Sustainable Growth and Welfare Democracy:
The Prospects for Capitalism 4.0 in South Korea

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1. Introduction: Crisis in the Compatibility of Capitalism and Democracy

Until the global financial crisis that erupted in October 2008, the parallel development of democracy and market economy has been explained mostly by neo-liberal market economists. neo-liberal market economists insisted in chorus that the liberalization of trade and capital movement would promote the parallel development of democracy and the market economy.

In contrast, many social democratic activists counter-argued that what Anatole Kaletsky called Capitalism 3.3 or neo-liberal market fundamentalism has deepened inequality among the countries, regions, social classes, and between regular and irregular workers, and thus, seriously weakened the material base of democracy in both advanced and developing countries.
1. Introduction: Globalization and Democracy

The third group who advocates welfare democracy has argued that, once consolidated, mature democracy has never been collapsed but, on the contrary, has saved economically vulnerable people from economic crisis and inequalities by providing welfare compensation.

The compatibility of democracy and market economy has not been determined by ready-made correlations, but depends upon how relevant political actors make ‘right policy choices.’
1. Introduction: Globalization and Democracy

In this presentation, I will discuss the compatibility of market economy and democracy in South Korea.

My main argument is that it is welfare that sustains democracy and economic growth.
2. Contending Perspectives: Neo-liberal Economic Argument vs. Social Compensation Argument

The realization of fairness

‘Neo-liberal economists’
- social expenditure would obstruct the economic growth

VS.

‘Social compensationists’
- social expenditure promotes to some degree economic growth

“Social compensationists” have contended that democracy can coexist with neo-liberal globalization by sustaining a decent level of social integration through the provision of more social welfare.
2. Contending Perspectives: Neo-liberal Economic Argument vs. Social Compensation Argument

1) Neo-liberal Economic Argument

Comparative advantage theory argue that the wealth of all countries would increase if countries abolish trade barriers to foreign goods and if countries trade, barter and exchange goods and services with comparative advantages over trading counterparts.

Neo-liberal assumptions on ‘comparative advantage’ have been proven right by the fact that recently free trading countries accomplished faster economic growth than countries pursuing autarky under closed economy, like North Korea.
2. Contending Perspectives: Neo-liberal Economic Argument vs. Social Compensation Argument

1) Neo-liberal Economic Argument

- The size of government has to be as **smallest** as possible by reducing tax rate.
- State intervention distorts the equilibrium of economic system, retards economic growth, and obstructs the workings of the market. Thus, government provides **minimal assistance** for the market to work efficiently, and then lets ‘the invisible hand’ of the market run the rest of the economy.
- Government regulations obstruct luring investment from foreign capital such as global MNCs.
2. Contending Perspectives: Neo-liberal Economic Argument vs. Social Compensation Argument

1) Neo-liberal Economic Argument

- Government in the era of globalization has no choice but to reduce taxes and social welfare expenditures.

However,

- Fritz Scharpf: corporation tax has high magnetic permeability and strong positive correlation with investment rate and thus economic growth. (Scharpf, 1998)
- Scharf and social democrats conclude that neo-liberal argument for forfeiting full employment, social security, and equality to resuscitate economic vitality in advanced industrial countries have not fitted well in the cases of Denmark, Swiss, Austria and Netherlands.
2. Contending Perspectives: Neo-liberal Economic Argument vs. Social Compensation Argument

2) Social Compensation Argument (Argument)

- **Stolper & Samuelson**
  The wage gap between high paid skilled workers and low paid unskilled workers rises and social polarization will ensue in advanced industrial countries. (Stolper, W. F. & Samuelson, P. A., 1941)

- **Alesian and Perotti**
  Social instability is bigger and economic growth rate lower in countries with high gap between the rich and the poor than in countries with lower gap (Alesina and Perotti 1996; Keefer and Knack 1999)

- **Dani Rodrik (1997)** emphasized the importance of social welfare policy because of political and social instability that accompanies with trade liberalization even though it brings higher economic growth rate.
2. Contending Perspectives: Neo-liberal Economic Argument vs. Social Compensation Argument

2) Social Compensation Argument (Argument)

Geoffrey Garrett (1998) shows us that among OECD countries in which governments have promoted social welfare system in cooperation with organized labor have been maintaining better scores in the area of economic growth rate, employment, and price index than the countries which could not have pursued the social welfare policy steadily.

