Asia’s developed and emerging economies are both facing a common challenge following decades of rapid growth: how to address growing inequalities in wealth and income that are creating increasing social tensions and, in some instances, have the potential to threaten social stability.

While the problems require different solutions from one country to the next, all of Asia must address the need for inclusive growth, if the region is to keep itself on a path that is sustainable in the future.
Rising Inequalities in South Korea and the Search for a New Business Ecosystem

By Choong Yong Ahn

South Korea’s remarkable rise from the ruins of the Korean War to becoming a member of the OECD only decades later is well known. Less well known is how the social consensus and equity that underpinned that economic success have gradually come unraveled as the country evolved into one of Asia’s most unequal economies in terms of income and wealth distribution.

Choong Yong Ahn charts that history and points to a private-sector initiative and other policy options that could turn things around.

Just a few decades ago, South Korea was seen as a model — along with countries such as Taiwan and Canada — for achieving both growth and equity. In the aftermath of the Second World War, the Korean War virtually destroyed whatever economic infrastructure and social hierarchy Korea had inherited from the Chosun dynasty (1392–1910) and Japanese colonial rule (1910–1945). In the poverty-stricken, post-war economy of the late 1950s and early 1960s, most Koreans suffered from malnourishment and starvation. When South Korea embarked from scratch on the path to modern economic growth in the early 1960s, almost everyone was on an equal economic footing.

In the past half-century, South Korea has gone from being one of the poorest agrarian societies in the world to an advanced industrialized economy, joining the OECD in 1996. The country’s rapid industrialization and export-led development are often cited as an example of “compressed growth and transformation” in the developing world.

Then came the 1997-98 Asian financial crisis and 2008 global economic meltdown. Both hit South Korea hard; it quickly showed serious symptoms of slow growth, low employment and rising income and social inequality. Today, South Korea must reinvigorate its slowing economy while addressing rapidly growing income inequality and pursuing inclusive growth strategies.

ChAebols And CompressEd Growth

South Korea’s rapid industrial growth began with the first labor-intensive exports of wigs, plywood and apparel in the early 1960s. Its modern growth model entered a new phase in the early 1970s with a shift from light manufacturing for export to heavy and chemical industries. The seemingly premature shift was motivated by an urgent need to upgrade the industrial structure in the face of labor-abundant competitors and to improve national defense capabilities after US President Richard Nixon decided to cut US troops stationed in South Korea by a third. At that time, the administration of President Park Chung-Hee (1961-1979) identified textiles, shipbuilding, automobiles, iron and steel, machinery, non-ferrous metals and chemicals as future strategic industries.

To meet the economies of scale and capital requirements for heavy and chemical industries, the government promoted the large conglomerates that came to be known as chaebols, which operate many business lines simultaneously and are often controlled by a single owner or family. The government provided a wide range of carrot-and-stick policies for the chaebols. Carrots typically included mutual loan guarantees and cross-shareholding schemes among subsidiaries of a single business group, so that chaebols could pursue the necessary specialization to compete in the global market with special and privileged bank loans while also diversifying with minimal risk.

President Park Chung-hee took the lead, together with Korea’s risk-taking and innovative entrepreneurs, in realizing the country’s industrial ambitions through the administered credit allocations of banks. These synergistic partnerships between the government and business in pursuing national objectives were significant. Despite global oil shocks and security challenges from North Korea, South Korea grew at an annual average of 8.4 percent from 1970-1996, one of the highest rates in the world. Given this government-business relationship, perhaps the most powerful “stick” for chaebols was the threat of losing subsidized policy loans if they failed to comply with state guidelines for investment and exports.

South Korea’s “compressed growth” model was an effective strategy until the mid-1990s. High growth provided job opportunities for those under disguised unemployment through an unlimited labor supply curve during the economic takeoff. Thus, the trickle-down theory was applicable to South Korean development to ensure both economic growth and equitable distribution. Among countries with a population above 50 million, South Korea became in 2007 the seventh to have a per capita income above the benchmark of US$20,000.

Large companies and smaller enterprises must work together to narrow the productivity gap by developing collaborative programs. Small- and medium-sized enterprises must be able to climb the growth ladder to a larger enterprise category.

