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Employment and Labor Policies in Transition : Social Policy

## Income Inequality : Current Status and Countermeasures

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### I. Patterns of Income Inequality

The problem of income inequality has continued to grow since the Asian financial crisis of the late 1990s. Among the Korean population aged 20 years and over, the income share of the richest 10% grew from 32.9% in 1999 to 48.5% in 2015 (Minki Hong, 2015). During the 2010s, with the income share of the highest 10% exceeding that of Japan (41.6%), U.K. (39.1%), France (30.5%) and Sweden (30.7%), Korea was second only to the United States (50.5%) in terms of uneven personal income distribution.

Although both Korea and the Anglosphere witnessed growth in income inequality, they showed different patterns. In the Anglosphere countries, the rise in income inequality was caused by a rapid increase in the wealth of the top 1% of the income distribution. On the other hand,

the rise in Korea was attributed to the income stagnation of the bottom groups. Consequently, Korea falls behind the Anglosphere countries both in terms of the income share of the top 1% and that of the bottom 50%. In 2015, the income share of the poorest 50% in France, China, and U.S. was 23.0%, 15.5%, and 10.1%, respectively, while that of the same group in Korea was only 4.5%. The income share of the top 1% was 21.2% in the U.S., 12.8% in the U.K., 8.6% in France, 10.5% in Japan, and 14.2% in Korea.

Table 1 shows the results of calculating the 2015 personal income distribution using the data from the Statistical Yearbook of National Tax. Here, personal income is the sum of all incomes received by individuals including earned income, business income and property income. Individuals earning a personal income of 10M KRW a

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Table 1. Personal Income Distribution in 2015

Lowest in the Income Bracket(10M KRW)	Highest in the Income Bracket(10M KRW)	No. of Persons	Frequency Distribution (%)	Cumulative Distribution (%)
0	1	10,227,204	38.4	38.4
1	2	5,625,572	21.1	59.5
2	3	3,778,988	14.2	73.7
3	4	1,847,792	6.9	80.6
4	5	1,595,628	6.0	86.6
5	6	930,163	3.5	90.1
6	8	1,304,259	4.9	95.0
8	10	587,373	2.2	97.2
10		747,371	2.8	100.0
Total		26,644,350	100.0	

Source : The above table has been compiled by the author from the data from the Statistical Yearbook of National Tax.

year or less accounted for 38.4% of all income earners (approximately 26.64M persons). The share of those with a personal income of 20M KRW or less was 59.5%. In 2015, 73.7% of all income earners reported a personal income of 30M KRW a year or less.

The percentage of 3-person households with a single income earner that are able to meet the average household expenses of 40.85M KRW is only 19%. In the case of 4-person households, only 14% of them can cover the average expense of 49.41M KRW per year with a single income earner. One of the main reasons for a record-low number of marriages and births in Korea is the difficulty of making sufficient income to meet regular household expenses.

Due to the excessively high number of low-income earners, those who earn a moderate level of income are considered as relatively high-income earners. As of 2015, those who earned 50M KRW or more were placed in the top 10% of the income distribution. Although their income can barely cover the average yearly expenses of 4-person households (49.41M KRW), they had a very high position in the income distribution.

## II. Causes of Growing Income Inequality

The reason that the bottom 50% of the income distribution contributes only a small share of the overall income is that there are many unemployed individuals and low-income earners. For over 40 years, companies have maintained the practice of employing a smaller number of workers than are required and making them work long hours. Since they have always had access to a large pool of workers including young job-seekers, the unemployed, the working poor, low-income earners, and those who often move between these boundaries, they could easily hire qualified workers without having to raise wages. Structural problems such as low employment rates and long working hours, coupled with changes in market conditions such as globalization, as well as policy factors including the advent of “labor flexibilization,” have all come into play since the Asian financial crisis, leading to the significant growth in income inequality.

In the 2000s, a considerable increase in trade with China had a huge impact on employment. Many Korean SMEs (small and medium-sized enterprises) were hit by a

flood of cheap products exported from China. Meanwhile, large exporting companies were able to make huge profits from overseas markets by increasing their foreign investment and importing cheap intermediary goods. As more of them turned to outsourcing to cut costs, the production activities of their local partners and suppliers contracted. Consequently, the gap in value added between large firms and SMEs rose, resulting in significant wage disparities between the two groups. Compared with the earnings of those employed by large companies with 300 or more employees, the income of those in SMEs stood at 60% in 2004 and 56.7% in 2014.

