The rise and decline of extreme economic inequality in 20th century Japan
A literature review through the lens of institutional changes

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As economic inequality is rising in many countries around the world, the interest in how inequality has risen and declined in the past is being revived. Some researchers have seen modern history since the industrial revolution as a positive story of economic growth and technological progress that enhanced social development for all. Others have seen modern political economies as wrought with vicious cycles of inequality and social instability. This study investigates the rapid rise of economic inequality in Japan beginning in the 1880s and its equally dramatic fall in the 1930s. Using the World Income and Wealth Database's new statistical data, I argue that Japan's early economic development was characterised by highly inegalitarian institutions: taxation laws transfered resources from agriculture to urban centres for decades, corporate, financial and land properties were heavily concentrated in top income groups and rights-based organisations built by labour and women's movements took time to gain national influence. The unequal strength of these institutions prevented economic growth from fostering inclusive development. Only with the outbreak of World War II were these institutions reformed during the collapse of the global economic system. This article thereby supports the development literature that draws clear distinctions between unequal growth and socio-economic equality tied to institutional change.

Keywords: economic inequality, Meiji Japan, labour movements, capitalism, globalisation

When Piketty (2014) published the fruits of his collaborative research on economic inequality, it caused widespread public debate. By applying a unified statistical method accounting for both income and wealth, the group was able to compare inequality in all major economies going back over a century. Piketty's (2014) *Capital in the Twenty-First Century* thereby demonstrated for the first time how extreme levels of inequality have been the normal state of society in today's high income countries. In concrete measures, these inequality economists discovered that between 1850 and 1940, from when the industrial revolution began in several parts of the world until World War II, it was common that just 10% of the population in Japan and Europe received 40-45% of total national income and owned 80-90% of all wealth. In contrast, at the bottom of the income distribution, 50% of the population merely received a 20-30% share of national income and owned less than 5% of national wealth (Piketty, 2014; Piketty & Saez, 2014). During World War II these scales of inequality dropped sharply but have started rising again since the 1980s. Today inequality in the US has already reached Europe and Japan's highest 20th century levels. Other studies also reveal a gloomy picture. Milanovic (2016) accounted for global income inequality from the fall of the Berlin Wall in 1989 to the worldwide financial crisis in 2008. He was forced to conclude that, on average, in the rich countries the bottom half of the income hierarchy has experienced 'the absence of growth in real income over twenty years' (Milanovic, 2016, p. 19). With stagnating wages in a reformed labour market, concentrations of wealth building up again, and income from capital surpassing labour income (UN 2016), Japan might possibly be poised to go in America's direction (Baldwin & Allison 2015).

Japan in the pre-World War II period is a valuable case for understanding inequality's significance in a country's course of economic development. As Japan attained industrial growth rates in the 1880s, it started a path to become the first high income country outside of Europe and America, but for half a century Japan's distribution of income growth was completely unlike the relatively egalitarian decades in the post-war period. This transition from extreme inequality to relatively equal growth was anchored in a sweeping confrontation with the 'old world's' economic order (Piketty, 2014, p. 322). Starting in the key year 1937, World War II became the setting for a global collapse of capital systems, which had supported top income groups. State policies finally confronted major social divisions with redistribution of property and progressive taxation. Labour unions became a powerful parliamentary influence. This study ties previous research literature to the statistical data published by Piketty and Atkinson in 2010.

Economic theory: refuting the growth-equality nexus

How economic growth is intertwined with equality, social hierarchies, parliamentary institutions and labour's rights is a long-standing question in development scholarship. Economists writing in the mid-20th century, like Kuznets (1955, 26) who deemed that his own calculations were "95 per cent speculation", argued that the early phases of industrialisation widen income inequality while growth in the later stages is a virtuous cycle as it lifts farmers into professional and industrial occupations. Atkinson (1983, p. 190) questioned this analysis and argued that we are starting to see the presence of 'dynastic' inheritance again. Leading economist Minami (1998, p. 55) countered the explanation in Kuznets's theory for Japan by linking its equality during the post-war period to 'the new government's policy of heavy taxes on assets and wealth', concluding that 'equality does not always result from economic growth but can only be realised by strong policy measures'.

