

Interview with Sébastien Lechevalier, Professor at the School for Advanced Studies in the Social Sciences (EHESS) in Paris

Expanding Income Inequality During the Transformation of Japanese Capitalism

By Japan SPOTLIGHT

Economic issues are best seen from a long-term perspective. Income inequality is no exception, and should be examined from a historical perspective and viewed over the long term. There are some French economists, regulationists, who are good at analysing the economy in this manner, emphasizing the historical and insitutional perspectives of economic progress and development. Dr. Sébastien Lechevalier, a Paris-based French economist, is a distinguished expert in this field, and has recently published *The Great Transformation of Japanese Capitalism*, an invaluable analysis of the latest developments in the Japanese economy that provides good lessons for all capitalist nations to consider regarding the future of capitalism. *Japan SPOTLIGHT* had a chance to interview him in Tokyo when he came to Japan to give a presentation on his book, which also addresses the issue of income inequality.

Introduction

JS: Could you briefly introduce us to your recent research activities, including your book *The Great Transformation of Japanese Capitalism* and your activities at EHESS?

Lechevalier: Within EHESS, I am conducting research these days on what we call institutional change. My particular interest is Japan, and I find it particularly interesting because from the viewpoint of many scholars, especially US scholars, it seems Japan is not changing at all and always faces the same inability to reform. I first came to Japan in 1998, and find that from the

late 1990s to nowadays Japanese institutions of capitalism have changed a lot. This is the topic of the book, which I collaborated with several professors in writing; I try to show some empirical evidence and logic for this change.

Beyond my research, I created the *Nichi-Futsu Zaidan* (Fondation France-Japon de l'EHESS) in 2009, of which I am the president, to try to develop the relationship between Japan and Europe in the academic environment. We organize many



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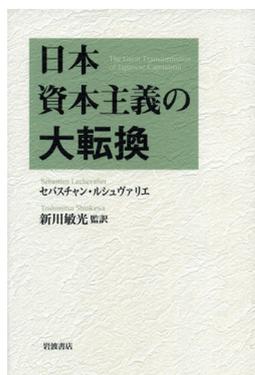
conferences: for example, we had a conference with the Japan Science and Technology Agency on innovation and society in September 2016 in Tokyo. So I hope this book and our activities may contribute to a better dialogue between Japanese and European scholars.

Background to Expanding Income Inequality in Japan

JS: How do you see the background to expanding income inequality in Japan in recent decades?

Lechevalier: Until around 10 years ago there was an academic disagreement about this matter and its causes, but these days I think everybody agrees that inequality has increased. Inequalities in Japan are still less than in the

United States, but in the last 30 years have increased much more than in France. And of course when we think of increasing income inequalities, immediately we think about the excellent work of my colleague from EHESS, Thomas Piketty, who looks at them from a long-term perspective and explains them with the dynamic of capital, especially the gap between the growth rate of the economy and the return on capital. I think his thesis applies relatively well to Japan in the long term, but not to explaining the expanding income inequalities during the last 30 years. The thesis I develop in this book is that we have to look at the labor side rather than the capital side. The mechanisms are not the same as in the US or in Europe, so the background for me is in labor dynamics, connected to increasing dispersion of productivity across firms.



The Great Transformation of Japanese Capitalism by Sébastien Lechevalier (Iwanami Shoten, 2015)

JS: Are you referring to the increase in non-permanent employees? Is that one of the main sources of income inequality in Japan?