Social democrats:

Governments have to expand more social welfare policy when they try to pursue trade liberalization and financial liberalization.

With the provision of more social welfare, governments can pursue globalization more efficiently.
2. Contending Perspectives: Neo-liberal Economic Argument vs. Social Compensation Argument

2) Social Compensation Argument (Proofs)

"Golden straitjacket theory" (Thomas Friedman, 2001)

- Globalization narrows down nation-state's policy choice to "Pepsi or Coca Cola" (Friedman, 2001)

- While private capital can move to any place in the world without any control, democracy always sheds blood wherever private capital moves and democratic governments place "profits over people" in the era of globalization (Przeworski and Yerba, 2005).
2. Contending Perspectives: Neo-liberal Economic Argument vs. Social Compensation Argument

2) Social Compensation Argument [Proofs]

Przewoski: We should not rely on “golden straitjacket” but increase choices that people make autonomously by reinforcing democracy. Nonetheless, populism and plebiscitarianism which arose in reaction to technocracy and oligarchy are not the answer.

We have to make political choice which can heal side-effects of the growth under globalization and can cure and compensate for problems and costs accruing from that growth. It is crucial for our democracy to be upgraded (Przewoski and Yerba, 2005).
Since the global financial crisis in 2007-2009, the capitalist world economy has entered what Anatole Kaletsky calls ‘Capitalism 4.0.’

Capitalism 1.0 was a laissez-faire economy based on Adam Smith’s Wealth of Nations; Capitalism 2.0 gave government a pivotal role in macroeconomic management and the direction of industry; Capitalism 3.0 is regime of market fundamentalism that Thacher and Reagan inaugurated.

The neo-liberal market fundamentalism of Capitalism 3.0 created inequality, polarization, and deprivation but paid little attention to inequality.
3. Kaletsky’s capitalism 4.0

- After series of economic and financial crises, particularly global financial crisis in 2007-2009, Capitalism 3.0 has turned out to be incapacitated and Capitalism 4.0 has emerged as the alternative capitalism.

- Capitalism 4.0 rejects both laissez-faire economy of Capitalism 1.0 and market fundamentalism of Capitalism 3.0, while controlling government spending, preferring Keynesian stimulus to bolster demand, and concerning to mitigate inequality.
4. The Crisis of Capitalism 3.0 in South Korea

1) “Business-friendly” and Social Polarization

“Business-friendly”
- Tax reduction to the rich generated reverse income transfer from the poor to the rich
4. The Crisis of Capitalism 3.0 in South Korea

1) Business–friendly and Social Polarization

- Class structure in post-financial crisis in Korea shifted from “diamond-shaped” to “snowman-shaped” or “sandglass-shaped”
- The whole society disassembled into a “society without the waist.”
- Society-wide polarization has taken place in every area of income, property, employment, education, industry, and class.
Two methods measuring the gap between the rich and the poor:
- Wolfenson Index
- ER (Ebesten and Ray) Index

- Both show that the middle class in Korea has been shrinking.
The Korean middle class members are now shuddering about being unemployed since new flexibility system in labor market has been introduced by progressive Kim Dae Jung government in 1998.

Forced or voluntary layoffs became widespread after the financial crisis in 1997.

As private education costs have risen, many Korean middle class families gave up their dream to move upward to be upper middle class members and they are frustrated by the cold reality that only downward move is left in terms of status shift.
4. The Crisis of Capitalism 3.0 in South Korea

3) Polarization in Income Groups

Since global financial crisis in 2008, massive bankruptcies of small self-employed shop owners, tax reduction to the rich, sharp rise of unemployment due to recession have worsened the polarization between high income groups and low income groups.
4. The Crisis of Capitalism 3.0 in South Korea

4) Polarization in Education

- The gap of private education costs between low income family and rich family has increased steeply to 11.28 times in 2010 from 7.66 times in 2003 and 10.14 times in 2008 respectively.

