

J-nomics and a New Policy Agenda in Korea

Joseph E. Stiglitz¹

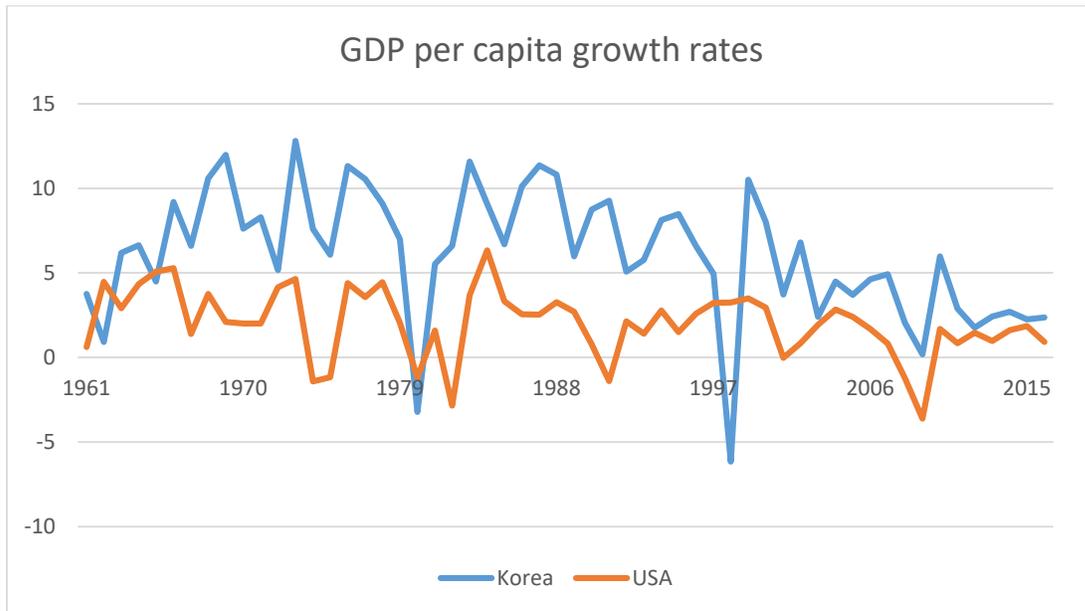
Korea has embarked on a new and innovative economic strategy, sometimes called J-nomics, a possible solution to the problems plaguing so many advanced and emerging markets. In this brief essay, I first will outline some of the main challenges facing Korea and many other advanced countries, and then explain why J-nomics provides a hopeful answer to these challenges.

The economic challenges

In setting the stage, it is important to understand that while Korea faces many problems similar to those facing the U.S. and other advanced countries, these problems often take on a different form, and in many cases, are less serious and therefore more manageable. Broadly, the problem facing both advanced countries and many emerging markets is that there has been a slowdown in economic growth compared to recent highs — though it remains above historical norms — and what growth that does occur benefits those at the top. The World Income Database shows that among Asian countries, inequality in Korea is especially pronounced, with the top 10 percent of Koreans earning 45

¹ University Professor, Columbia University. Paper prepared for the Korea Institute for Industrial Economics and Trade (KIET). I wish to acknowledge research assistance from Haaris Mateen and editorial assistance from Debarati Ghosh, as well as financial support from the Institute for New Economic Thinking (INET) and the Rewriting the Rules project at the Roosevelt Institute, supported by the Ford and Open Society Foundations, and the Bernard and Irene Schwartz Foundation.