Atkinson and Piketty (2010), Moriguchi and Saez (2010) and Alvaredo et al. (2017) have strengthened Minami's refutation and weakened Kuznet's growth theory with their statistical work. In Figure 1 below, the evolution of top incomes in Japan and America 1913-2015 are shown. I take these two countries' top 1% income elites as examples of well-known inequality evolutions to prove that inequality can both rise and fall dramatically regardless of growth rates. The graph presents the share of total national income received by the top 1% in those two countries in any given year. These persons are a small minority who received very substantial incomes of 18% (Japan) and 20% (US) of the national total in the peak year 1925.

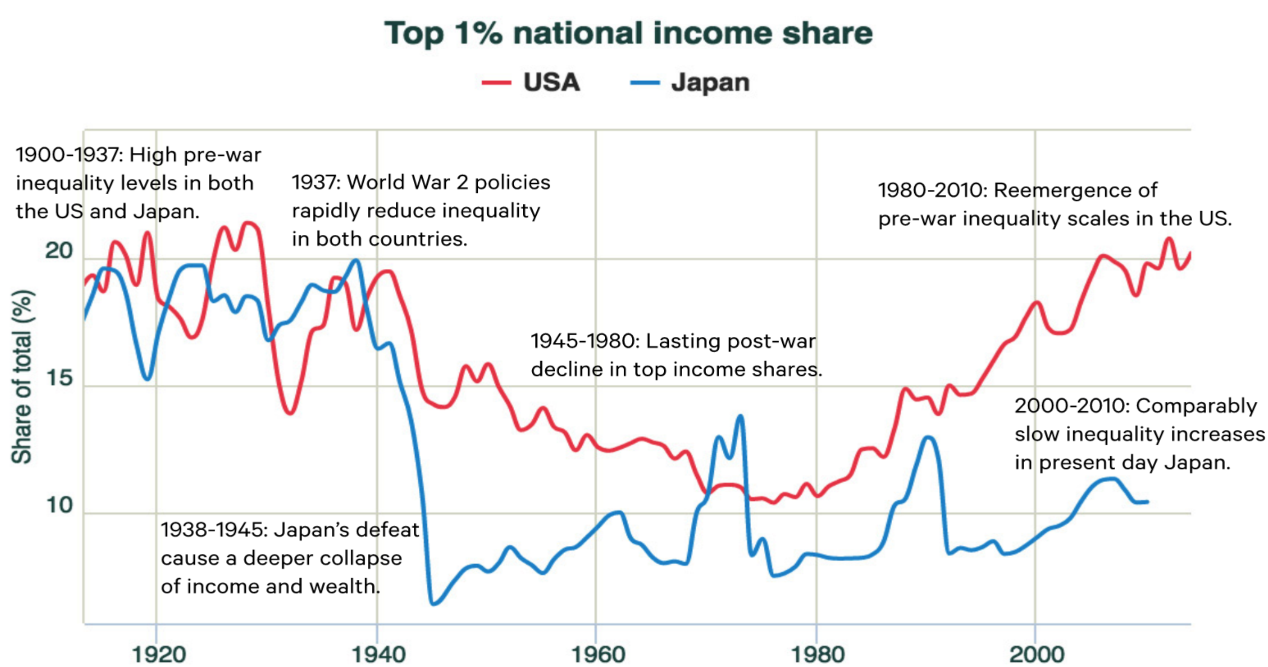


Figure 1: The top 1%'s share of national income in the USA and Japan, 1913-2015.
Source: WID (2018) and author's comments.

In the late 1930s, World War II broke out and inequality declined rapidly. In Japan income inequality had nearly vanished by 1945. Similarly in the US, top incomes gradually declined year after year to a low level both during and after the war. Since the 1970s, a reverse course begins: in the US the pace stepped up, from an 8% share in 1978 to an astounding 22% in 2007, thereby returning to the heights of the 1920s (Piketty, 2014; Stiglitz, 2012). In Japan the rise is moderate but significant: from around 8% in the 1970s to 11% in 2007.

