

# Income-led growth policies in the past year

June 29, 2018

Won Jun Nah

Kyungpook National University

# Contents

- Some theoretical issues
- Policy arrangements for income-led growth
- Performance and evaluation: Labour policy
- Performance and evaluation: Wage policy
- On the recent employment condition
- On the recent amendment to the Minimum Wage Act
- Performance and evaluation: Complementary policy measures

# Some theoretical issues

# Genesis

- Wage-led growth paradigm in the history of economics: Were the recessions in the 1970s supply-side crises?
- Basic representations of idea as a growth model in the 1980s: Rowthorn, Dutt, Blecker, etc...
- Generalization of the principle of effective demand to long run growth

# Inclusive, pro-poor growth?

- In what aspects wage-led growth distinct from pro-poor growth of the World bank in the 1990s or inclusive growth of the recent IMF and OECD?
- Wage-led policies intervene in the distribution of primary income between labour and capital.
- The relevant target is wage share. Success of wage-led policies hinges on raising wage share. Supports for the bargaining position of labour is at the core of policies.

# Wage share as a target?

- What does determine it?
- Stockhammer (2012): Technology factor can explain only a part of the decline in wage share across the globe.
- Possibility that we can correct inequality by interventions in the form of policies and institutions.

# Cyclops?

- Does wage-led growth theory have only one eye?
- Post-Keynesian emphases on hysteresis and path-dependence: The warrant growth path is affected by the historical development process itself, which is shaped by various factors including demand.
- The hypothesis that potential rate of growth is not related to demand disturbances has been challenged.

# Demand and Supply

- Neoclassical AD and AS are orthogonal with each other.
- Post-Keynesian concepts of demand regime and productivity regime are AD and AS viewed in relation to functional income distribution, respectively.
- But, they are inter-dependent and determined simultaneously.

# Employment regime

- Keynes once argued that lower wages curtail effective demand and thus employment.
- Employment regime is wage-led when the demand regime is more strongly wage-led than the productivity regime is.
- Empirical results are not definite: Storm and Naastepad (2013), Stockhammer and Onaran (2013)

# Should employment constrain wage-led policy?

- Full employment is the most important objective of general macroeconomic policies. Employment should be managed carefully not to hurt growth potential, while pursuing income-led policy.
- However, wage-led growth strategy does not require a faster growth in employment. Employment expansion itself is not a relevant target variable for wage-led policy.

# Considering overhead labour...

- Due to the presence of fixed overhead labour costs classified as ‘compensation of employees,’ a rise in growth tends to be associated with a fall in wage share statistics in the short term.
- Therefore, the conventional method of determining growth regime seems to be biased toward profit-led regime.

# ‘Wage-equality-led’ growth

- Two strategic objectives: raising wage share and reducing wage inequality
- The more equal the wage distribution is, the stronger the wage-led nature of the growth regime is.

# Policy arrangements for income-led growth

# Primary measures

- Policy interventions should be to target the distribution of primary incomes between labour and capital.
- Primary measures are to support the position of labour and to increase reservation wages.
- Reinforcing basic labour rights, Institutionalizing bargaining structures, Protecting non-regular and unorganized labour, Raising minimum wages

# Complementary measures

- Complementary policies are to control various factors that potentially affect wage share.
- Redistribution policies : Social safety nets and unemployment benefits which affect reservation wages
- Solidarity wage policy and industrial policies to promote ‘economic democracy’
- Job creations
- Demand management

## **An idealized policy arrangement for wage-led growth**

[1] Primary policy instruments : Labor policy and wage policy

- Strengthening basic labor rights
- Institutionalization of bargaining structures
- Minimum wage raise
- Protection for non-regular and unorganized labor, Conversions of non-regular workers to regular positions

[2] Complementary policy instruments : Institutional complementary measures for managing variabilities of wage share

- Welfare policy and unemployment insurance
- Economic democracy
- Labor policy: Solidarity wage policy
- Employment policy: Enhancement of public sector employment
- Trade Policy: Expansion of domestic demand base
- Financial policy: Establishment of democratic controls by citizens upon financial activities and international capital movements
- Demand management: Expansionary fiscal policy

[3] Supply-side policies that combine traditional growth policy tasks

- Expansion of public investments for human resources development and strengthening of public education and vocational education
- Employment policy: Active labor market policy
- Innovation growth policy

## **Three detailed tasks for income-led growth of the incumbent administration**

### [1] Increases in household income

- Minimum wage raise
- Reduction in key costs of living such as expenses for housing, medical service, transportation, communication and education

### [2] Ensuring adequate income for vulnerable households by expanding social safety nets

- Expansions of national basic social security system, and of EITC (earned income tax credit)
- Improvement of unemployment benefit protection, raising the payment from 50% to 60% and extending the payment period by one month
- Income support by life cycle, increasing child allowance, youth employment promotion allowance, and senior basic pensions

### [3] Strengthening the income base of households by expanding human capital investment

- Customized education, support educational expenses for low-income class, vocational education, industry-college cooperation cluster

# Features

- Pursuit for an alternative growth instead of unconditional ‘growth-first’ view based on trickle-down economics
- Focuses are on securing the income base of ‘general households.’
- A considerable amount of time seems to be required for our society to change in its constitution and to secure institutional affinity through new structuring. In this respect, there should not be any ambiguity in the vision for income-led growth.

# Questions

- How can the measures for economic democracy and chaebol reforms can placed within the framework of income-led policies?
- What is the relationship between innovation growth and income-led growth?
- What role is given to the labour-centrality?

# Performance and evaluation: Labour policy

# Labour rights

- No progress in the ratification of ILO core agreements and the improvement of the legal system for it
- No progress in the institutionalization of ‘beyond-firm-level’ bargaining structures: Need to consider a ‘collective agreement extension system’
- No progress in the institutionalization of workers’ participation in the decision making of some relevant policies

# Turning non-regular workers to regular positions within public sector

- A big step forward: Unprecedented number of conversions
- Principle of restricting non-regular employment abuse
- Principle of direct employment of regular workers
- Definition of ‘ordinary and continuous’ works
- The workers indirectly employed are not excluded from the conversions.

# Turning non-regular workers to regular positions within public sector

- Wide scope for exceptions to the conversion
- Failures in correcting wage inequality: Most of the conversions were shifts to the unlimited-term contracts.
- Less than 3% benefited out of all non-regular workers.

# Turning non-regular workers to regular positions within public sector

- Indirect employment using subsidiaries is allowed as a way of conversion.
- This leaves the dual structure of the public sector labour market unchecked.
- Private sector will prefer to choose the same way in conversions following the precedent of the government.

# Turning non-regular workers to regular positions within public sector

- Employee representation on board
- Corrective system against discriminations
- Regulations to reduce the opportunities for abusing indirect employment

# Amendments to the Labour Standard Act

- Change in the maximum working hours per week from 68 to 52
- An effort of social transformation to restore the balance between work and life, which was lost in long hours of work

# Amendments to the Labour Standard Act

- Disadvantage to workers: No more double premium for holiday work
- Likelihood that this regulation will become ineffective: Without double premium, employers have an incentive not to comply with the rule.

# Amendments to the Labour Standard Act

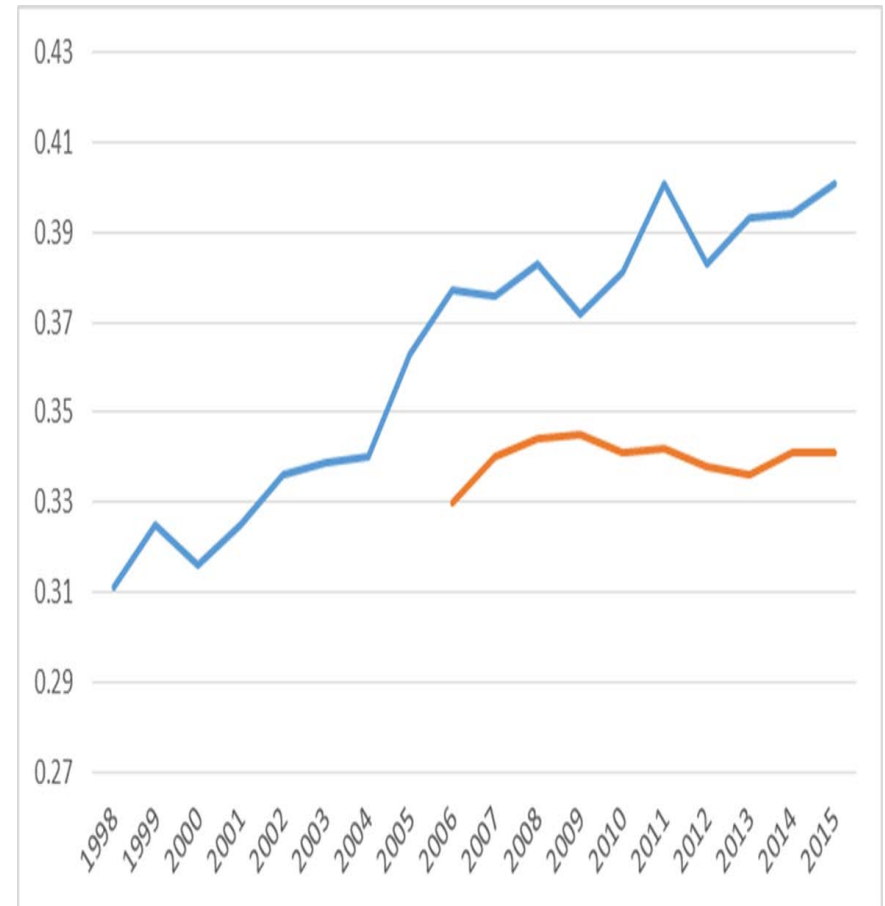
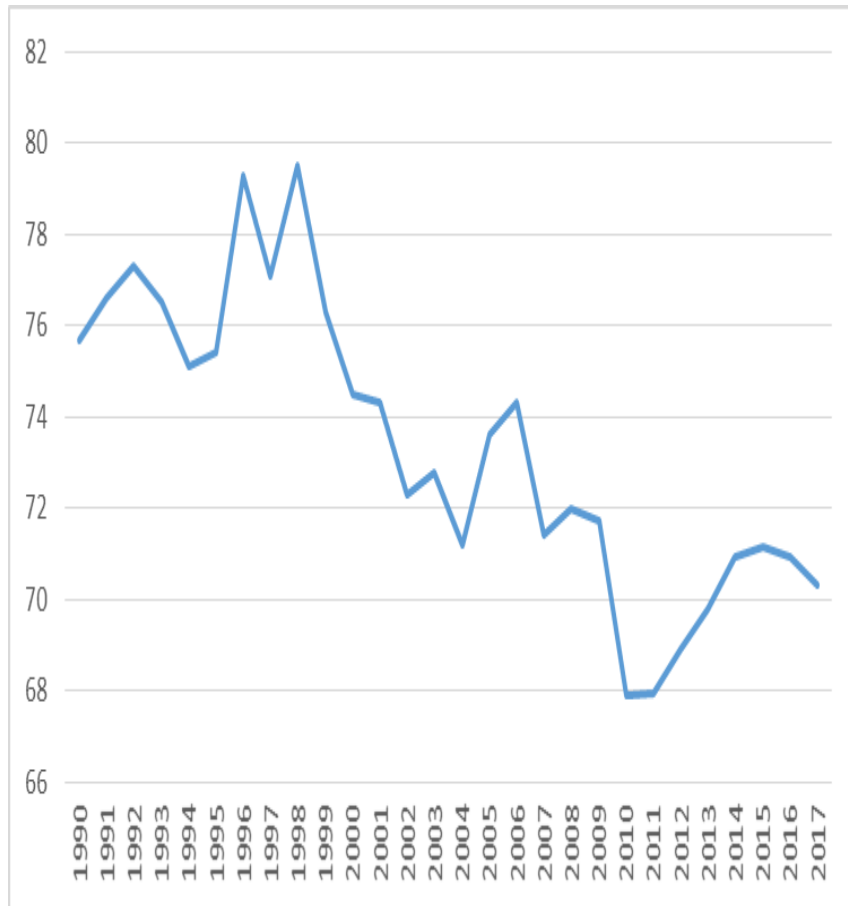
- Labour inspection system
- Enforcement by increasing employers' burdens on non-compliance