However, from the late 1990s, South Korea’s high-growth model began to show some serious shortcomings, such as a “too big to fail” business culture and symptoms of high cost and low efficiency due to highly leveraged business expansion, especially by chaebols. When the Asian financial crisis erupted in 1997-98, South Korea had no choice but to seek financial help from the International Monetary Fund under stringent conditions as it drew the largest-ever sum of standby credit for a single country, US$54 billion. In return, the IMF demanded that Korea reform four inefficient...
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RISING INEQUALITY: GOLD SPOON VS. CLAY SPOON

South Korea’s high growth in the 1980s was accompanied by rather equitable income distribution, deviating from Simon Kuznets’ hypothesis of a necessary tradeoff between growth and equity. During the high growth period, the Gini coefficients for urban working households reached about 0.307 in 1980 and gradually declined, with little fluctuation, to 0.281 in 1995. But the unprecedented negative growth rate of -6.9 percent in 1998 during the Asian financial crisis resulted in massive unemployment due to the restructuring and downsizing of many companies with toxic assets. The economic crisis caused an upsurge in the Gini coefficient to about 0.320 by 2000.

With economic recovery and aggressive efforts to improve the public welfare system in the post-crisis period, the Gini coefficient dipped to 0.310 by 2009. However, the prolonged recession that followed the 2008 global financial crisis has kept the Gini coefficient at around that mark, as the country has been unable to return to the equitable distribution levels of the early 1990s.

South Korea’s rising income inequality was also accompanied by income polarization, which refers to income distribution in which the proportion of the middle-class shrinks and the distribution shifts heavily to two extreme poles of the income spectrum. Korea’s income polarization worsened during the Asian financial crisis. Polarization indices remained stable from 2001 to 2007, but they began to increase again on a larger scale during the global financial crisis beginning in 2008. Figure 1 clearly shows that South Korea’s middle-income class shrank from 64.8 percent in 1997 to 56 percent in 2010, the relatively short period of time in which the two financial crises occurred. The shrinkage of the middle-income group was accompanied by a major expansion of the high-income group and a relatively smaller ballooning of the low-income group.

Compared with other Asia-Pacific economies, between 1990 and 2013, the income share of South Korea’s top 10 percent increased by 16 percentage points, accounting for 45 percent of the country’s total income in 2013, which is the highest among the 22 countries in the region (Figure 2). In terms of the top 1 percent’s share of income in 2013, Singapore topped the list with 14 percent, followed by South Korea with 12 percent. The top 1 percent in Japan, Australia, Malaysia, and India owned around 9 percent of their nation’s respective income in 2013 (IMF study, 2016). The share of the top 1 percent in South Korea rose five percentage points over the period 1990-2013, the biggest hike among the countries studied. According to the IMF’s analysis, South Korea’s rising inequality can be attributed to three major factors: rapid population aging, large wage gaps between regular and non-regular workers, and occupational inequality between genders.

Due to worsening income distribution and rising unemployment among young job seekers, South Korea posted its highest-ever youth unemployment rate of 12.5 percent early this year. Young people complain that Korean society has returned to the pre-modern Chosun era, a time when rigid social stratification determined the course of one’s life. “Hell Chosun” became a self-scouring buzz-phrase as it seemed no matter how hard people try, they remain stuck at the bottom of the social ladder. The self-disparaging terminology underscores the depth of young people’s resentment and frustration at being jobless. Koreans once held to an old adage about a man being born with a spoon with which he could eat to survive. The offspring of the wealthy were “gold spoon children.” Those of the poor were “clay spoon children.” Income inequality tends to lead to inequality of opportunities, especially for education, healthcare and financial services, thus the feeling of being stuck with the clay spoon.

The concentration of economic power has also deepened income distribution inequalities. Total sales from just four large conglomerates (LCs), or chaebols, namely Samsung, Hyundai Motor, LG, and SK, now account for 60 percent of the country’s gross domestic product, although GDP is estimated by value added, not by sales. About 10 years ago, the share of these four LCs was about 40 percent. In addition, people in South Korea tend to feel insecure if they are not on the permanent payroll of a large company, in the civil service or fortunate enough to have been born with “gold spoons.” Those who lose jobs typically take out loans to open bakeries or fried chicken shops. Their businesses are often not profitable and soon close down in the face of rising debt. As a result, the good fortune of the wealthy fails to trickle down. The majority in the bottom half cannot afford to spend much, causing a critical weakening of domestic demand.

