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*Implicit Contracts, the Great Depression,
and Institutional Change: A Comparative
Analysis of U.S. and Japanese
Employment Relations, 1920–1940*

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This article combines a game-theoretic framework and a comparative analysis to study the impact of the Great Depression on private welfare capitalism. Recharacterizing welfare capitalism as an implicit-contract equilibrium, the article documents *parallel* institutional developments in the United States and Japan in the 1920s and the process of *bifurcation* thereafter. In the United States, the breach of contract by major employers induced by the depression led to the rise of explicit contracts and legal enforcement institutions. By contrast, the less severe depression in Japan allowed the maintenance of implicit contracts and the formation of complementary labor laws.

The rise of private welfare capitalism—employers’ voluntary provision of nonwage benefits, greater employment security, and employee representation to their blue-collar workers—in the United States during the 1920s and its downfall in the 1930s have been a central subject of a number of historical studies.¹ Yet, there is a continuing debate over its importance and implications for the subsequent development of American industrial relations. Some historians have argued that the primary motive for private welfare capitalism was to enhance employers’ welfare at the expense of workers’ welfare. According to this view, the employers introduced company housing, corporate pensions, and company unions to divide workers by firm and forestall trade unions to minimize labor’s bargaining power. Stuart Brandes highlights the lack of employees’ appreciation of corporate welfare,

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¹ Bernstein, *Lean Years*; Brandes, *American Welfare Capitalism*; Brody, *Workers*; Berkowitz and McQaid, *Creating the Welfare State*; Jacoby, *Employing Bureaucracy*; Zahavi, *Workers*; Cohen, *Making a New Deal*; Fairris, *Shopfloor Matters*; and Tone, *Business*.

concluding that an “inequitable distribution of wealth and prerogative” under private welfare capitalism could not have been maintained indefinitely.² The replacement of corporate welfarism by the welfare state and industrial unionism was inevitable, and thus, the Great Depression was certainly sufficient but far from necessary for welfare capitalism’s decline, argues Irving Bernstein.³

Other historians have claimed that the primary goal of private welfare capitalism was to achieve greater efficiency that would improve employees’ welfare. According to this view, employers preferred company-level employee representation to trade unions because the former could facilitate employer–employee cooperation whereas the latter were “outsiders” with little understanding of firms’ internal operation. Emphasizing the breadth and depth of corporate welfare programs in the 1920s, David Brody contends that corporate welfarism might have prevailed had the Great Depression not hit the economy as strongly as it did.⁴ In a similar spirit, Michael Piore and Charles Sable claim that the American industrial-relations system that had emerged under the New Deal was neither necessary nor uniquely efficient, but rather a “historical accident.”⁵ As the depression challenged even the most resourceful and committed employers, the widespread failure to meet their promises led to disillusionment among their workers, observes Lisabeth Cohen.⁶

Was American private welfare capitalism a form of managerial domination destined to fail, or was it a Pareto-improving initiative that ended prematurely due to an extraordinary economic shock? The objective of this article is to shed new light on the debate by introducing a game-theoretic analysis and a comparative perspective. First, using a methodology pioneered by Avner Greif, I apply insights from contract theory to examine the economic institution of private welfare capitalism.⁷ Based on historical observations, I redefine corporate welfarism as a set of personnel policies that could constitute an implicit-contract equilibrium in repeated employer–employee interactions. The game-theoretic framework not only enables us to study the contractual nature of private welfare capitalism, but also provides boundary conditions for its existence and efficiency, indicates potential complementarity among a diverse set of practices, and captures the role of expectations in an equilibrium selection as well as the importance of history in shaping expectations.

Second, I employ a *comparative* historical analysis, using Japan’s experience in the 1930s as counterfactual evidence to that of the United

² Brandes, *American Welfare Capitalism*, p. 146.

³ Bernstein, *Lean Years*.

⁴ Brody, *Workers*, chap. 2.

⁵ Piore and Sable, *Second Industrial Divide*, p. 113.

⁶ Cohen, *Making a New Deal*.

⁷ Greif, “Contract Enforceability.”

States.⁸ Private welfare capitalism was not uniquely an American phenomenon: most notably it was also seen in Britain, France, Germany, and Japan. But as noted by Sanford Jacoby, among these countries, the United States and Japan shared more in common as the rise of corporate welfarism *preceded* the rise of the welfare state and mass unionism in both countries.⁹ Japanese employers' conscious learning from contemporary U.S. practices also contributed to the similarity of corporate welfarism across the two countries. The differential magnitude of the Great Depression experienced by the two thus provides a natural experiment—albeit not ideal—for evaluating the impact of the economic shock on corporate welfarism and subsequent institutional developments.¹⁰

The historical analysis identifies the early 1930s as a *bifurcation* point at which the institutional trajectories in the United States and Japan began to diverge toward two distinct equilibria. In the United States, despite their initial efforts, the deep and prolonged depression induced a majority of welfare-capitalist firms to renege on their corporate welfare practices pertaining to blue-collar workers. The repudiation of the implicit contract changed the expectations of both employees and the public, which in turn supported the rise of union movements, adversarial labor-management relations, and the development of explicit and legally enforceable employment contracts in place of implicit contracts. The initial unraveling of implicit contracts was reinforced by government legislation that changed the “rules of the game” for private players. I argue that the *nature* of the change was endogenous, reflecting the shift in the relative power of constituencies and the dominant beliefs in the society. By contrast, during a shorter and less severe depression, a majority of the proponents of corporate welfarism in Japan adhered to their implicit contracts, while developing institutional arrangements that would mitigate further negative impacts of business fluctuations. As the perceptions of employees and the public remained relatively appreciative of private welfare capitalism in Japan, government intervention prompted by the depression resulted in labor legislation that *endorsed* corporate welfare provision and employee representation plans.

By the early 1940s corporate welfarism in the United States and Japan began to take different contractual forms and enforcement mechanisms, foreshadowing distinct postwar industrial-relations systems in the respective countries.¹¹ In the United States, although corporate welfare programs

⁸ The counterfactual analysis was first proposed by Chuma, “Economic Rationality.”

⁹ Jacoby, “Pacific Ties.”

¹⁰ This is not to say that the employment systems in the United States and Japan were identical prior to 1929; it is to claim that employment practices pertaining to blue-collar workers in comparable sectors in the two economies were developing in parallel in the 1920s, converging towards an implicit-contract equilibrium.

¹¹ For the comparative analysis from 1900 to 1960, see Moriguchi, “Evolution.”

pertaining to blue-collar employees were revived with the advent of World War II, discretionary benefit plans and company unionism were replaced by explicit contractual rights and industrial unionism. In Japan, although workers obtained greater bargaining power and legal rights immediately after the war, implicit and discretionary contracts and enterprise-wide unions continued to shape labor–management relations in major industrial concerns. The analysis thus indicates a path dependence in which the depression left a lasting impact on the subsequent institutional development.

ECONOMICS OF CORPORATE WELFARISM

Historical Background and Three Economic Rationales

Historians have documented employers' voluntary provision of nonwage benefits and services to factory workers in the United States since the early twentieth century.¹² The so-called welfare work became a nation-wide movement during World War I, as numerous firms introduced a variety of employer-sponsored programs in order to attract workers and preempt labor discontent. The early movement was often characterized by its paternalistic nature, piecemeal formulation, and erratic implementation, and many firms abandoned their programs once the postwar recession reversed economic conditions.¹³ Among the employers who had continued to experiment, however, corporate welfare programs matured into more sophisticated corporate programs with sounder financial bases and more impartial administration.¹⁴ Although union avoidance continued to be a strong motive, it became less important in the 1920s among major employers who emphasized economic efficiency.¹⁵ Distinguishing the latter movement from the earlier welfare work, I define *corporate welfarism* as a set of comprehensive personnel programs pertaining to blue-collar workers that developed after World War I.

The most comprehensive survey on corporate employment practices was conducted in 1928 by the leading employers association, the National Industrial Conference Board (NICB), covering over 6,000 industrial establishments.¹⁶ As Table 1 shows, larger establishments were more likely to have

¹² Bernstein, *Lean Years*; Brandes, *American Welfare Capitalism*; Nelson, *Managers*; and Jacoby, *Employing Bureaucracy*.

¹³ U.S. Department of Labor, Bureau of Labor Statistics (hereafter BLS), *Employers' Welfare Work*; Brandes, *American Welfare Capitalism*; and Nelson, *Managers*.

¹⁴ These employers included Bethlehem Steel, Du Pont, Eastman Kodak, General Electric, General Motors, Goodyear Tire & Rubber, International Harvester, Procter & Gamble, Standard Oil of New Jersey, and U.S. Steel.

¹⁵ Slichter, "Current Labor Policies"; National Industrial Conference Board (hereafter NICB), "Industrial Relations"; Hicks, *My Life*, pp. 43, 108; Berkowitz and McQuaid, *Creating the Welfare State*, p. 56; Jacoby, *Employing Bureaucracy*, p. 159; Cohen, *Making a New Deal*; and Kaufman and Taras, *Nonunion Employee Representation*, p. 39.

¹⁶ NICB, *Industrial Relations Programs*.

TABLE 1
CORPORATE PERSONNEL PROGRAMS IN THE UNITED STATES, 1928

Personnel Programs	Small Plants		Large Plants		Total
	Occurrences	%	Occurrences	%	
Incentive contracts					
Retirement pension plan	121	4.8	474	28	685
Group life insurance plan	1,600	36	774	47	2,374
Stock-ownership plan	163	3.7	287	17	450
Profit-sharing plan	168	3.8	80	4.8	248
Saving plan	168	3.8	328	20	496
Housing plan	264	6.0	386	23	650
Length-of-service bonus	384	8.7	183	11	567
Paid vacation plan	926	21	427	25	1,353
Plant medical service	1,556	35	1,027	61	2,583
Human-capital investment					
Apprenticeship training	683	16	499	30	1,182
Training unskilled or semi-skilled	472	11	330	20	802
Foreman training	216	4.9	322	19	538
General education	35	0.8	119	7.1	154
Internal promotion	176	4.0	401	24	577
Internal enforcement mechanisms					
Picnics or outings	666	15	657	39	1,323
Athletic teams	454	10	717	43	1,171
Employee club	106	2.4	288	17	394
Employee magazine	97	2.2	303	18	400
Centralized employment	273	6.2	701	42	974
Centralized discharge	194	4.4	401	24	595
Personnel department	110	2.5	575	34	685
Suggestion system	212	4.8	389	23	601
Safety committee	1,270	29	1,126	67	2,396
Group meetings	300	6.8	251	15	551
Mutual benefit association	198	4.5	498	30	696
Employee representation plan	110	2.5	146	8.7	256
Number of plants	4,409		1,676		6,085

Notes: All the programs were for blue-collar workers and were not required by law. The survey covered 4,409 “small plants” employing 250 or fewer workers and 1,676 “large plants” employing more than 250 workers. Saving plans included saving and loan funds, saving and investment funds, and building and loan funds. Housing plans included company housing programs and home-ownership plans. Plant medical service included plant dispensary, nurses, physicians, hospitals, and special clinics.