Performance and evaluation:

Wage policy

– Minimum wage raise of 16.4%

# Trends in income distribution: wage share (corrected, left) and Gini coefficient (corrected, right)

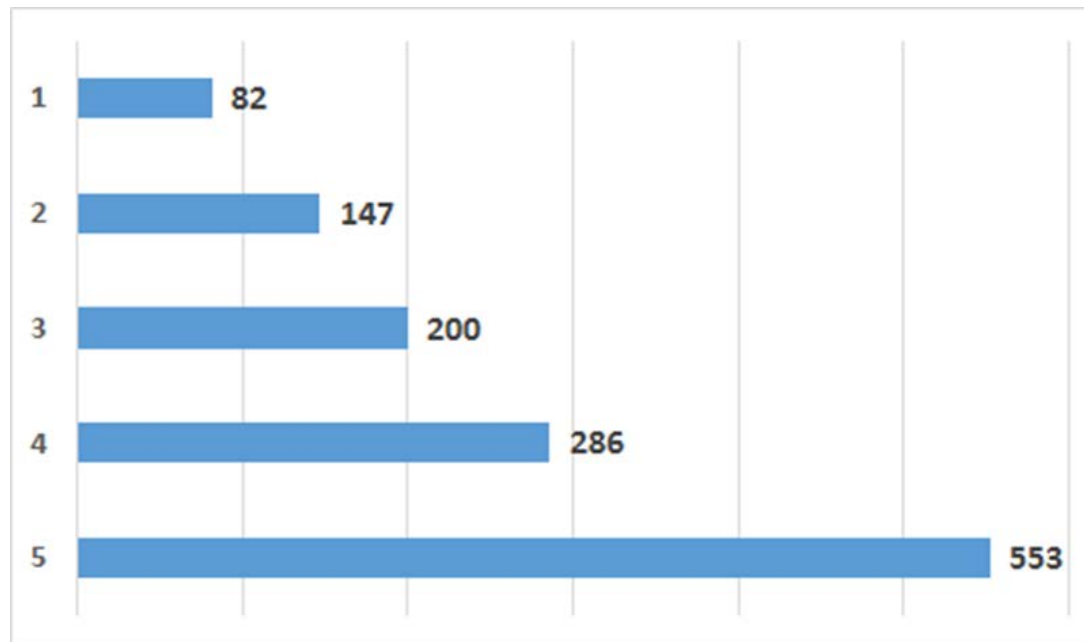


# Background

- A number of minimum-wage workers are a key source of income in their households: More than 60% of minimum-wage-earner are responsible for the households' livelihood by herself/himself (*NSO Household survey and KLI*).
- In 2016, monthly avg. cost of living amounts to KRW 2.7mn for 2 persons, KRW 3.4mn for 3 persons, and KRW 4mn for 4 persons (*Minimum Wage Council*). Compared to this, monthly minimum wage in 2018 is KRW 1.57mn.

# Wage distribution

- Avg. monthly wage of total 15.35mn workers is KRW 2.53mn.
- Avg. monthly wage per quintile (unit: KRW 10thn)



# Wage distribution

- From the 1<sup>st</sup> to 4<sup>th</sup> quintile, it is hard for an individual worker to bear the full cost of living for 3-person households.
- About half of workers are not earning enough for the livelihood of 2-person households.
- The proportion of low-wage workers is significant.

# Wage distribution

- Right-skewed and left-leaning distribution: Median wage is lower than average wage.
- Bias may be involved in discussing the adequacy of the level of minimum wage based on some percentage of median wage.
- The most important criterion for the adequacy is the actual conditions of life for low-wage workers.

# Vertical subcontracting structure

- Vertical division of labour between contractors and subcontractors
- A typical firm's capability to pay wages and a typical worker's wage income depend on the position in the vertical structure.
- Chaebols or public corporations are usually located at the very top tier. After them, the first vendors go next, and then the second vendors follow, and then the third vendors go under them, and so on.

# Vertical subcontracting structure

- Vertical structure as a hierarchy: For example, treatments for the workers in the second vendors should not be worse than those for tertiary subcontracted workers.
- It is known that large firms with more than 300 workers including in-house subcontractors and public sector are responsible for about 60% of the total employment.

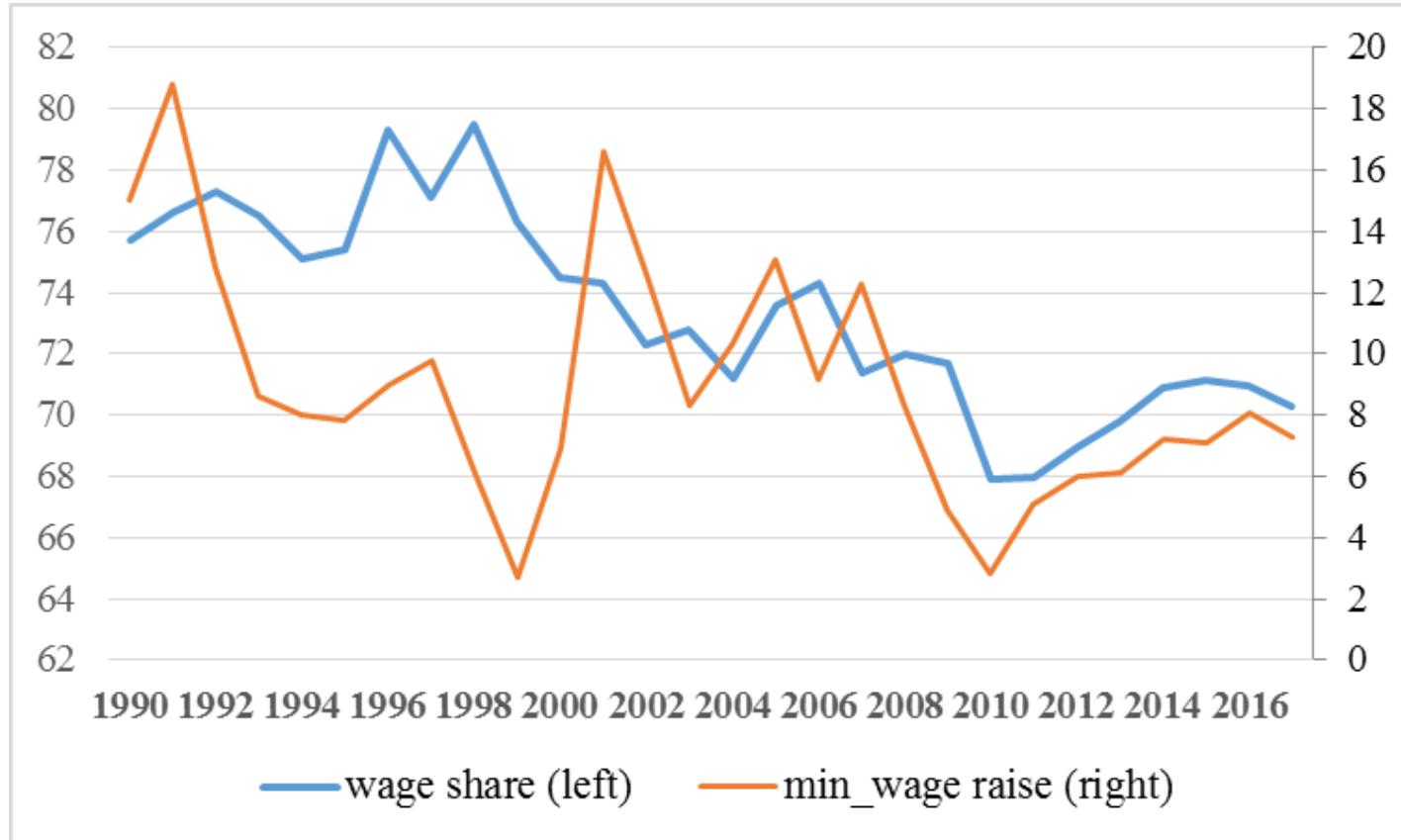
# Amplification mechanism

- *Skewed wage distribution*: The effected range of minimum wage raise is larger when wage distribution is more skewed to the right.
- *Vertical hierarchy*: For example, if the effects of minimum wage raise are directly received by the third vendors, wages in the second vendors also rise due to hierarchical order.