Figure 1

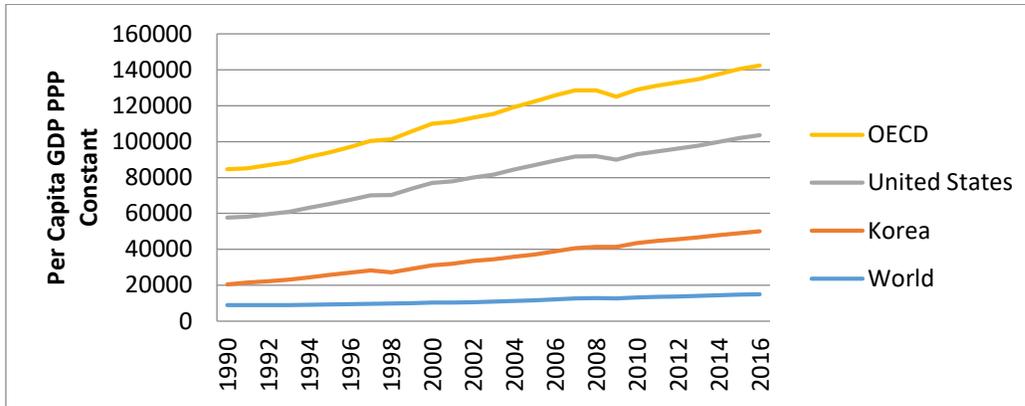


Source: World Bank

While Korea's GDP per capita remains markedly lower than the United States and the OECD average — showing that there are still opportunities for growth (“catch-up”) (figure 2) — it performs relatively well in broader measures of well-being, such as the human development indicator of the UN (HDI), which takes into account not just income, but health and education. Korea ranked 18 in 2015, better than France (21) and Finland (23). In comparison, the U.S. ranked 10. In recent years, the UN has constructed an inequality adjusted-HDI, reflecting large differences in inequality across countries. Employing this

measure, both the U.S. and Korea do worse: the U.S. slips 10 points in its ranking, and Korea drops by 19 points⁶.

Figure 2



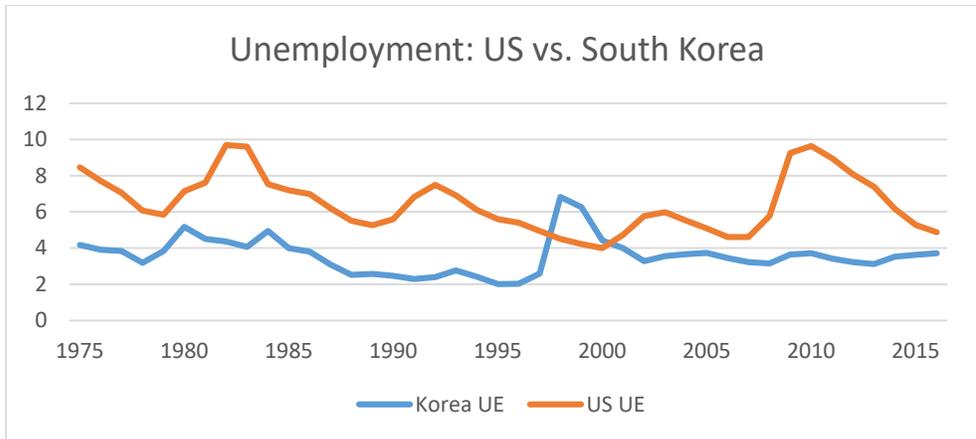
Source: World Bank

Unemployment is markedly lower in Korea than in the U.S., and even more so compared to Europe. Korea has consistently performed better in this dimension than the U.S. (see Figure 3.) Except for the financial crisis of 1997-98, Korea's employment rate has been below 4 percent for the past third of a century, while the U.S. has never recorded an unemployment rate that low.⁷

Figure 3

⁶ Table 3: Inequality Adjusted Human Development Index, United Nations Development Programme for the year 2015. Accessed at: <http://hdr.undp.org/en/composite/IHDI>.

⁷ Source: World Bank.

