# The End of Egalitarian Growth in Korea:
# Rising Inequality and Stagnant Growth after the 1997 Crisis

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## Abstract

This paper examines rising income inequality and stagnant economic growth after the 1997 financial crisis and neoliberal economic restructuring in Korea. It argues that the egalitarian growth model was over as inequality in income and assets became serious and economic growth became slow since then. The labor market reform, corporate and economic restructuring, and more economic opening caused a rise in wage inequality, a growing disparity between household income and corporate profit, and that between industries. Rising inequality in the neoliberal growth model in the post-crisis period in Korea is likely to lead to a vicious cycle of high inequality and slow growth through several channels including repression on domestic consumption and human capital investment, and hindering development of inclusive institutions. This is exactly the opposite direction of the East Asian miracle. The author calls for active efforts of the Korean government for redistribution and re-establishing an egalitarian growth model with more social welfare and a democratic structural reform.

## I. Introduction

Korea was a paragon of the East Asian miracle for rapid economic growth and equal income distribution managed by the developmental state. It achievedspectacular poverty reduction for three decades since the 1960s in the egalitarian economic growth model. The Korean economy, however,went through a sea change after the 1997 financial crisis. Neoliberal economic restructuring and financial opening in the wake of the crisis transformed the economy to such a great extent that Koreans now suffer from rising inequality and insecurity. Not only did inequality rise but also economic growth became stagnant and volatile in the post-crisis period. This suggests that the structural changes of the economy finally ended the former egalitarian growth model and the new neoliberal growth model is in the opposite direction of the East Asian miracle.

Thispaper aims at examining the recent rise in income inequality in Korea after the 1997 financial crisis from the perspective of institutional changes in the growth model. It first investigates the egalitarian growth model in the past and causes of the financial crisis in 1997. Then, it presents how neoliberal restructuring ended the egalitarian growth model and how the new neoliberal growth model has deteriorated inequality and growth as well. Rising inequality is highly likely to hinder economic growth through channels such as stagnant domestic demand, higher social instability and concentration of political power, causing a vicious cycle of high inequality and lower growth. The author calls for more active efforts on the part of the government for income redistribution and establishing a new egalitarian growth model.

Section I presents key elements forrapid growth and equal distribution in Korea, including historical conditions and government policies. Section II discusses capital account liberalization that led to the 1997 financial crisis and neoliberal economic restructuring following the crisis. Section III examines how inequality and poverty became serious after 1997 and presents the causes for this change. Section IV discusses the limited role of the government for social welfare and emphasizes the need for an alternative growth model in Korea.

## II. Egalitarian Growth in the Miracle Periodin Korea

The Korean economy isknown for its rapid economic growth together withequal income distribution. Its growth rate had been higher than 6% for about four decades since the early 1960s. The miraculous economic development in Korea was led by successful state intervention such as strong industrial policy, and control of domestic and foreign capital. The government established a state-led financial system by nationalizing banks and setting up special financial institutions to mobilize financial resources, allocate them to priority sectors and take risk of investment(Cho and Kim, 1995). This system successfully promoted investment and economic growth. Its success was based on the 'developmental state', which was highly capable, relatively autonomous from interest groups, and was strongly oriented to economic development, different from many other developing governments (Amsden, 1989). In particular, the Korean developmental state was wise enough to support domestic big businesses, called '*chaebol*', effectively by mixing the market and state mechanism.[1]

Korea's income inequality had been lower than that of other developing countries. It clearly contributed to growth by lowering social instability and strengthening institutional capacity of the government (Rodrik, 1997).Figure 1 demonstrates high institutional quality is associated with inequality of land ownership after controlling for the level of growth. Equal distribution also prevented the Korean government from turning to populism and made it more development-oriented, opposite to Latin America. The Korean economy also succeeded in mobilizing resources thanks to equal income and asset distribution. Low inequality helped households to invest in human capital when the financial market was underdeveloped, and encouraged entrepreneurs to increase investment. It is certain that Korean workers worked hard and long with low wages and their struggle was repressed by the autocratic government in industrialization. But their real wages continued to rise together witheconomic growthand the rapidly growing businesses provided lifetime employment for workers.Thus, there was a virtuous circle of equal distribution and rapid growth in Korea, which can be termedegalitarian economic growth. Table 1 demonstrates Korea and East Asian countries achieved rapid growth and equal distribution simultaneously.

Table 1.

[1]The Korean government not only supported but also disciplined them by exchanging preferential credit with export performance and investment, providing a kind of 'contingent rent'. This could reduce unproductive rent-seeking and corruption.

Initial historical conditions and government policy were crucial to Korea's egalitarian growth. First, the Korean governmentimplemented progressive land reform, partly affected by a threat of socialism. It distributed land to a large number of tenants from between 1946 and 1950. The share of land with tenants fell from 65% in 1945 to 8% in 1951 and more than 1.6 million households came to own their land (Jang, 2004). The land reform spurred agricultural productivity and reduced power of landlords significantly, changing some of them into manufacturers. The Korean War in 1950 also made the distribution structure very fluid by shaking the society. These conditions helped the developmentalstate in the 1960s to be strongly autonomous from weakened landlords and businesses.

It should be noted that active policy efforts including encouraging education and avoiding economic instability contributed to egalitarian growth too. The governmentpromoted public education by introducing compulsory education for elementary schooling just after liberation and continuously expanding opportunities for education. The Park government introduced a reform to equalize junior schools in 1969, and high schools in 1974 by repealing entrance examinations. The secondary school enrolment ratio in Korea rapidly rose from about 40% in 1971 to 91% in 1985 along with a raise of government spending for education. Equal and widespread opportunities for education made an essential contribution to the egalitarian social structurein Korea (Lee, 1994). Sound macroeconomic management with low inflation and infrastructure development also contributed to both equal distribution and rapid growth, emphasized by other studies. A distinctive approach to external policyplayed another role (Singh, 1995). While promoting export-led industrialization, the Korean governmentpursued a strategic integration into the global economy by regulating imports and implementing capital controls. Domestic markets were protected by high tariffs and various non-tariff barriers,and foreign exchange rates were controlled to promote exports and restrain imports. Foreign direct and portfolio investment and foreign borrowings werestrongly regulated until the 1990s with several regulation measures such the compulsory use of domestic parts. These measures for managed openness and strategic globalizationcontributed to stability of the economy, leading toequal distribution and rapid growth as well.