# Minimum wage raise: a key tool

- Due to these two structural causes, the minimum wage raise can be a powerful policy instrument in targeting wage share in Korea.
- Reflecting this, since 2001 when the minimum wage has been extended to all workplaces, the close match is found to exist between wage share and the rate of minimum wage raise.

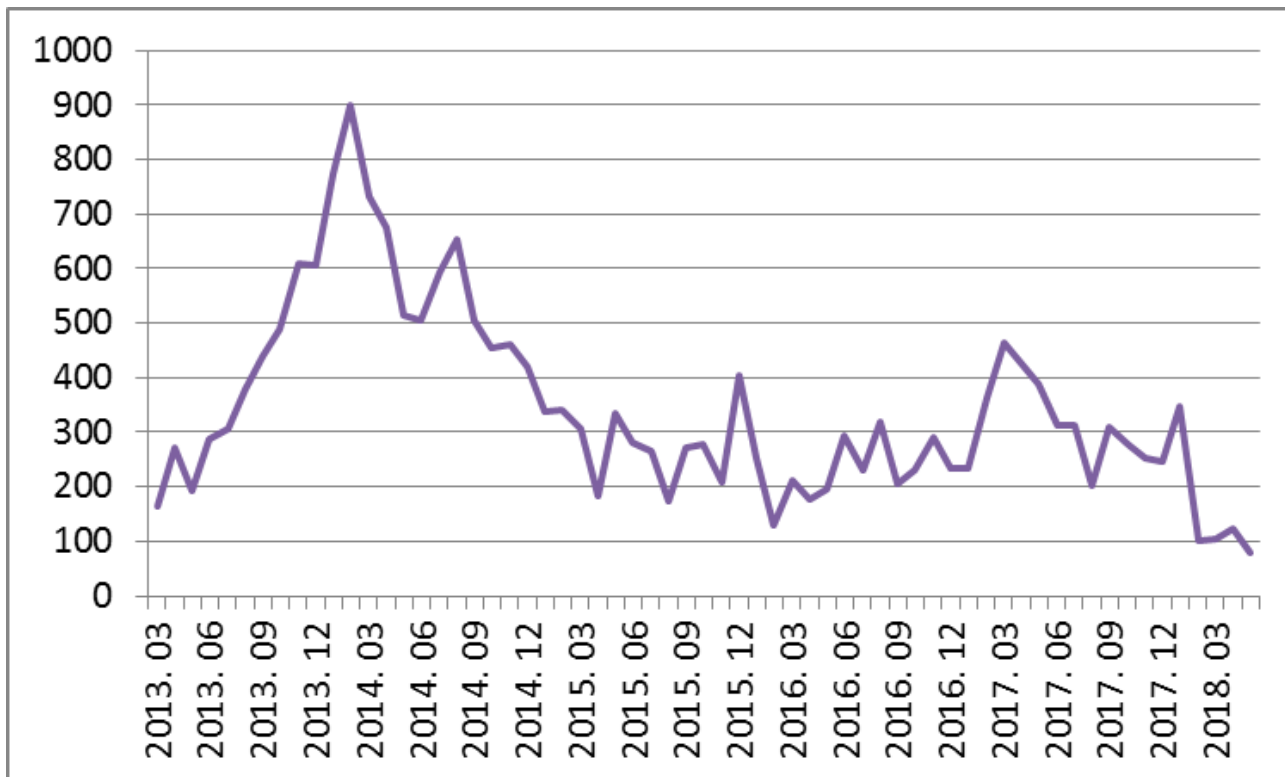
# Minimum wage raise: a key tool



# On the recent employment condition

# Employment situation

- The increase in the number of employed workers over the last year dropped to 78 thousand persons in May.



# Decomposition

- We decompose changes in employment into two parts, which are population factor and employment rate factor.

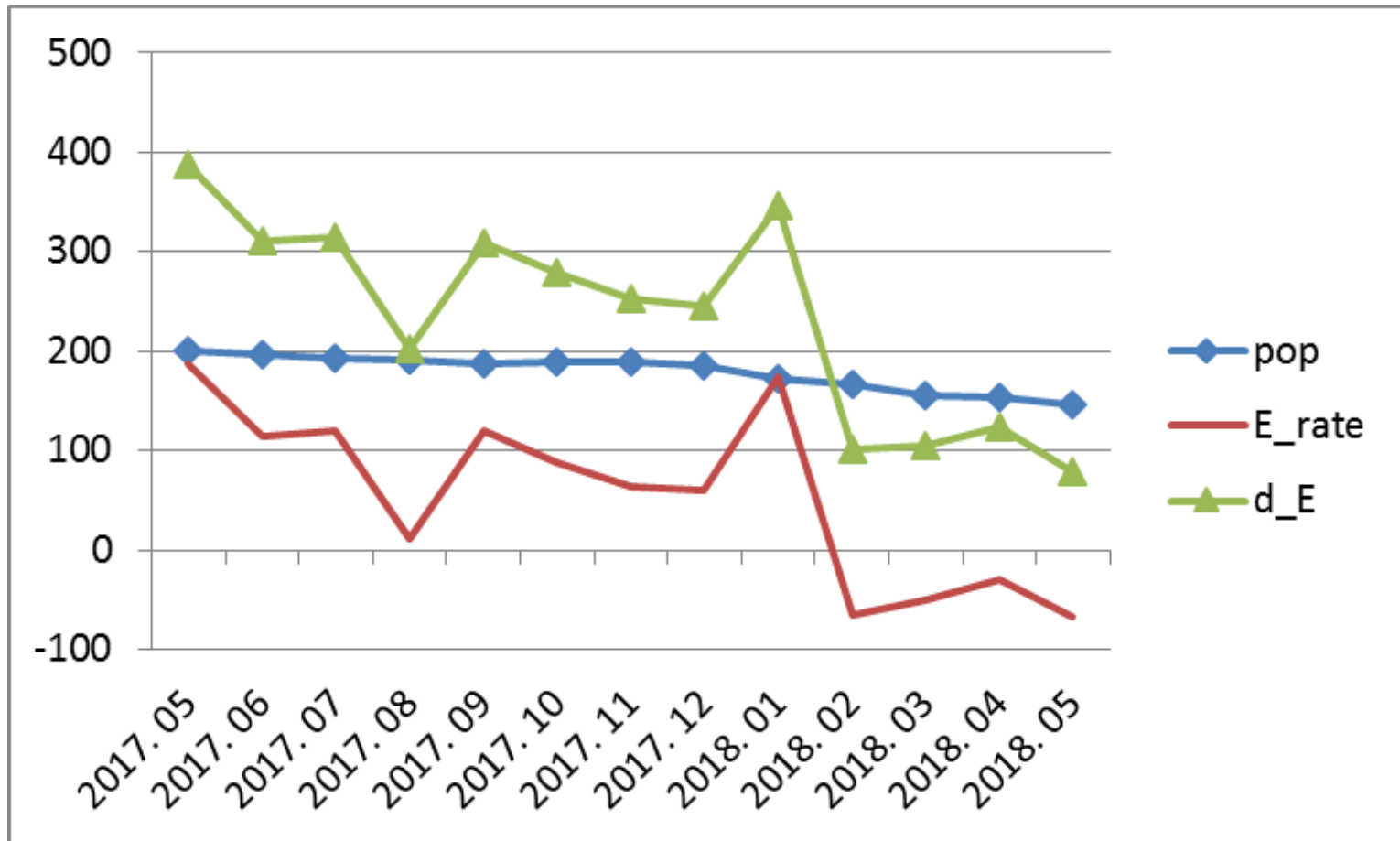
*$\Delta \text{ employment} = \text{population factor} + \text{employment rate factor} + \text{error}$*

*$\text{population factor} = \Delta \text{ population} \times \text{employment rate}$*

*$\text{employment factor} = \text{population} \times \Delta \text{ employment rate}$*

*$\text{error} = \Delta \text{ population} \times \Delta \text{ employment rate}$*

# Decomposition



# Decomposition

- In May, employment should increase by 145 thousand if we consider only population factor. But employment rate factor decreases 67 thousand. That's how we have 78 thousand.
- The loss in employment solely due to employment rate factor for the recent 4 months since February is around 210 thousand.

# Decomposition

- We again decompose employment rate factor into two parts, which are participation factor and unemployment factor.