In the US the 1% highest income group today receives the same share of national income as the 1% did in 1920. Japan's inequality has risen more moderately. The immense shifts in inequality occurring in the mid-20th century and the significantly diverging patterns in recent decades cannot be explained as a result of changing growth rates (Piketty 2014).

Atkinson & Piketty's (2010) research breaks new ground by using sophisticated statistics on wealth to unravel the various dimensions of economic inequality and anchor them in institutions and historical events. The evolution of income inequality in Japan and the US shown in Figure 1 provides evidence that, unlike Japan which was defeated and subjected to severe destruction in World War II, the US emerged unscathed and with a healthier economy than before, yet the US also experienced a reduction in inequality. This is partly explained by the labour movement's increased strength during the Great Depression and preparatory planning for war, which led to the government's adoption of various innovations in tax and corporate policies as part of the New Deal (Piketty, 2014; Moriguchi, 2003).

In Japan 'the defining event for the evolution of income concentration' was 'a historical accident, namely the Second World War' (Moriguchi & Saez, 2010, p. 78). Its outbreak created a series of exigencies that demanded unprecedented transformations in the economy from both capitalist and bureaucratic groups (Moriguchi, 2003; Gordon, 1991). The centrality of historical accidents and regressive/progressive policies whose influence lasts for decades made Piketty & Saez (2014, p. 842) conclude that 'powerful forces [push] alternately in the direction of rising or shrinking inequality. Which one dominates depends on the institutions that societies choose to adopt'.

Methodology: income inequality and institutions

Without any conclusive linkage between growth and economic equality, an explanation of inclusive economic development must combine changes in political institutions, legislation, shifts in the world economy and historical accidents. Development research on Japan has revealed this but it has paid little attention to the central role of inequality.

Amartya Sen's (1999) influential 'human development' theory sought to account for necessary virtuous linkages in economic and social development. Supported by the United Nations' human development statistics, Sen (1999, p. 153) argues that Meiji Japan was the 'pioneering example of enhancing economic growth through social opportunity, especially basic education', achieving higher literacy rates than Europe's growth economies already in the 19th century. Literacy, lower mortality rates and poverty amelioration must support growth in successful development.

The classic Asian 'developmental state' scholarship (Johnson 1982; Cumings 1984; Schmiegelow & Schmiegelow 1990; Chang 2002) has similarly focused on the mutually enhancing aspects of government initiatives and income growth. In Japan, in addition to implementing national education, the state initiated growth through a state-supported industrial and military sector by utilising foreign technology imports and taxation to channel resources from agriculture to urban centres and various monetary policies.

This article investigates why Japan's growth was highly inegalitarian and how political changes turned everything around when World War II broke out. I explain the rise of inequality by looking into early taxation law and the unequal relationship between labour and employers' organisations. I then present precise data on both income and wealth inequality to account for the structure of unequal economic development and discuss the weak impact of post-Great Depression labour legislation on the continuing income scale divides. Finally, utilising those data further, the study identifies the key years when inequality fell and links this dramatic shift to the global financial economy's collapse as well as to an array of domestic reforms resulting from war-time power struggles in government.

The Meiji nation state and early regressive taxation

The Meiji Restoration of 1868 was less of a one-sided 'modernisation' story of a new regime planting the first seeds of future development and more of a 'revolution from the top' (Lockwood 1968, p. 505) that built upon substantial economic developments of the late Tokugawa period (Macpherson, 1987, p. 24). The victorious Meiji leaders ended the reign of local lords and took from them the key prerogative of eliciting taxes from the peasant population that cultivated land in Japan's previously fragmented domains. Policy jurisdiction was transferred to the central state. The Meiji period therefore saw the consolidation of a national bureaucracy in the already emerging urban centre of Tokyo. Powerful Tokugawa merchant families would continue to expand their wealth in the following decades. The major administrative reform (Gordon 2003, p. 64) established a nationally unified tax system based on credit payments by each individual following market prices.

