Asia’s developed and emerging economies are both facing a common challenge following decades of rapid growth: how to address growing inequalities in wealth and income that are creating increasing social tensions and, in some instances, have the potential to threaten social stability.

While the problems require different solutions from one country to the next, all of Asia must address the need for inclusive growth, if the region is to keep itself on a path that is sustainable in the future.
Achieving Both Efficiency and Equity in Japan

By Toshiaki Tachibanaki

Once a society that prided itself on its equality of income distribution, Japan is now mired in a debate over how to revive its long-moribund economy without exacerbating inequalities that threaten social harmony.

One consequence of three decades of economic stagnation is that discrepancies in wealth and income distribution have become acute. Toshiaki Tachibanaki argues that Japan could adopt policies to achieve both efficiency and equity.

IN THE 30 YEARS after the end of the Second World War, Japan was known for its equality of income distribution. There was a popular phrase that characterized the whole society: “I belong to the middle class,” a statement that implied there were neither extremely rich nor extremely poor people in Japan. The important fact at that time was that economic efficiency, which was illustrated by rapid economic growth, and income equality went together. Since economic efficiency and equality (or equity) are normally seen as a trade-off, Japan’s period of rapid growth in the 1950s, 1960s and early 1970s was something of a fairy tale in world economic history.

The situation changed from the 1980s and 1990s. Japanese income distribution showed an increasing trend toward inequality. In particular, the bubble economy in the late 1980s produced an increase in the unequal distribution of wealth. As a result, Japan saw inequality in both income and wealth distribution in the 1990s, and that has continued to characterize the country until now. (See Tachibanaki [2009] for more detail.)

There are, needless to say, many economists, civil servants and politicians who say that this inequality does not exist, and dismiss it as a problem for the following reasons: they believe that Japan should become strong economically again in order to play a leading role on the world stage; they think that Japanese economic power cannot be sustained if policies aimed at achieving higher income equality are introduced.

Former Prime Minister Junichiro Koizumi was a principal advocate of a strong economy. He introduced deregulation programs, promotion of greater competitiveness and a weakening of social security programs. Wise readers will remember that these policies were also adopted by British Prime Minister Margaret Thatcher and US President Ronald Reagan, thus Koizumi wanted to follow the so-called neo-liberal philosophy that champions the market economy.

Current Prime Minister Shinzo Abe has adopted economic policies similar to those of Koizumi. His “Abenomics” involves the use of quantitative easing, sound public finances and tax policies, and implementing structural reforms to boost growth. It is too early to judge whether these policies will ultimately be successful in achieving the goal of a strong Japanese economy.

It should be emphasized, however, that the Abe government is not interested in reducing the current inequality in the economy, which some see as a serious problem. Abe and his supporters argue that Japan does not suffer from higher inequality in income distribution, despite facts to the contrary.

WHY THE INEQUALITY?

There are several reasons why Japan has moved toward greater inequality, which I will list briefly:

First, the collapse of the bubble economy in the early 1990s left the Japanese economy in a seemingly permanent state of weakness, with growth rates sharply lower than in previous decades. The country has suffered years of zero or even negative growth, with an average growth rate around 1 percent a year for the past 30 years as the country slips in and out of recession. This gave rise to calling Japan’s post-bubble era “The Lost Decades.”

A number of observations flow from this long slump. First, the official unemployment rate reached its highest level at just over 5 percent, still considerably lower than what has been seen in Europe or the US, and thus it may not be regarded as serious. Having said that, the potential unemployment rate is much higher than the official rate, estimated at over 10 percent (see Tachibanaki [2009]). This is roughly equivalent to official European unemployment rates, and thus can be considered fairly serious.