Rapid economic growth after the mid-1960s, however, did not go hand in hand with equal income distribution. Inequality rose high in the 1970s along with uneven economic development that supported big businesses and supressed workers very harsh under strong dictatorship. The Gini coefficient went up and top income concentration became serious throughout the 1970s (Kwack and Lee, 2007; Hong, 2015) Economic stabilization policy and friendly international environments in the 1980s including Cold War and so-called three lows such as oil price, interest rate and strong yen helped to reduce inequality. In particular, the wave of democratization and struggle of workers in 1987 played an important role in more equal income distribution. Korean workers demanded and achieved rapid increases in wage higher than productivity growth by general strike after 1987. This resulted in a significant rise in household income and domestic demand after the late 1980s, which provided further momentum for growth. There was apparently a virtuous circle of growth and equality then. Overall,income distribution remained relatively equal internationally and functional income distribution did not become bad while the economic grew very fast over 30 years by the mid-1990s as the growth of labor productivity and real wage were not diverged in the long run. That is the outstanding feature of the East Asian miracle.

## III. The 1997 Financial Crisis and Neoliberal Restructuring

### 1.From Mismanaged Capital Account Liberalization to the Financial Crisis

The egalitarian growth model in Koreaworked superbly, but it came unravelled in the 1990s. It is ironical that falling inequality and rapid growth in the 1990s hid the emergence of structural problems of the Korean economy. Its own success weakened the former development regime as the change in the financial system and political economy by the late 1980s. In the financial market, non-bank financial institutions and the capital market grew rapidly throughout the 1980s, weakening government control over financing of the corporate sector. The *chaebol* wanted more freedom in their investment and financing and requested financial liberalization and the government could hardly discipline or regulate them in the early 1990s. Adominant free market ideology and political democratization made the government retreat from the economy, ending its industrial investment coordination policy in 1990. The most outstanding change was extensive financial and capital account liberalization from 1993, demanded by domestic big businesses and by strong external pressure (Lee et al., 2002). Thiscomprehensivederegulation of short-term foreign borrowing wasdangerous when the financial supervision system was weak(Cho and McCauley, 2003).

The aftermath of this mismanaged financial opening wasa surge in foreign capital inflows and financial vulnerability. Foreign debt rose from some $44 billion in 1992 to more than $120 billion at the end of 1997, most of which was due to rising short-term borrowings by financial institutions and firms (Lee, 2010a). This foreign borrowing financed the investment boom driven byaggressive investment spending of the *chaebol* in the early 1990s. While operating profitability of the Korean corporate sector was not significantly low, the mode of financing of chaebol companies was problematic since they relied on short-term foreign borrowings too much.[2] Financial institutions, mainly merchant banks,also became fragile owing to the term structure and the currency mismatch problem. In 1996, the external shock of the export market collapse dealt a hard blow to the Korean economy and several *chaebol* firms started to go bankrupt in early 1997. Finally, along with the contagion effect of the Southeast Asian financial crisis, foreign investors refused a rollover of short-term foreign loans. Then, the Korean economy plunged into the crisis leading to the bailout finance by the IMF in December 1997.As a cause of the crisis, many point to the problems of the government-led growth model such as crony capitalism andinefficient big businesses. There is, however, no strong evidence for this (Crotty and Lee, 2009). The cause of the 1997 financial crisis lay in careless financial opening and liberalization, which had much to do with the unravelling of the East Asian growth model (Singh, 2002).

## 2. Neoliberal Restructuring and Opening of the Economy

The 1997 financial crisis was a historical moment for the implementation of full-blown neoliberalism and financial globalization in Korea. The government accepted the mainstream view and carried out the IMF-suggested restructuring program. First, it introduced restrictive macroeconomic policy, raising interest rates very high, only to give up as of mid-1998. Nevertheless, the economic restructuring toabolish the old growth model and establish a more open and liberalized neoliberal model was far-reaching (Crotty and Lee, 2002). As for the labor market,new capital-friendly labor laws were enacted in February 1998 that legalized the layoff system to assist restructuring. Temporary help agencies were also made legal after July 1998 and temporary workers, dispatched to firms for up to two years, were allowed (Ministry of Finance and Economy, 1999). This flexibilization of the labor marketwas long demanded by domestic businesses but was not introduced until then. This sweeping labor market reformresulted in the increase of irregular workers and job insecurity, and weakening workers.

[2]For example, the share of the foreign debt in overall corporate debt rose from 8.6% in 1992, to 10.0% in 1994 to 16.4% in 1996, due to the rapid growth of short-term foreign borrowing by *chaebol* firms.

Financial restructuring included shutdown of insolvent financial institutions, cleaning up nonperforming loans, and applying strict prudential regulation. The government injecteda huge amount of public money into the banking system, almost 30% of GDP in the process in which about a half of financial institutions were shut down. In addition, the Bank for International Settlements capital adequacy standard was introducedin 1998. Financial restructuring brought about a severe credit crunchand worsened recession by a vicious cycle of reduction of credit, investment, wage and domestic demand (Crotty and Lee, 2002). Commercial banks had rapidly shifted out of shaky corporate loans into high margin household loans. Thus, financial restructuring enfeebledfinancial intermediation for the corporate sector as the share of corporate lending out of all loans fell from 65% in 1997 to 43.5% in 2004.The Koreangovernment announced five principles of corporate restructuring for *chaebol*including a reduction of debts, improvement of transparency and others in 1998. Following them, top 30 *chaebol* reduced their debt ratio from about 500% in late 1997 to less than 200% in 2000, further down to 118% in 2005.Ordinary profitability recovered rapidly after the mid-2000sover sales in the manufacturing sector recovered after 2002 from negative 1.8% in 1998, thanks to the decrease of the debt ratio. But a side effect of corporate restructuring was a decline in investment because of business conservatism along with the change of the economic system.

All-out financial opening of the Korean economy was anotherpillar ofthe structural transformation of the economy. The government repealed remaining restrictions on foreign investment in the capital market including foreigners' share ownership and those in corporate bonds, forward market and commercial papersin 1998. It also permitted hostile mergers and acquisitions by foreignersandtried to sell financial institutions to foreigners. The second phase of capital market opening plan in 2001 intended to promote full deregulation of foreign exchanges transactions and cross-border capital movements. These measures encouraged foreign investment into Korea strongly with inward FDI only $3 billion in 1996 and $8 billion in 1997 up to cumulative $31 billion in 1999 and 2000. Foreign portfolio investment also rose in general, especially on large Korean *chaebol* firms, but it was volatile.[3]Foreign borrowing fell dramatically following the crisis but that of financial institutions soared again in 2006 and 2007, associated with the forward exchange market transactions. The Korean

[3]Because of huge foreign capital inflows, the share of foreigner investors in total capitalization of the Korean stock market tripled between 1997 and 2004 from 14.6% to 42%. Foreigners as a group became the largest shareholders of many major firms such as Samsung electronics and Hyundai automobile and financial institutions, especially commercial banks. See Lee (2010a).

economy almost faced a currency crisis again in late 2008 when foreign financial institutions withdrew their lending in the middle of the US financial crisis.