Source: NICB, *Industrial Relations Programs*.

any given program, but even among large plants with more than 250 workers, only a minority of them instituted these programs. The NICB study listed a wide variety of personnel programs, including such nonwage benefits as training and education, health and safety, housing and dining, social and recreational activities, and employee-relations programs. Contemporary scholars, as well as historians, saw little coherence among diverse personnel activities and made little attempt to examine their interrelations. Bureau of Labor Statistics (BLS) officials defined personnel work as “anything for the

comfort and improvement, intellectual or social, of the employees, over and above wages paid, which is not a necessity of the industry nor required by law,” or as Bernstein simply puts it, it was the “congeries of policies” embracing numerous features.¹⁷ Why did some employers offer a variety of nonwage benefits and services to their blue-collar workers *beyond* legal obligation? Why did *employers*, rather than markets, supply them? Could these programs generate returns greater than their costs? In addition to the managerial domination theory, I consider three economic rationales for corporate welfarism.¹⁸

First, *incomplete markets* may give firms an advantage in providing these services. For example, when financial markets are incomplete, firms may profit by offering their employees risk sharing and consumption smoothing in the form of life insurance, accident benefits, savings plans, and housing loans. Similarly, employers may have an advantage over markets in providing location-specific goods, such as medical services, safety education, on-the-job training, and recreational activities. Other nonmarket institutions, most notably governments and unions, could and did supply some of these services, but the relative absence of the welfare state and the limited reach of trade unionism prior to the 1930s gave American employers a substantial first-mover advantage.¹⁹ When employers were indeed a more efficient provider of the goods than markets, they could either charge premiums to their employees or lower wages by an equivalent amount (i.e., compensating wage differentials) to reap profits from these activities.²⁰

Although the incomplete-market hypothesis seems to fit well with historical observations, it leaves some contractual features unexplained. First, evidence indicates that, although there certainly were cases in which benefits were substitutes for wages, most welfare capitalists were leading manufacturing employers who provided benefits and services at substantial discounts, if not free, to employees and paid wages that were above industry and regional averages.²¹ Second, company records reveal that in most benefit plans the amount of the benefit was made contingent on employees’ characteristics. If employers were simply substituting for markets, why would they leave positive rents to employees and distribute the rents according to employee characteristics? Third, the incomplete-market hypothesis would not explain the adoption of such programs as company picnics, centralized employment, and employee representation plans, which were often simultaneously introduced.

¹⁷ BLS, *Bulletin No. 123: Employers’ Welfare Work*; and Bernstein, *Lean Years*, p. 174.

¹⁸ For related work, see Fishback, “Economics,” on corporate welfarism in coal mining; and Alston and Ferrie, *Southern Paternalism*, on agricultural paternalism.

¹⁹ Berkowitz and McQuaid, *Creating the Welfare State*.

²⁰ See Fishback and Kantor, “Did Workers,” for compensating wage differentials in the context of workers’ compensation.

²¹ BLS, *Bulletin No. 458, Health*.

An alternative hypothesis is suggested by *implicit-contract theory*.²² According to the theory, employers may offer efficiency wages or performance pay to employees contingent on the level of noncontractable effort, i.e., effort that is observable within an organization but unverifiable to a third party.²³ Employers have an incentive to design such an implicit contract if greater employee effort generates positive returns after compensating for the disutility of effort. However, because an implicit contract is by definition not legally enforceable, it requires internal enforcement mechanisms that compel both employers and employees to conform to the proposed contractual terms. The hypothesis thus indicates that management may install enforcement institutions together with pecuniary benefit plans.

Many of the corporate programs, such as pension and stock-ownership plans, however, promised benefits that would accrue over a long time period. Why did employers offer long-term contracts to their factory workers? In contrast to static efficiency-wage theory, *human-capital theory* provides the reasons for dynamic contracting. It indicates that employers may design long-term contractual arrangements, such as employment guarantees, internal promotion, seniority wages, and deferred compensation, to encourage employees to acquire desirable human capital and to reduce employee turnover.²⁴ The human-capital hypothesis predicts that the rise of systematic corporate training would be accompanied by a set of long-term incentive contracts.

The Contractual Nature of Corporate Welfarism

The preceding three hypotheses are theoretically distinct but not mutually exclusive.²⁵ I first examine the nature of corporate programs using qualitative evidence, and then develop a theoretical framework, which is based on implicit-contract theory with noncontractable employee human capital. For clearer exposition, I divide personnel programs into three categories: long-term incentive contracts, human-capital investment, and internal enforcement mechanisms.

Historical evidence indicates that a central element of corporate welfarism was a long-term incentive contract that offered benefits and services contingent on employees' firm-specific tenure and other characteristics such as merit, workmanship, loyalty, and reliability. Corporate records reveal that

²² An implicit contract is defined as a contract that is not legally enforceable, and an explicit contract is defined as a contract that is legally enforceable.

²³ MacLeod and Malcomson, "Implicit Contracts"; Shapiro and Stiglitz, "Equilibrium Unemployment"; and Baker et al., "Subjective Performance Measures."

²⁴ Lazear, "Why is there Mandatory Retirement?"; Prendergast, "Role"; and Kanemoto and MacLeod, "Optimal Labor Contract."

²⁵ Although the relative importance of the three rationales in motivating welfare capitalists is an important empirical question, differentiating these hypotheses requires far better data than are available and is beyond the scope of this article.

many personnel programs exhibited this contractual feature: retirement pensions, supplementary bonuses, group insurance, accident and sickness benefits, profit-sharing plans, stock-ownership plans, savings and investment plans, paid vacations, housing loans, internal promotion, and, in some cases, medical services. In these programs, the level of benefits received by employees was defined as an increasing function of their length of service, while management retained the right to grant, withhold, reduce, or terminate the benefits in individual cases.²⁶

As emphasized by contemporary management, the provision of benefits surpassed the legal obligations specified by state-level workers' compensation laws. Moreover, an employee's tenure and characteristics were both noncontractable variables because indefinite employment contracts were terminable at will according to prevailing legal norms, whereas the characteristics such as "workmanship" and "loyalty" were nonverifiable to a third party.²⁷ Thus, private welfare provision was based on an implicit contract that conferred no legal rights upon employees, and therefore management could modify or abandon it if so desired with legal impunity.²⁸ In the words of John R. Commons, even though employers often made pledges not to renege on a plan once it was implemented, that promise "rested on the integrity of the company alone."²⁹

In the second category, human-capital investment, a number of leading employers introduced two- to five-year corporate apprenticeship courses, combining on-the-job training and in-class instructions. Apprenticeship wages were set low and employees who had proved "meritorious" received job offers from their employer with higher wages upon graduation. The long-term human-capital investment was tied to a policy of internal promotion, which offered career prospects to production workers based on their merits, skills, and seniority.³⁰ Major employers also offered safety and health

²⁶ International Harvester's pension plan specified the amount of annual payment based on the years of service and wages, while stipulating that its establishment "shall not be held as creating a contract or giving to any employee a right to be retained in the service or any right to a pension" (Annual Report (1922); Ozanne, *Century*, p. 83). At Endicott Johnson, upon offering company homes on liberal terms, employment officers took charge of selecting qualified buyers to insure that only "desirable" workers with more than five years of service and good employment records would be considered (Zahavi, *Workers*, p. 47). At General Electric, employees received one week of paid vacation after three years of continuous service and two weeks after ten years of service; management also provided free life insurance starting from \$500 up to \$1,500 depending on an employee's length of service and employment records (Annual Report, various years).

²⁷ Jacoby, "Duration."

²⁸ BLS, *Bulletin No. 250: Welfare Work*, p. 11, and *Bulletin No. 458: Health*, p. 74. A number of lawsuits were filed against management by employees who were disqualified from or denied payments in profit-sharing and pension plans. The courts consistently ruled in favor of companies on the ground that, since these benefits were mere gratuities on the part of employers, management had the sole right of determining the conditions under which they should be paid (BLS, *Bulletin No. 250: Welfare Work*, p. 6).

²⁹ Commons, Lescoghier, and Brandeis, *History*, pp. 338–39.

³⁰ Allen, *House*; Rumm, "Mutual Interests," p. 360; Nelson-Rowe, "Corporation Schooling"; Young and Tuttle, *Years*; and Schacht, "Toward Industrial Unionism," p. 14.

education, disseminated practical information through employee magazines and pamphlets, and set up a library for employees with general and technical references. Safety committees were introduced not only to educate employees in accident prevention, but also to encourage their initiative in eliminating hazardous working conditions. To utilize human capital at the shop floor, some employers established a formal suggestion system with monetary awards soliciting suggestions for efficiency improvements from blue-collar employees.³¹

With respect to the third category, internal enforcement mechanisms, evidence suggests that employers were generally concerned about possible labor disputes and the negative impact on employee morale and future recruitment that the termination of corporate benefits might trigger. Management argued that the best way to prevent labor conflicts was to build up a corporate reputation for fair dealing and consideration of the interests of employees.³² At Kodak, a famous profit-sharing plan was maintained despite changes in business conditions, as management was afraid that “employees would misunderstand such a change and feel that Kodak had reneged on a deal.”³³ At Endicott Johnson, managers felt that they could not abandon their corporate welfarism “for fear of violating the explicit and implicit expectations” it had created among employees.³⁴ Leading employers were keenly aware that even though management could exercise its discretion in adopting a personnel policy in the absence of state regulations, it was public opinion that would exercise compulsion.³⁵

To facilitate internal enforcement, welfare capitalists instituted various personnel programs promoting communication, coordination, and employee involvement. To establish commitment, management formalized welfare programs and announced their rules, regulations, and operations through bulletin boards, employee handbooks, and employee magazines. At Standard Oil of New Jersey, for example, management distributed a printed labor policy to all employees so that “every worker can always hold the company to its promised word.”³⁶ An increasing number of employers set up benefit funds, committing corporate resources *ex ante* to meet future obligations. To facilitate bilateral communication and employee participation, leading employers set up suggestion systems, joint committees, and employee representation plans. To ensure fair and consistent implementation, personnel policy was increasingly formed at the corporate level and personnel administration was centralized in a personnel department.³⁷ Coordinating employees’

³¹ Nelson, “Company Union Movement”; and Fairris, *Shopfloor Matters*.

³² NICB, *Industrial Relations*, p. 13.

³³ Jacoby, *Modern Manors*, p. 79.

³⁴ Zahavi, *Workers*, p. 143.

³⁵ NICB, *Industrial Relations*, pp. 15–18.

³⁶ Chase, *Generation*, p. 20.

³⁷ To provide coordination within managerial ranks, top management instituted foremen training courses in an effort to check foremen’s decisions over hiring, firing, and promotion that could under-

expectations and promoting “coöperative” employer–employee relations were also important. To build employee loyalty and corporate identity, many employers signaled their goodwill by sponsoring or assisting a wide variety of recreational activities. Company picnics, dance parties, employee clubs, and athletic teams, which involved employees and their families, were regularly featured in employee magazines.

