



## The "Second Plateau": Japan's Economy and Structures of Inequality

Uichiro Niwa

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Sekai Interviews Niwa Uichiro

Translated by John Junkerman

*[In this incisive interview Niwa Uichiro, Chairman of Itochu, critiques the economic policy of the Koizumi regime. Before addressing the details of Niwa's critique, it is important to point out that Itochu is one of Japan's leading Sogo shosha (general trading) companies. It is also one of the world's largest firms, with over 1,000 subsidiaries and associated companies in over 80 countries. Niwa is a highly respected figure in Japanese business circles, and his comments carry considerable weight in Japan's public debate.]*

*While Niwa is critical of the Koizumi reforms and the effect they have had on Japan, he is not one of the frequently caricatured pork-barrel conservatives who lament the erosion of their vested interests. Niwa brought Itochu back from the brink of mega-debt in the late 1990s, is progressive on the role of women, and is an internationalist. He can compete with any neoliberal as being representative of the "new Japan."*



*Niwa does not, however, believe that Japan must adopt US-style capitalism in order to be new, reformed, rising, modern, or whatever buzzword the international investment community happens to be using. Niwa's critical approach reflects an increasingly powerful and credible backlash against Japan's neoliberals. Only a few years ago the latter were labelling virtually any institution they saw (or believed they saw) in the US as "the global standard" and insisting that Japan adopt it or fall into the dustbin of history. They have succeeded in setting the broad thrust of policy change in the direction of a US-style small state that shifts the risks of ageing, unemployment, technological change and health care onto individuals. Like others, Niwa argues that the economic recovery now trumpeted as the fruit of neoliberal reforms is in fact weak. He also charges that the costs of the reforms are mounting and pose a threat to weaken Japanese society as well as to hamstring the competitiveness of the economy.*

*Japan's recovery is indeed at best tentative rather than the sure thing touted in the business press. Niwa emphasizes the more long-term hurdles posed by ageing's "slow demand" effect on domestic consumption. In the wake of his interview, moreover, further supporting evidence has come to light. The May 12 Nikkei newspaper reports that average household consumption in Japan dropped by 3.2 percent in the first quarter of this year. That leaves Japan even more dependent on growth in overseas markets, while energy and raw materials prices skyrocket, the US dollar declines, the American property bubble deflates, and a host of other problems threaten to crimp global growth.*

*Niwa highlights another problem receiving increasing attention by scholars and business leaders (including the head of Keidanren), but little effective policy response from the neoliberals dominating the Koizumi administration. As the labour forces shrinks and ages, Japan will have to boost its human capital in order to compete in the increasingly knowledge-centred economy.*

*Neoliberals appear to believe that this challenge is best left to the market. But that approach risks worsening inequality while also leaving the country overall with an undersupply of talent. Even austere models of the state generally understand that it has an essential role in providing goods and services that the market either won't provide at all or will provide in insufficient quantity and quality.*

*Japan is a country whose modern prosperity was in large part built on equity in basic education. So it is incredible to see it run by a regime that uses "equality of opportunity" as a cheap slogan rather than a serious policy. As Niwa argues, a lot of opportunities are being sacrificed on the altar of an American neoliberal model that is driving the pace of income and wealth inequality while destroying the fragile sinews of the welfare state and public funding of education. Niwa shows that it is time to change course and aim reform at Japan's demographic, geographical and socioeconomic realities. AD]*

Sekai: First, could you tell us how you see the current state of the Japanese economy? What is your forecast for 2006?

Niwa: My sense is that the Japanese economy has arrived at a "higher plateau." There's been a debate over whether Japan has escaped from the plateau, and I think that Japan has left the low-level plateau it has been on. But this is a result of the jump in energy prices, and the rise in the price of raw materials, driven by China. I have some doubt that the Japanese economy has begun a truly strong recovery. Because of the favorable wind from China, it has escaped the first plateau but it is now stalled on a second, higher plateau. And there are several factors that make me wonder about the direction the Japanese economy is headed.

Trade has historically been the force behind the Japanese economy. The nation's current account includes foreign income and trade balances, but foreign income (13 trillion yen) has surpassed the trade balance (10 trillion yen). The result is that Japanese funds have been invested overseas to purchase bonds and stocks, and to purchase or set up companies, and dividends from those companies and income from patents and other non-trade related income have increased.

The problem here is that we may see some decline in the balance of trade that has been the driving force of the economy. In economics,  $S - I = X$ , savings minus investment equals the current account. The savings rate in Japan was 15 percent in 1991, but it had fallen to 8 percent by 2005. It is projected to fall to 3 percent by 2010.