Tax reform tied the agricultural economy closely to the urban centres and made it susceptible to administrative initiatives and market instability. In 1880 Japan was still predominantly an agricultural economy. 72% of the population was employed in agriculture and 90% of state revenues derived from agricultural land taxes (Minami, 1994, p. 258). The state taxed this large and developing resource base, channelling resources into incipient urban industries.

Inequality-reducing tax legislation aimed at the emerging high-income industrial economy proved more difficult to implement. In 1887 Japan's first wage income tax code was enacted. The Meiji administration sought to impose a progressive, rudimentary 1-3% taxation on personal income. With people earning below 300 yen (10 times average annual income) exempted, only 0.3% of the population were liable tax payers (Onji & Tang 2017, p. 443). The top 1,089 largest companies of the 1880s Tokyo Stock Exchange, including the wealthiest family-owned *zaibatsu* conglomerates, were in large part able to circumvent this law. To avoid personal tax, top conglomerates reorganised and incorporated smaller companies, gradually replacing them. By 1892, 54% of large textile companies had become branches of joint stock corporations, and 1/3 of sole proprietors disappeared.

Migration and unequal organisation between labour and employers

In the 1880s, on the eve of Japan's boom in manufacturing, peasant families were subjected to the new administrative state's attempt to establish a currency economy. The pressure on public finances caused by the expense of suppressing revolts and building infrastructure in the 1870s was met by printing large amounts of money, which caused high price inflation. Finance Minister Matsukata responded to the situation by implementing severe deflation policies. Almost over night, rice prices declined by as much as 50% (Ericson, 2014). These deflation policies created a spiral of inequality in which desperate peasants became indebted to meet rent and tax payments, often having to give up land ownership and urge their children to take up work in the urban factories to earn additional income. These events therefore linked up with the tremendous reorganisation of labour that took place during Japan's industrial boom around 1886.

Japan's early industrialisation was based primarily on textile manufacturing. Between 1876 and 1900, the agricultural sector's share of employees fell from 78% to 65%, then to 51% in 1920 (Moriguchi & Saez, 2010, p. 86). By 1909, 500,000 Japanese were employed in textile manufacturing. With 50% of total national exports consisting of textiles, the sector accounted for 60% of all growth until 1938 (Minami, 1994, p. 98). No less than 85% of this workforce was female and nearly all of them were migrant peasant daughters in their late teens (Patrick, 1976, p. 59).

According to labour scholar Tsurumi (1990), during these decades factory compounds were institutions of social control. Because urban residents knew about the degrading and miserable conditions, factory owners were forced to recruit girls from rural regions where fathers, hardpressed by debt, forced their daughters to become textile hands. The living quarters of locked and fenced off factory dorms were tightly packed with small sleeping pads and inadequate bathing facilities having 'more in common with a prison' (Yamamura, 1997, p. 257). The small portions of bad quality food that were served every day were a major reason for flight and caused malnutrition. A death rate of 9% was probably normal. Working twelve hours a day, cotton hands were forced to work demanding night shifts every second week. The result was a turnover rate of 100% (ibid., pp. 256-261). Tsurumi (1990, p. 138) argues that only 10% of the girls in this heart of production were literate, which underlines how force rather than education was necessary to make people contribute to the new socio-economic system, as one worker song testified: 'Factory work is prison work. All it lacks are iron chains' (ibid., p. 98).

Factory owners, on the other hand, formed wide-ranging organisations. In the absence of state regulation, the Yamanashi and Suwal silk employers' alliances wrote legislative treaties that gave them the right to fire employees without constraint and to unilaterally set and withhold wages while making it compulsory for workers to stay at the same company for a whole year (1990, pp. 49, 74).