*employment rate factor = participation factor + unemployment factor + error*

*participation factor*

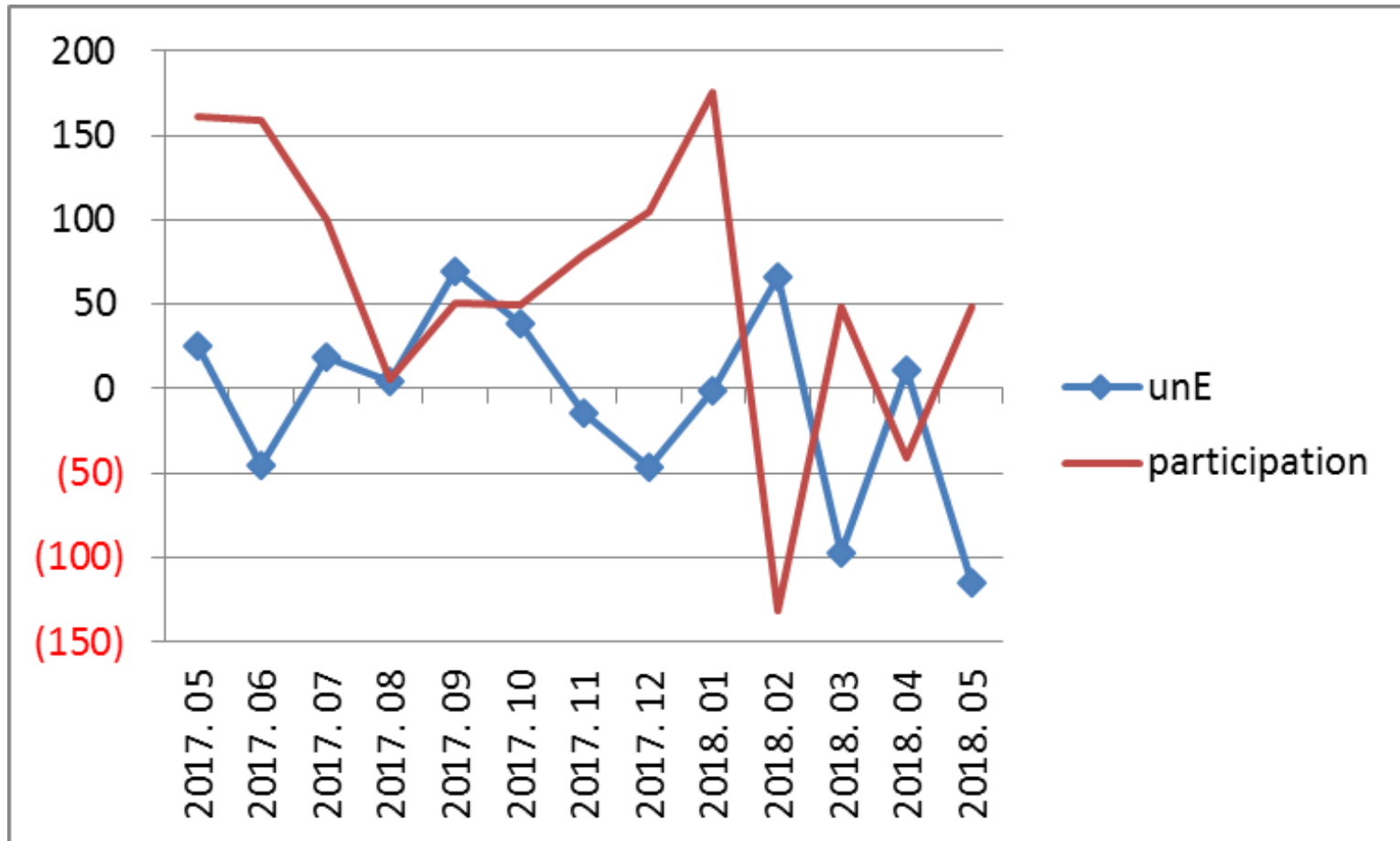
$$= \text{population} \times \Delta \text{participation rate} \times (1 - \text{unemployment rate})$$

*unemployment factor*

$$= \text{population} \times \text{participation rate} \times (1 - \Delta \text{unemployment rate})$$

$$\text{error} = \text{population} \times \Delta \text{participation rate} \times (1 - \Delta \text{unemployment rate})$$

# Decomposition



# Decomposition

- If we associate participation factor with labour supply and unemployment factor with labour demand, then we can say that the cause of poor employment in March and May is due to a decline in labour demand.
- The unemployment factor is expected to continue to have a negative impact in the near future, if we consider the recent trends.

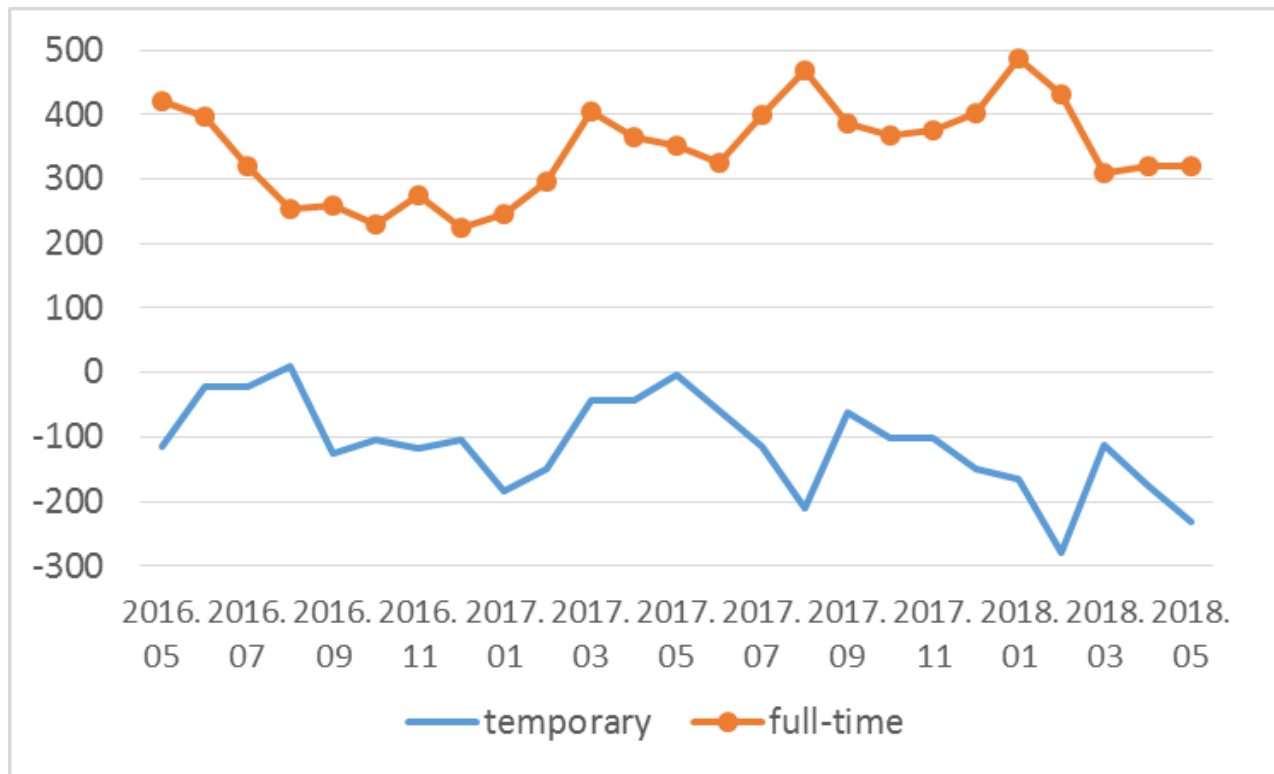
# Decomposition

- For the recent 4 months since February, participation factor decreased a total of 75 thousand jobs, while unemployment factor reduced employment by 135 thousand. Of the 210 thousand jobs lost, 36% is due to a decline in labour supply and the remaining 64% is due to decline in labour demand.

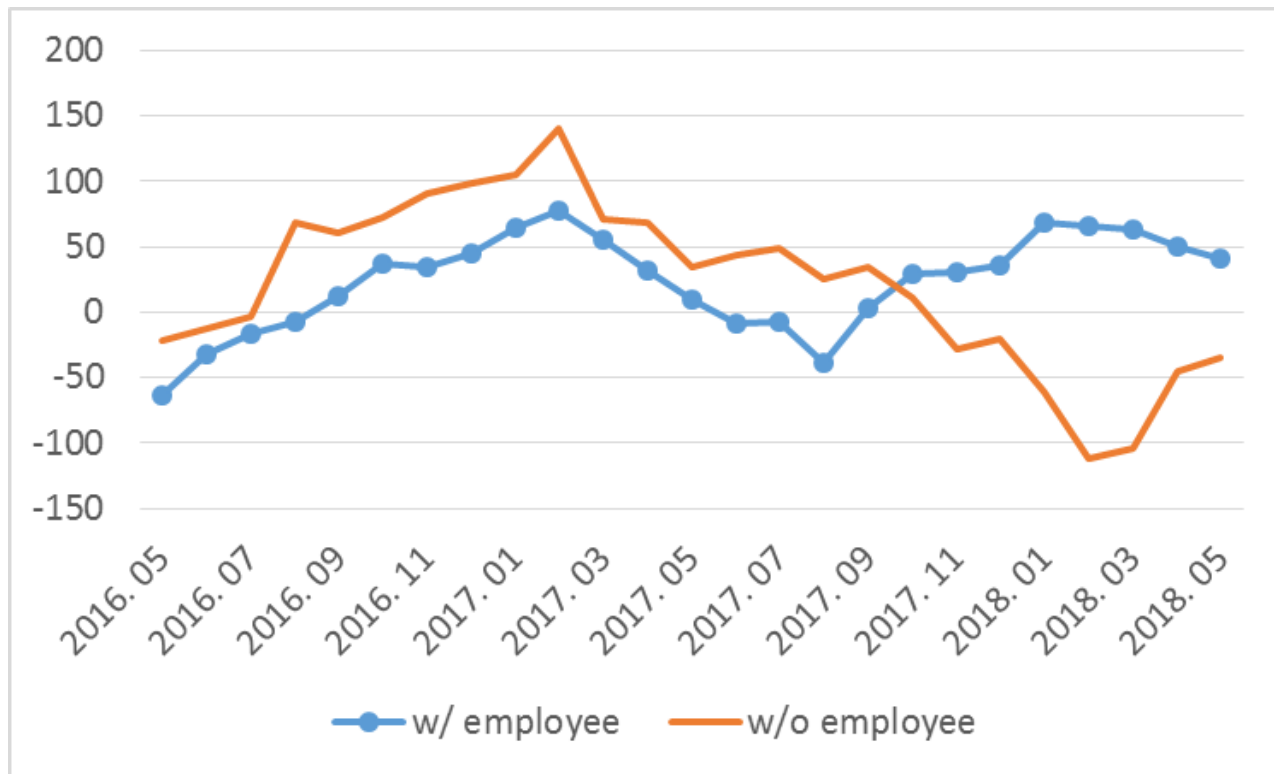
# Concerns

- General debates on the employment effects of minimum wage raise: Neutral or weakly negative
- Is the recent slump in employment due to the recent minimum wage raise?
- Officially, no evidence of negative effect by at least March (KLI)

