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# Korea

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## OECD warns Korea of inequality challenge

By Donald Kirk



SEOUL - The image of modern South Korea as a rising, shining giant, spewing forth cars, computers, ships and chips for global consumption, comes in for a beating in a report by the Paris-based Organisation for Economic Cooperation and Development.

While economists in the United States and Europe are accustomed to singing South Korea's praises , the OECD begins its annual review of the country with the declaration, "Korea is confronting a serious challenge."

How's that, exactly? "It has to improve income equality in the context of a severe demographic transition" - that of "transition from one of the youngest populations in the OECD at present to the second oldest by 2050." That attenuated process, the report warned, "may boost the need for public spending and slow economic growth".

But the problem goes much deeper than that, according to the report. "Sustained rapid growth during the first decade of the 21st century has been accompanied by a marked rise in income inequality," it noted. "Underlying social problems were further exacerbated by the 2008 global economic and financial crisis."

Even "as Korea integrates into the global economy, said the OECD study, "it faces many of the same forces that have led to rising inequality in other OECD countries. "In the Korean case, however, the problem is actually worse than in most member states.

"First, its level of social spending is among the lowest in the OECD area," said the report. "Second, the impact of its tax and transfer systems on income distribution and poverty is among the weakest. Third, Korea's dualistic labour market is highly segmented between regular and non-regular workers, leading to wide inequality in wage income."

The OECD report comes up with starkly realistic recommendations that Korean politicians and bureaucrats do not appear in any hurry to accept: "As the pace of population ageing is accelerating, it is important to act quickly in a wide range of areas." These include:

- Policies to sustain Korea's growth potential in the face of falling labor inputs;
- Measures that improve both growth and equality;
- Carefully targeted increases in social spending to reduce inequality and poverty;
- Financing higher social spending, with priority given to a reform of tax and social security that minimizes the negative impact on output growth.

Chances of Korea's digesting such a menu appear remote given the emphasis of the conservative government on welfare - not social welfare but that of the *chaebol*, the conglomerates that dominate business and industry. Korean bureaucrats prefer to dwell on the country's recovery from the economic crisis that swept the world in 2008 - a "downturn" from which the world's economic leader, the United States, is far from recovering.

"Korea has recovered from the global financial turmoil triggered by the sub-prime mortgage crisis faster than other OECD countries thanks to its rapid and decisive policy responses," said Kim Dong-soo, chairman of South Korea's Fair Trade Commission, the day after the OECD issued its report. "The Korean economy posted positive growth (2.9%) in 2009 when major advanced economies were contracting."

Then, in 2010, Kim Dong-soo told a meeting of the American Chamber of Commerce here that the Korean economy "grew by as much as 6.2%, the highest growth over the last eight years."

No less an economic analyst, adviser and policy-maker than the International Monetary Fund "commended Korea for its exemplary performance in recovery from the crises," Kim observed.

Moody's accorded Korea the ultimate badge of honor by raising Korea's national credit rating from A2 to A1 in April 2010, he said, while the World Bank forecast in May that six countries, Korea, Indonesia, and the BRICs, that is, Brazil, Russia, India and China, "would account for more than half of the world's economic growth for the next 20 years."

After all that success, then, what could be going wrong? Kim prefers to lay the blame on popular opinion rather than government policies.

"The problem is that the general sentiment on the economy is not

Kenya and a white woman from Kansas

10. Another sewer swim for Harbin Electric

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improving in Korea," he said. "despite strong signs of recovery from these macroeconomic indicators." Besides "inflationary pressure in the Korean economy," he acknowledged that "large companies' undue influence over small and medium-sized enterprises (SMEs), collusion practices, institutional and structural factors" and "the creation of monopoly and long-sustained monopolistic market structures" were all "aggravating the current conditions".

Kim addressed the issue of reforms, however, in vague terms that suggested few real possibilities for reversing a trend in which the power of the *chaebol* has been smothering competition from upstart rivals. The Fair Trade Commission "is implementing competition policies", he said, that would:

- Create an open market where entry or exit of the market occurs freely;
- Uncover and correct illegal practices of companies that harm the principles of market economy;
- Ensure shared growth between large companies and SMEs by inducing them to change their corporate culture voluntarily;
- Create an environment where consumers serve as a competitive pressure.

Kim Dong-soo spoke of "the ultimate goal" in verbiage that resembled that of a pastor inveighing against sin. The key, he said, was "to spread competitive principles across the economy, building more transparent and sound economic systems, thereby keeping the national economy stable."

He predicated those fine words, however, on President Lee Myung-bak's "three values" for a "fair society", that is, "autonomy, fairness and responsibility". Considering Lee's background as top executive of Hyundai Engineering and Construction and his support of expanding the *chaebol* while paying lip service to the SMEs, one had difficulty viewing such "values" as anything other than window-dressing.

Kim himself recognized the problem from his years as president of the Korea ExIm Bank. "Unfortunately these experiences have brought me to the conclusion that mutual partnership between large and small companies has yet to take root in Korea," he said.

Kim, however, was not in favor of rule and regulations that might bring about change. "Companies need to improve their culture and attitude through their voluntary effort," he made clear, "rather than being forced by laws or regulations."

That's a view that contradicts the recommendations of the OECD, which Korea joined 15 years ago in a great show of national pride over acceptance into one of the global economy's most elite clubs.

The OECD placed top priority on increasing the efficiency of labor in a system in which hours are long but productivity in the service sector is half that of the manufacturing sector and 40% of the service sector in the United States.

"Faster labour productivity in services requires strengthening competition through regulatory reform" said the OECD report.

The report called for "greater openness to the world economy as one way to boost productivity in an inward-looking society in which foreign direct investment as a percentage of the gross domestic product is the second lowest in the OECD area.

Foreign affiliates, it said, account for only 8% of service-sector turnover and 4% of employment, "well below OECD averages of 19 and 10%".

The report called for "strengthening international competition" by "reducing barriers to foreign direct investment, including foreign ownership ceilings in key services, and liberalizing product market regulations". Besides, it added, it is "important to foster a foreign investment-friendly climate by enhancing the transparency of tax and regulatory policies and reforming the labour market".

The issue of social spending lay at the heart of the problem of overweening inequities. "Social spending - at 7.5% of GDP - remains well below the OECD average of 20%," said the report, while Korea's "tax and transfer systems have the smallest impact on inequality of any country in the OECD area and "well targeted tax and benefit programs are needed to mitigate increasing inequality trends".

That was an area in which Kim Dong-soo of the Fair Trade Commission did not care to venture while calling for "open competition" on a "level playing field".

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