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The Mechanism of Income Redistribution: The Case of South Korea

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This article presents a case study of income redistribution in South Korea. By analysing the most comprehensive household income survey (National Survey of Family Income and Expenditure), it identifies a growing sign of change regarding the extent to which social security is beginning to play an important role in reducing income inequality. Nonetheless, it argues that its impact is yet to be sizeable enough to make a significant difference and, still further, that social security is of little use in terms of mitigating increasing inequality of original incomes which comprise the largest part of gross income.

Introduction

Over the past three decades, the East Asian Newly Industrialised Countries (NICs) of South Korea (hereafter Korea), Taiwan, Hong Kong and Singapore have become an intriguing subject area in the social sciences. This is not only because these four countries have converged on a distinctive path to growth different from the Latin American NICs – Brazil, Argentina, Mexico – but also because their growth patterns have formed a new development orthodoxy that has achieved a relatively egalitarian distribution of income (e.g. Haggard, 1990; White and Goodman, 1998). The experience of Korea, among all these countries, shows us one of the most intriguing cases of development not only because it was one of the world's fastest growing economies, but also because it was one of the countries hardest hit by the economic crisis in the late 1990s. Despite this economic turmoil, it also became one of the fastest recovering economies managing to repay all loans to the IMF three years earlier than due (see Table 1). Whilst much attention has been paid to Korea's economic development, the mechanisms behind its income distribution have been given relatively little attention. This is not surprising given the fact that the fundamental goal of its developmental state paradigm was to achieve economic growth. Social policy was used as an instrument for attaining this goal (Gough, 2001). In consequence, little attention has been paid to the value premise of social policy that assumes collective responsibility, and that provides the underlying principles behind the operation of the welfare state which are thought of as being explicitly redistributive (Titmuss, 1958).

The issue of equality is of great importance because limited resources in society have always been the greatest obstacle to achieving social justice (Goodin, 1985a). Though the welfare state might not be a perfect instrument for achieving social justice

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Table 1 GDP growth rates in selected countries

Country	1984–93	1996	1997	1998	1999	2000	2001	2002
United States	3.2	3.6	4.4	4.3	4.1	4.1	1.2	2.3
Germany	2.8	0.8	1.4	2.0	1.8	3.0	0.6	0.9
France	2.0	1.1	1.9	3.5	3.0	3.6	2.0	1.4
United Kingdom	2.4	2.6	3.4	3.0	2.1	3.0	2.2	2.0
Japan	3.7	3.6	1.8	−1.0	0.7	2.2	− 0.4	−1.0
Korea	8.2	6.8	5.0	− 6.7	10.9	9.3	3.0	5.0
Taiwan	8.3	6.1	6.7	4.6	5.4	5.9	− 1.9	2.3
Hong Kong	6.5	4.5	5.0	− 5.3	3.0	10.5	0.1	1.5
Singapore	7.5	7.7	8.5	− 0.1	6.9	10.3	− 2.1	3.2

Source: World Economic Outlook (WEO) database, April 2002, at www.imf.org/external/pubs/ft/weo/2002/01/data/growth_a.csv (visited on 8 April 2003).

and social equality, its primary goal still remains to relieve the distress of those who are more vulnerable than others (Goodin, 1988). Therefore, the welfare state is the political and principal mechanism which distributes these limited social resources, often already dispersed in the market, to those who need them most (Goodin, 1985b; Ringen, 1987).

Given this, this article uses income inequality as an outcome measure of welfare state effort. By comparing most comprehensive household income surveys (National Survey of Family Income and Expenditure) under the administrations of Rho Tae-Woo (1988–1992), Kim Young-Sam (1993–1997) and Kim Dae-Jung (1998–2002), this article identifies a growing sign of change over the extent to which social security begins to play an important role in reducing income inequality. However, it argues that its impact is yet to be large enough to make significant difference and, still further, that social security is of little use in terms of mitigating increasing inequality of original incomes which comprise the largest part of gross income.