# Recent trends in employment: Temporary workers



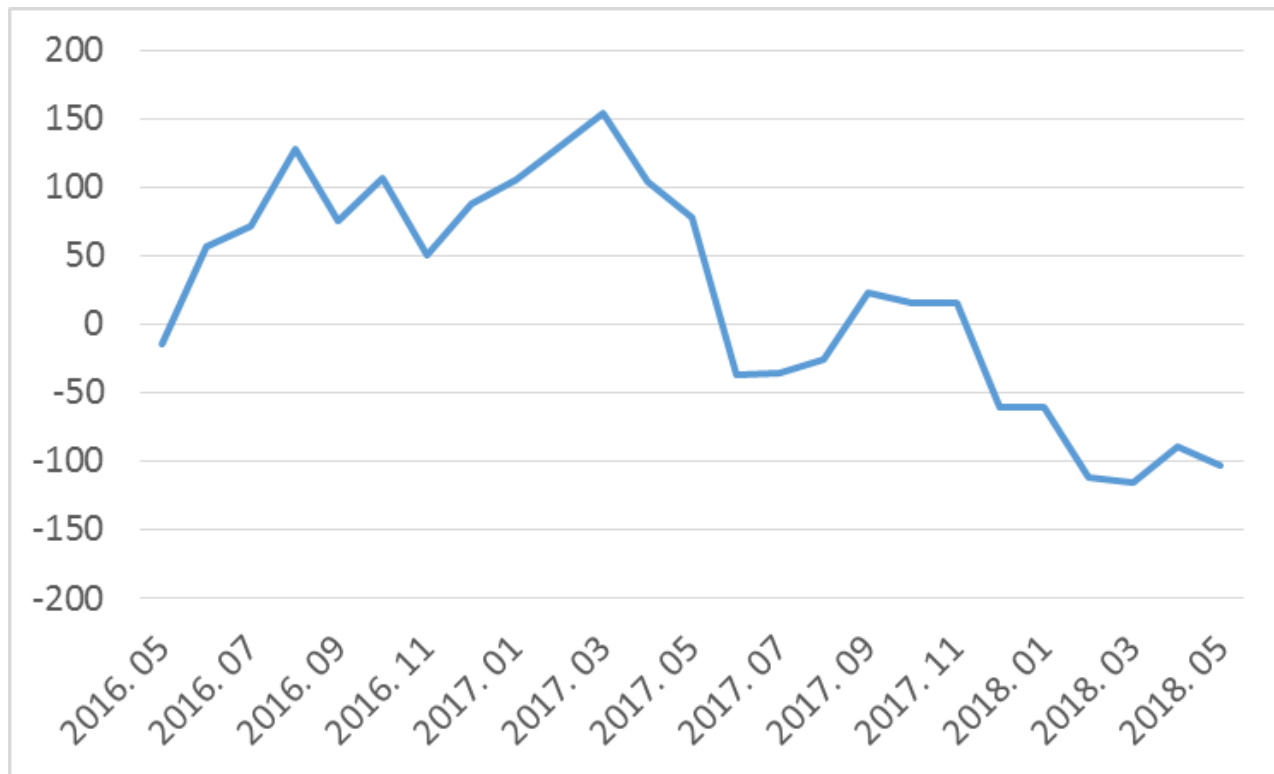
# Recent trends in employment: Self-employed workers



# Recent trends in employment by employment type

- While the number of temporary workers is gradually decreasing, the number of full-time workers is increasing.
- The number of self-employed workers with employees has continued to increase recently. On the other hand, the number of self-employed workers without employee has decreased.

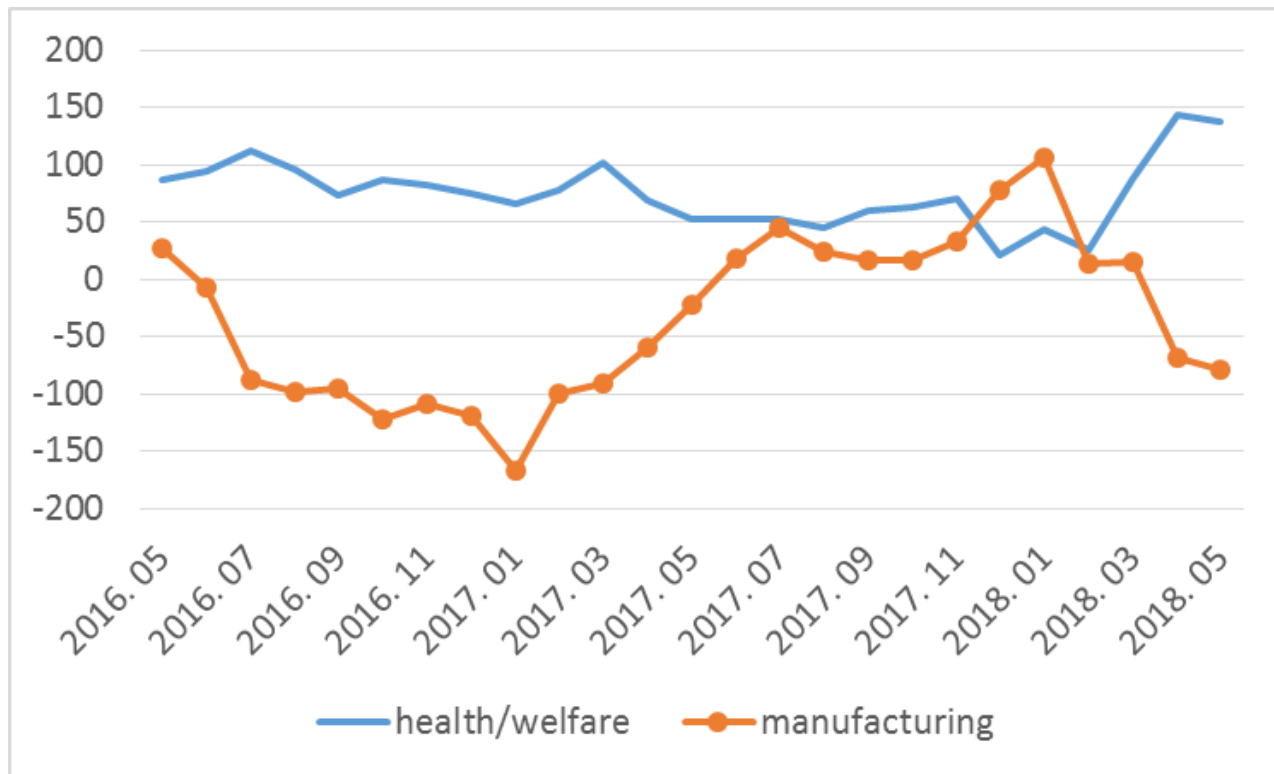
# Recent trends in employment: Wholesale/retail/restaurant/lodging



# Recent trends in employment: Wholesale/retail/restaurant/lodging

- The increase in the number of jobs began to slow down already in early 2017, and the number of jobs began to decline since the 2<sup>nd</sup> half of 2017.
- Jobs in these self-employed sectors are expected to continue to decline.