- Since the financial crisis in 1997 as unemployment rate of the poor increased and their income has decreased, the poor have to cut down their private education expenses.
But, high-income families maintained or even increased private education expenses, polarization in education has worsened to make bad impact on future growth. (*Hankyoreh* 21, 2010.08.26)

Low childbirth rate has been rapidly diffused among low income families. As poverty has inherited to next generation, a class society has been solidified in Korea.
Since East Asian financial crisis, due to the introduction of labor market flexibility, irregular workers have rapidly increased.

While the portion of irregular workers had remained below 45% in 1998, the portion increased to 55.9% (7.37 million) in 2001, 55.4% (7.84 million) in 2003, 55.9% (8.16 million) in 2004, 56.1% (8.4 million) in 2005. (Choi Tae-uk, 2005: 82-83)
5. The Trilemma in Achieving a Fair Society

The Trilemma in Achieving a Fair Society

Budgetary Restraint

Christian Democratic Model
Earnings Equality

Social Democratic Model

Neo-liberal Model
High Employment

5. The Trilemma in Achieving a Fair Society

a) The Neoliberal Model

- Budgetary Restraint
- Earning Equality
- High Employment

0.16

(-2.1)
5. The Trilemma in Achieving a Fair Society

b) The Christian Democratic Model

Budgetary Restraint

Earning Equality

0.17 (-2.1)

High Employment
5. The Trilemma in Achieving a Fair Society

c) The Social Democratic Model

- Budgetary Restraint
- Earning Equality
- High Employment

0.05
(-1.9)
5. The Trilemma in Achieving a Fair Society

- **Neo-liberal model** creates irregular, unskilled, and low wage jobs that would have threatened the jobs of middle class and deteriorate income polarization between high wage worker of high-tech industry and low wage workers with insecure job stability.

- **Christian Democratic model**, new employment is restricted; government concerns only for raising income of already employed and organized workers; limits the creation of new employment; conflicts could occur between regular, organized workers and irregular, unemployed workers and polarization between regular and irregular workers would deepen.

- Under **Nordic model**, governments have to give up budget balance and as a consequence, the possibility of financial crisis would likely increase.

The trilemma among fiscal soundness, income equality, and increase in employment shows all governments that it is impossible to catch all these three rabbits simultaneously without sacrificing at least one rabbit.
Lee Myung Bak’s “Business-Friendly” Capitalism 3.0 policies worked positively for escaping from being contagious of Global Financial Crisis, but deteriorated polarization and brought middle and low income people’s “revolution at ballot box” in local elections of June 2010.

After reading people’s voice, Lee government changed the course and partially adopted Capitalism 4.0.
President Lee announced new policies at the National Independence Day Speech at August 15, 2010, that have been called the “Fair Society.”

Lee Myung Bak’s welfare policy has been characterized as a “supply-side” workfare.

It is not a demand-side welfare system that directly provides welfare to low-income families.

1) Fair Society

- but, supports low-income families to be self-reliant and self-sufficient by providing “micro-finance” supports such as “smile finance(미소금융),” “sunlight loan(햇살론),” and “hope seed-money(희망홀씨)”

- The policy focuses on “job creating welfare system”

- President Lee’s policy of constructing a “fair society” cannot be called to be a fundamental revision of his neo-liberal policy, but still a welfare policy of neo-liberal kind.

1) Fair Society

- Neo-liberal welfare policy could not create more jobs without causing income inequality and social polarizations.

- Lee’s “fair society” could not realize what John Rawls called “the difference principle of justice as fairness,” i.e., “to the greatest benefit of the least-advantaged members of society.” (Rawls, 2001: 59)
In his National Independence Speech at August 15, 2011 President Lee introduced “ecosystemic development” as a model to redress the limitations of Capitalism 3.0, i.e., widening income gap between rich and poor under “jungle capitalism” and those of Capitalism 2.0, i.e., worsening fiscal soundness of welfare state.

Ecosystemic development emphasizes co-prosperity, ethical management, greater corporate social responsibility, healthy local market ecosystem, more intervention of government into market.

