

Future Challenges of the Income-led Growth for Korea

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June 29, 2018

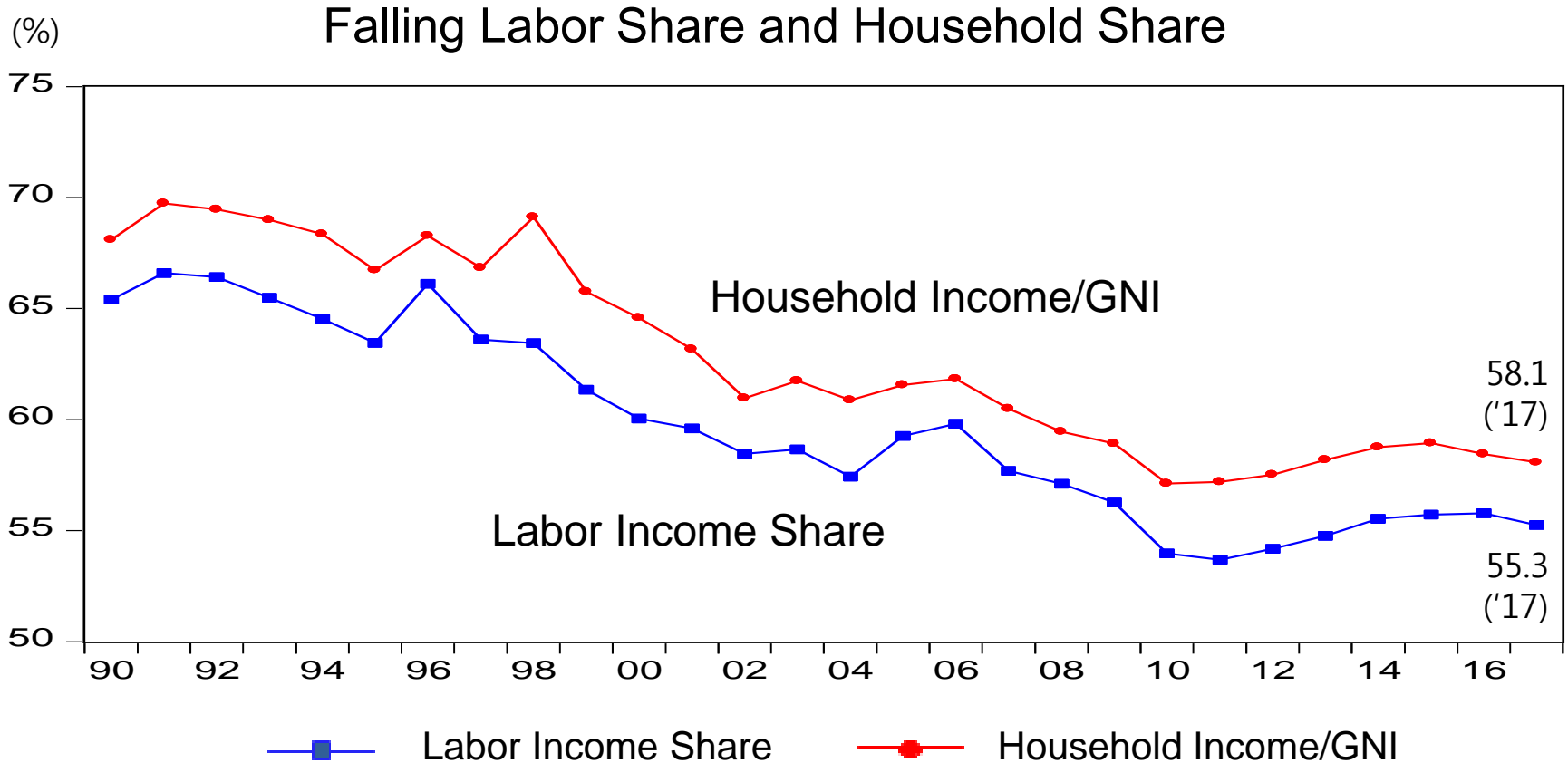


1. A Brief Overview

2. Policy Challenges



A Brief Overview: Distribution and Demand Sides



The labor income shares are adjusted by assuming self-employed earnings are divided into labor income and capital income as the same fraction in the rest of the economy.