The expansion of social security and the progress in income survey

It is since 1988 that the previous emphasis on the superiority of informal, familial, community-based mutual support groups has begun to transform towards more state-provided welfare systems (Lee, 1999). Under the authoritarian governments (1961–1987), it was difficult to examine the role that social security played in reducing inequality. This was partly because there were only three major social security programmes in operation – industrial accident insurance (1965), national health insurance (1977), and public assistance (1965) – and partly because the trickle-down effect from economic growth on income distribution was taken for granted as a dominant policy discourse.

Since Korea's democratic transition in the late 1980s, there has been increasing development of the social security system, which includes the introduction of national pensions (1988), universal expansion of health insurance (1988), minimum wage (1988), and employment insurance (1995). Further to this expansion of social insurance programmes to cover all citizens, the highly strict eligibility rule under public assistance was finally relaxed in 2000, meaning the citizens' entitlement to a minimum living standard has since been guaranteed by the state (Kwon, 2003). These systems of social

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security might not have been fully fledged, yet there is little doubt that we are now in much better position to examine whether social security in Korea plays an important role in reducing income inequality as a principal mechanism of income redistribution.

In addition to this development of social security, a marked progress was made to the first comprehensive household income surveys, 'the National Survey of Family Income and Expenditure'. These surveys enable us to analyse income distribution in Korea with more credibility. Compared with previous research that used different data sets for the analysis of income distribution (e.g. Adelman, 1974; Adelman and Robinson, 1978; Choo, 1979, 1982; Choo *et al*., 1996; Kwon *et al*., 1992; Leipziger *et al*., 1992), the launch of this large-scale nation-wide survey on a regular basis was indeed a progressive step forward because, as Kwon (1993) argues, the most significant difficulty underlying the measurement of inequality had been a lack of reliable and consistent data. For example, the 'yearbook of urban household income and expenditure' and the 'farm household economic survey' exclude more than 20 per cent of the entire households (Kwon, 1993). This exclusion may be a substantial proportion of the bottom and the top deciles of income distribution. These data sets also exclude income of the urban employer and of the self-employed, which may generate a downward bias towards the degree of inequality. In addition, the 'yearbook of national tax statistics' may not be a valid source of income measure as might be the case of other countries (see Bradshaw, 1999; Corden, 1999). This is because income in the yearbook is likely to be under-reported in general. Those in both extremes such as the upper-income group and the lowest income group are least likely to be correctly reported. Hence, a rather simplistic adaptation of these sources is likely to be misleading.

In comparison, the 'National Survey of Family Income and Expenditure' is based on a sample of 30,000 households, representing the entire population. In other words, it is much larger than the 'Family Income and Expenditure Survey' which has been carried out on a monthly basis since 1993 but conducted only in urban areas with a sample size of 5,200 households. The National Survey was carried out in 1991 and published in 1993. The second survey was undertaken in 1996 and published in 1998. The third survey was undertaken in 2000 and published in 2002 and will thereafter be repeated every five years.

Table 2 shows the changes of income distribution that occurred between 1991, 1996 and 2000 based on the 'National Survey of Family Income and Expenditure'. These data sets enable us to analyse the detailed composition of income distribution of all households in Korea. The analysis is estimated on the basis of yearly income by yearly income decile groups, instead of monthly income by monthly income decile groups. This is important because the income of those in rural areas is more likely to be seasonal. Indirect transfers such as charities to those in bottom decile groups are also likely to be of seasonal fluctuation (Atkinson, 1975).