FIGURE 1 SHARE OF INCOME BRACKETS IN SOUTH KOREA
Source: KOSIS DB, Bureau of Statistics of Korea

FIGURE 2 SHARE OF INCOME TAKEN BY TOP 10%, SELECTED ASIA-PACIFIC ECONOMIES (2013 OR LATEST)

The BIG AND SMALL BUSINESS DIVIDE
A main source of rising income inequality in South Korea is an acute dichotomy between LCs and SMEs in term of productivity, salaries and the composition of regular/non-regular workers. Korea’s SMEs, relative to LCs, suffer from low productivity and low salaries and are dominated by non-regular workers. As a result of rapid chaebol-led industrialization, South Korea’s SMEs, ranging from self-employed and family-based micro-businesses to medium-sized firms and near-large enterprises, became multi-layered, technologically outdated and domestic-oriented.

Within manufacturing industries, South Korea’s
SMEs are symbolized by “9988,” meaning they account for 99 percent of the country’s total business establishments and 88 percent of total employment. The dichotomy between big and small businesses is very clearly seen in Figure 3. In terms of value added per worker, as seen in Figure 4, the performance of SMEs is less than one-third that of LCs. The low productivity of SMEs contributes to a wide salary gap between SMEs and LCs.

Seriously impacted by the Asian financial crisis and the current global economic downturn, South Korea has experienced a systematic economic slowdown, with an average growth rate of about 3 percent per annum between 2008 and 2015. This prolonged and unprecedented stagnation has worsened the gap between big businesses and SMEs, urban and rural communities and regular and non-regular workers, resulting in a shrinking middle-income bracket and increasingly acute income polarization.

In addition, South Korea’s SMEs have not been on an equal footing with LCs in setting transaction prices and costs. Both the informality and duality of the labor market impede access to well-paid and secure jobs and incomes. While labor market duality can keep unemployment low, non-regular workers typically earn less and have lower social insurance coverage, which contributes to high wage inequality and lower social mobility. Non-regular workers are much more prevalent in SMEs compared with LCs, another factor contributing to income inequality.

**INCLUSIVE GROWTH STRATEGIES SOUGHT GLOBALLY**

Given the global new normal, characterized by slow growth, low employment and subsequent income polarization, the leaders of major economies, advanced and developing, have started to discuss policy priorities for inclusive growth. Social and economic inclusion lies at the heart of the World Bank’s goals to eliminate poverty and boost shared prosperity.

The widening gap between rich and poor poses dangers in both developed and developing countries suffering from prolonged stagnation. The terms “warm capitalism” and “inclusive growth” have dominated recent meetings of the World Economic Forum in Davos, Switzerland. They have also been the focus of major IMF and OECD research reports. To revitalize economic recovery, many countries have been mobilizing both macro-fiscal and monetary policies. Typical examples are quantitative easing, zero interest rates and the early implementation of fiscal stimulus to boost economies and encourage domestic consumption.

US presidential candidate Hillary Clinton champions “inclusive capitalism and prosperity.” Market-oriented inclusive capitalism was pitched by former US Treasury Secretary Lawrence Summers, who joined Hillary Clinton’s team of policy advisors. Summers warned that unless there is serious government intervention, inequality and a lack of financial resources among those in the bottom half of the population will result in insufficient aggregate demand and a slowdown in gross domestic product.

In 2014, global entrepreneurs from more than 250 major companies joined hands with political and opinion leaders from 37 countries to spread the idea of inclusive growth at the Conference on Inclusive Capitalism, held in London. At the conference, IMF Managing Director Christine Lagarde stressed that inequality would hamper growth and sustainability. The OECD also maintains that as inequality and poverty have worsened since the global financial meltdown of 2008, only inclusive growth can ensure sustainable global economic growth. The business concepts of self-restraint and sharing are catching on fast worldwide. Notably, a new business discipline has emerged at Harvard Business School that embraces the idea of “creating shared value” beyond “corporate social responsibility towards inclusive and sustainable growth.”

**SOUTH KOREA’S WIN-WIN STRATEGIES THROUGH CORPORATE PARTNERSHIP**

For the past eight years, South Korea’s economy has grown 2.95 percent annually on average, below the mid-3-percent potential growth rate. The prolonged slowdown has mass-produced jobless young people and worsened income disparities, endangering social unity. Restoring the benign cycle of invigorating the economy to cre-
ate more jobs has become imperative. For this purpose, the growth of leading sectors and the upper reaches of society must trickle down to the lower levels of society. But in the past decade or so, the South Korean economy has experienced several bottlenecks. One of the most serious appears to be the great dichotomy and weak linkages between chaebols and SMEs. Therefore, it is crucial that Korea upgrade relatively stagnant and inefficient SMEs to become more robust, and even globally competitive, companies.

