Korea’s Private Spending Caught in “1 Percent Trap”

Depressed private spending in Korea has served as a stumbling block to growth.

Korea’s private spending is in a long-term slump. The nation’s private spending growth rate has remained far below its GDP growth rate, dragging down the overall economic growth rate. Following a credit card crisis in 2002 and 2003 and the global financial crisis of 2008 and 2009, the gap between Korea’s private spending growth rate and GDP growth rate has shown no sign of narrowing. Recently, private spending has fallen into a “1 percent trap,” the private spending growth rate in 2012, 2013 and 2014 was 1.9 percent, 1.9 percent and 1.8 percent, respectively. This growth rate is expected to remain in the 1 percent range this year, with private spending having risen by 1.5 percent in the first quarter of the year and with fears over the Middle East Respiratory Syndrome having taken a heavy toll on the economy in June. The Korean economy is unlikely to climb out of the 1 percent trap anytime soon.

Private spending: Help or hindrance

In other countries, private spending served as a stepping stone to an advanced economy. Private spending grew faster than GDP, boosting per-capita income above USD 30,000 and USD 40,000. But in Korea, private spending has been a stumbling block in the country’s efforts to join the ranks of advanced economies. Private spending was already low, at 55.7 percent of the GDP, when Korea’s per-capita income was between USD 10,000 and USD 20,000, but fell even further, by 5.4 percentage points to 50.3 percent, for the period in which per-capita income stood between USD 20,000 and USD 30,000.

Then why has private spending been a stumbling block to growth in Korea while serving as a stepping stone in other countries? First, the phenomenon of household income shrinking while corporate income grows is much worse in Korea than in other countries. In leading economies, household income accounted for 76.8 percent of the national income in 2000 and decreased by 2.7 percentage points, to 74.1 percent, in 2012. But in Korea, the decline was steeper, falling from 68.7 percent in 2000 to 62.3 percent in 2012, indicating a 6.4 percentage point decrease. Second, the household debt burden is growing in Korea while it is decreasing in leading economies. Household debt as a percentage of disposable income in advanced countries fell by 2.2 percentage points, from 124.1 percent in 2002 to 121.9 percent in 2013. In Korea, it jumped by 29.6 percentage points, from 131.2 percent to 160.8 percent in the same period. Third, the force that translates income into consumption is growing stronger in advanced countries but weakening in Korea. The average propensity to consume (consumption as a percentage of disposable income) in advanced countries grew 1.8 percentage points, from 75.9 percent in 2008 to 77.7 percent in 2012, while it contracted in Korea by 1.8 percentage points, from 75.9 percent to 74.1 percent. The reluctance to spend is stronger in Korea than in other countries due to housing instability, employment insecurity and poor financial preparedness against retirement.

Drastic measures needed to escape the 1 percent trap

The first and most important solution would be to increase household income. To create more quality jobs, the government should focus on fostering high value added service industries such as tourism and medical services, and ease unnecessary regulations that hinder corporate investment. Also, the quality of jobs should be enhanced through making non-regular workers regular workers to increase future income, and through other measures. Second, steps should be taken to ensure the rate of household debt increase will not outpace household income growth, and the household debt structure should be improved. Third, to ease worries over financial stability after retirement, post-retirement income should be guaranteed by strengthening social insurance such as national pension, establishing a retirement pension system and promoting the private pension market. Fourth, the price of jeonse ( lump-sum deposit) and monthly rent for housing should be stabilized to ease housing cost burdens.

By Lee Jun-ik
Research Fellow
Hyundai Research Institute
sododuki1@hri.co.kr