

It gives me special pleasure to welcome Japanese readers to *The new economics of inequality and redistribution* (Otsuki shoten, 2013). The key proposals in the pages that follow can be traced back to a day 60 years ago, in a farmer's field in Japan, when I was just 13 years old. I cherish a photo in my family album: my father and I are standing with the farmer who, as a result of a land reform, was the full owner of the crops he produced, rather than a share cropper, as had been his father and grandfather.

My dad had explained to me that it was good for the farmer, and good for the Japanese economy. I believed him. As I write these words today I imagine, without much exaggeration, that among the farmer's daughters or sons is a retired engineer or school teacher; and that none of his grandchildren are sharecroppers.

I did not know his name, but the farmer stayed with me. As a university student, my major research paper sought to understand why land reforms sometimes fail. Much later, as a teacher of economics and an advisor to policy makers, I remain convinced that a more equal distribution of land, knowledge, and other assets is at once good economics, an ethical imperative and a political possibility. And something else: what was good for that farmer and for the Japanese economy might also be good for machine operators, waitresses, medical technicians and other workers and their economies. This book explains why.

Without ignoring the substantial inequalities of wealth, income, and economic opportunity that exist in all capitalist economies, two quite different sets of nations may lay claim to the title, *egalitarian capitalism*: the Nordic nations – Finland, Norway, Sweden, and Denmark – and the East Asian egalitarian economies – South Korea, Taiwan and Japan. In none of these nations has economic insecurity and deprivation been eliminated. But the two sets of nations share common characteristics that differentiate them from most other capitalist nations: remarkable equality in living standards, the distribution of years of schooling, and intergenerational mobility. In this respect these countries that are approximately as equal as the world historic prototype of egalitarianism – the hunter gatherer economies of our distant

ancestors (These comparisons of the Nordic, East Asian and other data are based on Fochesato and Bowles (2013). Intergenerational earnings mobility data are from Lefranc, *et al.* (2011)).

But the differences are striking. In the Nordic economies, despite inequalities in wealth equivalent to the U.S. and other highly unequal capitalist nations, disparities in well being are limited by policies of redistribution.. By contrast, the foundation of the East Asian model is not income redistribution but rather a relatively equal distribution of wealth and human assets. The contrast between the two models is exemplified by differences in what Mattia Fochesato and I term the redistribution ratio, defined as one minus the ratio of the Gini coefficient for disposable income – a family's income after paying taxes and receiving government transfers --to the Gini coefficient for market income. (The Gini coefficient is a measure of inequality with a value of 0 indicating perfect equality and a value approaching 1 indicating that a single individual has all of the income. A redistribution ratio of 1 means that disposable income is equally distributed whatever is the distribution of market income, while the redistribution ratio is 0 when disposable income is no less unequally distributed than market income). The average redistribution ratio for the Nordic economies is 0.45, while the ratio for both Korea and Taiwan is 0.06. According to unpublished data from the OECD, Japan's redistribution ratio in the mid 1980s was even lower than Korea and Taiwan; while it has increased considerably in recent years it is still well below that of the Nordic nations.

Thus the East Asian nations implement a level of equality in living standards (measured by the after tax and transfer Gini coefficient) that rivals that of the Nordic nations, but with substantially less redistribution. This suggests that wealth inequality in Japan is substantially less than in the three Nordic nations on which we have data: Sweden, Finland, and Norway. Recalling that income is a flow (it is measured per unit of time) and wealth is a stock (it has no time dimension), we can simplify by saying that the Nordic model works primarily by equalizing flows stemming from unequal stocks, while the East Asian model is egalitarian because of relatively equal stocks.

Japan became an egalitarian capitalist nation by a route quite different from the Nordic nations, and the same is true – though less dramatically so – of Korea and Taiwan. In the

Nordic nations, decades of egalitarian policies – notably in education – and growing strength of leftist parties preceded the advent of the social democratic model. In contrast, in Japan during the four decades prior to its egalitarian phase, economic inequality – indicated by the before tax income share of the richest tenth of one percent of income earners – was extraordinarily high and rising. In the course of just 6 years – 1938 to 1944 – that income share fell from over nine percent of total income to less than two percent, where it remained for the next half-century. The losses in income shares of other top income groups were less dramatic, but still substantial and no less durable. The Gini coefficient of before tax and transfer incomes fell from a value that was probably well over one half (alternative data series differ) to about half that value (Moriguchi and Saez (2008).)

Changes of this magnitude and persistence are called phase transitions in thermodynamic systems when, for example, at 0 degrees centigrade water becomes ice, or punctuated equilibria when new biological species appear after long periods of stasis. Economic revolution is the most apt term for the emergence of Japan as model of egalitarian capitalism. The challenge implicit in the term is to understand the persistence of both a highly unequal elite-dominated Japan and the durability of the more democratic and egalitarian system that replaced it, and the process by which the latter replaced the former. Lessons from other revolutions – the origins of private property 12 millennia ago, or the end of central economic planning and Communist Party rule in many nations two decades ago – make it clear that a convincing response to the challenge will draw on the insights of many disciplines, not just economics, and that positive feedbacks often involving the exercise of political power will be essential to the explanation of the persistence of two such different states of Japanese society (Bowles and Choi (2013), Bowles (2004)).

My own attempts to explain similar institutional and macroeconomic transitions in my own country (Bowles, *et al.* (1991), Bowles, *et al.* (1989)) have convinced me that the challenge can be met only if we understand how institutions affect people's values and preferences, and correspondingly how what people want and value can alter a society's institutions. This is neither microeconomics providing the foundation for macroeconomics, nor the reverse. Rather it is a unified understanding of the co-evolution of individuals (their

preferences and behaviors) and institutions (the societies legal and informal conventions governing social interactions) each affecting the dynamics of the other. An on-going decade and a half long project at the Santa Fe Institute – the Coevolution of Preferences and Institutions Working Group – is dedicated to developing this approach.

In the years since I stood as a boy in that farmer's field, both models of egalitarian capitalism – the Nordic and the East Asian – have performed well. For both sets of countries, standard measures of inequality such as the degree of intergenerational transmission of economic status and income dispersion are well below the averages of other capitalist economies. Rates of productivity growth over the past half century average well above those of the less egalitarian nations (Bureau of Labor Statistics (2013).) In recent years both Nordic and East Asian economies have seen some increases in income inequality. But the long run record of both models shows that greater equality need not impede and may even strengthen the productivity-enhancing dynamics of the capitalist economy.

Of the two models, the East Asian approach is closer to the proposals I make in the pages that follow. The name I have given my proposals – asset based productivity-enhancing redistribution -- is perhaps just a long and academic term for the East Asian model. My Japanese readers will know more about this model than, I of course, so comments, criticisms, and extensions of this approach are particularly welcome.

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