Restoring middle class

ANALYSIS

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New President Park Geun-hye promised to increase the middle class to make it up to 70 percent of the population.

In order to do this, the new government is supposed to implement various measures. The first is to help reduce the financial burden on households.

Increasing, protecting, and upgrading jobs will be the second. The third measure is to help small-and medium-sized enterprises be competitive.

In order to reduce the financial burden on households, Park proposed to provide subsidies for the households that are suffering from huge levels of debt and high educational expenses.

Other measures also focus on helping and subsidizing people who are in need. But do those measures truly contribute to an increase in the proportion of the middle class?

To answer this question, we need to define what the middle class is. The middle class is classified as the group of households whose income lies between 50 and 150 percent of the median income according to the definition provided by the OECD.

In terms of this definition, the proportion of the middle class is highly dependent upon the level of income inequality. Korea has been industrialized since the 1960s.

Since then the middle class in Korea was formed and developed, and the proportion of the middle class increased until the mid-1990s.

Rapid economic growth and industrialization contributed not only to the formation of the middle class but also to the increase in the proportion of the middle class. However, since the mid-1990s it appeared that the proportion of the middle class has been decreasing.

According to the research, it was 75.4 percent in 1990 but in 2010 the middle class shrank to 67.5 percent of the population. Other sources also estimated that the proportion of the middle class is between 55 and 65 percent.

Stagnating economic growth and globalization are the factors that might have contributed to the decreasing trend in middle class. Low economic growth and the lack of structural adjustment in the weak sectors such as the low-skilled manufacturing sector have limited the creation of good quality jobs.

Low economic growth will limit the increase in investments and employment and then cause the stagnation of the income level.

Thus it will encourage the downfall of households from the middle class to the poor.

Since the currency crisis in the late 1990s, we have seen an increase in the number of self-employed people for mom-and-pop stores, the stagnation of the productivity and profitability in the small-and medium-sized manufacturing sector, and the highly protected full-time workers due to the inflexible labor market that caused an increase in the number of part-time workers and limited the creation of good quality jobs.

Globalization, especially the expansion of trade with China, also contributed to the decreasing trend of the middle class.

As the trade with China expanded since the 1990s, Korea lost its comparative advantage in the labor-intensive light manufacturing sector.

It resulted in massive job losses and reduction in incomes of people who used to work in that sector.

Combined with the lack of structural adjustment for that sector and the inflexible labor market that limit the move of labor between sectors and the creation of jobs, the increase in trade with China played a role in causing the proportion of the middle class to decrease.

The existence of stable and relatively affluent middle class is indispensable for the market economy and democratic society.

According to the results of various studies, as the proportion of middle class grows, the influence of interest groups and the level of corruption decreases.

Thus, we need to reverse the decreasing trend of the middle class. The best way to restore the middle class is to boost economic growth.

Regulatory reform and measures for encouraging competition for economic growth will also increase the number of innovative enterprises and high value-added companies in the service sector, which will create more good quality jobs.

US, Japan intensify currency wars

GLOBAL ECONOMY

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Several central banks around the world continue to implement aggressive monetary policies in order to minimize deflation risks, overcome the credit crunch, and provide an impetus for economic growth.

These actions, though sorely needed in the context of an underperforming global economy, have caused numerous conflicts, dubbed by some observers and governments as "currency wars."

In particular, downward pressure on the value of the dollar and the yen in the wake of excess liquidity through quantitative easing and/or lower interest rates has provoked a number of complex effects on the relative competitiveness of European, Latin American and Asian economies.

The European Central Bank, for instance, cannot use monetary policy to affect the exchange rate. Several Latin American and Asian countries are pursuing tighter budgetary and monetary policies due to inflationary pressure or persistently high inflows of capital.

These persistent asymmetries have generated much concern and led government officials in countries such as Brazil to blame the United States for "exporting" its problems, and France to ask the European Central Bank to become much more active.

The recent G20 summit at Moscow included currency manipulation as an explicit item on its agenda.

The goal was to avoid a chain reaction in the form of competitive devaluations, something that would greatly distort global trade and capital movements. The G20 represents 90 percent of global GDP and 75 percent of the world's population.