Falling labor share has negative effects on C, while little effects on I and NX.

$$Y = C(Y, LS, \lambda_C) + I(Y, LS, \lambda_I) + G(Y, \lambda_G) + NX(Y, LS, \lambda_{NX})$$

Yearly Real Consumption Growths: 1985-2016

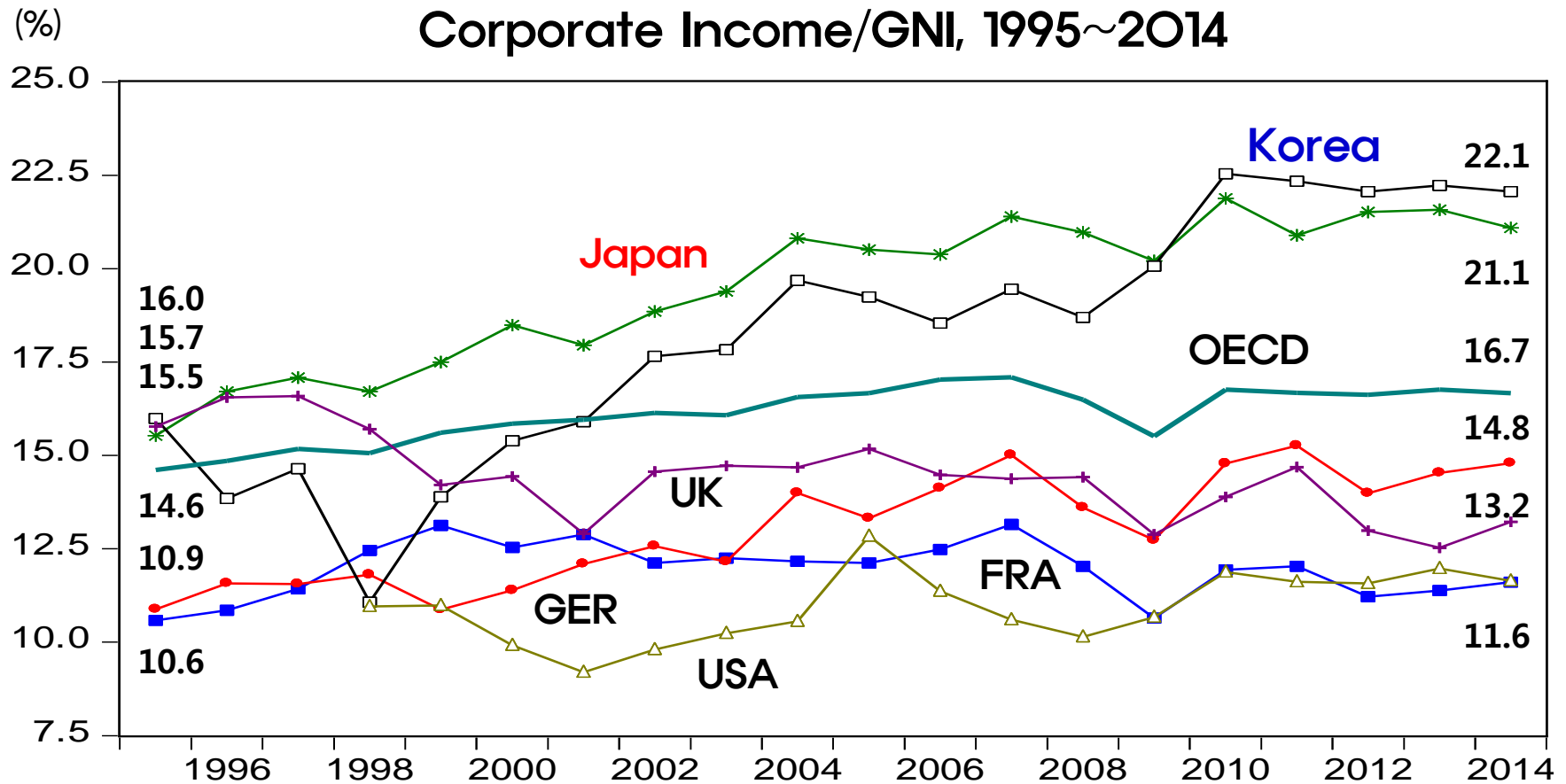
	I	II	III	IV
Consumption Growths(-1)	0.051(0.122)	-0.144(0.172)	0.063(0.242)	0.059(0.145)
Labor Share(-1)	0.315^{***}(0.062)	0.235^{**}(0.113)	-	0.227^{**}(0.089)
Real Stock Price Changes(-1)	0.062 ^{**} (0.031)	-	0.053 ^{**} (0.02)	0.052 ^{**} (0.023)
Real Effective Exchange Rates	-	0.172(0.108)	0.180 ^{***} (0.064)	0.130(0.081)
Life Expectancy	-0.193 ^{***} (0.042)	-0.359 ^{***} (0.089)	-0.200 ^{**} (0.082)	-0.301 ^{***} (0.071)
R^2	0.459	0.413	0.461	0.539

Newey-West standard errors in parentheses.

*, **, ***: statistically significant at 1%, 5%, 10%, respectively.

The REER(from BIS) set to be 100 at the year 2010 rises as the Korean Won appreciates.