Atkinson (1975) also points out why yearly income is more favoured than monthly income. He argues that when income is measured over a longer period, it becomes less unequal. The observed degree of dispersion is likely to be reduced by taking a longer period of assessment. Different periods of assessment can be applied to different income groups for different purposes. On the one hand, averaging of income is difficult for low-income groups, especially to measure the number of people in poverty. On the other hand, however, the use of scope over a year for the distribution of income among the population as a whole is more appropriate than that over a month. The reason for this is

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Table 2 Income distribution in Korea[1] (per cent)

	I	II	III	IV	V	VI	VII	VIII	IX	X	Com[2]
						1991					
H	3.12	5.99	7.37	8.73	8.40	10.82	10.98	12.15	14.85	17.59	64.04
B	1.94	3.77	4.86	5.07	8.96	6.93	10.30	13.04	14.38	30.75	28.82
P	4.23	3.65	3.29	4.29	3.99	5.95	8.01	10.46	15.41	40.72	3.70
D	9.75	6.59	6.72	5.40	3.95	6.85	7.64	8.30	25.56	19.24	0.53
I	18.62	9.76	7.76	7.00	7.97	6.36	7.33	8.71	9.78	16.71	2.91
G	3.31	5.38	6.51	7.44	8.36	9.37	10.55	12.22	14.64	22.22	100.00
						1996					
H	2.64	5.80	7.49	8.34	9.88	9.45	12.34	12.55	13.87	17.64	59.45
B	1.23	2.81	3.97	5.97	6.20	9.95	8.50	12.55	17.12	31.70	31.17
P	3.98	4.08	4.09	3.66	4.83	6.45	6.78	8.48	14.46	43.19	4.95
D	6.69	10.75	9.61	8.03	6.35	10.32	12.22	6.54	12.26	17.23	0.77
I	20.41	11.31	8.00	6.77	6.82	8.32	6.44	11.49	9.57	10.87	3.67
G	2.95	5.03	6.26	7.31	8.34	9.42	10.65	12.27	14.74	23.03	100.00
Pen.	3.41	10.94	9.08	6.18	5.01	11.15	14.15	7.16	12.76	19.76	0.64
						2000					
H	1.87	4.29	6.10	7.22	8.31	9.75	11.35	13.71	16.89	20.51	56.63
B	1.07	2.83	4.02	5.43	6.68	7.92	9.58	10.18	12.96	39.33	31.83
P	3.90	3.64	4.09	4.69	5.88	6.92	7.40	11.54	13.57	38.37	5.73
D	9.38	0.05	10.19	8.18	11.11	7.80	7.07	10.13	10.17	16.92	1.74
I	11.89	11.43	7.67	10.38	9.32	9.53	9.28	8.62	9.06	12.82	4.07
G	2.27	4.16	5.46	6.65	7.74	8.96	10.40	12.19	15.02	27.15	100.00
Pen.	2.17	6.71	10.28	6.21	12.95	9.11	6.71	12.27	12.09	21.50	1.16

Notes: 1. Households of two persons or more, nationwide; 2. Composition: Percentage of total income; H. Household Earnings: wage and salaries, and bonus, including breadwinner's, spouse's, and other household member's earnings; B. Business Income: agriculture, forestry and fishery income, subsidiary work, and other business income, including breadwinner's, spouse's and other household member's income; P. Property Income, i.e. returns from assets: interest, dividend, and rents received; D. Direct Transfers: social security benefits, including pensions and benefits from public assistance; I. Indirect Transfers: gifts and assistance, subsidies from other households, and others (indirect transfers often refer to taxes in contrast to social security benefits in the literature, see for example Shanahan and Tuma, 1994); G. Gross Income: Earnings plus business income plus returns from assets plus direct transfers plus indirect transfers; *Pen*. Pension: benefits from the National Pension Programme. This profile of pensions was included in the profile of direct transfers but was separately shown for the analytic purpose.
Sources: NSO (1993,1998, 2002).

that it is possible to average income for the majority of the population, in addition to the fact that it would be misleading to take a shorter period for those at the upper end of the scale. Table 2 elucidates that property income was not only more unequally distributed than business income but also substantially unevenly distributed between the poorest and the richest. These incomes are often underestimated within the measurement of income inequality. Further it was indirect transfers, not direct transfers in 1991, 1996 and 2000 that made a relatively sizable impact on income distribution. Their share of gross income

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is also considerably higher than direct transfers, contributing 2.91, 3.67, and 4.07 per cent in 1991, 1996, and 2000. In contrast, direct transfers accounted for only 0.53, 0.77, and 1.77 per cent of gross income in 1991, 1996, and 2000 respectively. Compared with the result of 1991, distribution of gross income in 1996 did not make much progress. In fact, it became much worse in 2000 after the financial crisis in 1997.