# Recent trends in employment: Health/Welfare vs. Manufacturing



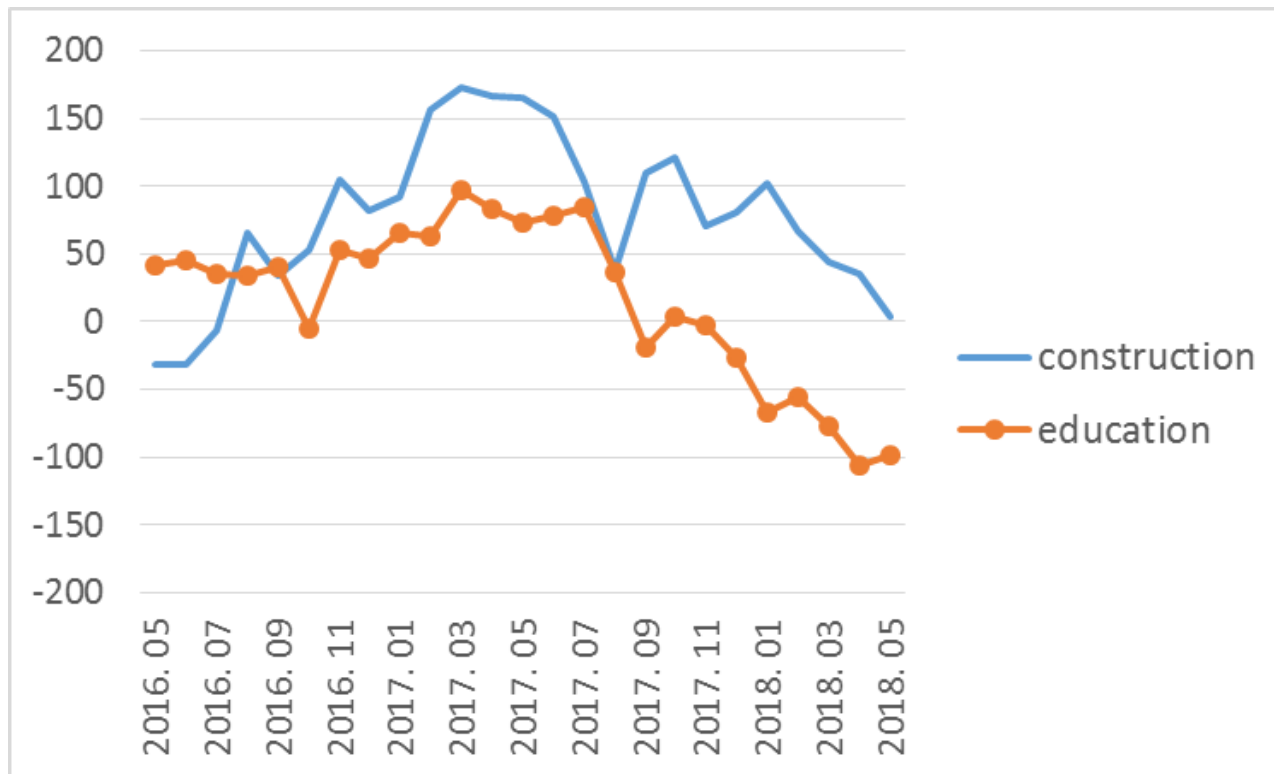
# Recent trends in employment : Health/Welfare vs. Manufacturing

- Restructuring in manufacturing sector such as automobiles and ship-building: In April and May, the number of employed workers in this sector decreased by 147 thousand.
- In February, the sluggish job creation began in the manufacturing sector. In the same month, the employment rate factor started to exert negative pressures on employment.

# Recent trends in employment : Health/Welfare vs. Manufacturing

- Trends indicate that employment decline in manufacturing is absorbed by employment growth in health and welfare service sector. However, in recent months, the job creation in health and welfare sector was not strong enough to offset the situation.

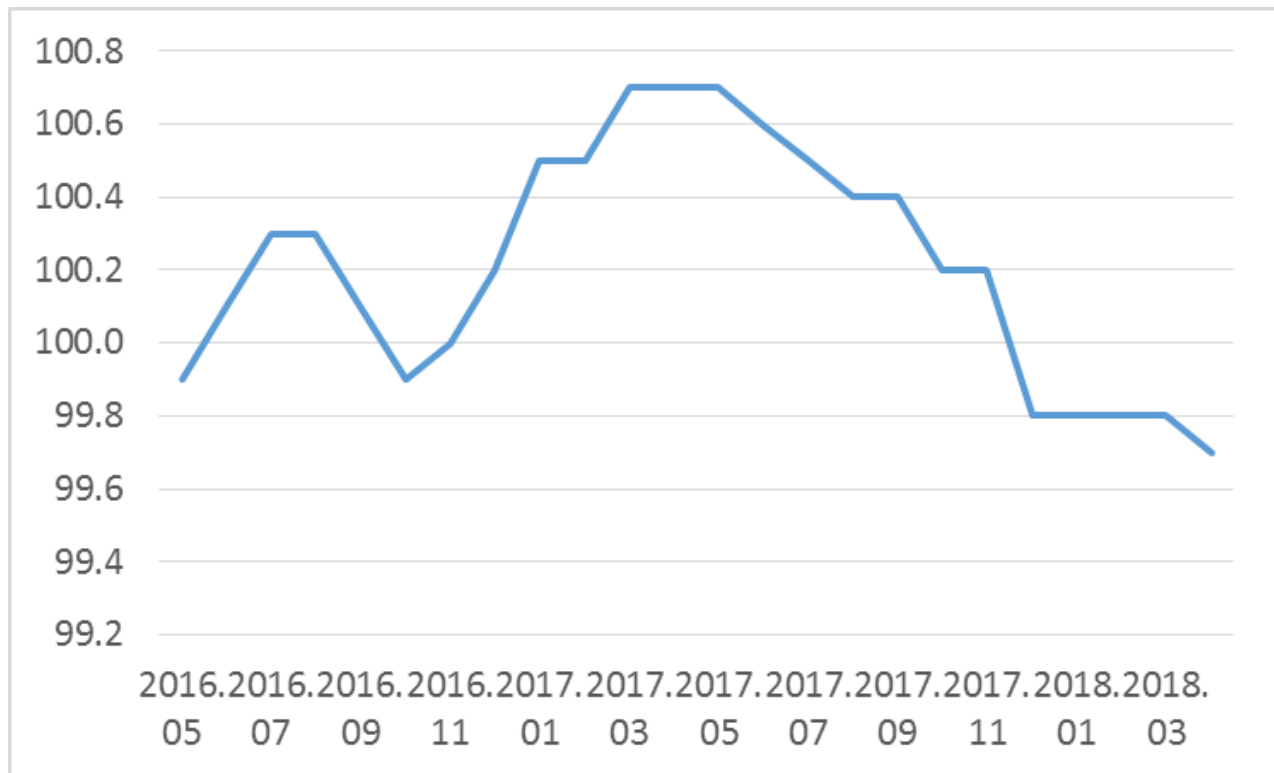
# Recent trends in employment: Construction, Education



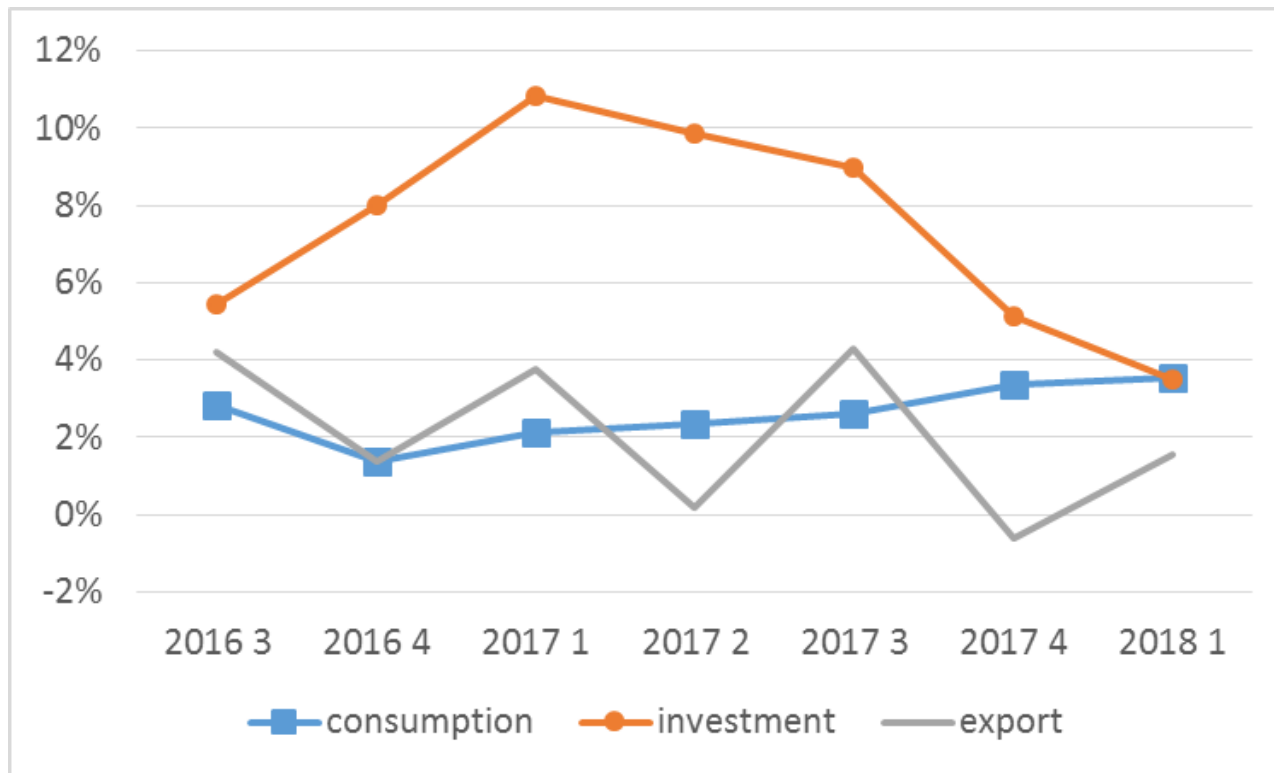
# Business cycle

- The deterioration in employment seems common across industries.
- Hence, it is necessary to identify which phase we are at in the business cycle.
- The recent composite coincident indices show that business cycle seems to have entered a cyclical downturn since December last year.