## IV.RisingInequality and Stagnant Growth in the Neoliberal Regime

### 1. RisingInequality after the Crisis

The financial crisis and deep recession greatly aggravated income inequality and poverty in 1998, when the GDP growth rate recorded -5.7%. Mass unemployment due to bankruptcies of companies and layoffs led to a serious deterioration of income distribution as Figure 1 demonstrates. The Gini coefficient of market income among urban households with two or more membersrose from 0.264 in 1997 to 0.298 in 1999. It fell in the early 2000s along with the economic recovery but kept rising from 2004 up to the peak of 0.320 in 2009 in the recent recession. Inequality since the mid-2000s became even higher than that in 1999, reflecting the structural change of the economy toward a neoliberal model.[4]The Gini coefficient of disposable income also demonstrates a similar rise but the increase in social welfare spending made it lower.The relative poverty rate, that is the share of households that earn less than 50% of median income, also jumped from 8.7% in 1997 to 12.2% in 1999, and 15.4% in 2009.

Figure 2.

The rise in inequality was mainly driven by a relative fall of income of the poorest group in comparison with that of other groups. The survey of the government in the post-1997 period reports the increase in the gap between the bottom 10% and the median income group was much more than that between the top 10% and the median group(Choi, 2013).[5]The concentration of income by the top income group has also worsened in Korea abruptly after the 1997 crisis (Kim and Kim, 2014). The top 1%income share recorded 12.2% and the top 10% share about 44.9% of total incomein 2012 as Figure 3 shows.

[4]An examination of the long historical trend of the Gini coefficient reports that it remained constant throughout the 1980 after a rise in the late 1970s. It gradually fell after 1990 and its level was generally lower than that in the 1980s until 1997 (Kwack and Lee, 2007).

[5]In the early 1990s, both the bottom and top market income gap (D5/D1 and D9/D5) was about 1.8. But in 2009, the bottom gap is 2.6, while the top gap is 1.9. This is because of a sluggish income growth of the bottom group, while both the median and top income group continued their income growth. See Choi (2013).

Figure 3.

It is notable that income distribution started to improve after 2010. This may well reflect the recovery of the economy from the serious recession due to the global financial crisisin part. It is also associated with the recent decrease of the wage gap between regular and irregular workers after 2010 (Kim, 2016), and more importantly with rising social welfare spending for the poor, in particular the benefits of pension in the more recent period. But we should note the limit of the household survey because of underreporting of the income by the rich. In fact, the top income share including the top 1% and 10% did not fall but rise according to a recent study using the income tax data (Hong, 2015).Thus, the recent change is probably thanks to the increase of disposable income for the poor. Although we should watch if it will continue, it certainly suggests that the more effort for social welfare and reduction of the wage gap is essential to improvement of income distribution.

The other aspect ofunequal distribution is asset inequality. One study reports that the Gini coefficient for assets rose from 0.61 in 2000 to 0.65 in 2007, much higher than that for income.It is reported that the top 10% households own 53.3% of all assets and 66.5% of all financial assets in 2007. According to Samsung Finance Institute, the ratio of assets owned by the top 20% and the bottom 20% households 19.5 for total assets, 12.1 for financial assets, and 23 for real estate in 2006, showing much higher inequality than income. A recent study using tax data reports that top 1% and 10% wealth share are 26% and 66% respectively in 2013, verifying very high concentration of wealth (Kim, 2015). Asset inequality worsened because of the real estate market bubble in the mid-2000s stimulated by the change in the financial system and deregulation sincereal estate is the most important asset.

Figure 4.

The most important factor to rising inequality were, of course, the financial crisis as such and neoliberal economic restructuring, particularly the neoliberal labor market reform(Bank of Korea, 2004). Korean firms took advantage of new labor laws by firing permanent workers and hiring cheaper, temporary workers. The strong influence of the logic of shareholder capitalism and the increase in foreigners' stock ownership prompted companies to care about short-term profit. Labor unions struggledagainst it, only to no avail, and the tradition of lifetime employment of key employees in Korea was over. The share of irregular workers rose after the crisis along with labor market restructuring. The share of unsecure workers including temporary and daily workersrose up to about 52% in 1999 from 43% in 1996 though it has been in decline gradually after 2002. Many argue that the share of irregular workers in reality is about 10% point higher than the official statistics.According to them, hourly wage of irregular workers ismuch lower. It constantly fell in the 2000s from about 56% of that of regular workersin 2000 toa mere 48% in 2010. Furthermore, there are large differences in working conditions and social welfare between regular and irregular workers. (Kim, 2016).

Wage inequality is the most crucial cause for income inequality since household income consists of mainly labor income. According to Choi (2013), about 80% of market income inequality in 2010 and almost all of the change in inequality from 1995 to 2010 is attributed to inequality in labor income. Another study also finds that the biggest element to increase overall inequality from 2002 to 2007was within the group of wage laborers(Kim, 2009).As for the causes of inequality within wage laborers, the status of workers, that is regular or irregular, was the most important in 2007, while factors such as education and gender made larger influences in 2002.

Of course, there could be many other factors in rising inequality in addition to the changes in the labor market. Mainstream economists emphasize that skill-biased technological change that increaseseducation premiumplayed an essential role in worsening income inequality in developed countries. Some empirical studies report that technological change has increased inequality also in Korea as the growth of unskilled workers' wage was in relative stagnation (Choi and Jeong, 2005). But it is difficult for technological change to explain the abrupt rise in inequality after the financial crisis. The polarized structure of the labor market after the 2000s was associated with the higher use of irregular workers and deindustrialization with the growth of the service sector, more than technological change (Jeon et al., 2006). The broad structural changes in the Korean economy toward a neoliberal model was an underlying cause of the rising inequality after the 1997 crisis.