The contribution of direct transfers on income distribution had increased slightly, yet indirect transfers still remained more important. The poorest decile groups received an even lower proportion of direct transfers, the overall percentage of which became slightly lower in 1996. In 2000, for the poorest decile groups, there was a dramatic decrease in household income, business income, property income, and even in indirect transfers. In contrast, the richest decile groups gained a great return from their household income, business income and gross income.

The figure for 2000 reflects the changes that had occurred after the financial crisis in 1997. First, the composition of both direct and indirect transfer recorded a remarkable increase. For example, the composition of direct transfers recorded a 225.97 per cent increase from 1996 to 2000, while that of indirect transfers recorded a 110.90 per cent increase during the same period. Second, its relative impact on different income decile groups became more redistributive in 2000 compared with 1996. The important impact of direct transfer becomes more pronounced when we take account of the fact that indirect transfer recorded a 171.66 per cent decrease for the poorest decile groups.

This overall change in the mechanisms of income distribution might have resulted from a series of social security reforms that took place after the financial crisis (see Kwon, 2001, 2002; Shin, 2000). Although Table 2 does not show the detailed profile of each social security system, this change might have been affected most by the reform of public assistance which greatly relaxed its 'strict less-eligibility' criteria. For public pensions, its supposedly explicit redistribution effects were not pronounced. Those in the top income decile received the highest returns perhaps because, as its share of gross income shows, the system itself was too immature to be highly redistributive.

As a whole, neither direct transfers nor indirect transfers made any significant modifications on income distribution. As Piachaud clearly points out (1991: 217), social security might be an effective instrument of social justice, able to mitigate the effects of social and economic change. Yet social security is more or less of no use in mitigating increasing inequality of original incomes which comprised more than 95 per cent of gross income both in 1991 and in 1996 and over 94 per cent in 2000. Nonetheless, it is still worthwhile paying attention to their decreasing composition over time, because this in turn may imply that there is a growing sign that social security has begun to expand its redistributive role in income distribution in Korea.

The impact of taxation and social security contributions on income redistribution

The impact of taxation and social security contributions on income distribution is analysed separately in Table 3. As the comparison made between workers' households in 1991 and 1996 shows, the percentage of either direct tax or of social security contributions to gross income was less than 3 per cent, while the percentage of direct tax reached 3.95 per cent and that of social security contributions recorded 4.41 per cent in 2000.

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Table 3 The impact of tax and social security contribution to income distribution[1] (Unit: per cent)

	I	II	III	IV	V	VI	VII	VIII	IX	X	Com.[2]
						1991					
GI	3.44	5.42	6.52	7.52	8.49	9.44	10.79	12.46	14.81	21.11	100.00
DT	1.65	2.79	3.53	4.40	5.54	7.05	8.90	12.63	17.13	36.38	2.77
SSC	3.98	5.81	6.86	7.76	8.90	9.50	10.68	12.31	14.83	19.37	2.29
DI	3.48	5.49	6.60	7.60	8.57	9.51	10.85	12.46	14.74	20.70	94.95
						1996					
GI	4.35	5.65	6.92	7.86	8.52	9.91	10.66	12.70	14.09	19.34	100.00
DT	1.94	2.56	3.39	4.15	6.58	8.27	10.13	12.74	17.07	33.17	1.60
SSC	3.12	4.94	5.81	7.26	8.18	9.52	10.84	12.82	14.59	22.92	1.33
DI	4.41	5.71	7.00	7.93	8.55	9.94	10.66	12.70	14.04	19.06	97.06
						2000					
GI	3.12	4.72	5.86	6.87	7.93	9.16	10.51	12.23	14.85	24.75	100.00
DT	1.28	2.60	3.51	4.86	6.06	7.32	10.92	13.56	17.47	32.42	3.95
SSC	2.51	4.26	5.29	6.78	7.97	9.30	11.38	13.74	16.28	22.49	4.41
DI	3.23	4.83	5.99	6.97	8.01	9.23	10.45	12.09	14.67	24.53	91.64