Furthermore, leading employers incorporated some form of joint administration in operating welfare programs. The most formal expression of this was the adoption of an *employee representation plan* (ERP), also known as a “company union.” Under these plans, employee representatives were elected from among blue-collar employees and regularly met with management representatives to discuss matters of mutual concern, including corporate-welfare programs. As correctly criticized by labor historians, ERPs were by no means collective-bargaining units comparable to trade unions, as they were financially dependent on management and given only advisory power over limited subject matters. Nevertheless ERPs provided regular forums for employer–employee communication and information sharing that had not previously existed.³⁸ The plans also gave employees opportunities to discuss personnel programs, voice their concerns, and form collective opinions; once introduced, employers were often surprised by the amount of managerial time and commitment their ERPs required.³⁹

Lastly, company-specific evidence suggests that, at least in a number of instances, corporate welfarism became a *mutually binding* commitment between employer and employees as a result of their strategic interactions. According to the study by Gerald Zahavi, for example, workers at Endicott Johnson repeatedly demonstrated that their loyalty to the corporation had “limits” and that their goodwill had to be reciprocated by management. The workers developed formal and informal strategies for “extracting, sustaining, and expanding” managerial obligations. Eventually corporate welfarism at Endicott Johnson became an *independent code of just behavior* by which the workers judged managerial policies and actions, concludes Zahavi.⁴⁰

mine the corporate policy with their often-noted arbitrariness and injustice. The personnel department compiled employee records, including attendance, wages, length of service, and reasons for separation, which were essential in monitoring the behavior of blue-collar employees as well as foremen.

³⁸ For instance, some employers noted that ERPs were used not only to communicate the details of personnel policies but also to judge if these policies were successfully implemented; others observed that ERPs became educational opportunities for both management and employees as they discussed various aspects of the plant operation (Houser, *What the Employer*, pp. 15–20). At Bethlehem Steel, General Electric, and Standard Oil of New Jersey, a considerable number of grievance cases brought by their ERPs were settled in favor of workers (Slichter, “Current Labor Policies,” p. 413; Schatz, *Electrical Workers*, p. 41; and Gray and Gullett, “Employee Representation”).

³⁹ Nelson, “Company Union Movement”; and Ozanne, *Century*.

⁴⁰ Zahavi, *Workers*, p. 105.

Theoretical Framework: Implicit-Contract Analysis

Based on the foregoing observations, I characterize corporate welfarism as a set of employment practices that constitutes an implicit-contract equilibrium in a repeated employment game.⁴¹ More specifically, I consider a repeated game between an infinitely-lived firm and over-lapping generations of workers each of whom lives for two periods. I assume that each worker can invest in human capital with a cost that will increase his labor productivity one period later. The result of human-capital investment, which materializes as high employee quality (e.g., merit, loyalty) is assumed to be *noncontractable*, that is, observable within the firm but unverifiable to a third-party. The level of employees' output is also assumed to be non-contractable.⁴² To induce desirable human-capital investment, an employer may offer an implicit contract to a young worker that provides an employment guarantee for two periods and promises extra compensation in the second period contingent on his human-capital acquisition.

Under what conditions can this implicit contract be self-enforcing? Based on the historical observations, I assume reputation as a primary enforcement mechanism in which the employer's breach of the contract will cause current and future employees to withdraw cooperation by, for example, choosing a low level of effort, not investing in human capital, and joining outside unions. As is well known, the *self-enforcement* condition requires that the employer's gain from appropriating extra compensation be smaller than the present value of the future losses resulting from such appropriation.⁴³ I focus on two particular subgame-perfect Nash equilibria of the repeated game that resemble spot contracting and corporate welfarism. The Spot-Contract Equilibrium (SCE) is characterized by a short-term employment contract and high labor turnover, a low level of human capital, the same basic wage paid in every period, and low labor productivity. By contrast, the Implicit-Contract Equilibrium (ICE) is characterized by a long-term implicit employment contract, low labor turnover, a higher level of human capital, extra compensation paid in the second period in addition to the basic wage, higher labor productivity, and internal enforcement based on reputation. Note that the ICE is supported by a set of reciprocal expectations in which an employer expects workers to acquire desirable human capital and workers expect the firm to reward such investment when it materializes.

The foregoing model generates four implications that are consistent with the qualitative evidence presented and useful for further historical investigation.

⁴¹ A theoretical appendix is available from the author upon request; see Moriguchi, "Implicit Contracts" for a formal analysis.

⁴² That is, although quantity of output may be verifiable, quality and other dimensions of the output are assumed to be nonverifiable.

⁴³ See, for example, Baker et al., "Subjective Performance Measures."

First, the theory highlights internal enforcement mechanisms as an integral part of the ICE and indicates *complementarity* among seemingly unrelated personnel programs. Observe, for example, that an effective reputation mechanism requires not only workers' ability to monitor managerial behavior but also sufficient information transmission among workers. In contrast to a common view that the firm always benefits when it can "divide and conquer" workers, the model indicates that the firm may have an incentive to share information with employees and empower them to a certain degree, in order to establish credible commitment.⁴⁴

The second implication concerns the existence of the ICE. Given that the ICE outcome Pareto dominates the SCE outcome, why did all firms not use implicit contracts? The self-enforcement condition says that a firm can establish credible commitment *only if* its time-discount factor is above a given "threshold." Note that the threshold time-discount factor is a decreasing function of the returns from human-capital investment. If smaller firms have a shorter time horizon or lower returns from human-capital investment, then they are less likely to adopt implicit contracts, which is consistent with the evidence. The model further indicates that the ICE is vulnerable to economic fluctuations whereas the SCE is not. If a recession exogenously increases a firm's probability of bankruptcy and lowers its time-discount factor below the threshold, management will no longer maintain its implicit contract. If the discount factor remains above the threshold, however, management keeps the contract despite financial difficulty.

Third, the theory implies *multiple equilibria*, that is, whenever the ICE exists the SCE also exists. In the presence of multiple equilibria, management cannot unilaterally "select" an equilibrium as its realization will depend on workers' expectations. If workers believe that the firm will not honor its implicit contract, the ICE unravels and degenerates to the spot contracting outcome, self-fulfilling the workers' original expectations even if the ICE is more efficient. The model thus captures the two competing views of welfare capitalism (managerial domination versus efficiency improvement) as equilibrium beliefs associated respectively with the SCE and the ICE. This observation has two further implications. First, it underscores the importance of coordinating workers' expectations in realizing the ICE. Although the formal theory remains silent on how to achieve such coordination, the evidence reviewed previously suggests that socialization, recreation activities, and bilateral communication could play an important role in signaling employers' goodwill and nurturing mutual trust. Second, if workers have incomplete information over their firm's true motive for instituting corporate welfarism, once one view becomes dominant in the economy, the self-fulfilling nature of the

⁴⁴ For the analysis of internal enforcement mechanisms, also see Greif et al., "Coordination."

belief may generate an externality that drives all firms in the economy to converge to a corresponding equilibrium.

The fourth implication is the rise of the *Explicit Contract Equilibrium* (ECE). The model can be extended to show that, after the breakdown of the ICE and the reversion to the SCE, management and labor may advance an alternative contractual arrangement using third-party enforcement. That is, in the presence of mutual distrust, the employer and workers may agree to develop contractual “proxies” for noncontractable human capital and write legally enforceable contracts contingent on the proxies. The resulting equilibrium, the ECE, can achieve higher productivity than spot contracting. Although the ECE is less efficient than the ICE in general, the ECE requires no internal enforcement mechanisms.

CORPORATE WELFARISM IN THE UNITED STATES AND JAPAN IN THE 1920s

How prevalent was corporate welfarism in the United States prior to the Great Depression? Was the movement in Japan comparable to that in the United States in its contractual nature as well as in its prevalence? To address these questions, I present quantitative evidence using contemporary surveys in the respective countries.

Corporate Welfarism in the United States, 1920–1929

Although corporate welfarism, defined as a set of comprehensive personnel programs, was confined to a minority of large employers in the United States during the 1920s, it was a sizable minority representing a growing trend. At the end of the decade, several hundred large American establishments practiced corporate welfarism, employing roughly 15 to 20 percent of production workers in the United States. Corporate expenditures on these programs were not trivial.

Two detailed studies by the Bureau of Labor Statistics, which were conducted in 1917 and 1926 on overlapping samples of 430 large plants, documented a trend in corporate welfarism among American firms.⁴⁵ Despite the setback during the post–World War I recession, the studies recorded a net increase in the number of establishments adopting a major corporate program between 1917 and 1926. Most notably, the percentage of establishments having group insurance plans increased from 7 percent to 43 percent; disability benefit funds from 19 percent to 50 percent; paid vacation plans from 4 percent to 37 percent; employee classes from 17 percent to 33 percent;

⁴⁵ BLS, *Bulletin No. 250: Welfare Work* and *Bulletin No. 458: Health*; and Fairris, *Shopfloor Matters*, p. 33.

TABLE 2
EMPLOYEE REPRESENTATION PLANS AND TRADE UNIONS IN THE UNITED STATES, 1919–1947

Year	Companies with ERPs	Number of ERPs	Employees Covered by ERPs	Trade Union Membership	ERP Coverage as a Percentage of Union Membership
1919	145	196	403,765	4,125,200	9.8
1922	385	725	690,000	4,027,400	17.1
1924	421	814	1,240,704	3,536,100	35.1
1926	432	913	1,369,078	3,502,400	39.1
1928	399	869	1,547,766	3,479,800	44.5
1932	313	767	1,263,194	3,144,300	40.2
1934	N.A.	1,075*	1,769,921	3,069,000	57.7
1935	N.A.	1,577*	2,597,600	3,753,300	69.2
1941	N.A.	598	411,000	8,698,000	4.7
1947	N.A.	222	469,000	14,595,000	3.2

Notes: A large company with multiple plants or establishments typically had more than one ERP. The numbers with * were calculated assuming that the average number of employees per ERP remained constant (1,647) between 1932 and 1935.

Sources: NICB, *Special Report no. 32: Growth*, p. 10, *Individual and Collective Bargaining*, p. 16, *Individual and Collective Bargaining in May, 1934*, p. 12, and *What Employers*, p. 10; Jacoby, "Road," p. 82; and Troy, "Trade Union Membership," p. 1.

and recreational facilities from 35 percent to 55 percent. The percentage of establishments instituting joint administration of personnel programs rose from 46 percent to 80 percent. Although not covered by the BLS studies, the number of firms with formal retirement pension plans in the United States more than doubled between 1915 and 1926 to 370 firms covering 4 million white- and blue-collar employees; the number of firms adopting ERPs increased from 145 to 399 between 1919 and 1928, covering more than 1.5 million production workers (see Table 2); and the number of firms with stock-ownership plans for all employees doubled between 1921 and 1927 to about 280 firms.⁴⁶

According to the 1926 BLS study, consistently over 30 percent of the 430 establishments surveyed adopted major personnel programs, e.g., group life insurance, sickness and disability benefits, paid vacations, medical services, employee education, recreation and socialization, and joint administration.⁴⁷ According to the aforementioned 1928 NICB survey, consistently over 20 percent of 1,676 large plants implemented major programs (see Table 1). What cannot be inferred from these studies, however, is a distribution of personnel programs across firms. Were these programs uniformly distributed or clustered in a small set of firms? Unfortunately, no micro-level data are available to test the correlations among different programs adopted; how-

⁴⁶ NICB, *Industrial Pensions*; Epstein, *Problem*; and NICB, *Special Report No. 32: Growth, Individual and Collective Bargaining*, and *Employee Stock Purchase Plans*. The number of companies having profit-sharing plans, by contrast, is likely to have declined during the 1920s (BLS, *Bulletin No. 208: Profit Sharing* and *Bulletin No. 458: Health*).