The savings rate is the amount of savings divided by disposable income, so even with considerable fluctuation in disposable income, the savings rate will not fall greatly if there's no drop in the numerator, the amount of savings. So this implies that there has been a dramatic decrease in the amount of savings in Japan. This is likely to result in a reduction in the balance of trade, which has driven the economy. Foreign income will play a larger role than the balance of trade. This is an inevitable result of the increase in overseas investment.

In addition, to maintain economic growth at the 2 or 2.5 percent level that everyone talks about, it will be necessary to increase domestic consumption. Domestic consumption will have to drive the Japanese economy. Unfortunately, however, domestic consumption will show the effects of the falling birth rate and aging of the population more quickly than is widely thought.

There are about 2 million people in each year of the Baby Boom generation. Now fewer than 1.1 million babies are born each year. This year some 1.5 to 1.6 million people will graduate from college and enter the adult workforce. Some 1.2 million will enter elementary and junior-high schools. The drop from the Baby Boom generation is already 400,000 to 500,000, so demand will fall by that amount. In addition, the Baby Boomers will start to eat less, buy fewer clothes. It's called "slow demand." The number of people at the height of consumption of food and clothing will fall. So unless you supply goods with particularly high added value, there will be no force that can drive the Japanese economy.

In that sense, the economy has reached another plateau this year. To emerge from that plateau domestic consumption would have to increase to compensate for the fall in exports. I am, therefore, uncertain about Japanese economic growth this year.

### **The Key Word for the World Economy this Year is "Interest Rate"**

The US has been able to continue inflation-free growth through the manipulation of interest rates. It has been able to maintain fiscal deficits and current account deficits because Japanese money, Chinese Money and oil money has flowed into the US. The US Federal Reserve Bank has been raising short-term interest rates, and it is continuing to do so, to the point where the difference between long- and short-term rates has disappeared and there is no longer any room to raise short-term rates. Residential real estate prices are peaking, the domestic economy is losing steam and starting a downturn, which constrains raising interest rates. At the same time, Japan is also raising interest rates. The gap between interest rates in Japan and the US will narrow, and the merits of investing in the US will diminish.

There is now a 3 percent gap between Japanese and US interest rates on 10-year government bonds. Over 10 years, that represents a 30 percent difference. As a result, even many individuals are investing in the US right now. The same is true of China and Oil Money. The US has used that money to control inflation, keep long-term interest rates low, and maintain growth. In short, the American people are spending more than they earn. There is a negative savings rate, meaning that Americans spend more than they earn. Since real estate prices are rising, people borrow against their property. They spend that money. Real estate prices continue to rise, so they are able to borrow more. Then they spend that money. But this is only possible because money from the three sources continues to pour into the US. What happens when the flow stops? The dollar falls. The yen, or the Chinese yuan, rises.

The question is whether this situation will develop before or after the midterm elections in the US this coming fall. The strength of the US economy this year will likely depend on interest rates. For Japan as well, this year will be the year of the interest rate. This is true for Europe as well. In fact, "interest rate" is the key word for the world economy this year. What moves will the Federal Reserve Bank make? How will Japan modify its easy money policy? These things may well determine what happens with the world economy.

No one can really predict the percentage of economic growth. That's always been the case. At the end of last year, people were saying that things didn't look good for Japan. But there was robust growth, and everyone was able to greet the New Year with smiles. Historically, when 99 out of 100 people are bullish, they're usually wrong. I'm not saying it's best to bet against the market, but I see black clouds here and there in the blue skies.

I have mentioned, interest rates, the problem of domestic consumption, and the fall in the savings rate. China has begun complaining about excess inventories. Take steel, for example, China has stocks equivalent to an entire year of Japanese domestic demand for steel. But this cloud doesn't appear in the statistics, so everyone is still bullish. I just have the sense that this is rather strange.

### **The Gaps Are Widening**

Sekai: Since the beginning of the year, despite the growing economy, there's been a lot of talk about polarization and rising inequality in the economy.

Niwa: Asahi Shimbun reported on January 20, 2006 that the Gini coefficient that expresses income inequality stands at 0.314 for Japan, while the world average is 0.309 (OECD statistics). According to a survey by Japan's Ministry of Health, Labor, and Welfare the figure was about 0.32 in 1980, but it had risen to around 0.38 in 2001, indicative of rising inequality. But the Cabinet Office was reported as arguing that, because of the nuclearization of the family and the increase in elderly-led households, household income has been dispersed; the statistics appear to show increased inequality, but the actual reality, it claims, has not changed.