## 2.The NeoliberalGrowth Model and Inequality

There were structural changes in the pattern of economic growth in the new neoliberal regime. The economic growth rate following the 1997 crisis became systemically lower than that prior to the crisis and more unstable as Table 2 and Figure 4 demonstrates (Crotty and Lee, 2005).

Table 2.

Figure5.

In the neoliberal growth model, investment, particularly facility investment, experienced a constant decline due to economic restructuring and stagnant domestic demand. The Korean economy quickly recovered after 1999 thanks to a rapid growth of exports and experienced a consumption-led boom in 2002. But it fell into a recession in 2003 because of the burst of the credit-card bubble. Economic growth was ledby exports afterwards, while domestic demand was stagnant. The Korean economy went through a serious downturn due to the global financial crisis after 2008, resulting in serious income inequality and poverty. It grew more vulnerable to external shocks because its dependence on foreign markets and capital rose. As the Korean government adopted aforeign-dependent-growth strategy together with depreciation policy, the trade dependency ratio rose from 55% in 1997 to 66.2% in 2004,and 96.7% in 2011. This made the Korean economy more unstable, as is the case of the recession in 2008. Instability of the economy hadmuch to do with all-out financial opening after the crisis and volatile and pro-cyclical movements of foreign investment.

The new neoliberal growth strategy required workers' wages to be repressed, and the labor market reform contributed to this. Since the wage growth was slow in comparison with labor productivity growth, the labor share in Korea fell sharply after the 1997 crisis. The adjusted labor share in Korea fell constantly from about 80% in 1996 to about 72% in 2003 and 68% in 2012, which deteriorated income distribution.[6]The disparity between growth rates of corporate profit and household income after the crisis in Table 3highlights unequal distribution of growth. The decline of the labor share, the increase in foreign exchange rates and the unequal changes in tax rates were behind this change (Kang and Kim, 2012). This suggests that the shared growth principle, a principal feature of egalitarian growth in the past, was long gonein Korea after 1997 without any trickledown effects.

Table 3.

[6] The revision of the labor share is essential in Korea since the share of the employee rose rapidly along with the fall of the share of the self-employed. It iscalculated by assuming that income of the self-employed has the same composition to that of capital income and labor income in the whole economy. Other revisions give similar results (Lee, 2015).

Changes in the financial system were important to the transformation of the growth model and rising inequality. Banks in Koreaactively expanded household lending afterfinancial restructuring, thereby encouraging the real estate market bubble. On the other hand, the liberalized and more open financial system, seeking short-term profitability, cut down corporate lending. Moreover, financial institutions reduced lending to small and medium enterprises (SMEs) more than to large companies, which caused a decline oftheir investment. It should be noted that foreign capital played a role in this change since foreign-controlled banks such as *Korea First*took the lead of this change(Bank of Korea, 2003). The increase in household lending, interacting with the real estate market bubble, however, increased household debt rapidly. The ratio of household debt to personal disposable income continuously rose from about 85% in 1996 to 158% in 2011. Its current level is higher than that in the US and is making the economy vulnerable.

It should be noted that the gaphas risen between large businesses in the export sector and SMEs in the service and domestic demand sector.The large *chaebol* companies gained from the export market boom in sectors such as information technology (IT),shipbuilding and automobile in the early 2000s, whilethe domestic demand sector where SMEs mainly operated was in recession (Mckinsey Global Institute, 2013). Moreover, the link between exports and domestic investment weakened recently,because ofthe growing IT industry that had high import dependence. The share of imports in equipment investment increased from 30.2% in 1998 to 51.7% in 2005 (Bank of Korea, 2006). In consonance with this dualized pattern of economic growth, *chaebol* companies have fared well, often at the cost of their subcontractor SMEs. The gap of profitability between large companies and SMEs has widened after 2002, and the growth of equipment investment of SMEs has been relatively low. The difference in wage and working condition also became larger. While the number of the employed in SMEs rose from 80.6% of all workers in 2000 to 86.8% in 2010, relative wage of SMEscompared with that of large companies fell from 65% in 2000 to 52.6% in 2011. Moreover, outward FDI from Korea has been rising mainly by the labor-intensive SME sector seeking cheaper labor costs. It skyrocketed from $5.1 billion in 2000 to $10.8 billion in 2006 and $25.6 billion in 2011. It is highly likely that this was harmful to unskilled workers in SMEs, and thus enlarging the income gap among workers.

In sum, structural changes in the growth pattern of the Korean economy after 1997 worsenedincome distribution and poverty. Wage inequality and insecurity of workers grew acute owing to this change as well as the labor market reform. As firms and banks became conservative and risk-averse along with the breakup of the former growth model, financial intermediation and corporate investment stagnated. Financial opening and high export dependence intensified this structural change. The former East Asian egalitarian growth model was finally over by the 1997 financial crisis and economic restructuring in Korea.

## V. The Role of the Government for Egalitarian Growth

In spite of serious inequality, the effort of the government to reduce itis still limited in Korea. It is true that the Korean government increased social welfare spending after the crisis. Reduction of inequality by the government in Korea is only about 7%, much smaller than the average of 25% in the OECD as Figure 6 shows (OECD, 2013).

Figure 6.

This is because the level of total government spending in the economy and the proportion of social welfare spending in total spending are much smaller than those in other developed countries. According to OECD (2016), public social spending in Korea was 10.4% of GDP as of 2016, less than half of the OECD average, 21%. Korea ranked as 34 out of 35 OECD. Public social spending out of GDP in Korea has indeed been increasing rapidly from 3.2% in 1995 to 4.8% in 2000, 7.1% in 2007, and about 10% in 2016 (OECD, 2016). Butits current level is still much lower than that achieved by other developed countries when their GDP per capita was similar to that of Korea. This is associated with the especially low pension spending, resulting in the highest poverty rate as high as 48.8% for the elderly in 2014 (OECD, 2016). The government plays little role for income redistribution since total taxes and the share of direct taxes are relatively low. The current level of social welfare is not enough to support the poor since relative poverty rate was about 15% of population but only about 3% of population is covered by this basic social despite enacting the National Basic Livelihood Security Act in the aftermath of the 1997 crisis (OECD, 2011).[7]

Given the reality, it comes as no surprise that many Koreans have demanded more social welfare and economic democratization. The conservative government, however, has not made much progress opposite to its rosy promise for them in the election of 2012. More active efforts of the government to reduce inequality are urgently called on because the

[7] Its share was 3.2% of total population in 2006 and 2009, but since then fell to 2.6% in 2014. The number of population fell from 1.57 million in 2009 to 1.33 million in 2014 (Ministry of Health and Welfare data).