⁴⁷ BLS, *Bulletin No. 458: Health*.

ever, company-level evidence suggests that large establishments tended to adopt a set of comprehensive programs “en bloc,” combining financial incentives, corporate training, centralized personnel management, and some form of employee participation.⁴⁸ If the positive correlations are assumed, Table 1 indicates that there were 400 to 600 establishments in the United States adopting relatively comprehensive personnel programs at the end of the 1920s.

How costly was it to implement corporate welfarism? A 1923 study by the American Management Association (AMA) found the average expense for personnel activities of 90 firms to be 1.53 percent of total annual payroll; the 1926 BLS study found the average welfare expenditures of 190 companies to be \$27, or about 2 percent of a wage earner’s annual pay; the 1928 NICB study found the per-worker average of approximately 400 small establishments to be \$26.65, or about 2 percent of annual factory payroll; and a 1933 NICB study found the median per-worker cost of some 70 large establishments to be \$14.06, or 1.85 percent of payroll.⁴⁹ These observations led Jacoby to conclude that, “despite the high-minded rhetoric that accompanied it, few companies spent enough . . . to have had a widespread effect on worker loyalty or economic security.”⁵⁰ The same data, however, also indicate considerable interfirm variation; the 1926 BLS study reported the per-worker cost ranging from \$14 to \$120 among the sample establishments and the 1933 NICB study from \$1.36 to \$175.40. To assess the cost of implementing *comprehensive* welfare programs, I estimate the corporate expenditures on 14 personnel programs for which data are available (see Table 3).⁵¹ The most expensive program was profit sharing, followed by supplemental bonuses and paid vacations. Table 3 indicates that if a firm adopted *all* of the 14 programs listed, the total cost would have been 12 percent of annual payroll. When less prevalent programs (i.e., profit sharing and supplemental bonuses) were excluded, the welfare expenditures would have been about 6 percent of payroll.⁵²

⁴⁸ See Jacoby, *Employing Bureaucracy*, p. 118; and Moriguchi, “Did American Welfare Capitalists.” A 1923 study by the American Management Association (hereafter AMA), which surveyed 90 plants on ten personnel activities, found that plants with more than 1,500 employees had adopted on average 7.7 personnel activities, whereas plants with fewer than 500 employees had adopted only 2.2 activities (*Cost-Findings*).

⁴⁹ AMA, *Cost-Findings*; BLS, *Bulletin No. 458: Health*; and NICB, *Industrial Relations Programs and Effect*.

⁵⁰ Jacoby, *Employing Bureaucracy*, p. 199.

⁵¹ AMA, *Cost-Findings*; NICB, *Employee Magazines, Economic Status, Industrial Relations Programs, and Effect*; Epstein, *Problem*; and BLS, “Vacation” and *Bulletin No. 458: Health*.

⁵² Note that no data are available for stock-ownership plans, savings plans, and ERPs. As evidence suggests that these were relatively costly plans, the average expenditures could be higher if a firm adopted these plans.

TABLE 3
THE COST OF PERSONNEL PROGRAMS IN THE UNITED STATES
(cost as a percentage of total annual payroll)

Personnel Programs	AMA (1925)	NICB (1925)	NICB (1928)	NICB (1929)	NICB (1934)	Other Studies	Average
Pension	0.33	N.A.	0.50	0.80	N.A.	0.61 ^a	0.71
Group life Insurance	0.60	0.75	0.73	0.80	1.30		0.73
Disability benefit	N.A.	N.A.	0.20	0.30	0.78	0.46 ^b	0.34
Profit sharing	N.A.	N.A.	2.70	4.40	4.30		3.80
Supplemental bonuses	N.A.	N.A.	1.80	2.90	N.A.		2.35
Housing program	1.00	N.A.	N.A.	N.A.	N.A.		1.00
Paid vacations	N.A.	N.A.	1.50	0.90	N.A.	1.50 ^c	1.30
Medical services	0.32	N.A.	0.43	0.30	0.34		0.35
Dining services	0.31	N.A.	0.55	0.60	N.A.		0.49
Recreational services	0.26	N.A.	N.A.	N.A.	0.22		0.24
Training and education	0.15	0.17	N.A.	N.A.	0.10		0.14
Employee magazine	0.21	0.10	N.A.	N.A.	0.10		0.14
Health and safety	0.13	0.50	0.43	N.A.	N.A.		0.35
Employment procedure	0.31	N.A.	N.A.	N.A.	0.34		0.33
Total (all 14 plans)							12.26
Total (12 basic plans)							6.11
Sample size	90	1	200	400	70		

Notes: All numbers are estimated by the author; details are available upon request. All the costs are employers' expenses net of employee contributions. Supplemental bonuses included length-of-service bonus, attendance bonus, and quality-of-product bonus. The second to last row reports total cost of all the 14 plans in the table. The last row reports total cost of 12 "basic plans" excluding profit-sharing plans and supplemental-bonus plans.

Sources: AMA, *Cost-Findings*; NICB, *Employee Magazines*, *Economic Status*, *Industrial Relations Programs*, and *Effect*;

a. Epstein, *Problem*, with the sample size 100;

b. BLS, *Bulletin No. 458: Health*, with the sample size 80; and

c. BLS, "Vacation," with the sample size 90.

Corporate Welfarism in Japan, 1920–1929

The growth of corporate welfare programs pertaining to factory workers (*shokko*) in Japan in the early twentieth century is relatively well documented.⁵³ Early welfare work, referred to as "employer paternalism (*keiei onjo shugi*)," was often erratic, short-lived, and an inferior substitute for wages. With the rapid growth of capital-intensive manufacturing industries, however, corporate welfarism in Japan matured into more systematic and substantive programs after World War I.⁵⁴ By the end of the 1920s, a few hundred Japanese establishments adopted fairly comprehensive personnel

⁵³ Gordon, *Evolution*; Hazama, *Historical Studies*; and Hyodo, *Evolution*.

⁵⁴ Kyochoikai, *Recent Social Movements*, chap. 18.

programs.⁵⁵ As in the United States, the movement in Japan was confined to leading employers, covering no more than one-fifth of the nation's production workers.

The only available survey on corporate welfare practices in the 1920s was by the semi-public research institution *Kyochokai* in 1921, which covered 157 large private plants employing 300 or more workers. As Table 4 shows, major employers instituted retirement pension plans, sickness and death benefits for employees and their families, length-of-service bonuses, profit-sharing bonuses, stock-ownership plans, savings plans, company housing, and medical services for their blue-collar workers, all of which surpassed minimum legal requirements.⁵⁶ Table 4 also reports the findings of the 1932 survey by the Social Bureau of the Home Ministry, covering 2,310 private plants with 100 or more workers.⁵⁷ Similar to American corporate welfarism, these corporate programs were implicit contracts that conferred no legal rights upon employees, and management retained the right to change or deny benefits on an individual basis depending on employee characteristics.⁵⁸ A typical retirement allowance plan (*taishoku teate seido*), the equivalent of a lump-sum pension and dismissal compensation combined, specified the amount of allowance paid upon separating from a company contingent on an employee's length of service, age, and the reason for separation.⁵⁹

To encourage human-capital investment, major Japanese employers set up formal training programs for employees as well as supplemental education programs, lectures, and company libraries. In particular, leading manufacturing employers instituted corporate schools (*shokko gakko*) to foster skilled and semi-skilled employees in-house rather than relying on public schools, and adopted policies of internal promotion.⁶⁰ Uruga Dock, for example, offered an apprenticeship contract that specified a three- to five-year training period with periodic wage raises and compulsory savings, which

⁵⁵ Large *zaibatsu*-affiliated firms in heavy industries, such as Hitachi Engineering Works, Ishikawajima Shipyards, Mitsubishi Electric, Mitsubishi Shipyards, Nippon Steel, Oji Paper, Onoda Cement, Shibaura Engineering Works, and Sumitomo Electric Wire, were the major proponents of corporate welfarism.

⁵⁶ The 1926 Revised Factory Law mandated 14 days' wages as a severance pay in the case of dismissals due to business reasons and the 1928 Health Insurance Law obligated employers to provide injury, sickness, and death benefits.

⁵⁷ *Kyochokai, Overview*; *Shakaikyoku, Survey . . . 1 and 2* and *Survey . . . 3*. To maintain comparability with the U.S. data, government-owned plants are not included in Table 4.

⁵⁸ For example, in introducing seniority bonuses for factory workers, Nippon Steel required employees not only to have a minimum of five years of service but also to be deemed "diligent, loyal, and decent-mannered" by management; at Mitsubishi Shipyards, management retained full authority to determine the number of workers receiving a pay raise as well as the amount of the raise, based on merit, skill, and diligence of individual employees. Hyodo, *Evolution*, pp. 327–29; Hazama, *Historical Studies*, p. 521; and Sumiya, *History*, p. 135.

⁵⁹ *Kyochokai, Overview*; Zensanren, *Current Conditions of Retirement Allowance Plans*, p. 5; and *Shakaikyoku, Summary*, pp. 61–62.

⁶⁰ Hyodo, *Evolution*, p. 407; and Hazama, *Historical Studies*, p. 513.

TABLE 4
CORPORATE PERSONNEL PROGRAMS IN JAPAN, 1921 AND 1932

Personnel Programs	157 Large Plants in 1921		2,310 Plants in 1932	
	Occurrences	%	Occurrences	%
Incentive contracts				
Retirement allowance or pension	73	47	967	42
Group insurance plan	36	23	N.A.	
Nonwork injury and sickness benefits	107	68	515	22
Injury, sickness, and death benefits for family	79	50	227	9.8
Stock-ownership plan	N.A.		63	2.7
Profit-sharing plan			272	12
End-of-term bonus	126	80	N.A.	
Length-of-service bonus	55	35	102	4.4
Savings plan	84	54	N.A.	
Loans to employees	33	21	276	12
Company housing	101	64	796	35
Housing allowance	20	13	134	5.8
Discount purchase	91	58	777	34
Plant medical care	149	95	1,109	48
Human-capital investment				
Supplementary education	34	22	480	21
Corporate training program	28	18	249	11
Company library	48	31	811	35
Internal enforcement mechanisms				
Picnics or field days	97	62	863	37
Social gatherings	90	57	1,187	51
Athletic facilities	60	38	1,529	66
Employee magazine	48	31	287	12
Employee associations	68	43	919	40
Suggestion system	14	8.9	N.A.	
Safety committee	N.A.		1,385	60
Mutual aid association	N.A.		271	12
Joint administration	N.A.		211	9.1

Notes: The 1921 sample consists of 157 large private establishments employing 300 or more employees; the 1932 sample consists of 2,310 private establishments employing 100 or more employees. All the programs were for blue-collar workers and were not required by law. "End-of-term bonuses (*kimatsu shoyo*)" were bonuses given monthly or semiannually; some of them were profit-sharing plans. "Employee associations" include ERPs, mutual aid associations (*kyosai kumiai*), employee clubs, and other employee organizations. "Joint administration" includes employee participation in welfare administration through ERPs, mutual aid associations, or other employee organizations.

Sources: Kyochoikai, "Overview"; Shakaikyoku, "Survey 1 & 2," "Survey 3."

would pay out the savings and interest only if the apprentice completed the training and stayed with the company for five years afterwards.⁶¹ At Mitsubishi Shipyards and Hitachi Engineering Works, employers established corporate schools and gradually reduced mid-career hiring in favor of workers who graduated from company training programs.⁶²

Japanese management also sponsored various recreational and social activities including company picnics, field days, motion pictures, and athletic com-

⁶¹ Gordon, *Evolution*, pp. 103–06.