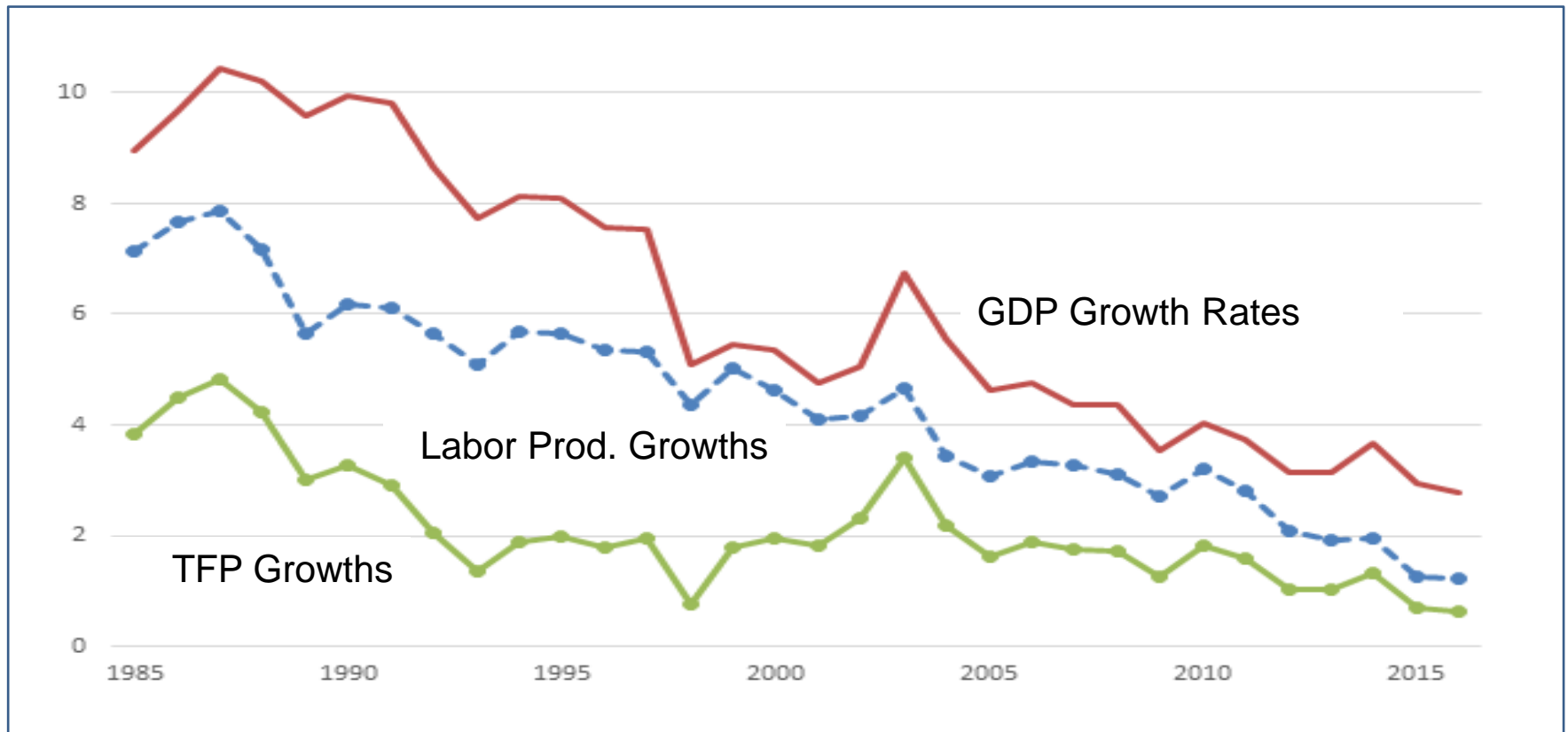
Rapidly Soared Corporate Income Shares together with Aging, Declining Population and the already High Capital/Output Ratio in Japan & Korea
 - **Symptom of Secular Stagnation due to the Lack of Demand?**



Source: OECD. Stat. 「National Accounts」, 2016. OECD: average of available 22 nations.

Supply Side

〈Productivity Growths; 1985~2016, 5-year MA, %〉



Granger Causalities among GDP growths, LP Growths, and TFP growths

$g_{Y/L} \Rightarrow g_{GDP}$	0.930 (0.407)	$g_A \Rightarrow g_{GDP}$	1.157 (0.330)
$g_{GDP} \Rightarrow g_{Y/L}$	3.176 (0.059)	$g_{GDP} \Rightarrow g_A$	3.857 (0.034)

Lag lengths 2 applied. *F*-values and *p*-values(in parenthesis)

Why do we need demand-driven or income-driven policies now?