Korean economy could suffer from stagnant growth because of rising inequality.Serious income inequality and disparity between the corporate and households could deter economic growth as a recent empirical study argues (Ostry et al., 2014). First of all, they could depress domestic demand and investment. Domestic consumption has been in stagnation recently in Korea, with its growth rate lower than that of GDP. A report from the Bank of Korea points out that marginal propensity to consumption in Korea fell significantly in the 2000s because of rising inequality and stagnant income growth (Nah et al., 2013). Inequality and income stagnation also resulted in a rapid rise in household debt and a fall of the personal saving rate at the same time. It is reported that more than half of the middle-income households are operating in deficit effectively (Mckinsey Global Institute, 2013). In this context, an increase in wage and more equal income distribution could spur economic growth by promoting aggregate demand strongly as a recent study estimates using a Post-Keynesian macroeconomic model (Hong, 2014).

Second, seriousinequality, particularly in assets, could be harmful to investment in human capital and productivity in the whole economy when the financial market is imperfect (Aghion et al., 1999).Education is the most important channel for inequality to be inherited and rising educational inequality lowers social mobility. While the private cost for education is already high in Korea, recent liberalization in the educational system would make inequality in opportunity more serious.[8] Rising inequality could also lead to social conflicts and instability, thereby hindering investment (Alesina and Perotti, 1996). Finally, inequality could generate concentration of political power, which blocks the development of inclusive political and economic institutions, doing harm to incentives for work and innovation (Acemoglu and Robinson, 2012; World Bank, 2005). Thus, the neoliberal growth model in Korea could cause a vicious cycle of inequality and lower growth and move the Korean economy in the opposite direction ofegalitarian growth of the East Asian miracle.

Therefore, it is about time that Koreans should re-establish the egalitarian growth model and promote a virtuous cycle of equal distribution and growth. The government should play an active role for income redistribution by increasing social welfare and implementing a progressive tax reform. In particular, more expansionary fiscal policy is called on for the Korean economy to prevent the looming stagnation and deflation. Though the Korean

[8]According to the OECD, the total expenditure for educational institutions as a share of GDP in Korea was 8.0%, higher than the OECD average, 6.3% in 2009. The share of private expenditure in GDP is about 3.1% in Korea, the highest in the OECD, compared with OECD average, 0.9%. But if we include a large amount of private expenditure on private preparatory schools and institutions in Korea, about 2% of GDP in 2009, it would be much higher in Korea.

government is half-hearted, there is much room to increase fiscal spending in terms of the primary balance and the low government debt ratio as Figure 7 shows. New macroeconomic research emphasizes that serious recession could lower aggregate supply due to the hysteresis effects, while fiscal expansion is crucial for stimulating demand and potential economic growth (DeLong and Summers, 2012).Strong fiscal expansion with more social welfare including housing and childcare in Korea could boost the economy in short run by promoting domestic consumption, and contribute to long-run economic growth(IMF, 2016). Besides, the Korean government should endeavor to reduce irregular workers, increase unemployment benefit and introduce active labor market policy.Strengthening the bargaining power of workers by encouraging organization of labor unions and enhancing workers' right, especially for irregular workers and workers in SMEs, would be essential to reduction of inequality.In addition, regulation of big businesses in an attempt to make the economy fair and managing financial openness to stabilize the economy are called on. The Korean economy should change the current neoliberal growth strategy dependent on exports to an alternative one dependent on domestic demand on the basis of equal income distribution. In terms of the institutional foundation for this change, Koreans should set up a democratic developmental and welfare state that overcomes problems of both neoliberalism and the government-led model through more participation of people.

## VI. Conclusions

The old egalitarian growth model in Korea finally came to an end after the 1997 financial crisis. The Korean economy has entered a neoliberal era since then, in which Koreans have experienced slow growth and high inequality. Inequalityin income and assets rose rapidly along with the rise of the disparity between regular and irregular. Industrial bipolarization also deepened, enlarging the gap between large *chaebol* companies and SMEs and that between the export sector and the domestic demand sector. The neoliberal growth model after 1997 not only deteriorated inequality but also made economic growth stagnant and unstable. It is highly likely that rising inequality could hinder long-run economic growth and produce a vicious cycle of high inequality and slow growth. What caused this gloomy change isthe transformation of the economic system by economic restructuring and opening followingthe 1997 financial crisis.

This post-crisis change was indeed shocking to many Koreans, who suffer from acute job insecurity and economic distress. Koreans passively accepted neoliberal economic restructuring pushed forward by the belief that the former government-led growth model was seriously flawed and liberalization and opening would stimulate economic growth. But what neoliberalism brought to Korea were rising inequality and stagnant growth,and this prompted Koreans to be concerned about inequality and demand for economic democratization and more welfare. This has made Koreans more expressive of their grave concern for inequality and social disparity. Koreans should learn precious lessons from their own development experience as well as from the global financial crisis. The Korean economy succeeded in both rapid growth and equal distribution, not only because of historical conditions but also active government policy efforts.Although it is impossible to return to the old developmental state model, Koreans need toestablish a new egalitarian growth model in which distribution and growth are in a virtuous circle. The new model should be more equal and stable, based on domestic demand rather than exports, and this calls for more active income redistribution efforts by the government. This egalitarian growth model requires Koreans to establisha welfare state and a democratic developmental state, which cannot be done without political mobilization.

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Table 1. Economic Growth Rates and Income Distribution in Selected Countries.

| | GDP growth rate, 1965-2003 (%)* | Gini coefficient for income, 1960-2000 | Gini coefficient for land in 1960 |
|---|---|---|---|
| Korea | 6.06 | 35.3 | 33.9 |
| Taiwan | -- | 30.1 | -- |
| Indonesia | 3.92 | 37.5 | 55.5 |
| Malaysia | 3.98 | 49.9 | 64.1 |
| Philippines | 1.23 | 48.5 | 56 |
| Brazil | 2.40 | 60.5 | 84.1 |
| Mexico | 1.75 | 54.4 | 60.7 |
| Argentina | 0.90 | 41.8 | 85.6 |
| South Africa | 0.64 | 49 | -- |
| Kenya | 1.27 | 63.8 | 75.0 |
| Turkey | 1.93 | 50.5 | 59.5 |
| Bangladesh | 1.00 | 35.9 | 41.8 |
| India | 2.54 | 30.8 | 61.4 |

Sources: World Bank Development Indicators, World Income Inequality Database.
Notes:
1) GDP growth rates are growth rates for per capitareal GDP.
2)The Gini coefficient for land ownership is for 1960, from Deininger and Olinto (2000).