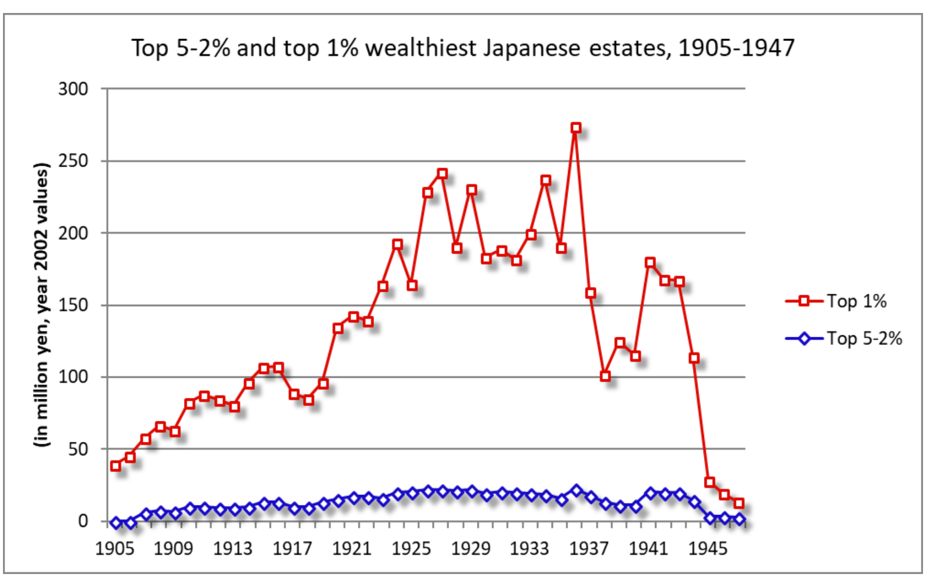
After World War I, social activism and labour unionisation became major movements in Japan. The urban labour organisation Friendly Society, founded in 1917, became the largest union, the Japan Confederation of Labour. Closely studied by Gordon (1991) and Garon (1987), the proliferation of civil society organisations was based on widespread protest against low material living standards and against lacking acknowledgement of labour's contribution to the economy. The fact that in Nankatsu, Tokyo's principal industrial centre, union membership grew from approximately 2% to 32% of the local labour force between 1912 and 1929—reaching approximately 7.9% on a national level—is testimony to the vitality of community-building in an environment where unions were still formally illegal (Gordon, 1991, p. 186). Union proliferation led to a comparable increase in disputes between workers and employers which rose from 500 to 3,000 incidents countrywide in the 1920s. This movement undeniably produced impressive victories for social progress: In 1922 women won the right of freedom of association and free public speech. In 1925 universal male suffrage was implemented (in 1908, only about 47,000 qualified to vote in elections). A year later a bill in the Japanese parliament, the Diet, legalised labour disputes. In 1928 night work by women and children was prohibited by law. At labour's peak strength in 1931 following the Great Depression, the elected representatives in the lower Diet found themselves flanked by socialist parties that had roots in the urban proletariat and they even managed to pass a bill to legalise unions, but the upper Diet's unelected members stopped the law indefinitely.

Slow material improvements, repressive factory institutions and unequal political rights spurred workers to organise themselves and to pressure employers through disputes and parliamentary participation. This movement achieved victories that resulted in better labour market regulation. However, this legislation was not enough to substantially reduce economic inequality, which contined to rise until the 1930s.

Wealthy dynasties, capital and corporations: expansion in the 1920s

We saw in Figure 1 that the share of national income going to the 1% highest income group was 20% until 1937. It did not decline during the labour movement's activist years. However, compared to wealth, capital and property, which accumulated rapidly through this period, income was relatively equally distributed. Moriguchi & Saez's (2010) account of Japanese estates—the capital portfolios and properties inherited within the wealthiest families—begins with data from 1905.

In Figure 2 below we observe the evolution of capital concentration among these rich families. The wealthiest 5-2%, of families owned substantial wealth compared to the rest of society. Their assets maintained values that floated around 10-20 million yen until the 1940s. However, this small wealthy group did not truly participate in the rapid economic changes taking place. The rise and fall of wealth is much more strongly pronounced



Data source: Moriguchi & Saez (2010, pp. 147-8).