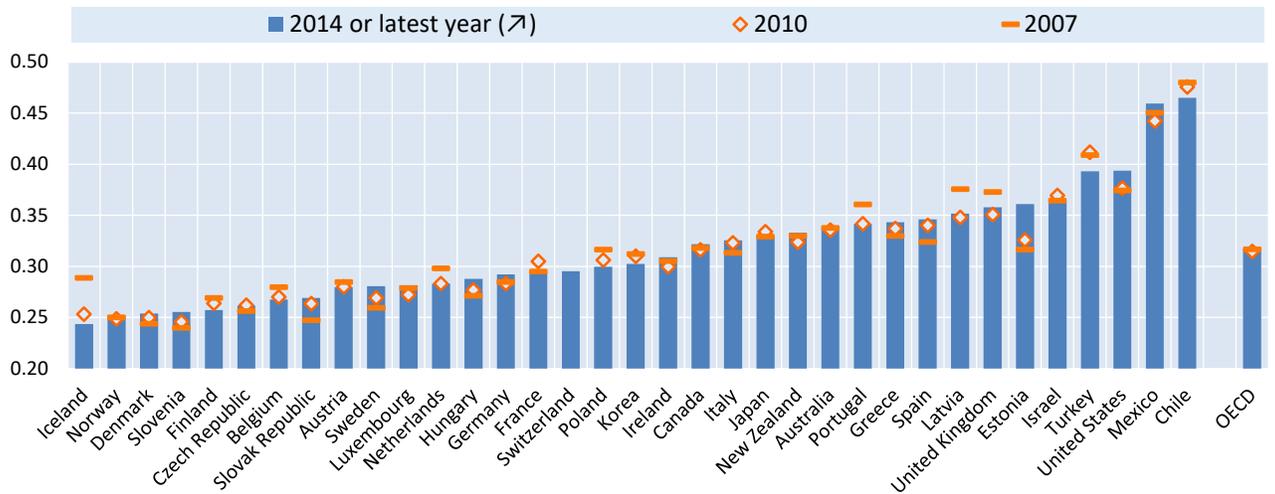


Source: World Bank.

Inequality too has been markedly lower. Figure 4 presents data for the standard measure, the Gini coefficient, which ranges between 0 (no inequality) and 1 (where all income goes to the very top). South Korea has a Gini coefficient of 0.29, compared to America’s Gini coefficient of 0.39 — a dramatic difference.⁸ But in this measure, Korea differs little from the average of other advanced countries.

Figure 4

⁸ Different data series give different measures, but the rankings among countries are consistent: Korea has far lower inequality than the US. Census Bureau data shows a Gini coefficient of 0.49 for the US but this does not adjust for taxes and transfers and additionally is computed at the household level (OECD looks at individuals).



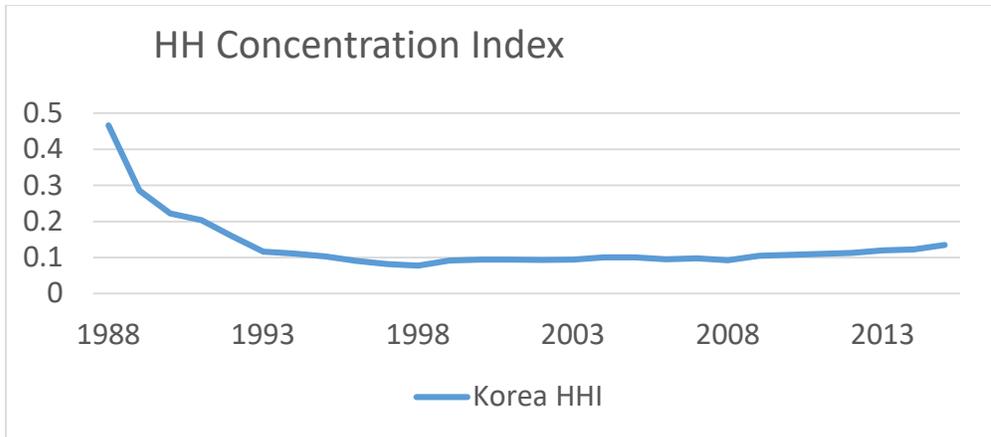
Source: OECD.

