

Trade and Inequality: South Korea's Achievements and Challenges



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Since the 1990s, the momentum of free trade and globalization, accelerated by the launch of the WTO, appeared unstoppable. However, after the 2008 financial crisis, skepticism and antipathy toward the global free trade order began to surface, and Trump's emergence in the mid-2010s explicitly mainstreamed the anti-free trade stance. With Trump's successful reelection, terms like 'nationalism' and 'protectionism' have become de facto standards in international politics.

This phenomenon stems from many countries' citizens beginning to politically support the perception that free trade is the main culprit behind their nations' 'middle-class decline' and 'income polarization'. While many studies in economics point out that trade may not be the biggest factor exacerbating income inequality in various countries, they clearly state it is at least one of the major factors. Most importantly, the proportion of people internationally who believe that restricting free trade will bring them better jobs and economic status is steadily increasing, regardless of whether trade is truly to blame for inequality.

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Despite recent global anti-trade sentiment, public opinion in South Korea remains strongly supportive of free trade. This is related to the fact that South Korea has benefited more from free trade than suffered from its side effects. Since the beginning of the 21st century, South Korea has pursued more aggressive free trade policies than any other country, leading to high economic growth rates. For example, from 2011 to 2020, South Korea recorded the third-highest average annual real GDP growth rate among OECD countries with populations over 10 million. Meanwhile, the disposable income Gini coefficient, which indicates income inequality, has been steadily decreasing since 2011. In this respect, South Korea can be considered one of the best countries to use as a practical example when explaining theoretical predictions about the positive outcomes of free trade in international trade textbooks.

Will South Korea continue to serve as a representative role model proving the success of free trade in the future? Recent studies conducted by KIEP raise concerns about this outlook. Koo et al. (2020, 2022, 2024) examined how changes in South Korea's trade structure, following the rapid economic growth of China and Vietnam since the 2000s, have affected South Korea's labor market and workers. These series of studies show that South Korea is also experiencing income polarization between trade winners and losers. According to these studies, Korean workers in import-competing industries experiencing increased imports from China and Vietnam saw gradual decreases in real labor income over the long term (10 years). In contrast, Korean workers in export-growing industries to China and Vietnam experienced higher real labor income growth rates during the same period.

The disparity in these real labor income growth rates can largely be explained by differences in employment stability and reemployment outcomes. First, workers in import-competing industries faced a much higher risk of involuntary job displacement. When tracking their job paths after job loss, they were more likely to work in different industries or occupations, risking the loss of their industry/occupation-specific human capital. Moreover, the likelihood of them being reemployed in another comparative disadvantage industry rather than comparative advantage industry limited their income growth rates. In contrast, workers in export-growing industries faced relatively lower risks of involuntary job displacement. Even if they experienced involuntary job loss, they were more likely to find new employment in the same industry and occupation, minimizing the loss of their accumulated human capital. Even in cases of voluntary job changes, the probability of moving to export growth industries was much higher.

In essence, during the period of experiencing changes in its trade structure, South Korea did not achieve a sufficiently smooth labor reallocation from comparative disadvantage industries

to comparative advantage industries, as postulated by traditional trade theory. As a result, certain groups in Korea who experienced job reductions due to trade suffered relative income losses over an extended period.

These research findings suggest at least two implications. First, it is premature to feel secure that Korea is safe from the side effects of free trade based on the current relatively favorable income inequality indicators. The characteristic of income inequality patterns experienced by Korean workers due to trade shocks, as revealed in the research, is that they occurred slowly over a long period. Whether in import-competing or export-growing industries, workers showed little difference in income levels early in their careers, but after 10 years or more, the income gap between them widened considerably. This means that income inequality due to trade shocks in Korea is likely to become more pronounced with age. In fact, the disposable income Gini coefficient for Koreans aged 60 and above is significantly higher than Korea's overall Gini coefficient. Considering Korea's rapid transition to a super-aged society, trade-related inequality issues may become increasingly contentious in Korea. Therefore, preemptive preparation is necessary.

Second, the fact that income disparities between workers due to trade have progressed slowly over the long term conversely suggests that the Korean government's domestic complementary measures have been somewhat effective. While pursuing aggressive FTA policies, Korea allocated and executed substantial budgets to support domestic industries expected to be adversely affected by trade. Furthermore, significant efforts in supporting SMEs' FTA utilization policies have yielded tangible results. Korea's employment insurance system has also played a considerable role in compensating for the income of unemployed workers from import-competing industries (Koo et al., 2022). While these various domestic complementary measures by the Korean government may not have completely eliminated individual Korean workers' losses from trade shocks, they have helped mitigate them to some extent. It should not be forgotten that the reason why benefits of free trade could be more highlighted than its costs in Korea's case is because active free trade policies and complementary domestic measures worked together.

For Korea, with its high dependency on foreign trade, pursuing policies that continuously expand trade opportunities is a natural choice. However, Korea must face the reality that it is not completely free from the income inequality issues that trade can cause. The prerequisite for Korea to engage in better free trade in the future is to create a system that can minimize trade losses and maximize benefits through the design and implementation of more effective domestic complementary measures. To achieve this, a thorough review of the achievements and

limitations of related domestic complementary measures implemented so far should be conducted first. Based on this, Korea needs to devote more effort than before to developing support policies for businesses and workers that effectively respond to the increasing uncertainty in the international trade environment and rapid changes in technology and demographic structure. It is hoped that by successfully proposing practical measures to maximize trade benefits for as many people as possible while minimizing trade damages, Korea can establish itself as a solid alternative to the prevailing anti-free trade sentiment. **KIEP**