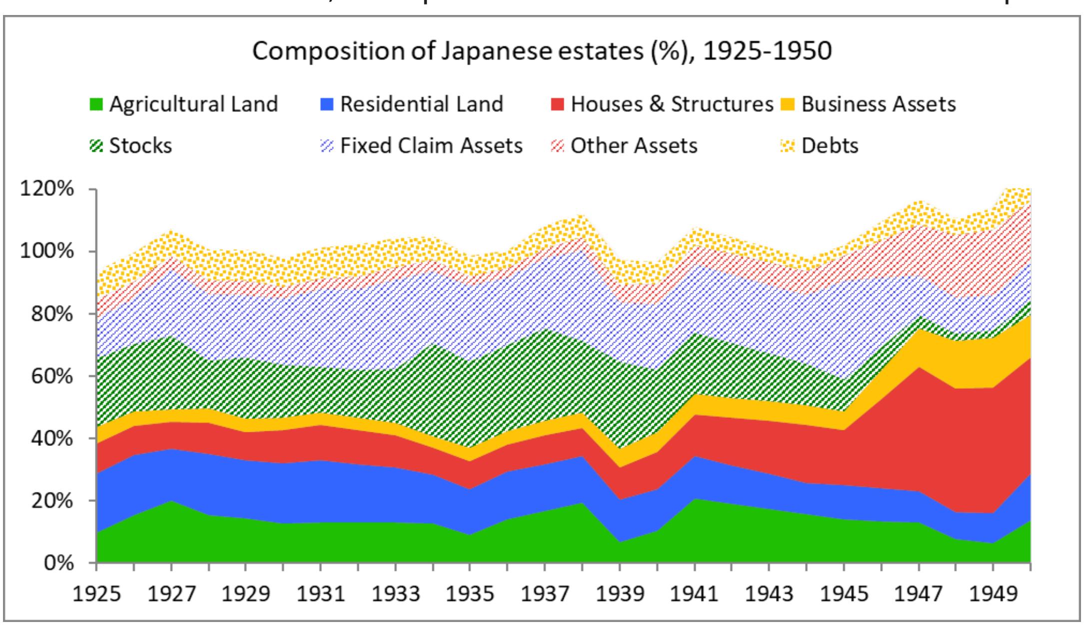
Figure 2: The top 1% and top 5-2% of the Japanese wealth scale from the 1905 until World War II.
Wealth inequality remained anchored primarily in the properties of Japan's 1%. Their fortunes surged upwards especially after World War I and did not decline until World War II policies were implemented in 1937.

among the top 1%. Their fortunes grew from 40 million yen in 1905 and peaked at over 250 million in 1936. The evolution was towards ever higher inequality, with a temporary precipitous decline during the Great Depression, but without a lasting fall until 1938, the very same year when income inequality took a nosedive. This scale of capital accumulation meant that income growth alone could never substantially reduce inequality. For the entire nation, annual growth rates reached 2.1% between 1905-1936 (Maddison 2003, pp. 180-182), but capital grew at the faster rate of 7.4% for the top 1%, 3.5 times faster. This is consistent with Piketty's (2014, p. 25) 'fundamental inequality' of capital growth exceeding income growth in extremely unequal societies.

The realm of the Japanese capitalist aristocracy is well-known. Throughout the 1920s, zaibatsu conglomerates grew and expanded their power (Minami, 1994, p. 114). Reflecting traditional aristocratic values, the Japanese estate was organised around patriarchy with the head of a dynasty managing the bulk of family wealth while also holding authority in overlapping board memberships in a conglomerate's corporate and banking branches. When possible, these positions and assets were inherited by the first-born son. In Figure 3, an overview of their wealth shows how capital property yields higher income: vast agricultural land ownership (34% of all wealth) provided property owners with income from renting farmland and housing to tenant families. With the new capital economy, massive amounts of financial assets (50% of total in 1937) provided high returns to stockholders in banks and corporations.