Market concentration: a continuing source of concern

A feature of the Korean economy which has been of persistent concern is its market concentration, with the large role played by the Korean conglomerates, the Chaebol. These were a distinctive feature of Korea's modernization, and perhaps allowed it to grow without dependence on foreign direct investment. Market concentration is a concern both economically and politically; it can undermine effective democracy, and impede the entry of young and dynamic firms into the market. It can thus lead to inequality, a lack of dynamism in the economy, and over the long run, slower growth.

Market concentration remains a concern. Even though it declined markedly in Korea in the 1980s (Figure 5 uses a standard measure, called the HHI), it has been increasing since the global financial crisis, despite economic reforms that were undertaken to curtail it in the aftermath of the crisis.

Figure 5



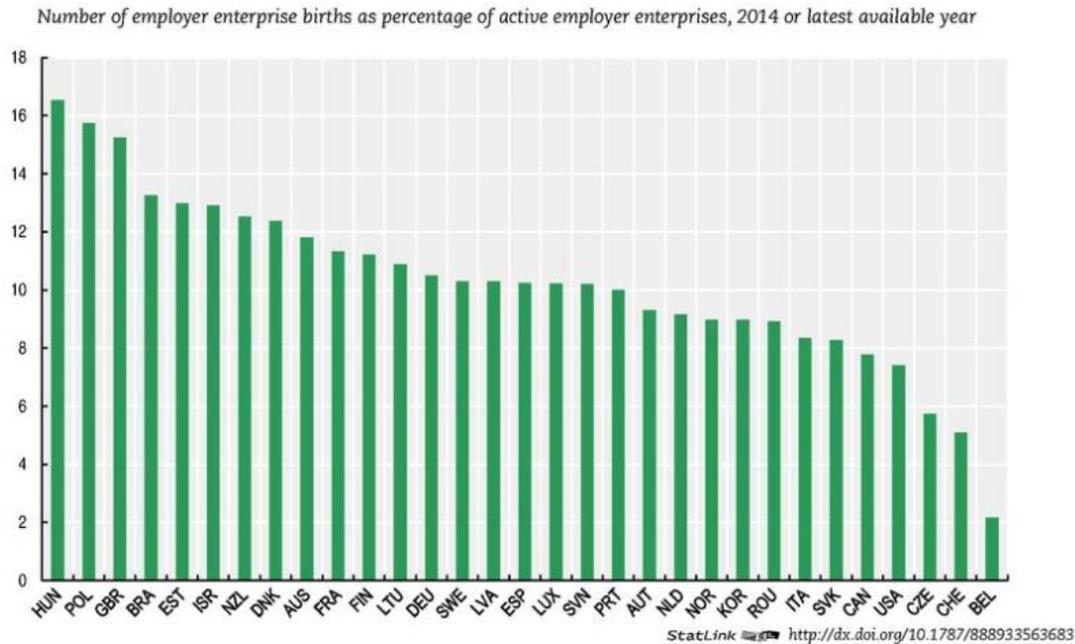
Source: World Bank

One of the very positive aspects of Korea is its dynamism, in spite of this market concentration, based on a highly educated labor force (the percentage of those aged 25 to 34 completing a college education in Korea was 70 percent in 2016, compared to 48 percent in the U.S.).⁹ This dynamism is reflected in a higher percentage of new firms than in the U.S., but not as high as in the best-performing countries (see figure 6).

Figure 6

Growth in share of new firms in Korea outpaces the US

⁹ Figure A1.2, Education at a Glance 2017: OECD Indicators. Accessible at: <http://www.oecd.org/education/eag2017indicators.htm>



Source: OECD.

A new policy agenda

For more than sixty years, conventional wisdom has held that the government should approach the problems of unemployment, inequality, and low wages only indirectly, with limited instruments, and specifically that it should stimulate aggregate demand through fiscal and monetary measures. Monetary policy should be limited to buying and selling short term government securities, and should not entail directing credit, either affirmatively, towards more productive sectors, or negatively, away from those that are highly speculative and risky. The conventional wisdom thus maintains that the best way to improve equality is through improving skills: grow the economy, and everyone will benefit.