- A lot of recent research have shown the fall in labor income share has contributed to the declining domestic demand, especially after the 1997 currency crisis in Korea.
 - Rapid aging and slow population growth are depressing domestic demand. The immatured national pension system makes the situation even worse.
 - People had long witnessed soaring real estate prices, so typical above-middle-class Koreans are desperate to accumulate wealth especially in the form real estates to prepare for their lengthened elderly life or bequest, which in turn make the wealth distribution more unequal: zero-sum game with lowered consumption propensity
- ⇒ Demand-driven growth policies are necessary and essential, which must include improving and re-balancing the distribution of income and wealth.

Future Challenges

Medium- and long-term perspectives of the Korean economy

(1) lower growth trend

- decreasing working-age population
- capital-output ratio(K/Y) = 3.3 as high as in JPN, GER, FRA and USA
- much lowered 'Solow Residuals' since 2011

(2) polarization of employment

- rising structural unemployment in manufacturing, construction, education services, etc.
 - new and uncertain trends in technological progress
- ⇒ saving capital as well as labor: investment-less and job-less growth
- ⇒ middle-skill jobs not created enough in private sectors

Future Challenges

Medium- and long-term perspectives of the Korean economy

(3) bright side?

- fiscal spaces: gov't debt to GDP less than 40% and rising tax revenues due to improvements in taxing administration

Year 2017	<i>expected</i>	<i>realized</i>
government fiscal deficits, % in GDP	1.70%	1.07%
tax burden ratio, % in GDP	39.6%	38.2%

- still weak, but consumption growth catching up with disposable income growth
- ⇒ rooms for fiscal expansion and boosting private consumption

Future Challenges for the Income-led Growth

(1) Refining the Concept

- The term 'income-led' is somewhat vague. To be clear, it should be; **"Structural Aggregate Demand Expansion including Redistributive Measures"**

(2) 'Structural' means;

- built-in stabilizers (e.g. more generous unemployment insurance)
- expanding public services: innovation networks, environments, health,...
- reducing wage inequality (e.g. minimum wages, living wages,..)
- raising tax on capital gains and incomes to expand welfare benefits

(3) Aggregate Demand Expansion

- not just temporary, at least for the medium terms, and aiming 'crowding-in'
- preventing secular stagnation, allowing fiscal deficits to fight against the bad consequences of population decline

Extending and Redesigning 'Income-led Growth' Policies

(1) Expansion of Fountain Effects

- Equal emphasis on minimum wages, unemployment insurance and EITC
 - raising minimum wages: **important, but** the current schedule is **too steep**.
 - minimum wages impact on agg. demand: positive but may be small.
 - both market distribution and secondary distribution are important.

(2) Reinforcing Trickle-down Effects

- pro-labor policy, but no obsession with the **'labor channel'**
- restoring virtuous cycles among large corporations, SMEs, and household
- tax incentives to raise wages and investment: the newly introduced "tax for promoting investment and mutual cooperation" must be reinforced.
- **'finance channel'**: restraining stock repurchases by law and boosting dividend propensity by the pressure of public pension funds

Extending and Redesigning 'Income-led Growth' Policies

(3) Job Sharing to raise labor incomes

- increases in labor income: $\Delta(wL) = \Delta w \cdot L + w \cdot \Delta L$
- wages policy($\Delta w \cdot L$) is not enough since markets adjust and bypass it.

1) public sector: $w \cdot \Delta L$

If retraining wage increases, lots of room for additional employment.
labor cost per employment in public sector, **industry averages = 100**

France	U.K.	Germany	U.S.A.	Japan	Korea
102	126	130	176	184	194

stats.oecd.org STAN Database for Structural Analysis

2) private sector

- A full-time regular job is ideal, but cannot be fully created in markets
- studies needed about making a new category such as 'semi-regular' jobs

Extending and Redesigning 'Income-led Growth' Policies

(4) Expansionary Fiscal and Monetary Policy : the goal of **"full employment"**

- Inflation rate is still low: mid-1%. Savings far exceeds investments.
⇒ lack of demand > lack of supply

1) Fiscal Policy

- public investments for balanced development remedying regional divide
- maintaining labor demand: government consumption and investment
- encouraging labor supply
 - wage subsidies on young workers entering S&M manufacturing firms
 - providing semi-regular jobs for career-cut women and early retirees
- Re-orienting government subsidies from firms towards working people

2) Monetary Policy

- faced with raising policy interest rate in the near future
- trying to design more of 'credit channels'
- planning for a new way of 'credit easing' (no QE at zero interest rate)

Extending and Redesigning 'Income-led Growth' Policies

(5) Structural Reforms

1) creative destruction or downsizing of inefficient 'Chaebol' subsidiaries

- lots of evidences that they occupy too much resources, capital productivity is low, and exit rate is low.
- efficient resource allocations: '**basics**' of the long-term growth

2) reforms in rent-seeking sectors

a policy initiative towards a new paradigm

policy packages of pro-labor/household policy, expansionary macro-policy, progressive tax, and longer-term structural reforms