Notes: 1. Wage worker's households of two persons or more; 2. Composition: Percentage of gross income; GI. Gross Income: earnings plus direct and indirect transfers plus returns from assets plus business income; DT. Direct Taxes; SSC. Social Security Contributions including pensions and social insurance contributions; DI. Disposable Income: gross income minus direct taxes and social security contributions.
Sources: NSO (1993, 1998, 2002).

The overall profile of the level of social security contributions in 1991 was also very similar to that of gross income. This may mean that no considerable vertical redistribution took place. Nonetheless, the degree of dispersion of the level of social security contributions in 1996 made a slight change. This is so in that those in lower-income groups contributed less than their relative level of gross income but those in upper-income groups paid more than their relative gross income. Further, whereas the level of gross income and that of disposable income (after direct taxes and social security contributions) were not very different in 1991, they became more equal in 1996. In 2000, similarly, while the overall degree of income distribution worsened as shown in the dispersion of gross income and disposable income, those in lower-income groups contributed less than their relative level of gross income. Those in upper-income groups, however, paid more than their relative gross income except for the richest decile group.

It is also important to note that there was a dramatic increase in both direct tax and social security contributions as a proportion of gross income from 1996 to 2000. This increase is mainly attributed to a series of welfare reforms. Examples include public pensions, which have, since 1998 covered the self-employed, farmers and urban informal sector workers. President Kim Dae-Jung extended employment insurance and implemented public works projects to provide emergency help for those hit by the economic crisis (Kwon, 2002: 26). For those affected by the economic crisis, temporary livelihood protection was in operation from 1998 and has, since 2000, been absorbed

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Table 4 Ratio of direct and indirect tax (per cent)

		Korea (1995–1999)				
Classification		1995	1996	1997	1998	1999
Internal Taxes	Direct	53.4	52.1	49.9	57.9	49.2
	Indirect	46.6	47.9	50.1	42.1	50.8
National Taxes	Direct	46.8	44.4	41.4	48.0	40.5
	Indirect	53.2	55.6	58.6	52.0	59.5
Tax	Direct	54.7	52.9	50.5	55.3	49.5
	Indirect	45.3	47.1	49.5	44.7	50.5
	Selected industrialised countries (national taxes basis)					
Classification	Japan (1998)	USA (1998)	UK (1997)	Germany (1998)	Italy (1997)	France (1998)
Direct	59.3	93.2	56.9	45.4	56.7	39.6
Indirect	40.7	6.8	43.1	54.6	43.3	60.4

Sources: MoFE (2000); NTS (2000).

into the reformed public assistance programme. This increase looks even more profound when it is compared with a marked decrease that took place in both direct tax and social security contributions from 1991 to 1996. The key cause of this change can be attributed to the introduction of a new policy idea, 'globalisation' which reinforced national competitiveness as a predominant policy objective in all state policies. This was done whilst encouraging the partnership between public and private sectors, developing human capital and avoiding dependency (Shin, 2000: 87). In Table 3, the impact of the tax structure is not clearly revealed in the analysis. Nor does the analysis include the impact of indirect taxes which would be more regressive in nature than direct taxes. As Table 4 shows, tax systems have become less progressive over time. In other words, it was indirect taxes that became more proportioned in the tax system. In international comparison, only Germany and France have a higher rate of indirect taxes than direct taxes. All in all, overall policy intervention for income redistribution in Korea has been rather modest. Substantial changes have not occurred either through taxes or social security. Only modest changes have taken place via the mechanism of indirect transfers. This may imply that the role of the state has been limited in reducing inequality. In fact, the income gap between the bottom decile group and the top decile group of urban wage workers' households has not been greatly moderated even during the period of economic growth since 1979. Instead, it has worsened seriously during the period of economic downturn since 1997 (NSO, 2000). More rigorous policy intervention is required precisely because social problems cannot solely be solved merely by economic growth, which may even exacerbate the polarisation of society in turn.