Table 2. Economic Performance in Korea after the 1997 Crisis (%)

| | 93-97[1)] | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|---|---|---|---|
| Real GDP growth | 7.1 | -6.7 | 9.5 | 8.5 | 3.8 | 7.0 | 3.1 | 4.7 | 4.2 | 5.0 |
| Consumption growth | 6.5 | -10.6 | 9.7 | 7.1 | 4.9 | 7.6 | -0.3 | 0.4 | 3.9 | 4.5 |
| Fixed investment growth | 12.3 | -22.9 | 8.3 | 12.2 | -0.2 | 6.6 | 4.0 | 2.19 | 2.4 | 3.2 |
| Investment rate | 37.1 | 25.2 | 29.3 | 31.1 | 29.4 | 29.1 | 30.1 | 30.4 | 30.2 | 29.9 |
| Saving rate | 36.1 | 37.5 | 35.3 | 33.7 | 31.7 | 31.3 | 32.8 | 34.9 | 32.9 | 31.4 |
| Net export/GDP | -1.1 | 12.9 | 6.7 | 3.2 | 2.3 | 1.4 | 2.4 | 4.3 | 2.4 | 1.1 |
| Ordinary profit / sales | 2.2 | -1.8 | 1.7 | 1.3 | 0.4 | 4.7 | 4.7 | 7.8 | 6.5 | 5.7 |
| Debt ratio[2)] | 319.5 | 303.0 | 214.7 | 210.6 | 182.2 | 135.4 | 123.4 | 104.2 | 100.9 | 98.9 |

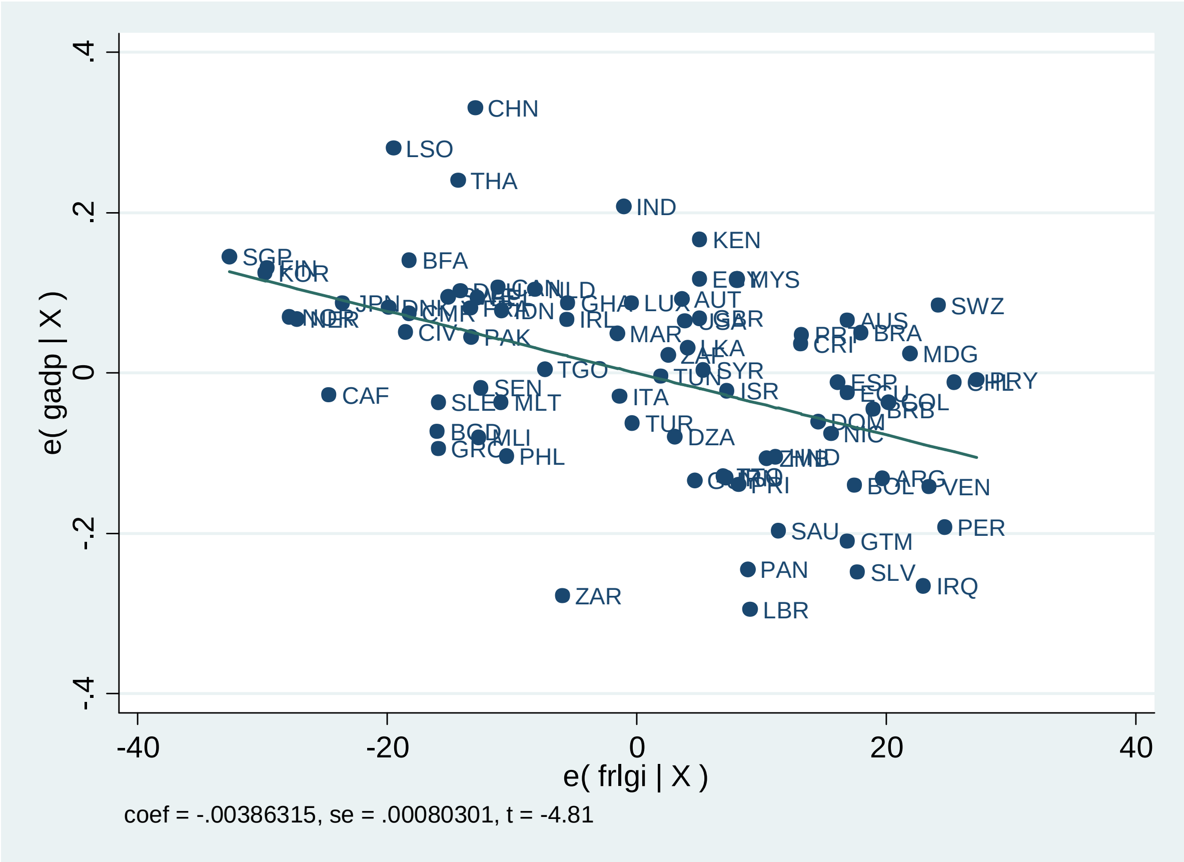
Sources: Bank of Korea, Ministry of Finance and Economy
Notes:
1) average value for 1993-1997.
2) profitability and debt ratio for the manufacturing sector

Table 3. Growth of Household Income, Corporate Income and GNI (%)

| | 1975-1997 | 2000-2010 | 2000-2006 | 2006-2010 |
|---|---|---|---|---|
| Household Income | 8.1 | 2.4 | 2.8 | 1.7 |
| Corporate Income | 8.2 | 16.4 | 14.9 | 18.6 |
| Difference | 0.1 | 14.0 | 12.1 | 17.1 |
| GNI | 8.9 | 3.4 | 3.8 | 2.8 |

