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President Moon's Anti-Corporate Policies Jeopardize South Korea's Future

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The South Korean government's recent move to nip in the bud any incipient asset bubbles by increasing the corporate tax rate on its largest companies (among other things) is an example of a government making proper diagnosis but prescribing the wrong medicine–and for the wrong reasons.

It is perfectly understandable that the South Korean government wants to be vigilant about the rapid run-up in real estate prices of late, given its country's history with financial crises–South Korea's economy suffered greatly in the East Asian Financial Crisis of 1997 as well as during the global collapse of financial markets in 2007. A third financial market crisis in twenty years would be disastrous economically as well as wreak electoral havoc for the incumbent party in the next election.

However, its decision to increase the corporate tax rates on large corporations as a way to throttle the expansionary predilections of its biggest companies makes little sense in that context. For starters, taxing capital is the most expensive and inefficient way to collect tax revenue–the Nobel Laureate Robert Lucas once remarked that ending capital taxation is the closest thing to a free lunch that he's ever come across.

The problem, in short, is that taxing corporate income reduces the return to capital, which causes firms to invest less, which in turn lowers productivity, since workers have less capital at their disposal. In the long run, worker productivity is the main driver of wage growth, so less capital dampens wages as well, not to mention economic growth.

South Korea's incipient tax increase also contradicts a decades-long trend across the globe of countries moving away from taxing corporate income: not only is it a costly way to collect revenue but it can also chase businesses away from a country. The whack-a-mole game that the U.S. Treasury has been playing with corporate inversions the last few years is almost solely a product of U.S.-based companies finding it difficult to remain competitive while still playing a corporate tax rate that can be twice as high as their global competitors.

My own research with Andrew Hanson of Marquette University showed that a higher corporate tax rate is associated with lower wage and employment growth. That truism is why there have been more than 100 corporate tax rate reductions in the OECD since 2000 with scarcely an increase.

It seems apparent that president Moon Jae-in wants to reform the chaebols–Samsung in particular–and he chose to use this exigency as a way to begin reining them in. Samsung is particularly vulnerable given the leadership uncertainty it's facing as its de facto chief executive

Jay Y. Lee is currently embroiled in a trial perceived to be driven at least in part by political machinations.

Samsung is probably the country's best-known and most profitable brand, and It employs a lot of people in the country. No one is above the law but pursuing a 12 year jail sentence for its embattled CEO seems almost punitive, and could leave the embattled company rudderless at an unpropitious time.

Reforming the chaebols is an understandable priority for President Moon, but a quick tax increase on them in the name of combating an asset bubble does not make sense. Moon should deal with the bubble first and then, in a more measured and deliberate way, consider reforms of the chaebol system.

Rahm Emanuel's aphorism to never waste a crisis is a bad lesson for South Korea: trying to accomplish two things at once with this edict could end up both hurting South Korean corporations while not fully and effectively putting brakes on the property bubble.

In 1933 John Maynard Keynes famously advised President Roosevelt in an open letter that he should separate the immediate problem at hand–helping the economy to resume economic growth– from the long-term reforms the president felt were necessary both to prevent another Depression as well as to ensure an economy that functions the way he felt it ought. Roosevelt never spoke to Keynes again after this public comeuppance but the economist was proven right, and the U.S. economy remained weak for years afterwards.

President Moon should heed the same warning.

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