Wartime reform and economic collapse: the fall of inequality

A series of historical events led to the demise of capital and extreme inequality in Japan. Labour unrest in the 1930s provided strong



Data source: Moriguchi & Saez (2010, p. 151)

Figure 3: Composition of Japanese wealth, 1925-1950. Both agricultural and residential property remained key sources of wealth and rental income until the 1940s, but financial assets constituted as much as 50% of total wealth in 1937. Half of all financial capital vanished during the years of war.

evidence for affluent circles that society and economy were dysfunctional. They held an 'obssessive fear [...] that domestic society was collapsing' (Gordon 1991, p. 10), and groups of reform bureaucrats 'believed that radical policies to nationalize industries, control private property, and thereby eliminate popular discontent were essential to national defense' and 'to reduce the tremendous gap between the rich and poor' (ibid, p. 279).

The state became an arena for conflict and collaboration between capital managers and civil servants. In 1938, the war-preparatory Mobilisation Law was passed, which in principle allowed the bureaucracy to control Japan's corporations. To accommodate business leaders in the wartime plans, the former Mitsubishi *zaibatsu* and Bank of Japan executive, Ikeda Seihin, entered government as the first minister of a newly established powerful Ministry of Finance. He tried to preserve independence in corporate boards while aligning their corporations to the war effort. Ikeda was forced to resign after clashing with the Home Ministry's planners who favoured stronger state-centered coordination (Johnson, 1982, pp. 145-8).

The shifting wartime governments managed to implement an array of unprecedented reforms to bolster social stability. They regulated and standardised wages across industries both at the top and bottom; they mandated workers' councils in factories to empower state-governed unions; and they put a ceiling on executive wages. The regressive tax system was finally turned around with the imposition of heavier taxation on corporate and rental income each year after 1938, while land was redistributed from property owners to tenant farmers and rice prices were fixed. In the stock market, war bonds replaced generous state obligations, thus nullifying a major rental income for capital-owners (Moriguchi & Saez, 2010, p. 101).

With Japan's defeat in 1945, the economy was in an advanced state of collapse. Hyperinflation increased the cost of goods 150 times in just two years. Zaibatsu empires in Asia were dismantled in conjunction with the American occupation government's demobilisation of the army. All these forces in combination dramatically weakned the institutions that had supported capital clusters. As Figure 3 shows corporate stocks and financial assets which had constituted 52% of estate wealth in 1938 fell to a mere 17% by 1950.

A new constitution legalised labor unions for the first time in an attempt to muster popular support for breaking up the zaibatsu conglomerates. In the crisis environment of inflation, food scarcity, unemployment, labour was revitalised like never before. In just four years, independent union membership came to cover 56% of the workforce. In June 1946, 157,000 Japanese participated in 233 takeovers of factories. After averting a planned national strike that involved 6 million people, the occupation government again decided to douse activism by making public union strikes illegal (Gordon, 1998, pp. 7-10).

In sum, historical accidents in the form of a collapsing global economy and hyperinflation decimated family-owned wealth clusters. Policies intended to foster social stability during war redistributed economic resources. Strong labour organisations only played a secondary role in the overall development by influencing parliament's legislation (Gordon, 1998; Esping-Andersen, 1990).

Conclusion

Japan's pre-World War II political economy of development transformed it into the first Asian country that reached high income levels. It was at the same time among the most inegalitarian countries in modern history. As a result of the highly concentrated and inherited ownership of capital, growing wealth inequality inhibited the possible positive effects of national income growth and early labour rights and tax legislation. Growth alone did not constitute a virtuous cycle. The turn-around took place in a time span of just 8 years and was directly linked to the breaking up of old power constellations. World War II both compelled and enabled the government to implement a flurry of first-time progressive taxation, to redistribute property, to reforge capital bonds and even to empower labour.

For development scholarship, the central conclusion is that policies designed to promote growth which neglect redistribution constitute a weak and disjointed approach to development in which growth may even lead to deeper socio-economic inequalities. This proposition is strengthened by the fact that the considerable victories in Japanese labour market regulation and social rights legislation won in parliament helped narrow social gaps but had a limited direct impact on the immense scale of income and wealth inequality. Only direct taxation and redistribution, or crisis events with comparable harmful effects to capital, alleviated that divide.

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