Concluding remarks

Measuring a number of proxy variables such as gross income and disposable income may not be the most appropriate approach to evaluate the ways in which the level of income is distributed across the whole population. This is arguably because inequality may have

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to be defined as the position of the worst-off citizens in relation to the average condition among the citizenry (Korpi, 1980). However, what is commonly understood is that in order to reduce inequality, the strategy of redistribution exists in almost all the industrialised capitalist democracies in one way or another. Yet the problem remains when it comes to the question of whether this mechanism is effective enough in reducing inequality (Ringen, 1987). Systems of welfare may actually benefit the higher-income group and the middle-class rather than the poor (see Baldwin, 1990; Bradshaw, 1985, Goodin and Le Grand *et al*., 1987).

In Korea, most replacement schemes are actuarially fair but modest in vertical redistribution. In other words, benefits expected by those insured are more or less equal to their contributions, except benefits from public assistance. Defined as 'interventions that reallocate market outputs or inputs in a way believed to be closer to collective goals' (Shanahan and Tuma, 1994: 734), redistribution may have occurred not between those of different income classes but between those of the same income class with different degrees of risks (see Baldwin, 1990; Jacobs, 2000).

By analysing the most comprehensive household income survey in Korea, this research has found first that it is indirect transfers rather than direct transfers that have made a relatively sizeable impact on income distribution. Second, while the financial crisis in 1997 worsened inequality, the composition of direct and indirect transfers within gross income experienced a dramatic increase in 2000. The increase of direct transfers from 1996 to 2000 is worth highlighting because of a series of welfare reform measures in response to the financial crisis. Third, the proportion of direct taxes and social security contributions to gross income has increased dramatically from 1996 to 2000, which made an important contribution to making income distribution more equal under the conditions of severe gross income inequality.

Despite all these, however, it has to be pointed out that neither the impact of direct transfers or indirect transfers on income distribution is sizeable enough to make a substantial difference in income redistribution. Nor is the impact of direct taxes and social security contributions. For all these reasons, although there has recently been a growing sign of the role that social security begins to play in income redistribution, it seems fair to conclude that social security in Korea is of little use in mitigating increasing inequality of original incomes.

These findings also guide us to expect that the role of public transfer will be reinforced in due course. This is not only because there have been increasing challenges and criticisms about Korea's sustained economic growth and egalitarian income distribution, but is also because there have been questions about the beliefs that household economies have the capacity to save and that Confucian family welfare could be an effective functional equivalent to welfare statism. The pro-family arrangement, as a unit that represents culture-embodiment social structure, has lost its preconditions. Not only have there been increasing doubts about the financial capacities of private households and the self-help potential in social networks, but also there has been a continuous decline in total fertility rates, a mounting aged dependency ratio, and a decrease in the average number of household members. In a nutshell, there is ample evidence that long-term trends make the potential for self-help in private or social networks appear much more likely to decline than to grow.

For similar reasons, public expenditures on welfare are bound to rise, so the level of protection will also grow, much beyond the level of minimum subsistence in other

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countries of the region, notably in Japan and Taiwan (Jacobs, 2000). In these cases, as well, the growing sign that social security is becoming an important mechanism of income redistribution should be taken into account in longer terms, since social policy measures are not meant to have an imminent redistributive impact on society. To this end, it will be interesting to see the ways in which the states in the region transform themselves from simply a regulator to more of an active provider in welfare provisions. For social security to be a more effective mechanism of income redistribution, it is essential not to overemphasise the hierarchical nature of the relationship between economic and social policies but to recognise that the dynamic of economic development is only manifested within pronounced articulation of social policy.

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