This is the doctrine of trickle-down economics, widely believed, though neither theory nor empirical evidence support it. More generally, small tweaks in the economy will achieve desired results.

There is now overwhelming evidence that this recipe has not, and will not work well. In many countries job creation has been weak; even where there has been more robust job creation, as in the U.S. and the UK, wages are low. Many of the jobs being created are temporary jobs, without economic security.

Voters have increasingly turned away the centrist parties that pretend this approach will work.

This centrist approach (adhered to both by the center-left and center-right) was based on a strong reliance on markets — with the center-left arguing for only slightly more intervention than the center right. The Democratic Party in the U.S. and social democrats in Europe argued for privatization, deregulation and liberalization. These economic policies were largely predicated on the blind belief that governments are inefficient and markets are efficient, but only if freed from government constraints and interference.

The reality says otherwise: no government has ever wasted money on the scale of America's financial sector, and there are pervasive inefficiencies and corruption in many parts of the private sector. America's private health care system spends 10 percent more per capita than France's largely public system, with worse results.

There is an alternative view that holds that we need to strive to increase efficiency of both the private and the public sector, to curb corruption in both, and to limit exploitation.

A more direct attack on societal problems

In some cases it makes sense for government to be more actively engaged in economic activity, for instance in the labor market. This appears to be a key part of J-nomics.

Of course, government is intrinsically engaged in the market, for it sets the basic rules of the game. Markets don't exist in a vacuum; they have to be structured, and how they are structured affects both distribution and efficiency. One of the main reasons for increasing inequality in the United States is that the rules have been rewritten over the last forty years, since Ronald Reagan became President, in such a way as to disadvantage workers. Labor laws have been rewritten and reinterpreted to give workers less protection and to make unionization more difficult. Globalization too has been managed in such a way to weaken workers' bargaining power.

Higher employment through strong monetary and fiscal policies and increased wages in the public sector will help drive up wages in the private sector, reducing inequality. It may, however, not be enough to rely on indirect means; the government may have to provide guarantee of employment for all who are willing to work, a backstop when the market fails. And markets often fail to reach particular regions and individuals with limited skills. India, with a much lower per capita income, has provided such a guarantee for hundreds of

millions of people in rural areas, and the provision of this guarantee has helped pull up rural wages.

As opposed to trickle-down economics, this strategy is based around building the economy up from the middle. Strengthen these segments of society and all of society will prosper. The middle class is the basis of the success of every society, of every economy, and of every well-functioning democracy.

Indeed, America's failures today can be traced to the evisceration of the middle class, with its stagnating (and relative to the top, declining) incomes, and more and more households moving into poverty. Life expectancy of the country as a whole is in decline.

This is the right time for such a policy, and Korea is the right place for this kind of institutional innovation.

Transitions and transformations

All economies are going through multiple transitions and transformations. Central is the broad transition from manufacturing to service, as increases in the productivity in manufacturing ensure that global employment in manufacturing will decline. Most countries are going through demographic transitions, with aging populations and women taking more active roles in the labor force. Many Asian countries are experiencing a transition from export-led growth to growth through domestic demand. This transition is especially important in the new world of protectionism. Finally, we are moving to an innovation and knowledge economy, and the knowledge economy is markedly different from the traditional industrial economy, even more different than an industrial economy was from the agricultural economy. Indeed, the increase in

knowledge is the basis for enormous increases in standards of living over the past two centuries. Success in the knowledge economy will rest on creating a “learning society.”