Source: Bank of Korea, Kang and Lee (2012).
Note: Real annual growth rate

Figure 1. Conditional Correlation between Land Gini and Institutions

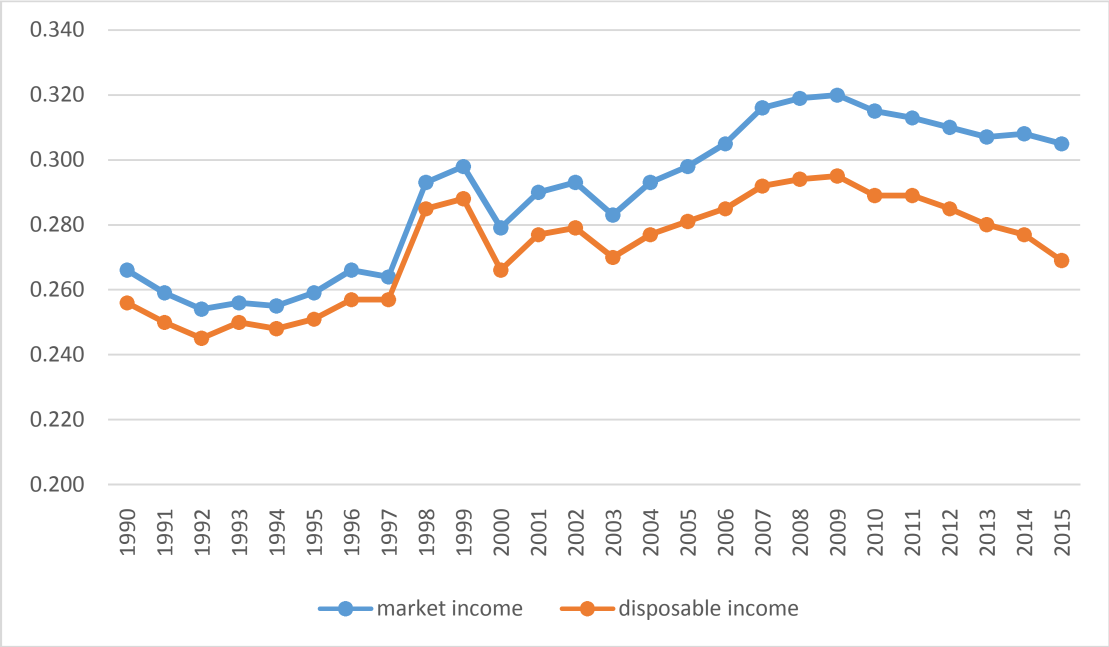



Notes:

1) Controlling for GDP per capita in 1970

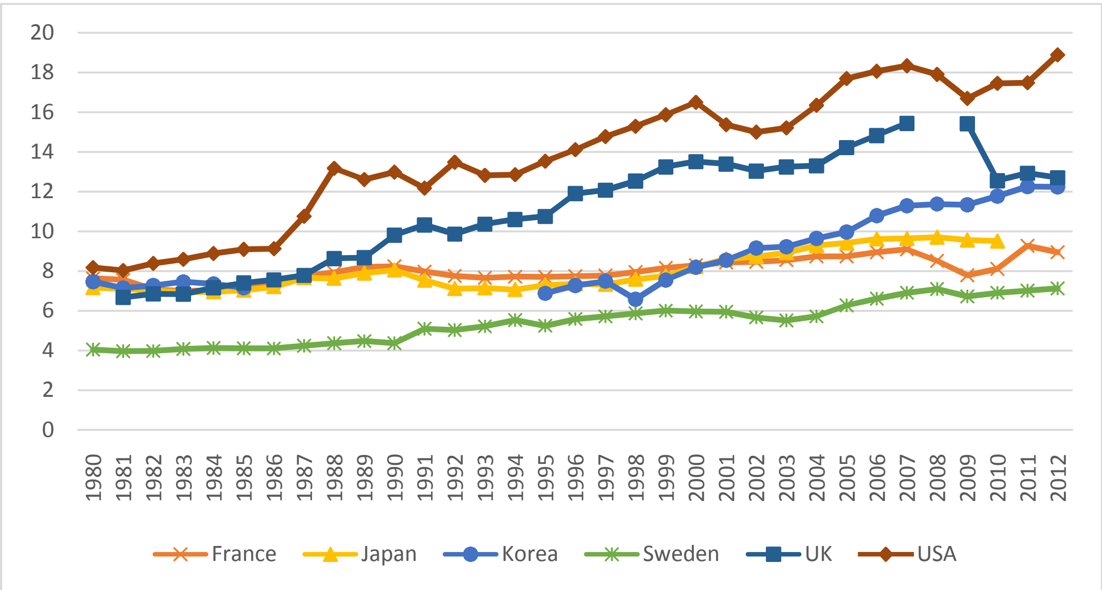
2) Land Gini for the 1960s, and institutions measured by GADP (government antidiversion policy) index, from Hall and Jones (1999)

Figure 2. The GiniCoefficient in Korea




Source: Statistics Korea
Notes:
1) For urban households with two or more members
2) The source is different from Table 1.