Lee Myung Bak said “escape from jungle where survival of the fittest rules and head for a forest of co-existence and co-prosperity.”
Ecosystemic development is heading for a sustainable development in which national wealth goes hand in hand with individual wealth and economic progress should promote social cohesiveness. For mutual prosperity, vicious cycle of the rich becoming richer, the poor becoming poorer must be stopped and discrimination against non-regular workers must be minimized.

- Chaebul should pursue a win-win growth with small and medium companies, create more jobs, and take social responsibility for enhancing the quality of life.

- Green growth, or growth without damaging the environment is part of goals of ecosystemic development.
“Ecosystemic development” is the paradigm shift of MB-nomics from MB-nomics of Capitalism 3.0 to MB-nomics of Capitalism 4.0.

So far, Ecosystemic Development of Lee MB has not generated tangible results to readdress the limitations of Capitalism 3.0 and to realize the virtues of Capitalism 4.0. It has still remained a statutory declaration of the revision of the core of old MB-nomics which had been a mixture of “business-friendly” Capitalism 3.0 and old Keynesian public works projects (e.g., 4 Great Rivers Project).
1) Nurturing Middle Class

- An alternative to Lee MB’s neo-liberal model of Fair Society is a “golden triangle model” that harmoniously mixes welfare, workfare, and learn-fare to promote parallel development of democracy and market economy (Im, Hyug Baeg, 2006).

- Aristotle: the best democracy or what Aristotle called ‘polity’ can be realized by strong and numerous middle class citizens. Economically stabilized middle class prefers tolerance, compromise and more democracies. (Moore, 1996: 55)

- Re-nurturing middle class must be included in the key policies to make a fair society.
By strengthening learn-fare, we have to nurture and train customized high-knowledge, creative workers that can fit well to IT industry, high-tech industry, contents industry, and culture industry.

By imitating the case of CVT (Continued Vocational Training) in Denmark, we have to remake our workers creative, innovative, and high-skilled by learn-fare and thus transform them into multi-functional ubiquitous workers that can be employed and reemployed at anytime and at anyplace.
2) The Welfare for Workers

- The irregular workers have increased in number and most of them have worked in small and medium companies which are mostly sub-contract companies of large Chaebul companies.

- As a consequence, wage gap has widened not only between large company workers and small company workers but also between regular workers and irregular workers in large companies.

- Government should guarantee income stability in return for their concession for the introduction of the labor market flexibility, helps them to find jobs with active labor market policy or workfare, and reeducate and retrain them to raise their employability by providing them learn-fare.
In order to resolve social polarization and at the same time to resume sustainable growth, we need parallel development of innovative growth and distribution (Yu, Jong Il, 2006: 13-20).

The motive power of innovative growth is not material accumulation of capital but human capital or investment in manpower.
7. An Alternative Model for Fair Society In Korea

### 3) The parallel Development of Growth and Welfare

- Allocating government spending by shifting priority from economic development to social spending

- The state has to make structural reform in “growth-enhancing redistribution policy.”

- **Industrial cooperation and sharing** should be strengthened by making **win-win network** between large companies and small and medium companies

- The human resource development of the disadvantage group exposed to the poverty has to be planned.
Korean democracy since 1987 has been unable to make progress toward an advanced welfare democracy.

When measuring social welfare level in terms of “welfare state generosity” rather than conventional social spending, we cannot find a definite tendency of increase in social welfare (1990-2007) under democratic governments (Lee, Dae Jin, 2010).

Also we found that progressive governments of both Kim Dae Jung and Roh Moo Hyun could neither reduce income inequality nor contribute positively to the realization of a fair society.

As a consequence, the advent of welfare democracy has been delayed.
8. Conclusion

As traditional welfares such as family welfare and company welfare in Korea declined with rapid proceeding of aging society and nuclear family,

Government has to take more important role than family and market in providing welfare.

Therefore

- As market fundamentalism of Capitalism 3.0 became obsolescent, we need some kind of Capitalism 4.0.

- A social welfare system with the state taking key role becomes not choice but precondition for realizing compatibility of sustainable growth and welfare democracy in South Korea.
THANK YOU