The Moscow meeting ended with a declaration as opposed to a commitment to action.

"We will refrain from competitive devaluation. We will not target our exchange rates for competitive purposes," read the resolution approved by the finance ministers, echoing the statement of the G7 of just a few days earlier. Both sets of countries declared a commitment to letting the markets set exchange rates.

While the Japanese government has managed to avoid being explicitly criticized for its monetary and exchange rate policy, some governments have taken good notice.

The beleaguered European economies, in particular, have suffered from the common currency's appreciation relative to the yen. Nobody expects, however, a different trend in the next few months.

Meanwhile, neighboring countries like Australia and Indonesia seem to be accepting a cheaper yen in exchange for Japanese economic growth.

Although both the European Central Bank and the International Monetary Fund believe that the euro trades quite closely to its long-term averages, businesses complain almost daily about the hands-off stance of policymakers.

The recent economic growth data from Germany and France corroborate that the end to the Eurozone's double-dip recession is not in sight. This is bad news for Europe's unemployed.

It is also a very bad omen for the global economy because if the Eurozone feels forced to manage its exchange rate, currency wars will get worse, not better.

ENTERPRISE

SMEs in 2018

STRATEGY

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The recent move by the commission on shared growth seems in favor of protection of small-and medium-sized enterprises (SMEs) including mom-and-pop stores.

It also seems to go in line with current public sentiment toward big companies. The lines are drawn clearly and specifically between businesses suitable for SMEs and those not suitable for big companies.

Even about how much a big company already in the business suitable for SMEs can grow annually.

Practically speaking, big companies would be under great pressure with not much choice but to toe the line.

What if this trend continues for the next five years? Let's imagine it is now the year 2018.

A best case scenario might look like this. SMEs grow well under protection and become competitive enough to compete with big companies.

They don't need protection any longer. SMEs can even compete with big companies at the national and global levels.

More jobs are created and higher economic growth is achieved. As a result, consumers enjoy more diverse, better quality and cheaper products.

At the end of the day, everyone is better off and happy with the outcome.

Then what would happen if the worst comes?

SMEs are still struggling and need protection, maybe, more and for longer. They still can't compete locally with big companies.

Consumers suffer from limited choice, low quality and high prices. At the end of the day, no one is better off. Not to mention no new jobs and no economic growth.

What's more likely? With all due respect, drawing the lines to tell big companies their business territories seems off base. It went a little too far.

A policy recommendation should be based on clear empirical evidence and at least sound economic rationale. It would be a big mistake if it is based on public sentiment and criticism toward big companies.

I wish I had a crystal ball. We all hope for the best but prepare for the worst.

More fundamental issues can be addressed by going back to the basics. First, government red tape should be minimized although it cannot be entirely eliminated overnight.

Although it is challenging, the right direction is to restructure the authorities spread with multiple ministries and consolidate them into a one-stop service authority.

The number one obstacle SMEs face day in day out is the lack of resources.

Too many chiefs frustrate and often fail SMEs from day one. Simply SMEs don't get help when they need it most. SMEs can't afford to waste their time and resources on dealing with a bunch of red tape.

Second, big companies need to get serious about what they owe to society. Society cares about success of SMEs and small mom-and-pop stores next door.

Society cares more about balanced growth as opposed to polarized growth. It's their corporate social responsibility for what society cares about.

It requires a serious mindset change within big companies themselves. It starts with work to get buy-in from shareholders. It takes time and should have taken place yesterday.

Most importantly, SMEs should realize that government protection, regardless of the legality or legitimacy of the move, is not a long-term solution.

They can't blame big companies for every difficulty they face.

They should not take advantage of public sentiment and mounting criticisms about the market power of big companies whenever they don't succeed.

The brutal reality is that globalization is in progress at lightning speed. SMEs can't bury their heads in the sand.

They need to make their own choice about what to do and focus on what they do well and better to be competitive.

The territorial protection, no matter how we slice it, is at the expenses of consumers. It means we all pay the price.

Yes, it is a no-brainer but quite often forgotten.