Lechevalier: Not the only source, but it is certainly part of the story. And of course income inequality is itself the outcome of even deeper inequalities. But what I found in my empirical research for the book is that even within regular or permanent workers we observe increasing income inequalities, and the reason is quite simple. From a historical perspective, Japan was famous in the 1950s, just after the war, for the gap between large and small firms known as *nijū kōzō* at that time. This gap was reduced, but I think it has increased again during the last 20 or 30 years; not only between large and small firms but even among large firms we observe some with high productivity and some with low productivity. One reason is manufacturing versus non-manufacturing; another is globalization. So the gap is not limited to the size of the firm, but is an issue of productivity, and this pattern is very important for explaining why two permanent workers with the same educational background do not earn the same income. I think this is the most significant mechanism, and I will add a second: the fact that given this dynamic, there is no effort to correct the inequalities. In Europe we naturally have some inequalities, but then as a second step we typically have welfare and fiscal systems to correct them, which is not the case in Japan.

JS: It could be said that the Japanese social welfare system was partly supplemented by a family system in the past, but that is now gone. Is that the reason we see such an increase in income inequality?

Lechevalier: I think the former welfare system in Japan had not one but two legs. One was the family, it was absolutely important. The second was the companies, which also contributed to welfare. And it seems to me that companies are under pressure from globalization: they try to be competitive, and some try to innovate, but some try to cut costs and the incentive to provide welfare to employees has decreased or become concentrated on some categories of employees. And on the family aspect, you are right, and the background goes beyond the economy and is a social phenomenon: families are getting smaller, and there is no longer the social norm that the family will be a security or welfare provider. So basically individuals are facing the problem by themselves, and are left to find a solution by themselves. As a French person, my first reaction would be that maybe the state can play a role. Of course this has a cost, which we will talk about, but if neither companies nor the family are able to support the welfare system, maybe the state should do more.

JS: You mentioned there are significant differences in productivity at the company level, with some companies better adapted to globalization than others. Some economists would also say adaptability to information technology (IT) culture might also be important in these differences. What do you think?

Lechevalier: I think these are two key factors that should be



separated. Globalization is one thing, technology is another. It is true that in the economic literature both factors have been discussed, and the general consensus 10 years ago was that new technologies may have increased inequalities between employees who were able to do their best with them and employees who were not; between companies which could adapt to them and those that could not. But on globalization, 10 years ago the empirical evidence was mixed, and it was not so easy to identify the links between globalization and increasing inequalities. But I think what we identify these days is exactly that some companies, for some reason, are enjoying the benefits of globalization which means you have more markets, can sell your products to China or Europe or the US, but that this is not automatic: you have to fight, adapt, be very competitive, and some companies succeeded in this while some companies failed. There is economic literature on this, especially a famous article by Andrew Bernard and J. Bradford Jensen which shows there is a kind of selection effect, by which globalization helps to select the best firms, but then there is also a learning effect that will increase the gap even more. When you are a Japanese company and start selling your products in Europe, you will learn and improve your production, and I think this is one key process that connects globalization to increasing productivity dispersion and through it income inequality.

JS: Do you think the adoption of neoliberal economic policies in Japan also provoked income inequality?

Lechevalier: Normally we observe that neoliberal policies increase the efficiency of the economy and introduce more market mechanisms, but often at the cost of increasing inequalities. In the case of Japan, frankly speaking, I do not see at this stage strong empirical evidence that shows neoliberal policies directly affected inequality. However, what I try to show in the book is that they have had an indirect effect. It is a little like globalization: neoliberal policies contributed to liberalizing the market and so created more opportunities for the companies; some were able to take the opportunities, and others were not. From this viewpoint, I think liberalization certainly contributed to increasing the gap between companies, which can then be connected to the background of expanding inequalities. But again this is an indirect effect, so we need to be a little careful in assessing the impact of neoliberal policies.



JS: How would income inequality be affected by the aging society?

Lechevalier: This is an interesting case. Through the work of Professor Fumio Ōtake of Osaka University we discovered that indeed, if we observe increasing income inequalities through the Gini coefficient, an important part of these inequalities was captured by the aging society. However, various empirical papers — by Professor Ryo Kambayashi from Hitotsubashi University, for example — have further tested this hypothesis and shown that in the last 10 years we observe increasing inequalities *within* age groups, for example among young workers. These inequalities cannot be explained by aging, so there are other phenomena too.