⁶² Hazama, *Historical Studies*, p. 513.

petitions, and promoted the spirit of employer–employee cooperation. Many major enterprises established personnel sections and personnel managers were put in charge of careful screening of job applicants, enforcement of work discipline, evaluation of employees, and administration of personnel programs.⁶³ An increasing number of employers established mutual-aid associations, ERPs (typically called “*kojo iinkai*” or factory councils), or less formal employee organizations, through which factory employees took part in administering corporate welfare programs.⁶⁴ As in the United States, ERPs were only a consultative body whose primary objective was to facilitate communication and build trust between employers and employees. In most ERPs, management initially tried to confine the agenda of council meetings to the enhancement of workers’ welfare and productivity. Once introduced, however, ERPs gave workers some voice in formulating personnel policies.⁶⁵ In the 1920s, as corporate programs became more permanent institutions, many large companies established welfare funds for their employee-benefit plans and committed corporate resources to improve their financial soundness.⁶⁶

The similarity between private welfare capitalism in the United States and Japan was often a result of direct and indirect learning. Major employers in both countries learned from British and German precedents, and leading Japanese employers studied American practices as possible role models. For example, a researcher at Mitsubishi was sent to the United States specifically to collect data on corporate personnel policies. A manager at Sumitomo Electric Wire established ERPs modeled on International Harvester and Standard Oil plans. The BLS and NICB studies were closely followed by contemporary Japanese scholars and government officials.⁶⁷

How prevalent was corporate welfarism in Japan? Although available quantitative data from the 1920s are limited, evidence suggests that the movement in Japan was also confined to a minority of leading firms consisting of 200 to 300 establishments. In 1932 consistently over 200 plants adopted major incentive

⁶³ Hazama, *Historical Studies*, pp. 512–13; Showa Dojinkai, *Historical Reflections*, p. 274; Hyodo, *Evolution*, pp. 436–37; and Gordon, *Evolution*, p. 110.

⁶⁴ Kyochokai, *Recent Social Movements*, pp. 912–13.

⁶⁵ At Sumitomo factories, workers protested when management refused to discuss subjects concerning standards for awarding supplementary bonuses, changes in incentive wages, and revision of the retirement allowance plan. Eventually, management conceded to include these issues as subjects for consultation. Similarly, at Mitsubishi Shipyards, three years after the introduction of its ERP, management allowed basic working conditions to be discussed at the ERP meetings in response to growing employee demands (Hazama, *Historical Studies*, p. 532; and Hyodo, *Evolution*, pp. 399–402). At Uraga, as its mutual aid society gave workers control over a part of welfare programs, what management once thought of as company benevolence became “the fulfillment of a company obligation” to its workers (Gordon, *Evolution*, p. 113).

⁶⁶ Kyochokai, *Overview*; Gordon, *Evolution*, pp. 110–14; and Kyochokai, *Recent Social Movements*, pp. 910–12.

⁶⁷ Kyochokai, *Welfare Facilities and Welfare Activities*; Mitsubishi Goshi, *Factory Councils*; Kyochokai, *Recent Social Movements*, chap. 9; Mimura, “Ten Years”; and Zensanren, *American Employers’ Views*.

contracts, training programs, socialization activities, and joint administration and other forms of employee involvement (see Table 4). Yet, only 112 establishments in Japan had ERPs in 1929, and only 132 out of 256 large establishments surveyed had formal retirement allowance plans in 1930.⁶⁸ In the late 1920s there were about 200 private establishments employing 1,000 or more workers in Japan, which together employed approximately 400,000 workers, or 20 percent of total production workers. Although these establishments did not entirely coincide with the set of welfare capitalists, because there was a significant overlap, I use 20 percent as an upper bound for the percentage of workers employed by welfare capitalists in Japan. The data on welfare expenditures were reported in a 1926 survey by a leading employers' association, Japan Industrial Club.⁶⁹ The average per-worker expenditures on personnel programs of 62 leading companies were 32.41 yen, or 10.7 percent of the annual payroll. In textiles and mining, however, the expenditures exceeded 20 percent of factory payrolls due to substantially lower wages paid in these industries. If these two industries are excluded from the sample, the average corporate expenditures on personnel programs were 7.9 percent of the annual payroll.

In summary, in both countries at the end of the 1920s, corporate welfarism was confined to a small set of large establishments in capital-intensive industries, covering no more than 20 percent of production workers. In other words, the nature of corporate welfarism and its prevalence in the economy in the late 1920s were roughly comparable between the United States and Japan.

The Impact of Corporate Welfarism in the 1920s

Toward the end of the decade, the two countries experienced common trends that were attributed to the diffusion of corporate welfarism by contemporary observers. First, turnover of factory workers declined in the 1920s in both countries. In the United States, both aggregate-level data and company-level evidence indicate a statistically significant decline in turnover rates in the 1920s.⁷⁰ Although aggregate-level data for Japan are less reliable (and unavailable before 1923), when combined with regional surveys and establishment-specific evidence, the data indicate a decline in turnover of Japanese workers during the 1920s.⁷¹

Second, the union movement in large establishments subsided in the 1920s in both countries. In the United States, the number of work stoppages

⁶⁸ Kyochokai, *Current Conditions*.

⁶⁹ NKK, *Survey*.

⁷⁰ Berridge, "Labor Turnover"; Sundstrom, "Studies," chap. 3; Owen, "Worker Turnover in the 1920s: Role" and "Worker Turnover in the 1920s: What Labor-Supply Arguments"; and Whatley and Sedo, "Origins."

⁷¹ NRUS, *Historical Data . . . Vol.10*, II-60; Hyodo, *Evolution*, p. 405; Sumiya, *History*, p. 132; Odaka, *Labor Market Analysis*, p. 205; and Nishinarita, *Historical Study*, p. 327.

remained low after 1922 despite economic prosperity. Union membership fell by 14 percent between 1922 and 1928 to 3.5 million, and the number of employees covered by ERPs doubled to 1.5 million (see Table 2). After examining corporate welfare practices, a contemporary leftist warned in 1927 that the trade unions in the United States faced in these practices a challenge to their very existence.⁷² In Japan, although union membership increased steadily and the number of labor disputes remained relatively high throughout the 1920s, the center of the union movement shifted to small establishments by the end of the decade. In both the United States and Japan, despite repeated organization drives by existing unions, leading manufacturing establishments remained unorganized in the twenties.⁷³ Major proponents of corporate welfarism in the respective countries claimed that the low turnover, stable workforce, and labor-management cooperation were the result of their personnel policies. Although causal relations are difficult to establish and are in dispute, the aforementioned trends lent credibility to private welfare capitalists in the eyes of contemporaries.⁷⁴

Lastly, even though corporate welfarism was confined to a minority of employers in the United States and Japan, because its leading proponents were industry leaders they had substantial political influence in both countries. In the United States, Secretary of Commerce Herbert Hoover became a promoter of “voluntarist corporatism,” endorsing private welfare capitalism.⁷⁵ Similarly, in Japan, the *zaibatsu* leaders had close ties with politicians or were themselves members of the Diet. Both governments supported private initiatives in industrial welfare and took a stance against trade unionism. In short, private welfare capitalism enjoyed growing political, intellectual, and social support during the 1920s in both countries.⁷⁶

THE CHALLENGE OF THE GREAT DEPRESSION

Among industrialized nations, the United States experienced the deepest and longest Great Depression whereas Japan experienced one of the mildest. U.S. industrial production fell by 50 percent between 1929 and 1932 and did not fully recover to the 1929 level for over a decade; by contrast, Japan’s industrial production declined by less than 10 percent between 1929 and 1931 and returned to the predepression level by 1933 (Figure 1). Consistent with the theoretical prediction, during the initial years when the depression was less severe, business leaders in *both* countries tried to maintain their implicit contracts. However, the difference in the magnitude and duration of

⁷² Dunn, *Americanization*.

⁷³ Bernstein, *Lean Years*; and Komatsu, *Origins*.

⁷⁴ Gordon, *Evolution*; and Jacoby, *Employing Bureaucracy*.

⁷⁵ Hawley, *Great War*, p. 68; and Fausold, *Presidency*, pp. 119–20.

⁷⁶ Berkowitz and McQuaid, *Creating the Welfare State*; and Garon, *State*.

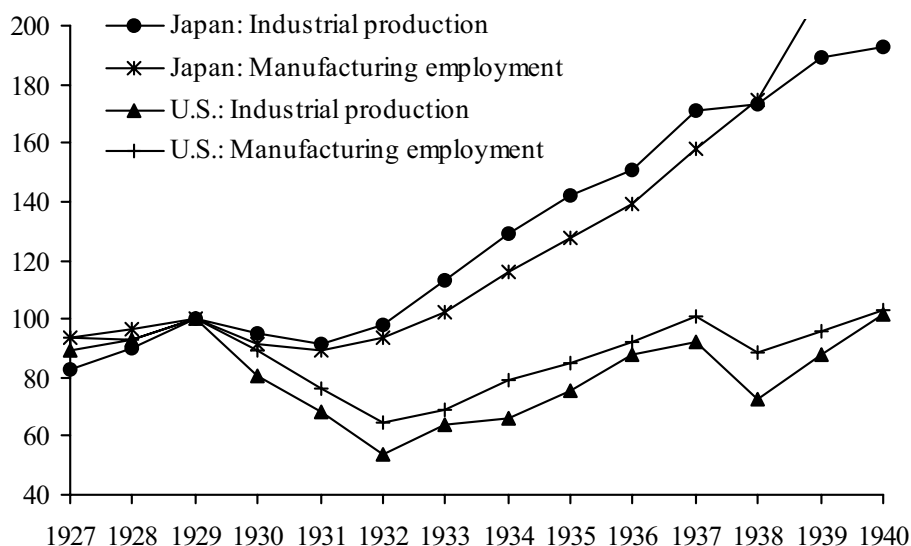


FIGURE 1
INDUSTRIAL PRODUCTION AND MANUFACTURING EMPLOYMENT INDICES IN THE
UNITED STATES AND JAPAN, 1927–1940
(1929 = 100)

Sources: U.S. Department of Commerce, *Historical Statistics*; Bank of Japan, *Hundred-Year Statistics*, p. 397; and Showa Dojinkai, *Historical Reflections*, statistical appendix.

the depression eventually led to divergent responses by American and Japanese employers, resulting in the bifurcation of institutional trajectories in the two countries.

The Great Depression and Broken Promises in the United States

For the first two years of the depression in the United States, the proponents of corporate welfarism made a considerable effort to keep their promises, expecting that the depression would soon end. Supporting employers' private efforts, the Hoover administration urged business leaders not to reduce wages and promoted a national "share-the-work" movement to prevent mass unemployment. In contrast to today's U.S. corporate practices, in an effort to protect their workforce, major companies ceased hiring, reduced hours, transferred employees to different departments, and cut executive salaries.⁷⁷ International Harvester, for instance, instituted a policy to produce goods beyond present demand to create extra work.⁷⁸ Western Electric reported in 1931 that shortened hours made it possible to retain all employees with "long service and experience."⁷⁹

⁷⁷ NICB, *Lay-Off*, p. 36; and Balderston, "Recent Trends," p. 261.

