Income and Wealth Inequality in South Korea: Government-led or Market-led Solutions?

By Jong-sung You

There is no doubt South Korea is experiencing worsening income and wealth inequality, some of it attributable to government-led increases in the minimum wage. But that doesn’t mean government intervention doesn’t have a role to play in solving inequality. Smart policies involving income transfers and taxes would help.

By Taeyoon Sung

The Moon Jae-in administration’s policy to reduce inequality in South Korea have surely been well-intended. But the policy of ‘income-driven growth,’ with its reliance on large, government-mandated increases in the minimum wage, have been an unmitigated disaster. It is time to focus on making the private sector more competitive, not less.
State Intervention Can Cut Inequality, But the Current Approach Is Wrong
By Jong-sung You

SOUTH KOREA’S per capita gross domestic product surpassed US$30,000 in 2018, making the country the seventh member of the so-called “30-50 club” — economies with US$30,000 in per capita GDP and a population of 50 million people or more. However, news of this remarkable achievement of a once-poor nation has been overshadowed by the uneasy revelation of a widening income gap between poor and rich households. During the last year, the average household income for the bottom fifth of the population fell by 17.7 percent, while that for the top fifth increased by 10.4 percent. However, the redistributive role of the welfare state was minimal. In particular, the amount of public transfers to the first quintile (or bottom fifth) increased only by 17.1 percent, while that to the fifth quintile (or top fifth) increased by 53.5 percent. As a result, the ratio of disposable income of the top quintile to that of the bottom quintile rose from 5.44 to 7.36. It’s time for the South Korean government to substantially increase redistribution through taxes and transfers.

Before we discuss the role of government in addressing growing inequality, we need to know the long-term trend of inequality and the causes behind it. Inequality in South Korea fell dramatically during the first few decades after liberation from Japanese rule. Low inequality was maintained during the period of rapid industrialization until the early or mid-1990s. The top 1 percent’s share of national income fell from around 7 percent from the late 1970s to around 5 percent in 1994 and 35 percent in 2004. The rate has increased slightly since then, reaching 42 percent in 2018. Corporate income taxes have also been lowered, and taxes on capital gains and capital income are still minimal. Numerous tax exemptions benefit the rich and large firms. It seems that policy-making is largely captured by the chaebols and the rich.

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Before export-led industrialization took off during the 1960s, the country was already enjoying very favorable conditions for economic development, such as a low level of inequality and rapid expansion of education. The provision of abundant and cheap labor with literacy and numeracy propelled industrialization, which in turn helped to maintain near-full employment by absorbing rural migrants into urban areas. Although President Park Chung-hee’s chaebol-centered strategy led to increasing economic concentration over time, near-full employment and a low level of wage gaps under the state’s repression of the labor movement helped to maintain a low level of income inequality. During this period, social welfare expenditures were minimal, because the priority in the budget was economic growth under the principle of “growth first, redistribution later.”

Thus, neither market forces nor the redistributive role of the welfare state was responsible for South Korea’s low level of inequality. The foundation for remarkable “growth with equity” was laid by land reform, with full employment and low wage disparity helping to curb the rise of income inequality.

However, increasing economic concentration by chaebols — South Korea’s large family-owned conglomerates — inevitably brought about widening gaps between large firms and smaller firms, as well as between the wealthy and the poor. Market forces played a role in increasing inequality, with the gradual liberalization of trade and markets that started in the 1980s and accelerated in the 1990s. Globalization further increased inequality in some ways. Wage gaps have increased in the dual labor markets. Organized labor concentrated in the regular workforce in large firms has been able to experience rapidly rising wages, while most of the non-regular workers in small firms are not organized. Also, democratic politics helped to reduce taxes on the rich. Top marginal income tax rates plummeted from a high of 70 percent during the 1970s to 40 percent in 1994 and 35 percent in 2004. The rate has increased slightly since then, reaching 42 percent in 2018. Corporate income taxes have also been lowered, and taxes on capital gains and capital income are still minimal. Numerous tax exemptions benefit the rich and large firms. It seems that policy-making is largely captured by the chaebols and the rich.

President Moon, who was inaugurated in May 2017, declared a strategy of “income-led growth” or “inclusive growth,” stressing the need to help