The potential unemployment rate is explained by the fact that when the economy is in a recession a large number of unemployed workers, in particular women, younger people and the elderly, will stop seeking jobs because of the difficulty in finding one. If we include these people in the unemployment statistics, we get the potential rate of unemployment. To be sure, all countries have such potentially unemployed people. The case of Japan, however, is much more serious with respect to this than other countries. In particular, housewives and young people are susceptible to falling into this category because they are supported economically by their husbands or parents.

Second, the long-term recession in Japan has created enormous difficulties for a large number of companies, forcing them to try to reduce labor costs in order to avoid bankruptcy or maintain competitiveness. A typical method is to increase the number of non-regular employees, such as part-time workers, student temporary workers and contract workers dispatched by employment agencies.

Companies can cut their labor costs when they hire these employees for the following reasons: First, hourly wages for these workers are much lower than those for full-time workers. Second, they can fire these employees easily. Third, it is quite reasonable to resort to these workers when the demand for labor is high — for example, restaurant workers at lunch or dinner times, and hotel workers during peak tourist seasons.

In the past, non-regular employees were relatively rare in Japan, but their numbers have increased dramatically in recent years. The cur-
rent share of non-regular employees as a percentage of total employees is about 40 percent, up from less than 20 percent some 20 years ago. This is one of the reasons why Japan has become a class-stratified society.

Third, if the wages for non-regular employees were kept at a reasonable level we would not see a large number of low-paid regular employees. But in Japan, the legal minimum wage is low. Surprisingly, in the past, cash payments for the non-working poor were higher than the minimum wage for working people. The minimum wage was subsequently raised in order to remedy this situation, and the current norm is for the minimum wage and cash payments to people to be roughly equivalent. The minimum wage, however, is still considerably lower in Japan than in European countries. This means that a large number of non-regular employees receive low incomes, and some of them are poor.

Fourth, unlike many European countries, Japan is not a welfare state. The level of welfare services in public pensions, medical care, unemployment compensation and other areas is considerably lower than in Europe. Therefore, it is impossible for the unemployed and low-wage workers to escape from poverty. Poverty for older people, in particular single females, is especially serious because they are not supported fully by the social security systems.

THE SERIOUSNESS OF POVERTY IN JAPAN
It is necessary to examine poverty if we are concerned with equality in Japan. There are three main issues regarding the state of inequality: 1) the presence of extremely rich people; 2) the degree of difference between the rich and the poor; and 3) the existence of poor people.

Thomas Piketty’s recent study, Capital in the Twenty-First Century, is an important contribution to our understanding of the subject. He showed that the capitalist economy produces a large number of rich people, and he derived a theory that explains the inequality (\( r > g \), \( r \) is the rate of return to capital, and \( g \) is the growth rate of an economy). It says that the capitalist economy encourages a process of wealth accumulation in the following sense: the rich can become richer as time goes on. He supported his theory empirically by showing that about 20 countries in the capitalist world experienced such a process of wealth accumulation. Japan was among these 20 countries.

There are a large number of studies that measure income inequality. The most popular tool is the Gini coefficient, and we know that the degree of inequality in income distribution in Japan has been increasing considerably, according to that measure. This has triggered serious debate in Japan among specialists, politicians and the media regarding inequality. Some say that we should not worry about inequality, while others argue we should be concerned by it. The former believe in the importance of economic efficiency over equality, while the latter regard equality as more important.

I believe equality is the most serious and important issue. We can point to two reasons why poverty is important. First, the number of poor people should be zero, ideally speaking, because possible death due to hunger must be avoided in any society. Second, the poverty rate in Japan is very high by international standards, as I will show.

Figure 1 presents the relative rates of poverty among major industrialized countries. Japan’s rate is 16 percent, ranking it the second highest after the US, at 17.9 percent. Incidentally, South Korea also has a high rate, although it is slightly lower than that of Japan.

Low rates are observed by some Scandinavian countries such as Denmark, Finland and Norway, as well as by the Netherlands and France. It is surprising to note that Sweden’s rate is now relatively high, at 9 percent, despite the fact that Sweden is widely viewed as representative of the welfare state. Since I discussed previously the reasons for Japan’s rising inequality, in particular lower incomes and greater numbers of poor people, I will next argue how Japan can solve these problems.