⁷⁸ Ozanne, *Century*, pp. 141–46.

⁷⁹ Western Electric's Annual Report (1931), p. 9.

The economy, however, continued to deteriorate: by late 1931 industrial production was 30 percent below its 1929 level, and tight monetary policy and multiple bank crises imposed serious liquidity constraints on firms.⁸⁰ In the fall of 1931 major business leaders announced wage reductions. In June 1932 the level of industrial production was 60 percent below and the S&P 500 stock price index was 70 percent below their respective 1929 peaks. By 1933 a majority of the proponents of corporate welfarism repudiated their implicit contracts, not only by withdrawing corporate benefits at the “time of the employees’ greatest need,” but also by implementing large-scale dismissals despite their earlier pledge to provide employment security in exchange for reduced work hours.⁸¹

According to an NICB study that surveyed 233 establishments in 1934, personnel programs that showed the highest rate of discontinuation were: employee stock ownership (52 percent), employee magazines (49 percent), paid vacation for wage earners (43 percent), social and recreational activities (38 percent), profit sharing (35 percent), corporate training (26 percent), home purchase plans (24 percent), and suggestion systems (18 percent).⁸² By contrast, a low rate of discontinuation was reported in pension plans (6.8 percent), ERPs (5.7 percent), safety committees (3.4 percent), centralized employment (2.2 percent), and group life insurance (1.2 percent). As David Fairris points out, the findings do not support the often-held claim that private welfare capitalism fell apart during the depression. Nevertheless, his conclusion that its basic structure remained “largely intact” also calls for reassessment.⁸³ The NICB survey likely understates the impact of the depression on corporate welfarism in at least three ways: first, the sample is biased towards very large establishments employing on average over 2,000 workers; second, company records indicate that downward revision and temporary suspension of welfare plans, which were unreported in the survey, were more prevalent than discontinuation;⁸⁴ and lastly, even if plans were in operation, the number of eligible workers fell drastically as most firms resorted to massive layoffs by 1932.⁸⁵ Murray Latimer found that, by 1932, 10 percent of company pension plans were discontinued or suspended, another 10 percent curtailed the amount of benefits, and still others raised the amount of employee contributions.⁸⁶ Over 100 ERPs (or 12 percent) were discontinued between 1928 and 1932 (see Table 2), and more became inactive as most employers preferred not to request ERP approval for every

⁸⁰ Friedman and Schwartz, *Monetary History*.

⁸¹ Schatz, *Electrical Workers*, p. 61.

⁸² NICB, *Effect*.

⁸³ Fairris, *Shopfloor Matters*, p. 61.

⁸⁴ Moriguchi, “Did American Welfare Capitalists?”

⁸⁵ NICB, *Studies . . . No. 10: Health Insurance Plans*, p. 10, and *Studies . . . No. 13: Developments*, pp. 11–12.

⁸⁶ Latimer, *Industrial Pension*, p. 847.

wage cut and benefit revision.⁸⁷ Even the largest firms could not avoid dismissals: between 1929 and 1932, Bethlehem Steel and General Electric reduced their workforces by 50 percent, International Harvester by 58 percent, and Ford by 72 percent. Although the unemployment rate rose to 25 percent, the extent of private dismissal compensation covering blue-collar workers was limited. A BLS study in 1932 found that only 18 out of 224 manufacturing establishments paid such compensation.⁸⁸

As a consequence, workers' belief in their employers' goodwill was considerably undermined. As Brody and Cohen emphasize, because American welfare capitalists had raised employees' expectations, their broken promises generated a deep sense of disappointment if not betrayal.⁸⁹ The work sharing reduced work hours so severely that workers who kept their jobs received what they called "starvation wages." Employees who initially cooperated with management to institute work sharing thus grew increasingly dissatisfied. In addition, when employers eventually resorted to layoffs, management typically used subjective criteria combining merit, seniority, and family needs, which inflamed discontent among workers.⁹⁰ Some workers were "disillusioned" by the loss of their savings, especially when they had been advised by their companies to enter into an unsound investment; some called their years of regular contributions to corporate programs "money thrown away"; some felt "heartbroken" when their company unilaterally eliminated the annual bonus, which they had expected as part of annual compensation; some resented management for the loss of company houses when they could not maintain their payments; and some even blamed management that their layoffs were motivated by employers' desire to avoid paying principal benefits promised after a certain tenure.⁹¹ A Ford worker bitterly wrote to an AFL union leader in 1933 that he had "spent a lifetime helping to create a millionaire" when the company dismissed him.⁹² Disturbed by reduced work, benefits, and employment, a small group of skilled workers at General Electric secretly began organizing a union in 1932.⁹³ In early 1933, prominent industrial relations scholar William Leiserson remarked that "this depression had undone fifteen years or so of good personnel work" and consequently "labor is going to look to legislation and not to personnel management for a solution."⁹⁴

⁸⁷ Ozanne, *Century*, p. 146.

⁸⁸ BLS, "Hiring." An NICB survey found 153 concerns with active dismissal compensation plans in the early 1930s, but many of them were exclusively for white-collar employees (NICB, *Studies . . . Dismissal*).

⁸⁹ Brody, *Workers*, p. 242; and Cohen, *Making a New Deal*, pp. 238–46.

⁹⁰ Commons et al., *History*, p. 244; and Schatz, *Electrical Workers*, p. 61.

⁹¹ Balderston, *Recent Trends*, p. 265; Cohen, *Making a New Deal*, p. 240; Zahavi, *Workers*, p. 133; and Fine, *Sit-Down*, p. 26.

⁹² Brody, *Workers*, p. 77.

⁹³ Schatz, *Electrical Workers*, p. 63; and Millis, *How Collective Bargaining*, p. 751.

⁹⁴ His address reprinted in *Management Review* 22 (1933), pp. 114–15.

According to the implicit-contract theory, once workers perceive that their employer has breached the contract, they mistrust management and withdraw any future cooperation. One may postulate, however, that because workers themselves observed the macroeconomic conditions, management should have been able to convince workers that the depression was an extraordinary contingency, which made the breach of contract inevitable. Historical evidence suggests that it was difficult because most factory workers did not possess sufficient information about their firm's financial condition to assess whether management's action was justifiable. Employers' efforts to provide such information in a number of firms met with skepticism as workers saw no incentive for management to report truthfully. Their mistrust was reinforced partly by the fact that management often maintained corporate programs pertaining to white-collar employees while discontinuing those pertaining to blue-collar workers.⁹⁵ Moreover, high rates of discontinuation of employee magazines, social activities, suggestion systems, and ERP meetings during the depression indicate that there was a general breakdown of labor-management communication at a critical moment, which might have made renegotiation even more difficult.

The Great Depression and Kept Promises in Japan

Though mild by international standards, Japan's 1929 depression was the deepest recession in the nation's modern history, and as such, it seriously challenged managerial commitment. As industrial demand contracted by 8 percent in 1929–1931, a large number of firms announced pay cuts and layoffs. In response, the number of labor disputes opposing these measures surged. As unemployment rose sharply, the Japanese government urged employers to avoid mass dismissals.⁹⁶ As in the United States, the leading proponents of corporate welfarism tried to circumvent layoffs by freezing new hiring, reducing hours, relocating workers, and creating relief work within the establishment.⁹⁷ When the reduction of the workforce became inevitable, leading employers proposed to *augment* the amount of retirement allowance and solicited "voluntary retirement" from among employees. Table 5 reports the value of retirement allowances stipulated in 142 formal plans in large establishments (employing 200 or more workers) in 1932. The first column shows the average payment schedule for the retirement due to employees' personal reasons (the equivalent of a lump-sum pension), and the second column shows the average payment schedule for the retirement due to business reasons (i.e., the augmented allowance for voluntary retire-

⁹⁵ Moriguchi, "Did American Welfare Capitalists?"

⁹⁶ Odaka, *Labor Market Analysis*, p. 203; NRUS, "Historical Data . . . Vol. 10," pp. 468–69; and Gordon, *Evolution*, pp. 145–47.

⁹⁷ Hazama, *Historical Studies*, pp. 508–10; and Gordon, *Evolution*, p. 203.

TABLE 5
RETIREMENT-ALLOWANCE PLANS IN JAPAN, 1932

Length of Service (years)	Amount of Allowance Stipulated (days of wages)		
	(A) Retirement Due to Personal Reasons	(B) Retirement Due to Business Reasons	Average of B – A
Less than 1	0 – 10	0 – 14	2.0
1 – 3	7 – 35	14 – 38	5.0
3 – 5	37 – 61	44 – 72	9.0
5 – 7	63 – 88	81 – 115	22.5
7 – 10	97 – 162	128 – 192	30.5
10 – 15	147 – 286	193 – 346	53.0
15 – 20	281 – 446	358 – 520	75.5
20 – 25	415 – 575	528 – 700	119.0

Notes: Using the same sample of 165 large establishments (employing 200 or more workers), the two surveys reported 145 retirement allowance plans and 142 augmented retirement allowance plans for production workers, respectively. The ranges of the amount of allowances stipulated in the representative plans are shown. The numbers in column B are *net* of advanced-notice allowance (14 days of wages) mandated by the 1926 Revised Factory Law.

Sources: Zensanren, *Current Conditions of Retirement Allowance*, pp. 22–23, and *Current Conditions of Dismissal Allowance*, pp. 22–23.

ment).⁹⁸ The difference between the two allowances is effectively dismissal compensation, which is reported in the last column. The amount of the proposed dismissal compensation increased substantially with an employee's length of service.

Whether or not major employers adhered to their promises during the depression can be partially inferred from annual government surveys of retirement allowances covering over 5,000 private factories employing 50 or more workers (see Table 6). At the trough of the depression, the number of workers dismissed due to business reasons increased to 59,000 or 5.3 percent of total employment in the sample, and the percentage of these workers receiving any allowances declined from 72 to 60 percent.⁹⁹ Among those who received allowances, however, the amount per worker increased sharply from 41 days in 1929 to over 182 days in 1931, far surpassing the legal requirement of 14 days of wages. The high level of the average payment during the depression indicates that older workers with relatively long tenure were induced to retire under the augmented retirement-allowance plan, and that a majority of the establishments with such plans did honor their promises. Company-specific evidence suggests that the system of voluntary retirement was often effective in moderating the worker discontent associated with large-scale dismissals and helped maintain the morale of the

⁹⁸ Zensanren, *Current Conditions of Dismissal Allowance* and *Current Conditions of Retirement Allowance*.

⁹⁹ The mandatory payments did not apply to concerns filing for bankruptcy.

TABLE 6
ACTUAL PAYMENTS OF RETIREMENT ALLOWANCE IN JAPAN, 1929–1933

Year	(A) Number of Dismissals Due to Business Reasons	(B) Number of Workers Receiving Allowances	B / A (%)	(C) Average Allowance per Worker (yen)	(D) Daily Wage (yen)	C / D (days of wages)
1929	45,123	32,536	72.1	66.2	1.59	41.6
1930	59,873	42,974	71.8	176.2	1.55	113.6
1931	58,496	35,348	60.4	268.7	1.47	182.8
1932	39,073	19,742	50.5	172.0	1.43	120.7
1933	29,396	13,297	45.2	97.6	1.39	70.3

Notes: The survey covered 5,000 to 5,600 private factories employing 50 or more regular workers. The reported allowances in C include the advanced-notice allowance (14 days of wages) mandated by the Revised Factory Law in 1926. The wages were the average basic daily wages (*teigaku chingin*) of male blue-collar workers in private factories employing 50 or more regular workers reported in NRUS, *Historical Data . . . Vol. 10*.

