


The Distributional Effect of Market Power and Its Implications for Inclusive Growth in Korea



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Identifying the causes of rising income inequality has become one of the biggest socioeconomic topics in many developed and major emerging economies. The most plausible explanations among both policy makers and analysts have to date been dominated by the textbook story of globalization and skill-biased technical change. Until recently, only a few studies have pointed to the role played by market power and corporate rent-seeking in rising income inequality. In the absence of competition and effective regulation, market power leads to an increase in prices relative to marginal costs. These higher prices hurt consumers but benefit business owners, corporate managers, and executives, who are concentrated at the top of income distribution, by disproportionately shifting extra profits towards these top income earners.

In recent research, Ju H. Pyun and I empirically explore the multifaceted aspects of the increase in market power. In our baseline estimation, we find that an increase in market power is positively associated with rising income inequality. More interestingly, even within top income earners (top 10% income group), higher income groups (top 1% for instance) tend to disproportionately benefit more from an increase in mar-

ket power than lower income groups (either top 5% or 10%). All of our main results seem to be robust with alternative data and methods.

Accompanied by the findings of the previous studies that rising income inequality poses a serious challenge to economic growth, we are tempted to conclude that every source of market power is harmful for sustained growth in and of itself. In order for new ideas to be discovered, however, an inventor should be compensated for his original research that led to the discovery. Therefore there should be a wedge between price and marginal cost. The presumption is that, as Paul Romer suggested in his celebrated paper in 1990, the key to sustained growth is the discovery of new ideas and increasing returns are one of the crucial features of the economics of ideas. Consequently, it is fair to state that many sources of market power such as intellectual property rights can still be strong contributory factors to sustained growth.

Our findings on the association between growing market power and rising income inequality are nonetheless suggestive of the recent debate on inclusive growth in Korea. Since President Moon took office in 2017, a series of inclusive growth policy actions have been implemented, commonly referred to as the “income-led growth model.” The main proposition of this approach is to raise the disposable income of low and middle income individuals whose consumption elasticities are larger than high income individuals, thereby triggering short-term demand driven growth. In recent years, however, only pro-labor distributional policies including a minimum wage increase have entered the public discourse in a highly visible way. In addition, some analysts have even argued that deregulations need to be expedited in order to empower the private corporations to play a bigger role, along with structural reforms in the labor market.

Gauging the size of corporate rent in Korea is a challenging task which requires a clear conceptual definition and appropriate data. Despite its limitations, our preliminary analysis suggests that, to be more effective, the income-led growth model needs to shift from a narrow focus on pro-labor distributional policies to a more comprehensive approach that considers the risks of market concentration and restrictive business practices. To do that, anti-trust registration and enforcement measures aimed at curtailing corporate abuses of power, together with pro-labor policies, need to be designed in a mutually reinforcing manner to ensure inclusive growth with an explicit distributional objective. In this context, a natural starting point could be to revisit much of the regulatory structure, which either has been dismantled in the past or is expected to be in the future, and to update and restore it, if necessary. **KIEP**