Figure 3. Top 1% Income Share in Selected Countries

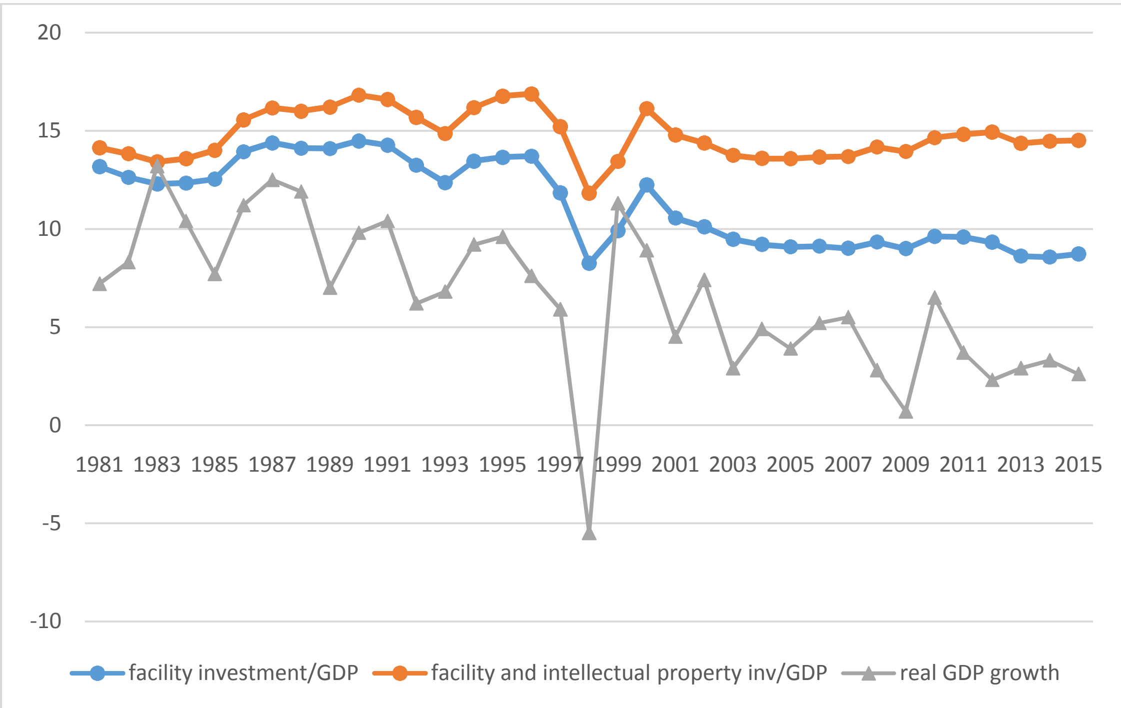



Source: Kim and Kim (2015), The World Wealth and Income Database

Figure 4. Gini Coefficients for Asset Ownership

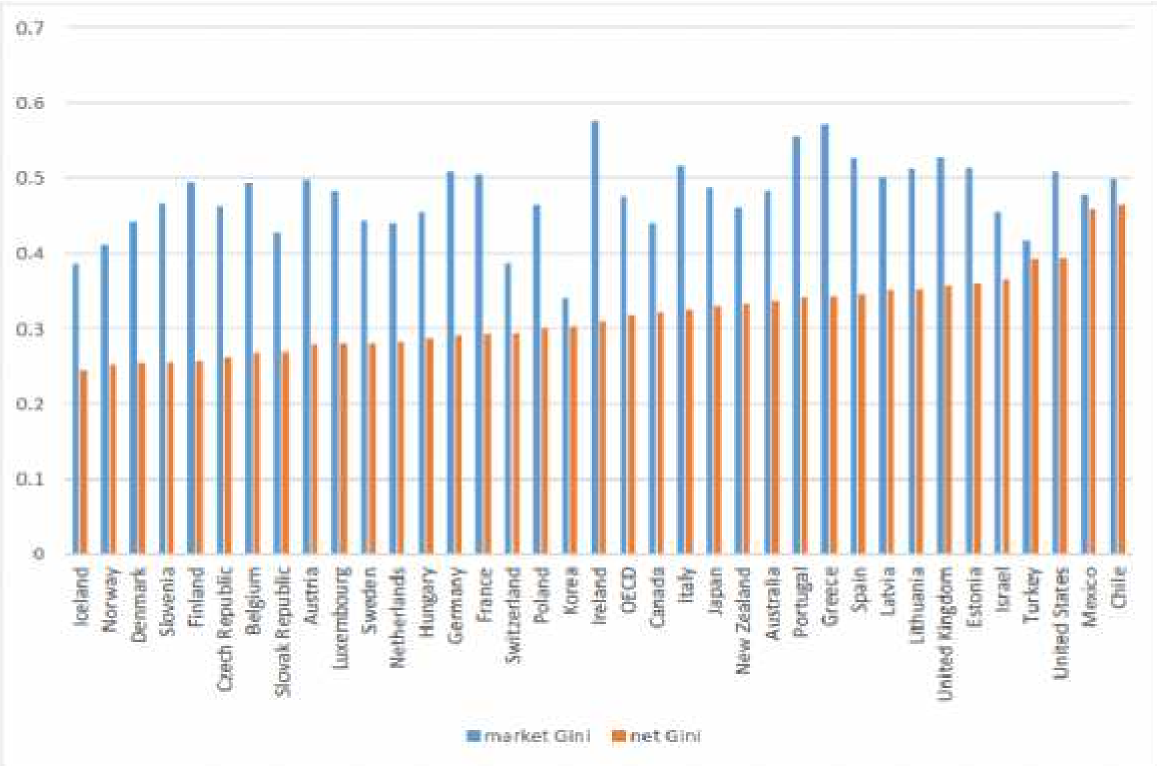

Source: KDLP, based on Labor panel

Figure5. The Economic Growth Rate and Facility Investment in Korea



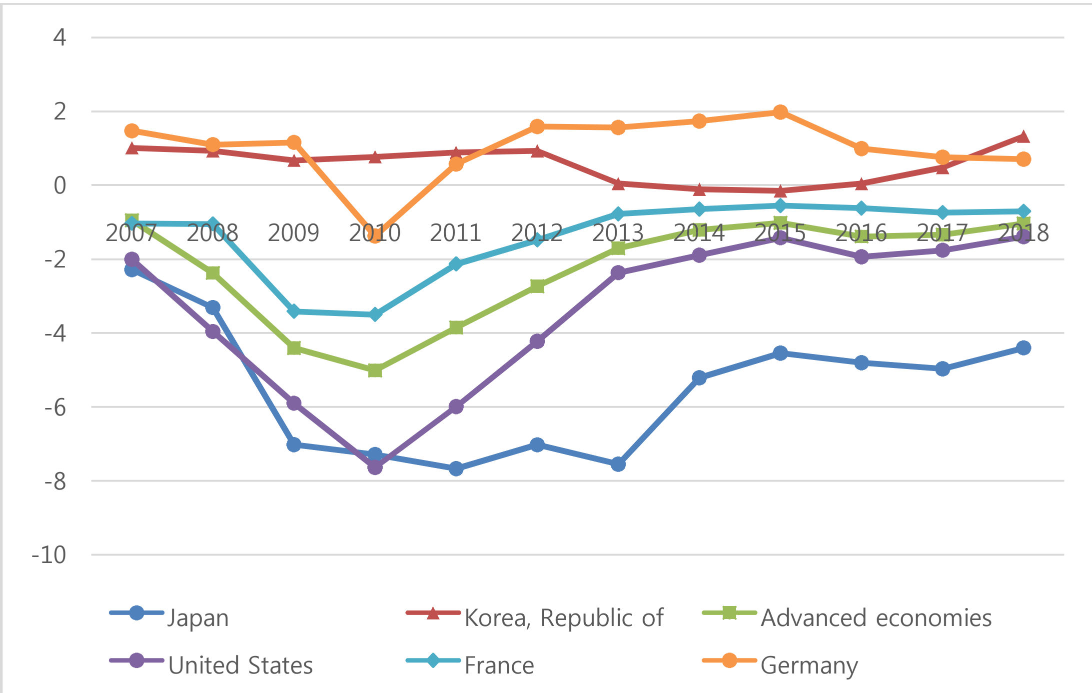

Source: Bank of Korea

Figure 6. Gini Coefficients before and after Taxes and Transfers




Note: Data for 2013
Source: OECD

Figure 7. Cyclically Adjusted Primary Balance out of GDP




Source: IMF, Fiscal Monitor Data