JS: Today some young people have no choice but to work under very strict conditions and cannot earn unemployment benefits. Could this be a cause?

Lechevalier: I think it is one important factor. I am a little cautious on unemployment benefits. Sometimes, as in France, we have a quite generous benefits system, and ideally this can help unemployed people to educate themselves and train and so on. In reality this is not always the case. But in Japan we find some young workers sticking to a job with no qualifications, and they cannot improve. For example, I have nothing against *kombini* (Japanese convenience stores), but in some *kombini* if you do always the same job you will not improve your position. It is pity for them: they earn a low wage, with no time away to educate themselves or train, and I am afraid when we see the result 15 or 20 years later that this might become a lost generation.

Policies to Correct Income Inequality

JS: Perhaps to solve this we need to reform our education system. Do you have any ideas on how this might be done?

Lechevalier: One thing I discovered through many books and articles is that Japanese people are very critical of their education system. Frankly speaking, viewed from Europe it is not that bad,

though you might improve it to give more place to creativity, dialogue and debate. I think there is one main problem: the Japanese education system used to be quite egalitarian, and in some aspects still is, but to enter the best universities you have no other choice these days than to invest a lot of money in pre-university education to train and go to the best preparatory schools. So this system is not yet like in the US, but there is a strong divide between public and elite schools and this is a problem. In the 1960s many students coming from remote parts of the country had a chance to enter the best universities, especially public; my impression is that this is becoming more and more difficult.

JS: You mentioned that Japan would need to consolidate social welfare policy to address income inequality. But given Japan already has a tremendous amount of debt, what would be the impact on its fiscal constraints?

Lechevalier: It does not seem very realistic to say we should increase social spending at a time when Japan has such enormous public debt, I fully agree. But what impressed me in Japan is that Japanese people seem not so happy with inequalities. When you ask them in surveys whether inequality is too high, generally the answer is yes. When you ask the same question in the US, people recognize that inequalities are high, but they say it is not a problem; in Japan there is a kind of ideology which is anti-inequality. But then, when you ask Japanese people the second question, on whether they want the state to reduce inequalities through tax policy, generally speaking the answer is no. It seems there is a paradox: Japanese do not like inequalities but do not want the government to intervene to reduce them, and you cannot reduce inequalities through the tax or welfare systems if there is no social consensus.

I would then rephrase the question differently. Clearly Japan needs to reduce its public debt, but one thing surprising to me is that when you talk about tax policy in Japan, basically you talk about consumption tax. But there are other taxes, the fiscal system is much more complex: you have inheritance tax, corporate tax, and income tax for example. I remember when Piketty came he tried to introduce this to the debate and it was a complete failure — people do not want to talk about it. Companies in Japan are suffering from many things but I do not think that they are pressured by corporate tax, which by comparison to Europe or even the US is not so high. So I would be the advocate of a more balanced approach: I would not tell you to double corporate tax, but corporate or inheritance tax could be tools to focus on fiscal consolidation while increasing spending. Another observation is that social spending in Japan is very much biased towards elderly people, who I am sure need to be helped, but there should be deeper reflection to have the welfare system also help the young people you mentioned.

JS: Perhaps labor market policy would also be important in resolving inequality, such as raising the minimum wage or indeed wages in general?

Lechevalier: On this I fully agree with Professor Hiroshi Yoshikawa, who was one of the first to very convincingly show how since the

1990s and the economic stagnation, the answer from companies has been to keep wages stagnant, which is maybe not bad in terms of competitiveness but has had negative side effects. From this viewpoint, to me the current Japanese government's approach to wage policy is not enough. If companies are only asked to increase wages when they can, I do not think they will, so there should be a negotiation. You cannot increase wages without taking into account the situation of the companies, and in this regard I think that *shuntō* (spring labor offensive) in the 1970s was a very useful tool. Of course your trade unions always wanted higher wages, but there was a bargaining process between them and the employers which took into account productivity increase, and so allowed realistic wage increases while avoiding inflation. I think we should invent a new institution to allow this kind of bargaining.