Because of its highly educated labor force, Korea is in a good place to make such a transition. While the overall share of college-educated adults is similar in Korea and the U.S., as we noted earlier, Korea’s youth are much more likely to be educated.¹⁰ Korean students outperform American students on the math PISA tests, averaging a score 524 compared to 470 for the Americans (#2 vs. #30 in the OECD).¹¹

Korea is already well into its transition into a 21st century learning economy.¹² In 2016, South Korea R&D spending accounted for 4.2 percent of GDP. Compare this to the U.S., where R&D spending accounted for just 2.8 percent of GDP, and much of that for military purposes.¹³

Markets don’t make such transitions on their own very well. The Great Depression can be viewed in part as a failure in the transition from agriculture to manufacturing. It was only through strong government intervention — an unintended consequence of World War II and the policies that were instituted after that war — that the transition was finally successfully made.

¹⁰ Source: Figure A1.2, Education at a Glance 2017: OECD Indicators. Accessible at: <http://www.oecd.org/education/eag2017indicators.htm>

¹¹ Source: PISA 2015 results, OECD. Accessible at: <http://www.oecd.org/pisa/data/>. According to the OECD, “The Programme for International Student Assessment (PISA) is a triennial international survey which aims to evaluate education systems worldwide by testing the skills and knowledge of 15-year-old students.”

¹² See J. E. Stiglitz and Bruce Greenwald, *Creating a Learning Society: A New Approach to Growth, Development, and Social Progress*, New York: Columbia University Press, 2014.

¹³ Source: World Bank.

Now, government will have to take an even more active role. The newly expanding sectors, including health, education and caring for the aged, are sectors in which government naturally plays an important role. Wages in those sectors are not really market-determined. They reflect societal values: how much we value the education of our children, and how important we view care for our elderly. If we truly value them, we would pay more for those who educate and care for them; such a policy would ameliorate inequality both directly and indirectly, by pulling up wages in other sectors.

A multi-pronged approach to facilitating transition — ensuring inclusive growth

The challenges facing Korea and other advanced countries are, as I have suggested, sufficiently deep and profound that mild tweaks to the system won't work. Indeed, I worry that unless stronger policies are undertaken, some of the problems could get worse. Artificial intelligence and robotization may drive down real wages, especially for unskilled workers. There could be a significant loss of jobs. What is needed is a comprehensive, multi-pronged strategy.

In this brief note, I can only list the principle ingredients of such a strategy, saying a few words about each.

Active labor market policies are important in moving individuals towards new work. But such policies only work when there are jobs, which means there have to be strong macro-economic policies, and education and training that is well-suited to the jobs that are being created. Some countries have managed to make these policies work well.

Industrial policies can be important in fostering new industries and technologies. Korea successfully used such policies in the past. Today, of course, industrial policies have broader objectives (not just encouraging *industry*, but other sectors as well, and not just focusing on growth, but also on environmental sustainability and inequality) and other instruments.

There are some who are ideologically opposed to such policy. That is nonsense. All countries engage in industrial policymaking, whether they know it or not. But not being aware that they are doing so opens the system up to manipulation by special interests. This happened in the U.S., where the financial sector got favorable treatment in taxation and in bankruptcy laws, resulting in an inefficient expansion of the sector, from 2.5 percent of GDP to almost 8 percent, without any concomitant increase in growth or efficiency, but with a marked increase in speculation, exploitation, inequality, and (most costly) instability, culminating in the Great Recession.¹⁴

Today, we have learned how to use a wide gamut of instruments for advancing transitions and transformations, including enhancing credit availability, promoting research and education, and strengthening public investment in complementary ways.

A kind of industrial policy that has historically received less attention than it has perhaps deserved is the place-based policy, where government attempts to affect the location of economic activity. It has long been noted that markets on their own are not in general efficient in spatial allocations, largely because

¹⁴ These problems are set forth at greater length in J. E. Stiglitz, *Freefall: America, Free Markets, and the Sinking of the World Economy*, New York: W.W. Norton & Company, 2010 written in the aftermath of the 2008 crisis.

of the presence of large spatial externalities, including those associated with transportation and congestion. That's why almost all governments at the local level engage in zoning. But at the macro-level, many countries are hesitant to implement place-based policies. The mantra has been: government should help people, not places. But this ignores the market failures I just mentioned. It ignores the fact that people are imperfectly mobile, and as a result, in the absence of such policies, populations located in certain areas may suffer unacceptably low incomes or high levels of unemployment. And it ignores the importance of place-based social and organizational capital.