There are problems with relying solely on the Gini coefficient to look at inequality, but for the Cabinet Office to put forward this interpretation and analysis is very much like a historian writing history to suit his own purposes. Let me offer a contrary interpretation. The Ministry of Finance compiles a statistical survey of Japanese corporations. What does this survey tell us about the earned income of company employees over the last decade? At small and medium businesses (those capitalized at under 100 million yen), employee earnings have fallen by 16 percent. At mid-sized companies (from 100 million to 1 billion yen capitalization), earned income fell 9 percent. At large companies (capitalized at over 1 billion yen), earned income rose 1 percent. The Cabinet Office can argue that the reality has changed despite the rise in the Gini coefficient, but how do they explain these figures from the Ministry of Finance? Small and medium corporations employ 70 percent of all company employees in Japan, and wages have fallen there by 16 percent. This shows that the gap between the rich and poor is growing.

Let's look at the United States. According to 2003 Internal Revenue Service statistics, the top 1 percent of households accounted for 14.7 percent of total income. This figure has doubled over the last thirty years. The earned income of the top 0.01 percent of American households, about 13,000 households, is an average of \$10.8 million, which is four times what it was thirty years ago.

In other words, the rich are getting richer and inequality is growing. It is now at one of the highest levels in American history. The highest was in 1928, the year before the Great Depression began, when the top 1 percent of households controlled 19 percent of income. Just eight months after declaring the era of "eternal prosperity for all," the crash occurred. Income inequality began to contract after that, hitting bottom thirty years ago, after which it began to climb again until it reached the 14.7 percent level again.

## Is Inequality Good for Japan?

Under capitalism and the market principle, the strong prey on the weak. As Max Weber said, capitalist society creates these ill effects, unless it is constrained by morality or religion. This is exactly what we see today. The reason is that in capitalist society, in competitive society, it is always the strong who make the rules. The poor, the NEETs (not in employment, education, or training), the freeters (temporary, part-time workers) never make the economic and political rules. Sohyo (the General Council of Trade Unions of Japan) and labor unions once represented the poor. But union membership rates have fallen, and the interests of the weak are no longer very well reflected in society. It's the rich and the politicians who make the rules, and they won't make rules on their own that weaken their position. The polarization of Japan will likely progress further. If capitalism continues on course, Japan will become more like the United States. We are already seeing the emergence here of the strong preying on the weak.

Will this actually make Japan stronger? What has sustained Japanese society until now has been the fact that the middle class received very substantial, generous compensation. On the average, Japanese were good workers who made products with few defects. Everyone shared a high level of technical skill, and it was people with a high level of comprehension and strong moral values who brought Japanese society to where it is today. But when Japan reaches American levels of inequality, will it be able to sustain that productive strength?

So, which path will Japan choose? Say, we go all out in pursuit of the principles of capitalism, which would be the same as the United States. While the wealthiest 1 percent controls an increasing share of income, wages and salaries don't rise at all. Then places like Wal-Mart spread, with their "everyday low prices," and the supermarkets that cater to the middle class fall into decline. People's consumer activities and society begin to change. There's a polarization into high and low, and products begin to change. The quality of university students and the quality of corporations will also split into high and low. 100-yen shops are booming these days, and now even national brand manufacturers have begun to sell products in those shops, dropping the quality from their higher priced goods. Shops that cater to lower-level society will proliferate, and the middle strata will decline.

In the end, what do we want Japan to be? And how will we regulate in order to achieve this? We've got to answer this question through the tax system, which is a means of redistributing income. Which path will Japan choose? This is another sense in which Japan is at a plateau. Japan has arrived at a plateau, and it must decide what to do about domestic consumption and decide which direction to turn the rudder of the nation. In this sense, the problem of polarization represents a major question that is pressing upon Japan as it sits on this plateau.

*Niwa Uichiro has been chairman of Itochu Corporation since 2004. Born in 1939, he joined Itochu after graduating from Nagoya University. After nine years in New York, he became president of the company in 1998. His books include Hito wa Shigoto de Migakareru (People are Polished by Their Work). Niwa is also chairman of the Japan Association for the United Nations World Food Program.*

*John Junkerman is a writer and filmmaker working in Tokyo. His most recent films are "Power and Terror: Noam Chomsky In Our Times" and "Japan's Peace Constitution."*

*This is a slightly abbreviated version of an interview that appeared in the March issue of Sekai and is posted at Japan Focus on May 12, 2006.*