Reinstatement vs. monetary compensation

4.1 Malfunction of the reinstatement system

As I explained above, Art.16 of the LCA provides the invalidity of abusive dismissal. Therefore, with the judicial decision in favor of the employee, the labor contract will be considered effective retroactively from the moment of the dismissal. However, in fact many dismissed workers do not return to the original workplace even if they win the lawsuit. There are some reasons for this. One reason is that they do not want to continue to work in the firm that stigmatized them as unnecessary personnel. The other reason is that according to the prevalent legal opinion, an employer has no obligation of receiving the labor provided by its employee, if it should not be exempt from paying the wage. It means that an employer can practically order its employee to stay at home on full pay, instead of incorporating him/her into the labor organization. Such a situation often occurs, because the dismissal dispute usually brings about the loss of mutual trust between employer and employee, which is indispensable to maintain a fruitful and productive employment relationship. Finally, in many cases an employer offers to the employee a payment of settlement money and after bargaining about the amount, both parties come to agree to the termination of the labor contract. Such a diffused practice of consensual resolution of the contract with settlement money has

undermined the significance of Art.16 of the LCA, which explicitly requires reinstatement rather than compensation.

4.2 Experience of Labor Tribunal Proceedings

Additionally, I should mention the experience of labor tribunal proceedings, which in 2004 was implemented by the Labor Tribunal Act; the new proceedings are aimed at resolving a dispute of rights arising from employment relations in a short term and in a flexible manner. The tribunal, which is composed of one career judge and two part-time experts in labor relations, attempt mediation and, if mediation efforts fail, render a decision. The decision of the tribunal is not binding and if either party objects, the case is automatically transferred to the formal civil procedure.

Dismissal disputes are the most common type of disputes handled in the proceedings. They are resolved in most cases by monetary agreements in mediation. If mediation fails, the tribunal tends to prefer the payment of some amount of money to reinstatement even if it considers the dismissal unjust. The reason for the preference of the tribunal for monetary resolution is that, as explained above, both parties do not want the 'invalidity and reinstatement' resolution laid down by Article 16 of the LCA.

Anyway, also in Japan, the monetary sanction system already exists informally in the practice of labor tribunals in spite of the intent of the law.

4.3 Comparative viewpoint

From a comparative viewpoint, many western countries have dismissal regulations, which require just cause or justified motives, and at the same time an economic sanction instead of reinstatement in the case of unjust dismissals. For example, in Germany, Article 9 of the dismissal protection law (*Kündigungsschutzgesetz*) provides for the termination of employment relations with the decision of the court (*Auflösung des Arbeitsverhältnisses durch Urteil des Gerichts*) and the severance pay of the dismissed employee (*Abfindung des Arbeitnehmers*). In Italy, after the workers' statute law (*Statuto dei lavoratori*) of 1970 was passed, unjust dismissal was invalid, but the dismissed worker could choose the option of monetary compensation if the dismissal occurred in undertakings with 15 and more employees. However, the reform of 2012 (*riforma Fornero*) made monetary compensation a standard sanction for unjust dismissal, and the subsequent reform (Jobs Act) of 2015 promoted and simplified the monetary compensation system.

Compared with these western countries, Japan stands out in that it does not have a statutory monetary compensation scheme in the case of unjust dismissals.

4.4 Economic viewpoint

From an economic viewpoint, it is thought that reinstatement is stricter as a sanction than monetary compensation. The amount of monetary compensation is not high: for example, in Germany, the upper limit of the amount is 15 months of wage for a worker with more than 50 years of age and more than 15 years of service, and 18 months of wage for a worker with more than 55 years of age and more than 20 years of service.

On the contrary, in the case of reinstatement, the cost is practically incalculable and consequently it is difficult for an employer to predict how much money to pay.

Moreover, as mentioned above, in many cases an employer and an employee are involved in tough negotiation for deciding the amount of severance pay, instead of reinstatement. Such transaction is carried out without legal indicators that could be used as a guide; its costs are not so low, especially for the employee.

However, it is also true that a statutory monetary compensation is not necessarily a cheap solution. It depends on how the law provides the amount be decided. If the amount is high, medium and small firms will object, and if the amount is low, trade unions and workers will object. In addition, if the law leaves the determination of the amount to the wide discretion of the judge, the problem of unpredictability rises again.

