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.
The Debate: Sung

Asia has experienced higher economic growth than Latin American countries with severe income inequality, which is a critical policy concern. As a result, severe income inequality that obstructs education and human capital accumulation can be detrimental to economic growth, but lowering income inequality directly may not always result in economic prosperity. Therefore, it would be more effective policy-making to find the channels through which income inequality negatively affects economic growth and focus on these channels rather than approach income inequality in general. In this context, it would be more important to prevent income inequality from adversely affecting education and human capital accumulation, as well as corruption when it invades property rights.

THE SOUTH KOREAN CASE

Such a perspective offers a particularly significant insight into recent South Korean policy. The administration of President Moon Jae-in, who came into office in 2017, has been pursuing what it calls “income-driven growth.” This is a type of wage-led growth that is based on the post-Keynesian idea of promoting economic growth by resolving income inequality and increasing the wages of lower-income earners. At its core, the Moon administration’s policy led to a 16.4 percent increase in the minimum wage in 2018 and a 10.9 percent increase in 2019. The policy objective has been to achieve economic growth by increasing the wages of low-income earners, which will strengthen their purchasing power. In reality, though, the policy has led to very different results from what was intended.

For example, year-on-year growth in average employment was approximately 100,000 people in 2018, which is around a third the level of roughly 300,000 people in 2017. The bottom 20 percent income tier — which is likely to be subject to the minimum wage — has been hit the worst, with the share of unemployed households in that tier increasing from 43.6 percent in the fourth quarter of 2017 to 55.7 percent in the fourth quarter of 2018. The monthly average income of the bottom 20 percent of households is reported to be 1.236 million won (about US$1,100) in the fourth quarter of 2018. That number is not the result of a slower increase, but rather the fact that the absolute income level has decreased by 17.7 percent compared to 2017. This was the most significant decrease since records have been kept. We should also note that their income has fallen significantly, despite the fact that the income transfer to this bottom 20 percent increased by almost 11 percent due to growing government expenditures including public pensions. Contrary to the government’s intention to improve the economy by raising the minimum wage, the jobs for those who are impacted by the minimum wage have disappeared, leading to a significant decrease in labor income and total income. The policy objective has been to achieve economic growth by increasing the wages of low-income earners, which will strengthen their purchasing power. In reality, though, the policy has led to very different results from what was intended.

The average national income per capita in South Korea is roughly US$30,000, while the US is approximately US$60,000. Thus, the real bur-
den of the hourly minimum wage on South Korea’s per capita GDP is 1.9 times greater than that of the federal minimum wage in the US. It is even 1.5 times above that of California, where the state minimum wage is one of the highest in the US. The ratio of South Korea’s minimum wage to its median wage is also one of the highest in the world, except for France. The sudden and drastic increase in the South Korean minimum wage also raised overall labor costs, so that companies that were previously holding off adding jobs are now even more reluctant to create new jobs. Meanwhile, companies that are mainly affected by the minimum wage have responded by eliminating jobs.

Consequently, income inequality has deteriorated further, because people have lost their jobs or cannot find jobs under the current policy. Those with stable jobs may have earned more as their wages grew, but people with lower incomes who also face relatively more insecure job opportunities have experienced severe income loss, because many can no longer find work. For example, the average number of working members per household in the bottom 20 percent income tier has decreased from 0.81 in the fourth quarter of 2017 to 0.64 in the same quarter of 2018. The relative income ratio of the top 20 percent income tier to the bottom 20 percent tier, which divides the disposable income of the top 20 percent by that of the bottom 20 percent, has worsened from 4.61 in the fourth quarter of 2017 to 5.47 in the same quarter of 2018. That increase in the income inequality index is the worst since statistics have been kept.

Moreover, real GDP growth in 2018 was at 2.7 percent, down from 3.1 percent in 2017. The overall labor cost increase from the drastic rise in the minimum wage acted as a negative shock to the economy, although it does not explain all the reasons for the decline in the GDP growth rate. In short, the government’s direct market intervention in the form of wage-driven or income-driven growth, particularly on the price factor involving lower income tiers through higher minimum wages, has appeared to fail in achieving the goal of resolving income inequality and promoting economic growth. Some argue it will take a bit longer for the policy to be fully effective, but in fact, all that we are likely to see is a dissolving of the negative impact of the initial shock, just as in all other shocks to the economy.

To be sure, income inequality is a critical issue in the economy, and it is essential to work toward resolving or alleviating the problem. However, this does not necessarily mean policies intended to deal with income inequality will result in economic growth. What we need to do instead is to ascertain clear channels between such critical problems and various other economic issues, including growth, and focus on how we can work around these channels, rather than directly intervene in income inequality or wages by using policies that stand against the market.

Even if income inequality may impede economic growth, we have to understand how exactly the issue poses a problem for growth and seek a reasonable solution for the specific problem. We also have to consider the possibility that direct government intervention to resolve income inequality may not succeed. The result may be completely different from what the government intends, especially when policy-makers fail to accurately reflect market mechanisms and current economic conditions. Another thing to remember is that the adverse effects of the government’s direct intervention involve a price: not only could the redistributive policy fail to achieve its intended goal, it could increase non-productive government expenditures, thus further aggravating the negative impact of unsustainable policies on the economy.

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