# Business cycle



# Demand components



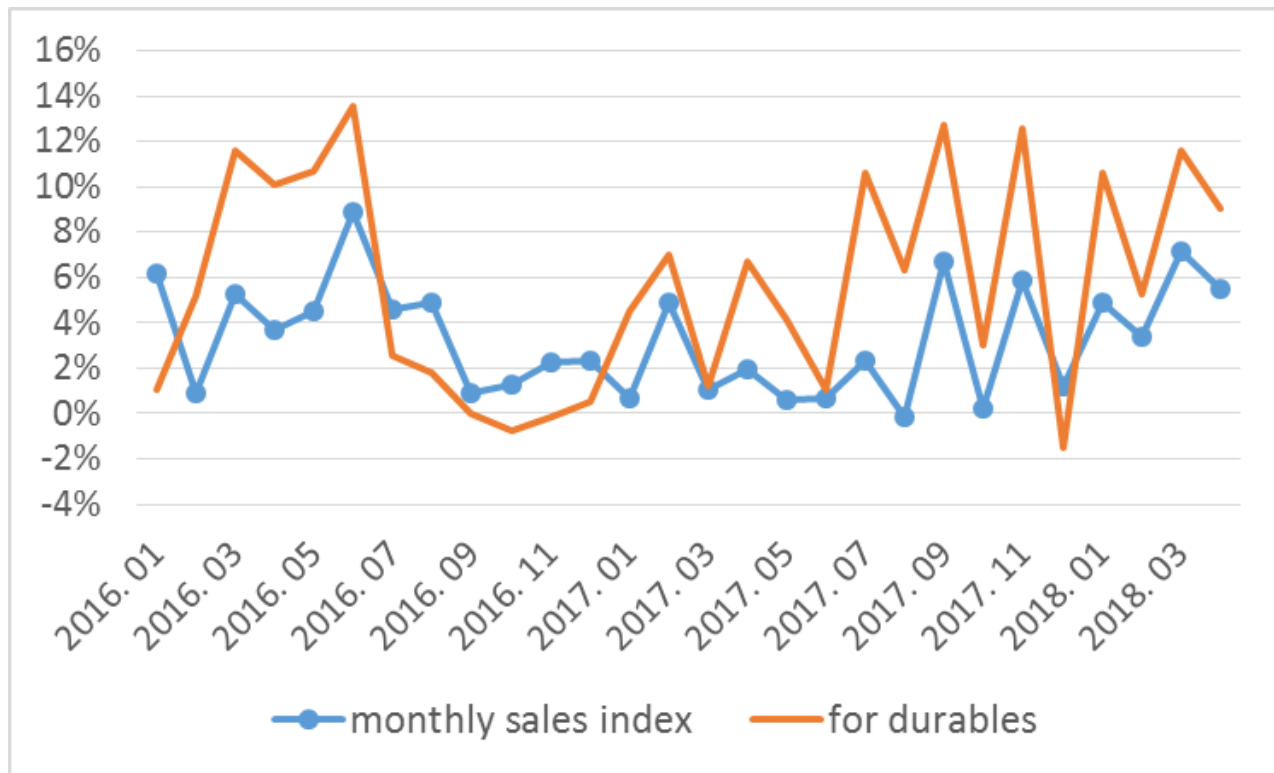
# Demand components

- Consumption continued steady growth in the first quarter.
- Exports recovered from the slump.
- Investment was the driving force of growth last year, but it is sluggish now.

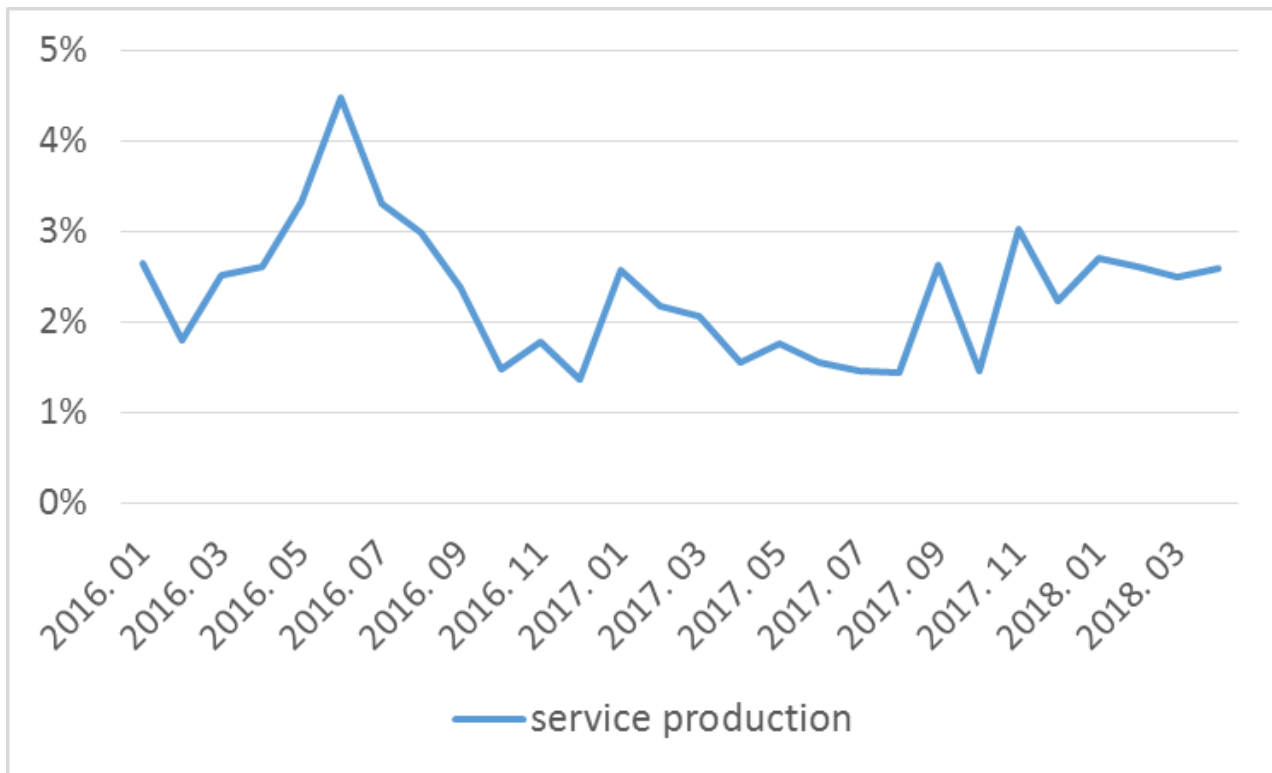
# Demand components



# Demand components



# Demand components



# Demand components



# Demand components

- Recent monthly indices reveal that consumption is stable, while investment is sluggish.
- Exports increased 13.2% YoY in May, but are showing a secular decline in trend since September 2017.
- The growth effect of income-led policy is likely to be realized over longer-run, and seems difficult to predict its short-term effect.

# Again on ‘Concerns’

- Need for rigorous empirical analyses and detailed investigations to determine the employment effects of the recent minimum wage raise
- Looking at the basic data, however, the recent deterioration in employment seems more likely to be due to the combined effect of population factor and cyclical downturn.

# On the recent amendment to the Minimum Wage Act

# What happened?

- Monthly bonuses plus welfare benefits are added to the scope for wages included in minimum wage.
- The government's excuses are that workers with higher-than-median income should not be benefitted from the minimum wage raise, and that burdens on employers are increased.
- There are oppositions from labour unions.

# Contradiction

- Minimum wage can be a key policy tool because it affects *more* than just the wage income of the poorest workers. Should the minimum wage lose power?
- How can we raise wage share, without increasing burden on employers at least in the short run, and without any concession from them?

# What is going to happen?

- Employers may try to pay the bonuses that they used to pay irregularly now on a monthly basis.
- This change in bonus payment scheme does not constitute unfavorable modifications of the rules of employment according to the revised Act.

# What is going to happen?

- Employers may try to pay welfare expense that used to be a part of operating expenses, now directly to workers in the form of benefits.
- Nominal salary increases for workers, but in fact there were only reclassifications of costs. Due to this change, workers cannot benefit fully from minimum wage raise.

# What is going to happen?

- This change is expected to exclude some of minimum-wage workers from benefitting from the raise.
- In order to reduce beneficiaries by 3 in the workplace with more than 300 workers, beneficiaries in the smallest workplace where most workers earn only minimum wages should be reduced by 10.

# What is going to happen?

Workplace	Number of Workers	The effected (old Act)	The effected (new Act)	decrease
Total	15.35mn	3.32mn	3.02mn	0.3mn
Workplace with more than 300 workers	1.95mn	0.09mn	0.06mn	0.03mn
Workplace with less than 4 workers	4.08mn	1.59mn	1.49mn	0.1mn

# Nullifying the raise

- Extension in the range of inclusion to minimum wage may severely weaken the linkage between minimum wage raise and wage share.
- Under the revised Act, the close association of the rate of minimum wage raise and the share of wages is likely to be hampered in the future.
- The most effective tool for income-led growth may lose its power.

# Bad decision

- Amendments were forced in the face of resistance of workers. In principle, this is not a direction that agrees with wage-led strategies which are supposed to strengthen workers' bargaining position.
- Amendments may break down the power base of income-led policy.
- In effect, the government slowed down minimum wage raise substantially.
- **Re-amendment** should be done before the revised Act will become effective next year.

# Performance and evaluation: Complementary measures

# Policies for economic democracy

- Policies for subcontractors, suppliers, and franchisees, etc. should be to increase the responsibility of large-scale contracting companies in the upper level and franchise headquarters.
- Policies should mandate SMEs and their upper level counterparties to share burdens from minimum wage raise.
- SMEs need to be protected by making it possible to apply for subcontract payment adjustments based on minimum wage raise.