Source: Shakaikyoku, *Factory Workers Dismissal Allowance Survey, 1929–1933*.

remaining employees. Many workers who were exhorted to retire saw a nontrivial sum of money provided by management as a token of goodwill.¹⁰⁰

Although it is difficult to assess the impact of the depression on corporate welfarism as a whole, a comprehensive three-volume government survey conducted in 1932 did not report any major setbacks due to the depression.¹⁰¹ The Japan Industrial Club conducted its second survey on welfare expenditures in 1931, at the trough of the depression, covering 118 large companies.¹⁰² The average welfare expenditures per employee were 41.94 yen or 12.4 percent of the annual payroll; if textile and mining industries are excluded, the figure was 10.6 percent of the payroll. Although the 1926 and 1931 surveys are not directly comparable due to sample differences, welfare expenditures as a percentage of payroll were higher in 1931 than in 1926 in every manufacturing industry except for textiles. Corresponding to the observation that major employers augmented retirement allowances, the percentage of expenditures spent on allowances (i.e., retirement, dismissal, and seniority allowances) in total expenditures rose from 39 percent in 1926 to 55 percent in 1931. Taken together, the evidence suggests that leading employers maintained, if not increased, the

¹⁰⁰ At Mitsubishi Shipyard, a worker with 18 years of service said: “As I have a large family and not much saving, it is truly regrettable that I got fired now . . . , but it is fortunate to receive an excessive amount of retirement allowance . . . ,” and similarly, a younger worker receiving retirement allowance stated that even though he was unfortunate to be dismissed he did “understand the company’s situation” that necessitated such action (cited in Nishinarita, *Historical Study*, in the author’s translation). During the depression, a number of leading employers used ERPs to communicate managerial decisions, discuss the amount of retirement allowances, solicit employees to accept voluntary retirement, and organize relief work (Nishinarita, *Historical Study*, pp. 183–92).

¹⁰¹ Shakaikyoku, *Survey . . . 1 and 2* and *Survey . . . 3*. Quantitative data are reported in Table 4.

¹⁰² NKK, *Survey Part 2*.

level of their financial commitment to personnel programs despite declining corporate profits.

Partly to mitigate the financial burden, large Japanese firms developed a system of temporary workers (*rinji-ko seido*) starting in the late 1920s. Previously, a common practice had been to promote a temporary worker to a regular worker status after a short probationary period, provided his performance was satisfactory. Under the new system, the status of temporary workers was, in principle, fixed indefinitely. Although temporary workers were not necessarily excluded from corporate benefit plans, they were deprived of employment security, as management could and did dismiss them without advance notice and retirement allowances.¹⁰³ Contemporary employers emphasized that the temporary-worker system served as a necessary buffer to insulate their regular “mainstay employees” from business fluctuations.¹⁰⁴

In short, during the depression, a majority of the proponents of corporate welfarism in Japan maintained their implicit contracts, realizing that failing to do so would result in costly labor disputes and a loss of employee morale. As noted by Andrew Gordon, workers’ protests against the elimination of existing benefit plans gradually helped establish a belief that the benefits were part of the “just reward” that could not be withdrawn at management’s will.¹⁰⁵ At the same time, leading employers modified existing practices and developed institutional arrangements (i.e., voluntary retirement and temporary-worker systems) that reduced the cost of long-term commitment.

ENDOGENOUS TRANSFORMATION OF THE “RULES OF THE GAME”

The divergent managerial responses to the depression in the United States and Japan were reinforced by concurrent government legislation that eventually changed “the rules of the game” for private players. Although the intents of the government interventions in the two countries were similar, I argue that the *nature* of labor laws was endogenously shaped. In the early 1930s the two countries were at similar political crossroads, introducing collective bargaining and social-welfare legislation prompted by depression crises. However, reflecting the changes in the relative power of constituencies and the dominant beliefs in the societies, legislative outcomes diverged between the two countries. In the United States, the New Deal legal framework brought an end to corporate welfarism characterized by implicit contracts in most establishments, whereas Japanese labor laws legitimized these practices.

¹⁰³ Nishinarita, *Historical Study*, p. 52; Sumiya, *History*, p. 134; and Odaka, *Labor Market Analysis*, p. 213.

¹⁰⁴ NRUS, *Historical Data . . . Vol. 7*, pp. 123–48; Hyodo, *Evolution*, p. 432; and Hazama, *Historical Studies*, p. 498.

¹⁰⁵ Gordon, *Evolution*, pp. 196–206.

New Deal Labor Laws and the Rise of Explicit Contracts in the United States

In the 1932 election the Democrats won both the presidency and a majority in Congress. The Roosevelt administration of 1933 critically relied on political support from progressive Republicans who were disillusioned by Hoover.¹⁰⁶ Reflecting his constituencies, Roosevelt's first economic measure, the National Industry Recovery Act (NIRA) of 1933, was primarily pro-corporate legislation that granted business a long-sought antitrust exemption coupled with one labor provision, Section 7(a).¹⁰⁷ Labor leaders declared Section 7(a) to be the first congressional sanction of trade unions in U.S. history, whereas business leaders claimed that it recognized ERPs as an equally legitimate collective-bargaining unit.¹⁰⁸ The NIRA thus set off a fierce rivalry between trade unions and ERPs. The number of labor disputes rose and union membership started to expand after 1933, while several hundred ERPs were created anew under employers' initiatives in 1933–1935.¹⁰⁹ By the time the NIRA was declared unconstitutional, it had generated two largely unintended outcomes: the failure to achieve economic recovery under business initiatives and the rise of organized labor.¹¹⁰ The former led Roosevelt to abandon voluntarist corporatism inherited from Hoover, whereas the latter enabled him to form a new political coalition with organized labor. As a result, after the midterm election of 1934 in which the Democrats further gained, there was an emerging rift between business leaders and the administration.¹¹¹

Against this political backdrop, Congress passed the National Labor Relations Act (Wagner Act) and the Social Security Act in 1935. The Wagner Act encompassed more than the reinstatement of NIRA's Section 7(a): it prohibited employers from engaging in "unfair labor practices," explicitly outlawing ERPs or any other employer-sponsored labor organizations, and established the National Labor Relations Board (NLRB), granting it exclusive judicial power in industrial relations. The Social Security Act introduced compulsory state unemployment compensation and federal old-age pensions financed by payroll taxes. Business leaders immediately launched a campaign against the two acts, emphasizing employers' voluntary efforts to improve employees' welfare, and filed legal challenges to their constitu-

¹⁰⁶ Finegold and Skocpol, *State*, pp. 45–47.

¹⁰⁷ Section 7(a) recognized the right of employees to organize and bargain collectively through representatives of their own choosing and prohibited employers from interfering with that right.

¹⁰⁸ Bernstein, *New Deal Collective Bargaining Policy*, p. 38; and Bernstein, *Turbulent Years*, p. 41.

¹⁰⁹ NICB, *Individual and Collective Bargaining*; and Troy, *Trade Union Membership*.

¹¹⁰ In a 1935 decision, the Supreme Court declared the NIRA unconstitutional because it granted undue power to the president with vaguely defined objectives in *Schechter Poultry Corp. v. United States* (295 U.S. 495).

¹¹¹ Finegold and Skocpol, *State*, pp. 136–38.

tionality.¹¹² In the meantime, the passage of the Wagner Act further stimulated the union movement: most notably, the newly established Committee of Industrial Organization (CIO) promoted industrial unionism in mass production industries.

In 1936 Roosevelt won his second presidential election, securing labor's support but further alienating business.¹¹³ In the same year, endorsed by Congress, the La Follette Committee began an investigation of employers' infringements of civil liberties. Collaborating with the NLRB, the committee discovered that numerous American firms, including welfare capitalists such as General Motors and U.S. Steel, had engaged in unlawful antiunion practices during the NIRA period.¹¹⁴ Because the La Follette congressional hearings generated wide publicity, even though the nature and extent of the antilabor practices varied substantially across firms, the reputation of "progressive business" fell apart, making American private welfare capitalism a synonym for antiunionism. Consequently, the investigation served to justify the Wagner Act's sweeping prohibition of unfair labor practices and mitigated the public sentiment against the radicalizing labor movement. Even though 4,720 strikes (mobilizing two million workers) broke out in 1937, as a clear departure from precedent, federal and state governments rarely intervened against unions despite the unions' obvious militancy.¹¹⁵ In watershed decisions in 1937 the Supreme Court narrowly upheld the Wagner and Social Security Acts.

The new legal framework had a far-reaching impact on corporate welfareism. Its first implication was the demise of ERPs. Between 1935 and 1941, the NLRB found 1,200 cases of company-dominated labor organizations in violation of the Wagner Act and ordered their disestablishment. The newly created ERPs under the NIRA were particularly prone to this allegation. After the court's validation of the Wagner Act, however, the employers who had long-standing ERPs, such as Bethlehem Steel, General Electric, and International Harvester, also had to dissolve their ERPs in compliance with the law. Although many of those ERPs were reconstituted as so-called independent local unions, a majority of them lost against CIO- or AFL-affiliated unions in subsequent unionization drives.¹¹⁶ By 1941 over 8 million workers had joined trade unions, whereas the membership of ERPs (or independent

¹¹² Jacoby, *Employing Bureaucracy*, p. 241; and NICB, *What Employers*.

¹¹³ Andersen, *Creation*, pp. 92–120; and Finegold and Skocpol, *State*, pp. 136–38.

¹¹⁴ Auerbach, *Labor*, p. 85. According to the committee's findings, the most common antiunion practices were labor espionage, strikebreaking, and munitioning. For example, the committee found that, between 1933 and 1936, some 2,500 firms hired 4,000 spies to infiltrate unions and that some firms spent a considerable sum of money on machine guns, pistols, and other weapons to arm their strikebreakers and private police forces (U.S. Committee on Education and Labor, *Industrial Espionage and Strikebreaking*).

¹¹⁵ Goldstein, *Political Repression*, pp. 228–29.

¹¹⁶ Troy, "Trade Union Membership"; and Jacoby, "Road."

local unions) declined to less than half a million (see Table 2). Major proponents of corporate welfarism, including Bethlehem Steel, General Electric, General Motors, International Harvester, and U.S. Steel, were organized by industrial unions between 1936 and 1941.