Since the 1980s, the development of information technology and the expansion of globalization have been witnessed in all capitalist developed countries. However, while the problem of income inequality worsened in the Anglosphere countries such as the U.S., the U.K. and Australia, the income share of the top income group did not increase in the European nations and Japan. Although the growth of income inequality may be accelerated by technological changes and globalization, it can be controlled to a certain extent with the right policies and regulations. The reason that income inequality did not rise dramatically in the European countries is that those countries have implemented a number of policies and regulations to curb the increase in the income of the top percentile and to protect low-income earners.

Meanwhile, following the Asian financial crisis, the Korean government introduced a variety of policies to promote flexibility in the labor market, resulting in the expansion of income inequality. During the 2000s, many firms relied on organizational restructuring, employment of non-regular workers, and outsourcing (indirect employment) in the name of crisis management and economic recovery; and the number of small self-employed entrepreneurs rose significantly. Although there were discussions on how to protect non-regular workers in the late 2000s, the flexibilization of the labor market had almost

been completed by then.

Policies and regulations reflect different levels of negotiating power. Ultimately, how companies will produce and how they will distribute profits to different members of society are determined by negotiating power. During the 2000s, the income of shareholders, managers, professionals (including doctors, lawyers and accountants), civil servants, employees of public institutions and large companies increased steadily. In any organizations that had labor unions, workers were able to raise wages by exercising negotiating power. In contrast, the wages of employees of SMEs, non-regular workers, and small self-employed entrepreneurs stagnated due to their weak negotiating power. Compared with the wages of regular employees of large firms, the wages of non-regular workers of SMEs stand at about 40%.

### III. Measures to Ease Income Inequality

There are largely two ways of easing income inequality: first is to ease the inequality of primary income, that is, market income before redistribution through taxes and transfers; second is to ease the inequality of secondary income, that is, disposable income after redistribution through taxes and transfers.

Primary income is influenced by not only technological changes and market conditions but also policies and regulations. And, given that policies and regulations reflect negotiating power, it can be said that how income is distributed ultimately reflects negotiating power. For example, the output of economic activities is distributed among workers in the order of negotiating power. In the Anglosphere countries and Korea where decision-making is done by management and no regulations or policies exist to compensate for the differences in negotiating power between management and employees, income is distributed from top to bottom according to the management hierarchy. In order to ease

income inequality, workers need to be to participate in corporate decision-making, as can be seen in Germany's Mitbestimmung ("codetermination") system, and there should be organizations like labor unions that are designed to represent the interests of workers.

When wages are determined through intra-company bargaining, it is impossible for wage differentials between firms to be narrowed. Given that labor unions tend to be formed and developed in large manufacturing establishments, when a small number of well-organized labor unions work efficiently to improve the working conditions of their members, wage differentials between firms tend to increase. During the 2000s, the wage differentials between employees of large firms with organized labor unions and those of SMEs without unions and non-regular workers widened. In order to address this issue, industry-level wage bargaining, such as the system in Germany, should be introduced. Or, the system of France where the effects of collective agreements are usually extended to cover most workers—even those working at establishments without labor unions—can be examined as a model system.

The interests of non-regular workers are not represented in the process of distribution because they are not able to participate in discussions or negotiations that take place at workplaces regarding the improvement of working conditions. Workers employed by contractors are excluded in the decision-making process of principal employers that determines the working conditions of contractors. Due to their employment instability, it is difficult for any group representing the interests of non-regular workers to grow and develop on its own. To enable workers of contractors to participate in labor-management negotiations of principal employers, the labor unions of principal employers should provide assistance and the government should come up with the necessary systems and regulations. And, in developing systems and regulations that will influence non-regular workers, the government must ensure that those representing the interests of non-regular workers

have their voices heard.