JS: Economic growth today is not leading to wage increases, and that is a problem. Do you think this is also important for reducing inequality?

Lechevalier: This engine for growth is missing these days in Japan. Just after the beginning of Abenomics we observed the recovery of growth, but it did not lead to higher wages and this may explain why this growth has not been sustainable. At the same time we should be careful: economic growth does not always mean reduction of income inequalities, and China is a great example. Certainly two-digit economic growth has helped many Chinese to get out from poverty, but at the same time we observe increasing inequalities. So growth by itself is not enough: you need a second characteristic which is good sharing of value added. What goes to profit should be in balance with what goes to the workers, and these days in Japan, as well as in other countries, for some reason we are not able to find a good balance.

JS: The service sector is becoming very important, and if we are able to raise labor productivity in it, this could help solve the income inequality issue as well. How might we achieve this?

Lechevalier: With the service sector, we have a problem of measurement of productivity. Based on my own French and European experience, please allow me to contribute with a nuance to this. People working in cafes and restaurants in Paris are the most productive in the world, because for 40 customers you have only one person. In Japan, by comparison, you enter a small restaurant and there are five persons serving you. The productivity is very low, but the satisfaction of the consumer is very high. So it is important to increase the productivity of the service sector, but not at the cost of satisfaction. Another side-effect is that in France in the past there were many people welcoming guests and so on, like in Japan; now this is very limited, and to me is also one reason for high unemployment rates. I think we should never forget this European experience.

Having said this, it is true that in Japan there is a problem with productivity in the service sector. Unfortunately I have no solution in one minute, but what has surprised me is that Japanese companies in the manufacturing sector have sometimes been very good at

incorporating new technologies to improve productivity. For some reason, it seems to be much more difficult for many companies in the service sector to incorporate new technologies. So maybe the non-manufacturing sector in general, and service sector in particular, could learn more from work organization in the manufacturing industry, especially in introducing new technologies.

Possible Impacts of Future Innovation & Globalization

JS: Looking toward the future, we are at the beginning of the so-called Fourth Industrial Revolution, defined by phenomena like data-driven innovation and artificial intelligence. Based on humankind's memory of the original Industrial Revolution, such innovations always led to increased inequality. Do you think we will see the same story again?

Lechevalier: I am afraid so. Again, theoretically it is true that this new technology may give anybody the opportunity to enjoy its benefits. But the reality is that to benefit from it you need to already have a certain intellectual background and skills. So we are just at the beginning of a very large process that will go very strongly in the direction of increasing inequalities, unfortunately. And if you are to reform your education system, it will be in this area, certainly.

JS: As for the future of globalization, the TPP and other FTAs seem often interpreted as bad for income inequality. Is that correct?

Lechevalier: I agree with this interpretation. The TPP is full of opportunities for the best companies and managers, but some people will not be able to take them because of different capabilities and sectors, and we should compensate for those inequalities. But if you look at what is going on between Europe and the US these days, there is a strange movement. On the one hand there are more and more ambitious giant FTAs, which is good, but at the same time there is more and more opposition. In the case of Japan, it is well-known that people from the agricultural sector are not happy with this. But in Europe the TTIP is about to fail and the reason is that there is an increase of populism there and also in the US: both of the US presidential candidates were opposing to the TPP, and in France and Germany there are many people opposed FTAs. We need to understand why, and to give answers. If I have one reproach to the TPP process and what has been done in Europe, it is true that these FTAs were very technical so the bargaining process had to be partly secret, but this meant it was really not democratic and our leaders and policymakers failed to involve or convince the population of the benefits. You cannot engage your country in such an ambitious program without convincing people that there are benefits. So I am not so optimistic about the TPP these days. **JS**

Written with the cooperation of Chaobang Ai, a Tokyo-based editor and blogger.