RECONCILING EFFICIENCY AND EQUALITY
The Abe government is focused on raising economic efficiency. Concretely, it aims to achieve a real GDP growth rate of 2 percent a year. My judgment is as follows: Since Japan has had low birth rates over the past 20 years — at about 1.35 babies per woman — the shortage of labor and lack of consumer demand will naturally lead the economy to negative growth rates.

I do not believe such negative growth is acceptable, because people’s living standards will decrease under these circumstances. Therefore, I propose that the growth rate of the economy should be around zero rather than negative. The zero growth rate might be considered equivalent to the concept of the stationary economy described by John Stuart Mill, the 19th century British economist. My proposition to raise the growth rate from negative to zero fits well with Abe’s growth strategy — the only difference being that I am targeting zero growth while the prime minister is targeting 2 percent.

How can we reconcile my growth strategy with equality in income distribution? My answer is as follows: First, we adopt a welfare policy like the Scandinavian countries by raising the degree of social services such as pensions, healthcare and unemployment compensation. This would, of course, require the Japanese people to accept a higher burden in terms of taxes and social security contributions. The most important benefit of this increase in social services lies in the fact that people would feel a stronger sense of security.

**Figure 1: Japan’s Relative Poverty Rate Compared to Selected Other Nations**

Source: OECD statistics, 2012
about their future, and thus would be more likely to increase consumer demand by spending more. Needless to say, such an increase would raise economic growth. Put simply, economic efficiency would be assured.

The above policy would lead to a considerable reduction in the degree of inequality in income distribution in Japan, and, in particular, would be useful in raising the incomes of poor people.

Having said that, it is necessary to propose concrete methods for the government to generate the revenues to support more social services. The first would be to increase value-added tax rates from the current level, namely 8 percent, to 15 percent or maybe higher. The current value-added tax rates in Europe are around 20-25 percent. Some remedies, however, would be desirable to reduce the regressive nature of value-added taxes. The second step would be to increase the progressiveness of both income and asset taxes in order to reduce inequality in both income and wealth distribution, and increase the amount of government revenues available to fund social programs.

Going back to the issue of reconciling efficiency and equality, it is necessary to add several other policies, because the ones proposed above (i.e., the increase in social services and in tax revenues and social security contributions), may invite opposition from those who believe that such policies would harm economic efficiency and lower growth rates.

In response, I would argue that there are several reasons why Japan can have both economic efficiency and greater equality. First, I believe that the economy’s growth rate will increase when Japanese people feel a greater sense of security about their future under the proposed favorable welfare services provided by the government. This helps to guarantee both economic efficiency and equality in Japan.

Second, the Japanese government should strengthen its monitoring of welfare benefits and the punishments for violating the rules. Japan is notorious for the large number of free-rider in social services, and at the same time, it has a weak system of monitoring and punishment.

Third, the government should abandon the policy that effectively prohibits firms from going bankrupt. Too often in the past, the public sector has provided troubled companies that have low levels of productivity with various kinds of support, such as wage subsidies and favorable financing. I believe it is much more reasonable to invite new firms to enter the market that have potentially higher levels of productivity or who could change the structure of an industry.

Fourth, an environment of greater productivity as outlined above would encourage workers to change employers more frequently. The government should provide these workers with job training that would help them seek jobs in newly formed companies.

Finally, it is necessary to raise the minimum wage and reduce the difference in wages and labor conditions between regular workers and non-regular workers. This would reduce unequal treatment among workers and increase consumer demand from low-wage earners.

In short, I believe Japan can achieve both economic efficiency and equality.

Toshiaki Tachibanaki is a Visiting Professor in the Faculty for the Study of Contemporary Society at Kyoto Women’s University in Japan.

REFERENCES