Like other countries, South Korea has attempted to apply effective monetary and fiscal policies to raise growth rates, create jobs and boost domestic consumption. For example, there has been the early execution of fiscal projects, low interest rate policies and the provision of subsidies for new hires by SMEs. Government policy efforts should also focus on improving access to education, healthcare and financial services to reverse rising inequality.

South Korea has also started fostering a symbiotic business ecosystem in which LCs and SMEs can pursue mutual growth. During the high growth period, LCs and SMEs both played a sort of zero-sum game, where the winner took all. In contrast to the poorly performing SMEs, Korea's chaebols developed competitive global brand names. Under these circumstances, if South Korea is able to combine its relative strengths in technological leaders with overseas networks and Korean SMEs with great flexibility, new ideas, and strong potential as venture startups, Korea can help enhance SME innovation. Large companies and smaller enterprises must be able to climb the growth ladder to a larger enterprise category. Mom-and-pop stores and self-employed businesses should upgrade their efficiency to survive. Large companies now mostly pay primary subcontractors on time. But payments to second- and third-tier suppliers are still late. Payments that arrive on time at the primary subcontractors should be shared quickly with lower-tier suppliers. Such symbiotic capital flow is likely to strengthen SME manufacturing competitiveness and boost domestic consumption.

South Korea's chaebols are now into their fourth generation of management under the era of modern economic growth. As a result, Korea's micro and small businesses number around 7 million, constituting the country's grassroots economic base.

In order to enhance SME competitiveness and their complementary linkages with LCs, Korea established five years ago the Korea Commission for Corporate Partnership (KCCP), which aims to encourage synergistic partnerships between SMEs and LCs. I currently serve as chairman of the KCCP, which consists of 11 CEOs, each from South Korea's top chaebols; 11 heads of various SME associations who run their own companies; and six independent professionals from universities and think tanks. The SME representatives include medium-sized companies, micro businesses, venture business associations, female business associations and so on. The KCCP is a purely private entity for social dialogue to determine public mandates and it serves an important market-augmenting role by lessening information asymmetry between LCs and SMEs.

The KCCP carries out two major functions through consensus-based dialogue among its standing members. One is to designate SME-proper business sectors, in which LCs are urged to maintain their current market share, or in a few cases, refrain from entering the business while letting numerous SMEs compete for the rest of the market share. Examples of SME-proper businesses include rice cake, sausage, auto repair services and wedding hall businesses, to name a few. The other function is to produce a mutual growth index of large conglomerates based on their collaboration efforts with SMEs, including their sub-tier companies and independent SMEs, through judging fair pricing practices and timely payments for products delivered by SMEs, R&D collaboration, joint marketing exploration overseas and so on. South Korea's FTA partners account for 75 percent of world GDP. But only 15 percent of South Korean SMEs have been involved in the globalization process.

The KCCP is working with the Business Cooperation Foundation on a number of collaborative programs. These include a benefit-sharing program through joint R&D efforts between big and small companies under a pre-agreed framework, timely payment settlements for products delivered by SMEs, open purchase fairs hosted by LCs for SME products, joint venture startup collaboration and joint marketing overseas.

South Korea's signature development model, the Saemaul Undong, or New Community Movement, launched in 1970 by President Park Chung-hee to modernize the rural South Korean economy, helped narrow the livelihood gap between rural and urban communities. A similar spirit of self-help and co-operation could be extended to a new business ecosystem to be nurtured in the years to come, especially for SMEs.

The two financial crises taught South Korea the lesson that prolonged low growth can lead to higher unemployment and worsening income discrepancies. Against this backdrop, the country needs a change in the corporate environment along with macroeconomic policies to boost a lethargy economy.

Large companies and smaller enterprises must work together to narrow the productivity gap by developing collaborative programs. Small- and medium-sized enterprises must be able to climb the growth ladder to a larger enterprise category. Mom-and-pop stores and self-employed businesses should upgrade their efficiency to survive. Large companies now mostly pay primary subcontractors on time. But payments to second- and third-tier suppliers are still late. Payments that arrive on time at the primary subcontractors should be shared quickly with lower-tier suppliers. Such symbiotic capital flow is likely to strengthen SME manufacturing competitiveness and boost domestic consumption.

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