# Policies for economic democracy

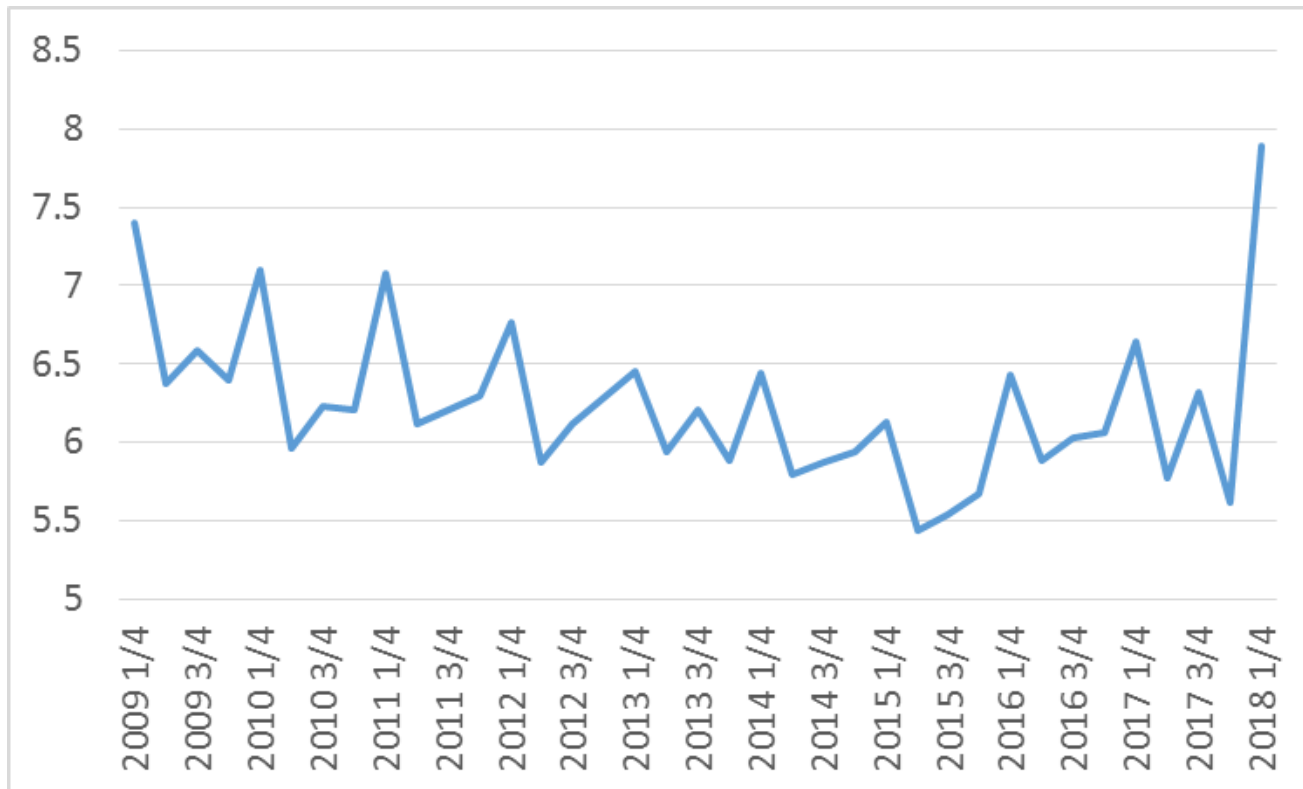
- Article 6 of the Minimum Wage Act stipulates joint liabilities of contractors and subcontractors in paying minimum wages.
- Legislations for clarifying the accountability of large firms as employers to subcontracted minimum wage workers should be introduced to complement the minimum wage raise.

# Policies for solidarity wage

- The process of asking concessions of firms should be accompanied by cooperation of trade unions in large firms.
- Large trade unions should refrain from demanding wage raises for themselves and instead require employers to fulfill their obligation to subcontracted workers.
- The burdens of the minimum wage raise should be socially shared through combined efforts for economic democracy and solidarity wage.

# Poverty

- Recent surge in Income quintile multiple



# Poverty

- Temporary workers count more than 40% in the 1<sup>st</sup> quintile households, and are decreasing in trend.
- Hence, the recent decrease in income of 1<sup>st</sup> quintile seems to be largely attributable to job losses due to downturn.
- Changes in average age from 61 last year to 63 this year also contributed to an increase in the multiple.

# Poverty

- Poverty of the elderly is an urgent issue. Elderly households are becoming sources of low-wage labour.
- The State should protect the elderly and the youth. Public welfare system should be expanded in essential areas such as housing, child care and medical care.

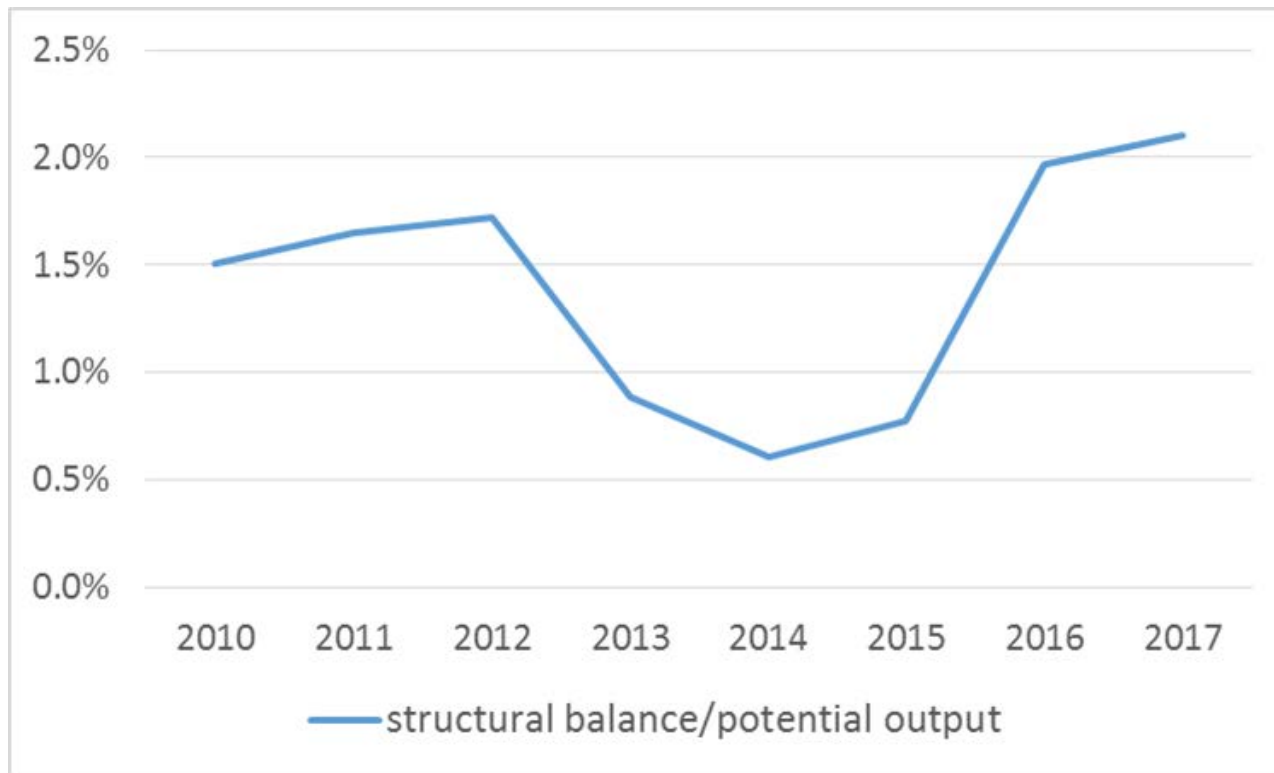
# Tax reform

- The highest rate of income tax was raised.
- For corporate tax, new brackets were established and also its highest rate was raised.
- However, the increase in tax revenue was not significant, because the raises were not sufficient.
- The ratio of tax burden still remains less than 20%, which is much different from OECD avg. of 26%.

# Fiscal balance

- The government is passive in increasing both taxes and spending.
- Consolidated fiscal surplus of KRW 24 trillion in 2017: Improved by more than KRW 7 trillion compared with last year
- Fiscal policy is mostly of austerity, as is confirmed by IMF's estimates for structural balances, which reflects policy stance.

# Fiscal balance



# Fiscal balance

- Budget for 2018 increased from budget for 2017. But its growth rate is about 7%, which is not very far from nominal rate of growth.
- Budget for 2018 is a surplus budget.
- According to the National Fiscal Management Plan until 2021, the growth rate of spending is 5.8% on average.
- Even with the urgent demand for more aggressive spending, the government pledged to lower its national debt-to-GDP ratio this year.

# Passive fiscal policies

- Passive fiscal policies make it more difficult for income-led policies to work out and to settle down.
- Difficult to expect any achievement of policy goals.
- Child allowance's super-hyper-complexity, frozen home care allowance, delayed increases in the basic pension, insufficient protections of health insurance.
- Obsessions with balanced budget may have a reason: The question is how much priority should be placed upon it now.

# Employment policy

- Fostering new industries is important, but job creation from it is not immediate.
- It would be quite nice if private sector created jobs, but it should not be waited on.
- Public sector should increase jobs boldly with fiscal input. The need to expand public services is great and there is a huge demand from citizens for this.
- Compared to OECD average, employment share of public sector is low enough.

# EITC

- The expansion of EITC also requires fiscal input.
- But, EITC is not a panacea. Non-working poor or self-employed workers are excluded from the benefits.
- EITC may worsen inequality among low-income households.
- Low income in the 1<sup>st</sup> quintile relates to the poverty issue of the elderly. Hence, EITC may not succeed in supporting the 1<sup>st</sup> quintile households.

# EITC

- If minimum wage is linked to EITC, employers have an incentive to reduce full-time regular workers and substitute minimum-wage workers for them.
- This may end up with higher proportion of low-wage workers and a deterioration in the overall employment status of workers.

# Functional finance

- The sum of the financial balances of all the economic agents including foreign sector should become zero.
- Hence, fiscal surplus can be accompanied with deficits and debt accumulation in the private sector.
- The government needs to consider fiscal balances as a means of reacting to fluctuations in private sector balances.

# We should not be late.

- It is high time to actively respond to the recent downturn: Fiscal expansion for demand management are desperately needed.
- According to one of the recent developments in post-Keynesian theory, the so-called super-multiplier effect needs attention. For example, it is argued that deliberately chosen growth rate of fiscal spending may affect medium- to long-run growth path of an economy.

# Concluding remarks