Some countries have managed to use such policies effectively. In the U.K., the city of Manchester used to be the textile capital of the world. It has transformed itself into an important educational and cultural center with the help of funds from the central government. Just as individuals who are displaced by technology or globalization are not in a position to help themselves, so too are communities.

Creating a new middle class society

These policies offer the hope of an alternative to the current American model which has failed so miserably. Success is, of course, not automatic. There are government failures as well as market failures. Success will require careful oversight — to make sure that money is spent well. A strengthened civil society can play an important role.

Another prong of policy reform: curbing market power

Concentration of market power has long been a problem in Korea. The Chaebol have been successful partly because they have invested well in

people, technology and research. Those lucky enough to get jobs in the Chaebol often receive higher incomes than others of comparable skill. But as I suggested earlier, there are economic, political, and social consequences of having an economy with excessive market concentration. Such consequences are the reason that at the turn of the last century, the U.S. passed its anti-trust laws.

While in Korea, the political consequences also have long been evident, this is especially so recently, leading to a loss of trust in societal institutions over the past few years.

Some of Korea's large firms have been very innovative. But there is an unlevel playing field, distorting the economy, especially when the large enterprises receive special favors from government. Small and medium sized enterprises (SMEs) are almost always at a disadvantage. They find it difficult gaining access to credit, for instance, and can't afford the large research programs that the Chaebol can undertake.

Good economic policy entails giving these firms some assistance — not tilting the playing field against them.

This is especially important as one thinks about creating an innovation economy. There is a need, for both large and small firms, for an innovation economy. Some of the most important innovations have been made by small firms, some of which then grew into large enterprises. We can see that clearly in today's tech giants in Silicon Valley.

Large firms can undertake research projects that are beyond the scope of small ones. Yet as I noted, despite this a significant portion of new ideas

originate from new and small firms; these small firms occasionally exhibit a kind of flexibility beyond the reach of larger and older enterprises. But an unlevel playing field stifles these firms, and this is especially so when large firms take actions to protect and extend their market power. This was evident in the U.S., when Microsoft tried to quash innovative firms like Netscape, going so far as to overstep the boundaries of legality, engaging in anti-competitive practices which were found to violate laws in three continents. There is widespread concern that big firms today are again stifling innovation, reflected in statistics showing that new firms occupy a diminished role in the American economy. Banks and investors won't extend credit to new enterprises when they know that big-tech could simply crowd them out of the market.

The role of government

A modern successful economy requires a government that ensures markets behave the way they should and that does what markets inherently can't do. There is thus an important role for government in protecting a competitive marketplace by preventing anti-competitive practices, as well in ensuring that companies and households don't pollute the environment.

Markets on their own won't provide adequate investments in technology, education, or infrastructure, and so the government has to step into the breach. We've seen too that markets on their own are not good at managing the transitions and transformations of the kind that Korea and many other countries are now confronting.

And markets on their own may lead to levels of inequality that are socially unacceptable and economically dysfunctional. We now realize that excessive

inequality is not just a moral issue. It has economic consequences, and especially when that inequality arises as a result of market power or exploitation.¹⁵

The basis of any successful economy and democracy is a strong middle class, but markets on their own may not result in a strong middle class. On the contrary, market forces in the U.S. (especially as they've been structured over the last forty years, beginning with Reagan) have led to the evisceration of the middle class. It is clear that a middle class life has moved increasingly out of reach for an increasing slice of America's population. So there is a need for government to rewrite the rules of the market economy in ways that result in a better balance of power and a fairer distribution of income. It has to run the economy in such a way that guarantees good jobs for all who want them, with decent pay and a modicum of security. Through housing, education, health care, and retirement policy, it must ensure that a middle class lifestyle is accessible for most, if not all of its citizens.