In order to eliminate any ambiguity in the way of determining the amount, it would be better to introduce the method whereby the amount is proportionate to the length of service. This method has a merit not only of being clear, but also of being able to approach the so-called single labor contract theory: in this theory, the difference between permanent and temporary workers would be eliminated, because the termination costs of both types of workers are determined only by the length of service.

After all, an appropriate economic sanction is that the amount should be sufficient to sustain the lives of unjustly dismissed workers and their families, and at the same time, the criteria used for the determination of the amount need to be as clear as possible.

4.5 Technical problems

There are some points to be tackled in the introduction of a monetary compensation system in Japanese law.

First, who would be able to claim it: Both parties? Or only the worker? The trade unions, wary of inducing easy dismissals, do not want the law to grant to an employer the possibility of any such claim.

Second, regarding what type of dismissal would an economic sanction be permissible. For the moment, it is without objection that discriminatory and retaliatory

dismissals should be invalid and only the dismissed worker can claim a monetary compensation.

The third point is a very controversial issue. There are two types of economic sanctions. One is the German or Italian style of sanction whose characteristic is the termination of a labor contract with compensation through the decision of a judge. The other style is as follows: If an employer pays a certain amount of money (which a law will decide) at the time of a notice of dismissal, such action constitutes a just case for dismissal. The latter style has been severely criticized as it is believed that if such a scheme were introduced, the concept that dismissals be justified would disappear.

4.6 Theoretical problems

As far as the theoretical aspects are concerned, a question arises regarding the legal qualification of monetary compensation. On the one hand, it is regarded as a compensation for the loss of the future wage that an employee would gain if he/she had not been dismissed. However, it would be impossible to calculate the precise amount of such damage. On the other hand, it could be regarded as a sort of remuneration for the service that an employee had provided until the dismissal was conducted. In this concept, logically speaking, the amount would be proportionate to the length of service. This method, as I say repeatedly, would improve predictability.

However, in Japan, the retirement allowances, which are not legally laid down, are diffused through collective agreements or work rules: these allowances are paid to all employees who end their employment relationship for any reason, except employees with a very small number of years of service or employees dismissed for serious misconduct. In addition, the amount of retirement allowance is usually determined according to the years of service. Assuming this fact, in the context of Japanese employment practice, if the amount of monetary compensation were determined simply by the length of service, this method would be nearly identical to already existing retirement allowances. However, if a function as sanction for unjust dismissal should be stressed, the law should include in the criteria of determining the amount, not only the length of service of the dismissed employee, but also other factors concerning the dismissal such as the intention or attitude of the employer. This is now an open question.

5 Conclusive remarks

As happened in Italy, a reform of dismissal regulation usually causes a fierce debate. This is the case even if a reform does not involve a radical change such as the

recognition of freedom of dismissal. Thus, a dismissal issue is likely to cause emotional debate, and any proposal for deregulation in particular tends to be so unpopular among most people that it is a hard task for a government to convince its people of the necessity of such a reform.

However, at least in the Japanese scenario, assuming the Japanese skill training system mentioned above, many regular employees are and will be free from a risk of dismissal. As the Japanese firms have a substantial investment in the training of regular employees, dismissing them would not pay except in the case of notably incapable employees or in a serious economic crisis.

Rather, in Japanese society, it is much more probable that the firms that do not give much importance to the employment stability of regular employees may lose the public trust. Namely, resorting to the means of dismissal in order to cope with less productivity of employees or economic difficulties involves a reputation risk. That is why the number of dismissals will not increase dramatically even if deregulation is promoted.

On the other hand, Japanese people should recognize that there is a more serious problem in actual Japanese dismissal regulation. First, since employment protection is in reality too strong, there is little chance to be promoted from a non-regular worker to a regular one. In other words, dismissal regulation has brought about a dual structure in the labor market, resulting in the problem of poverty among non-regular workers. Second, since Art.16 of the LCA applies to every undertaking: in Japanese law, there is no exemption from regulation for small and medium undertakings. In my opinion, these two facts alone justify the necessity of flexibilization of dismissal regulation.

In Japan, the ruling parties gained a stable majority in the last elections to the House of Representatives held in 2014 and the House of Councillors held in 2016. Taking advantage of this timing, I hope that the Japanese government, with an eye to the future, will tackle the labor market policy more actively with the introduction of measures such as the implementation of a monetary compensation system.

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