Narrowing the differences in negotiating power between large firms and SMEs is also essential in decreasing their wage differentials. While the survival of contractors depends upon their contract with principal employers, principal employers can easily change its contractor any time. As principal employers—mostly large firms—compete fiercely in overseas markets to make great profits, they tend to exert a high degree of monopsony power in the domestic market of production inputs by setting strict terms and conditions of business for suppliers, for example, requiring a certain level of unit costs. Since such power imbalances between principal employers and contractors are the result of Korea's conglomerate-oriented economic growth, they cannot easily be tackled without a fundamental reform of the industrial structure. However, the current circumstances could improve to a certain extent if the government regulates unfair business practices between principal employers and contractors and implements a policy that would make an alliance of contractors and grant it bargaining rights.

Some say that social polarization and inequality can be overcome by pursuing economic growth which would stimulate job creation. However, such a remedy is thoughtless and outdated, given that the time when economic development naturally led to job creation and a more equal distribution of wealth is past. Nowadays, economic growth itself is hard to come by, and it does not always accompany jobs. Even if it leads to more job opportunities, it does not always create quality jobs.

However, there is still much room for easing income inequality through redistribution policies. Social protection policies include public assistance, social insurance and social allowances (or demogrants). Examples of social insurance programs include the industrial accident compensation insurance, national health insurance, national pension and employment insurance. At present, however, these programs are not so effective as a tool of income

redistribution because the average level of benefits is low and they are based more on the principle of contribution—meaning benefits are bigger for those who make bigger contributions—than on the principle of redistribution. The principle of contribution, when followed in practice, tends to increase job stability and brings higher insurance benefits to high-income earners. While workers whose contribution period is less than a year are entitled to unemployment benefits for 90 days, those whose contribution period is 10 years or more can receive the benefits for 180~240 days. The national pension program is both contributory and redistributive; the lower one's income is, the higher the income replacement rate (pension benefits as a fraction of wages) is; but as the contribution period becomes longer, the amount of pension benefits rises proportionately. High-income earners who are stable in their jobs tend to have a long contribution period. In reality, the principle of contribution has a stronger influence than the principle of redistribution. The income replacement rate of pension benefits for the bottom quintile (low-income earners) is 24%, while that of the top quintile (high-income earners) is 35%.

It can be said that redistribution policies have not been very successful in Korea until now. Among various social protection schemes, social insurance has not functioned properly as a tool of income redistribution and average level of social benefits is quite low. While the gap between the Gini coefficient of primary income and that of redistributed income is around 15~35% in most OECD countries, the gap is only 8% in Korea. In order to ease income inequality through redistribution policies, first and foremost, the level of social benefits needs to be expanded significantly. It is necessary to increase the period and a amount of unemployment benefits and introduce an unemployment assistance system. In addition, social insurance must strengthen its redistribution features while weakening the principle of contribution. It is also important to simplify the entitlement period of unemployment

benefits and improve the current method of increasing the amount of pension benefits in proportion to the period of contribution.

Social allowances are the most effective form of redistribution. These are cash payments made to various groups defined as being outside the labor market regardless of their contribution, e.g. children's allowance, disablement allowance, and the basic old-age pension. The youth dividend and the basic income program for farmers which have recently emerged are also close to social allowances. Among various forms of social allowances, the basic old-age pension has been the most effective mechanism in addressing inequality. It has been reported that the elderly suffer the most due to income inequality. Korea has the highest relative poverty rate of persons aged 65 or over among OECD nations at 49.6%, and the basic old-age pension can be of direct help to many elderly people in tackling economic issues. The basic old-age pension also has strong redistributive effects because the same amount of payment is made to beneficiaries regardless of their contribution. Expanding the basic old-age pension with the general revenue while lowering the income replacement rate of pension benefits will not only improve the fiscal stability of the national pension funds but also relieve poverty of the elderly and ease income inequality.

To expand social insurance and social allowances, it is crucial to increase the nation's tax revenues. One way to do so is to increase the rate of property tax, which is currently set at low level and has minimal distortion of resource allocation. Although there are active discussions on raising the income tax and corporate tax revenues by means of raising the tax rates, there are other ways that can be considered such as reducing tax exemptions, reductions and tax credits. The first step would be to reduce tax exemptions and credits applicable to high-income earners and large companies, and then to expand sources of tax revenue by reducing other tax credits, thus encouraging more people to pay tax.

## References

**[References in Korean]**

Minki Hong(2015), Long-term Trends in Top Income Shares.