The weak performance of the U.S. economy can be explained partially by the fact that the government has failed to perform its central functions. It failed to adequately regulate the market, so the economy today is less competitive than it used to be. It failed to provide sufficient public investment in education, technology, and infrastructure. It rewrote the rules of capitalism to favor the 1% at the expense of the 99%, leading to the evisceration of the middle class. And it deregulated the financial sector, allowing Wall Street to prey on the rest

¹⁵ I have discussed these issues at greater length in my books, *The Price of Inequality: How Today's Divided Society Endangers Our Future*, New York: W.W. Norton & Company, 2012 and *The Great Divide: Unequal Societies and What We Can Do about Them*, New York: W.W. Norton & Company, 2015.

of the economy, rather than to serve it in the manner that it is supposed to. All of these failures should serve as lessons for other countries.

One of the reasons cited for the lack of public investment was a lack of funding. That can be blamed in part on the vast sums squandered in foolish wars (in Iraq most recently), costing the government well over a trillion dollars.¹⁶ But another reason for the lack of funds is that corporations do not pay the taxes that they should, and lobby heavily to have their taxes reduced yet further. Apple, Google, and Facebook employed the same ingenuity used in the creation of innovative products to avoid paying taxes. And with the recently-passed 2017 tax bill, all the corporate lobbying has paid off: companies were granted a massive reduction in corporate taxes, and few if any of the loopholes that enabled so many to escape paying taxes in the first place were closed and many new ones were opened up.

National innovation systems

There are two pillars to J-nomics: building the economy out from the middle and creating an innovative, knowledge economy. Before concluding, I want to say a few words about innovation. Success in innovation requires a comprehensive agenda, reflected in a national innovation system.

Successful national innovation systems require a range of institutions. Public investments in technology and basic research and education is crucial.

¹⁶ Indeed, the full costs of disability payments and health care costs of those injured in Iraq and Afghanistan are now estimated by themselves to be in excess of a trillion dollars. For a broader discussion, see J. E. Stiglitz and Linda Bilmes, *The Three Trillion Dollar War*, New York: W.W. Norton, 2008.

Intellectual property is important, but its importance has been exaggerated. When the U.S. Supreme Court curbed patents on naturally occurring genes, innovation increased, leading to lower prices of tests and higher quality tests; lives were saved that would have been lost if the Supreme Court had ruled the other way.

It is important to recognize that markets on their own don't work well in the production and dissemination of knowledge.¹⁷ There are typically large disparities between private and social returns to innovation. Creating the world's most efficient advertising engine is not the world's most important task, from a social perspective. Saving the planet from climate change and saving lives are more important. But much research is directed at enhancing market power and rent extraction, and not at maximizing social welfare.

Small firms can play an important part in a dynamic innovative economy, and for them to play that role will require support from government, which can come in a number of forms, including better access to capital.

New models of capitalism and the market economy

The sad reality is that American-style capitalism has failed to produce shared prosperity. Over the past forty years, while a few at the top have done very well, the average income of the bottom 90 percent of earners have faced near stagnation. It is no surprise that there is such discontent.

These overall failures come in spite of the fact that there are some areas of impressive strength (for example higher education, where the private for-

¹⁷ This is one of the central themes of Stiglitz and Greenwald, *op. cit.* who expand on the ideas presented in this section.

profit sector plays no important role; all of the major universities are either state-supported or not-for-profit).

A third of a century ago, under President Reagan, America undertook an economic and social experiment with supply side economics, with its policies of deregulation and lowering tax rates at the top. With the evidence of a third of a century, we can unambiguously declare: that experiment was a colossal failure. Growth slowed, and inequality increased. Even life expectancy is on the downturn. The political consequences are now evident. This should be an important warning for others.

There is a need for a new social contract in the 21st century. Korea is charting an alternative path, based on strengthening its highly-educated middle class and creating an innovative and dynamic economy, with the prospect of creating an economy and society around a new, shared prosperity.