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Top wage incomes in Japan, 1951–2005

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ABSTRACT

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Using wage income tax statistics, we construct continuous series of upper wage income shares in Japan from 1951 to 2005 to document the evolution of top wage incomes and investigate their long-run determinants. We find that, while the middle wage income class gained enormously both in absolute and relative terms during the period of high economic growth, the upper wage income class fared comparatively better after 1975. In particular, the shares of total wage accruing to the top 1% wage earners and above have risen steadily since the late 1990s. A simple time-series regression analysis indicates that marginal income tax rates, corporate performance, female labor force participation, and labor disputes are important determinants of top wage income shares in post-WWII Japan. Although not conclusive, our results suggest that much of the recent gains in wage income shares at the top can be explained by the changes in these four factors, placing a less emphasis on a story of structural change. *J. Japanese Int. Economies* 24 (3) (2010) 301–333. Institute of Economic Research, Hitotsubashi University, Tokyo, Japan.

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1. Introduction

Japan has been known for its solid middle class and relatively egalitarian society for much of the post-WWII era. Recently, however, there is growing perception among the Japanese public that income inequality is rising. Scholars have documented a gradual increase in inequality since the 1980s using a variety of household survey data. Yet, there is much debate over the timing and extent of the recent changes in income inequality, as well as its causes and implications for a future course of development (Tachibanaki, 2005; Ohtake, 2005; Moriguchi and Saez, 2008).

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With respect to wage income, labor economists have identified ageing of the Japanese workforce, an increase in non-standard employment, and the rise of unemployment among the youth as major factors contributing to rising inequality (Ohtake, 2005; Genda, 2005). At the same time, some argue that intra-firm pay inequality is also increasing as top executives are receiving higher compensation in recent years due to changes in corporate governance and payment structure. In fact, the share of Japanese firms introducing performance pay, especially for managerial positions, began to rise since the mid 1990s, and an increasing number of firms are implementing corporate governance reforms since 1997 (Tsuru et al., 2005, Chapter 2; Miyajima and Nitta, 2006). We know relatively little about the upper end of wage distribution, however, due to the lack of adequate survey data. In this article, taking advantage of the detailed information available in wage income tax statistics, we document the evolution of top wage incomes in 1951–2005, evaluate recent trends from a historical perspective, and investigate the determinants of top wage income shares.

2. Data and methods

We briefly describe our data and methodology for estimating top wage income shares.¹ Our wage income data are compiled from wage income tax statistics published annually in the *Survey on Private Wages and Salaries* by the National Tax Administration since 1951.² The statistics cover all employees in the private sector who worked for the same employer throughout a calendar year, but exclude employees in the public sector, day laborers and temporary workers whose job duration was shorter than a year, and employees who were hired midyear.³ Because the survey is based on the data filed by employers of all sizes who are legally responsible for withholding income tax at source for their employees, it provides comprehensive and accurate information on private wages and salaries. In particular, compared to household surveys, it offers more precise data on the high end of wage income distribution. Wage income in our definition is the sum of wages, salaries, bonuses, overtime pay, allowances, and taxable part of non-cash compensation, but excludes non-taxable fringe benefits and retirement benefits.⁴ As a result, our wage income data are subject to income shifting where employers manipulate the form of compensation to avoid taxation. Because of an extensive and sophisticated withholding system, however, wage income in Japan is subject to a minimum tax evasion, i.e., unlawful underreporting of income (Hayashi, 1987; Ishi, 2001).

Top wage income groups (e.g., top 0.1%, 1% and 10% groups) are defined relative to the total number of regular employees in the private sector in Japan.⁵ We estimate the total wage income denominator based on total salaries from National Accounts. The number of wage earners and total wage income for 1951–2005 are presented in Table A1 in the Appendix. We estimate the wage income numerator (i.e., the amount of wage income accruing to a given top group) from wage income tax statistics using Pareto interpolations. Our estimates of top wage income shares for 1951–2005 are reported in Table A2 in the Appendix.

We also estimate the effective marginal tax rates for various upper wage income groups for 1951–2005. The estimates are made for an individual with a non-working spouse and two dependent children, assuming that all income is employment income. Our estimates incorporate both national and local income taxes and take standard exemptions into account, but exclude non-standard exemptions and social insurance contributions. We summarize major changes in income tax laws from 1951 to 2005 in Table A3 in the Appendix. Our estimates of the marginal tax rates series are reported in Table A4 in the Appendix.

¹ See Appendix for detailed descriptions.

² Japan National Tax Administration, *Minkan Kyuyo no Jittai*, 1951–2005.

³ Our data thus include part-time workers and workers employed by temporary help firms, provided they worked for the same employer throughout a year.

⁴ Stock option, which was legalized in 1997 for the first time in Japan, is taxed as capital gains at the point of exercise and thus not included in wage income.

⁵ According to the definition used by the Japanese government, “regular employees (*joko*)” include not only employees on indefinite contracts but also those who have worked for the same employer for more than a year under repeated 1-year contracts. Therefore, regular employees include full-time as well as part-time employees who have stable employment relations.

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