The second implication of the New Deal labor laws was the rise of explicit employment contracts in major establishments. As most employers fought aggressively against trade unions, the process of union recognition was often confrontational and violent. As a consequence, adversarial labor–management relations took root in most unionized establishments.¹¹⁷ According to the implicit-contract theory, in the absence of mutual trust, management and labor cannot sustain the implicit-contract equilibrium. Instead of reverting to spot contracting, however, they may institute an alternative contractual arrangement based on third-party enforcement. Historical evidence suggests that adversarial labor–management relations led to the development of explicit and elaborate union contracts. During the collective-bargaining process, leading employers recognized the value of defining explicit and detailed rules *ex ante* in forestalling union grievances and protecting managerial prerogatives. Unions also preferred establishing contractual rights based on objective and verifiable rules, which minimized managerial discretion, and demanded third-party arbitration in case of disagreements. Accordingly, management and labor in unionized establishments began to develop explicit contracts, characterized by detailed job classifications and seniority rules, foreshadowing the “workplace contractualism” of the postwar U.S. industrial-relations system.¹¹⁸

The third implication of the new legal framework was the decline of discretionary corporate benefits pertaining to blue-collar workers in unionized plants. Because the Social Security Act provided compulsory pensions and unemployment benefits on a uniform basis, it diminished employers’ returns from providing benefits to induce the acquisition of desirable human capital.¹¹⁹ With the introduction of the federal pensions, a number of welfare-capitalist firms reduced or discontinued their corporate pension plans for wage earners. Furthermore, most unions opposed any discretionary benefits unilaterally granted by employers and demanded to make the payment of such benefits contractual obligations for the firm. In response, many major employers eliminated extra compensation plans pertaining to blue-collar workers (e.g., employee stock-ownership, profit-sharing, and bonus

¹¹⁷ Millis, *How Collective Bargaining*; and Bernstein, *Turbulent Years*.

¹¹⁸ Jacoby, *Employing Bureaucracy*, pp. 250–52; Slichter, *Union Policies*; and Brody, “Workplace Contractualism.”

¹¹⁹ As Berkowitz and McQuaid, *Creating the Welfare State*, and Tone, *Business*, point out, the social security measures incorporated aspects of private welfare practices. As shown in the following section, however, the degree of incorporation was much greater in Japan than in the United States.

plans), or incorporating some plans into union contracts as explicit benefits based on seniority rights (e.g., paid vacations, group insurance).¹²⁰

In summary, the New Deal labor laws imposed binding constraints on corporate welfarism based on implicit contracts and internal enforcement mechanisms. By the early 1940s employment relations in major unionized U.S. establishments were increasingly characterized by explicit contracts based on third-party enforcement.

Prewar Labor Laws and the Endorsement of Corporate Welfarism in Japan

The oligarchic regime declined in Imperial Japan by 1918. In the 1920s the elective Lower Diet gained political power vis-à-vis the peerage Upper Diet, giving rise to a brief period of parliamentary democracy.¹²¹ In the Lower Diet, conservative and rural-based *Seiyukai* and progressive and urban-based *Minseito* became two major political parties, alternately forming cabinets between 1924 and 1931.¹²² Drawing support from the working class, *Minseito* won a majority in the Lower Diet for the first time in the 1930 election.¹²³ Prompted by the depression crisis, the *Minseito* cabinet introduced three pieces of legislation to the Diet in 1930–1932 that were comparable to New Deal legislation in the United States during the same period: an economic recovery bill to authorize business to form cartels, a trade union bill to recognize workers' collective bargaining rights, and a national unemployment insurance bill.¹²⁴

Japanese employers immediately formed a united front against the trade-union bill. Testifying in the Diet, business leaders contended that the legal recognition of unions in the midst of the depression would only intensify labor disputes and create grave consequences for industrial development. Like American employers, they also claimed that such a law would endanger plant-level ERPs that had “greatly contributed” to the establishment of mutual trust between management and labor.¹²⁵ Government officials countered that corporate welfarism rested entirely on the “whims of capitalists,” offering no solution to the mounting problem of unemployment and labor unrest.¹²⁶ The Lower Diet passed the union bill in 1931 after overcoming substantial opposition, and the union movement surged in anticipation of the passage

¹²⁰ By 1949 court decisions had brought the terms of nonwage benefits within the scope of collective bargaining, upon which employers lost their discretion (Munts, *Bargaining*; and Harris, *Right*).

¹²¹ The Upper Diet possessed veto power, but by the 1920s, it was rare for peers to overrule any bills that received wide public support, as the government could and did threaten the Upper Diet with peerage reform.

¹²² Kawato, *Party Politics*, pp. 176–79.

¹²³ Garon, *State*, pp. 164–65.

¹²⁴ Rodosho, *History*, p. 441.

¹²⁵ Rodosho, *History*, p. 434.

¹²⁶ Garon, *State*, p. 173.

of the bill. In the Upper Diet, however, the bill was stalled indefinitely by a coalition of leading industrialists and conservative peers.¹²⁷

In contrast to the U.S. outcome, Japanese business narrowly blocked union legislation during the depression. As leading Japanese employers kept their reputation of benevolent management better than their American counterparts, they were able to draw on the goodwill of their employees. Organized labor in Japan, by contrast, was deemed “radical” by the public and failed to gain wide support from workers, especially in large establishments. Importantly, the defeat of the union bill in 1931 was not caused by military intervention. Political power effectively fell into the hands of the military in the following year. But even then, government policies toward unions changed relatively little between 1932 and 1937, and union membership continued to increase until 1936. Major establishments adopting corporate welfarism, however, remained nonunion. Even before the government repression of trade unions starting in 1937, the number of workers covered by ERPs or similar employee organizations far exceeded union membership in Japan.¹²⁸

In 1932 government officials began drafting an unemployment-insurance bill, which business leaders opposed, asserting that in the presence of corporate retirement allowance practices there was no need for state intervention. During the prolonged legislative process, the unemployment-insurance bill was transformed into the Retirement Allowance Fund Law of 1936, which obligated every establishment with 50 or more employees to set up a retirement allowance fund for each employee. Notably, affirming prevailing corporate practices, the law established the minimum amount of the retirement allowance *contingent on* an employee’s length of service and the reason for separation.¹²⁹ Employers further won a provision that allowed firms with retirement funds of “sufficient scope” to continue operating their original plans with little modification.¹³⁰ Gordon calls the law “an ingenious variant of unemployment compensation” as it did not simply rely on managerial benevolence, but explicitly linked a worker’s entitlement to unemployment benefits to “the quality of his service to a particular employer.”¹³¹ Thus, in contrast to the Social Security Act in the United States, unemployment insurance in Japan legitimized and incorporated corporate welfarism, while leaving substantial discretion to employers. By the late 1930s, regular blue-collar workers in large establishments saw corporate benefits as part of their compensation, and business leaders described the provision of employ-

¹²⁷ NRUS, *Historical Data . . . Vol. 10*, VI-1; Garon, *State*, pp. 177–84; and Rodosho, *History*, pp. 439–58.

¹²⁸ Gordon, *Evolution*, pp. 251–53; and Garon, *State*, pp. 157–70.

¹²⁹ Rodosho, *History*, pp. 310–23.

¹³⁰ NRUS, *Historical Data . . . Vol. 7*, pp. 280–328.

¹³¹ Gordon, “Right,” pp. 268–69.

ment security and nonwage benefits to these employees as their moral and social responsibility.¹³²

In summary, the Japanese government continued to support corporate welfarism and ERPs with the expectation that they would bring about industrial peace, social stability, and high productivity. Consequently, labor laws in the United States and Japan evolved in different directions during the 1930s, reinforcing the diverging institutional paths.

CONCLUDING REMARKS

This article documents parallel institutional trajectories in the United States and Japan in the 1920s and the process of bifurcation triggered by the Great Depression. By the early 1940s employment relations pertaining to blue-collar workers in the two countries began to diverge towards two distinct equilibria. It took, however, two more decades for the establishment of modern industrial-relations systems.¹³³ Labor regulations during World War II propelled the bifurcation process, as the respective governments tended to design their measures based on prevailing corporate practices and as selective compliance by employers and workers undermined regulations that were incompatible with prevailing practices. Despite a deep recession and labor law reforms during the U.S. Occupation (1945–1952), Japan continued down the same path due largely to accumulated institutional capital. By 1960 explicit and elaborate employment contracts based on industrial unions and third-party enforcement were institutionalized in large U.S. industrial firms, whereas implicit and discretionary contracts based on enterprise unions and internal enforcement mechanisms emerged in their Japanese counterparts.

The comparative analysis indicates the following counterfactual for the United States: had the economy begun to recover by 1931, American welfare capitalists could have maintained most of their implicit promises during the depression. If, as a result, the public support for private welfarism had been stronger, Congress might not have been able to pass the sweeping ban on unfair labor practices included in the Wagner Act. Consequently, a much larger fraction of ERPs in the United States might have prevailed against trade unions and supported corporate welfare practices. In other words, the Great Depression was not only sufficient but most likely *necessary* to induce the decline of corporate welfarism characterized by implicit and discretionary contracts. Thus, I argue that the replacement of American private welfare capitalism by trade unionism and state welfarism was not inevitable, but rather the outcome of a delicate historical contingency.

¹³² Morita, *Historical Development*, pp. 417–18.

¹³³ Moriguchi, “Evolution.”

The argument presented here highlights the dynamic process of equilibrium selection and the path-dependence of the U.S. institutional trajectory. There were, however, important differences between the two countries prior to the depression that were counter to the premise of the natural experiment. I consider three alternative hypotheses to the historical-contingency thesis developed in this article. First, cultural determinism argues that the individualism and cultural heterogeneity in the United States were sufficient to preclude implicit contractual relations. Second, technological determinism argues that the scientific management and mass production technology developed in the United States resulted in the rise of explicit contracts. Third, political determinism argues that the imperial government in Japan suppressed organized labor more than did the democratic government in the United States, ensuring the dominance of ERPs over trade unions. Although each of the three factors clearly played an important role, I argue that none of them alone would have *dictated* the observed outcomes. Historical evidence indicates the transformation of workplace culture (e.g., work ethics, loyalty, trust) in the respective countries in response to economic incentives and the institutional environment, which was not necessarily predetermined by the national culture.¹³⁴ The technological determinism overemphasizes the link between Taylorism and workplace contractualism: during the 1920s, American management often regarded scientific management and corporate welfarism as complementary practices to attain higher productivity, and postwar Japanese establishments combined both methods in developing a system of flexible mass production.¹³⁵

Regarding political determinism, it is important to note that even in democratic America, the passage of the Wagner Act was by no means guaranteed but depended on historical conditions. To assess the role of the Japanese government, I propose the following thought experiment. Suppose that the depression in Japan were as severe as in the United States. With a much higher fraction of employers abandoning their corporate welfare practices, business might have lost credibility and failed to block the 1931 union law, which, in turn, might have stimulated the labor movement in large Japanese establishments. It is correct to argue that the right-wing government would have eventually crushed unions regardless of the passage of the union law. However, *had* Japanese trade unions taken stronger roots prior to the military intervention, the outcome of the postwar union movement under a democratic regime might have turned out differently. That is, in the fiercely contested representation elections in the late 1940s, industrial unions might have prevailed over ERPs in major companies, promoting explicit-contractual relations. As powerful as it was, the military intervention might not

¹³⁴ Gordon, *Evolution*.

¹³⁵ Nelson and Campbell, "Taylorism"; and Tsutsui, *Manufacturing Ideology*.

have been sufficient to ensure the prevalence of corporate welfarism in Japan.

Finally, the account given here documents how the institutional change induced by the Great Depression in the United States became “irreversible” because it was accompanied by the endogenous formation of complementary institutions such as collective-bargaining organizations, a legal enforcement agency, and state social-welfare programs. This article thus identifies a mechanism in which a temporary economic shock could generate a lasting impact on long-run institutional development. By combining a game-theoretic framework and an empirical historical investigation, it contributes to a better understanding of the dynamics of institutional change.

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