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# Private Sector Development and Upward Mobility: The Case of Korea from 1962 to 2000

Park, Se-II\*

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## I. Introduction

Korea has achieved remarkably rapid economic growth for the past four decades. Korea's real GDP grew at an average annual rate of 7.8 % from 1963 to 2000. The real GDP growth rate during the first half of the period, from 1963 to 1979, was 9.0 % annually and was followed by slightly lowered rate of growth, 6.9 % per year in the second half of the period, from 1979 to 2000. Per capita GNI in 1962 was

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\* Professor of Law and Economics, The School of International and Area Studies, Seoul National University(sipark@snu.ac.kr)

US\$ 87, but has now reached to US\$ 9,628 in 2000, even after a severe drop during the 1997 Asian financial crisis.

The rapid growth of the Korean economy actually began with the expansion of exports. Korea's merchandise exports, which were small and stagnant in the 1950s, started to rise remarkably from the early 1960s. Table 1 shows that the exports amounted to only US\$ 55 million, or 2 % of GNP in 1962, but jumped to US\$ 15.1 billion, or 23 % of GNP by 1979, showing an average annual increase rate of 39 %. The exports continued to rise to US\$ 175.9 billion, or 38.6 % of GNP, by 2000, but the average rate of increase was lowered to 12.4 % per year from 1979 to 2000.

The rapid growth of exports was accompanied by a significant progress in the diversification of export products. During the 1950s, the greater portion of Korean exports consisted of primary products, such as tungsten, iron ore, fish, raw silk, and coal. After 1962, manufactured exports expanded far faster than primary exports<sup>1)</sup>. The manufactured exports, which had accounted for only 27 % of the nation's exports in 1962, reached approximately 90 % by 1979 and almost 98 % in 2000, as shown in Table 1.

The rapid expansion of exports contributed greatly to the structural transformation of the Korean economy. The manufacturing sector, which accounted for only 13 % of GDP in 1962, expanded to contribute approximately 32 % in 2000. In contrast, the share of primary sector declined sharply from 37% in 1962 to 5% by 2000. The SOC and other services in GDP showed a steady rise from 50% to 64% during the same period. Among service industries, interestingly enough, the financial and insurance sectors, which accounted for only 1.7 % of GDP in 1962, has grown to account for almost 20% by 2000. On the other hand, government services remained less than 10% of GDP during the same period.

Behind this backdrop, this paper is designed to answer the following three questions. The first is to what extent has Korean economic growth brought about upward economic mobility in Korean society for the past four decades. The second is how important has private sector development been in generating upward mobility?

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1) 1962 was the year when the First Five Year Economic Development Plan was introduced in Korea.

&lt;Table 1&gt; Major Indicators of Korean Economic Growth: 1962-2000

	1962	1979	2000
1: GNP (in 1990 constant price: billion Won)	17,583	71,590	277,313
2: Per capita GNI (US\$ in current prices)	87	1,636	9,628
3: GDP by Industrial Origin (% share in current prices)			
3-1: Agriculture and Forestry and Fishing	36.7	22.9	4.6
3-2: Manufacturing and Mining	13.1	24.1	31.8
3-3: Electricity, Gas, Water, Construction, Transportation, Communication	11.0 39.2	18.6 34.4	17.3 46.3
3-4: Other services (Public Administration and Defense) (Finance, Insurance, Real Estate,)	(9.7) (1.7)	(9.0) (3.4)	(7.5) (19.0)
4: Exports and Imports (in current price)			
4-1: Commodity Export (US\$ billion) Ratio to GNP	0.055 (2.0)	15.1 (22.9)	175.9 (38.6)
4-2: Commodity Import (US\$ billion) Ratio to GNP	0.4 (14.3)	20.3 (29.8)	159.1 (35.0)
4-3: Share of Manufacturing export	27.0	90.1	97.6
5: Per capita GNI ( US\$ )	87	1,647	9,628

Source: Bureau of Statistics, Economic Planning Board, *Korean Statistical Yearbook*(1965, 1981). Bank of Korea, *Quarterly National Account*(2001, 4).

What was the role of the government in Korea's economic development? What has been the major mechanism in producing rapid growth with high mobility in Korea? The third is what are the prospects for continued upward mobility. Can Korea follow the same kind of development model or strategy in the 21<sup>st</sup> century or should she develop a new one? What are the major challenges of forming a new development model?

## II. Degree of Upward Mobility

Upward mobility in this paper means to what extent Korean people's economic position has been better off over time due to the rapid economic growth during the

past four decades.<sup>2)</sup> However, there is no longitudinal (or panel) data in Korea that we can directly measure the economic mobility of persons through time. So we will use several indirect measures through which we can approximate the degree of upward mobility of the Korean people.

The first set of data would be the increased rates of GDP, employment, and real wages. We will see how rapidly these indicators have changed over the past four decades. But these indicators only provide quantitative aspects of economic growth. Thus, we need the second set of data, which will catch the qualitative aspects of economic growth. We are especially interested in the changes in the quality of employment over time. The rapid expansion of employment opportunities is, of course, important, but what is more significant is the number of good jobs (high productivity-high paying jobs) created, not of bad jobs. Thus, we will examine the change of employment quality and employment structure, which took place over the decades from 1963 to 2000.<sup>3)</sup>

The third set of data concerns the changes in income inequality and poverty reduction. We will investigate what has happened to the income inequality in Korea. Has it decreased or increased during the period of rapid economic growth? Has the absolute poverty reduced significantly or not? The final indicators are related to industrial relations. Industrial democracy is obviously another aspect of quality in employment as well as another indicator of socio-economic welfare of the working people. Thus, a more democratic and participatory work environment definitely suggests upward mobility of economic conditions. We will investigate how industrial relations have evolved in Korea from the early 1960s to the present. We will examine each data set in turn below.

## 1. GDP, Employment, and Wages

The past four decades of the Korean economy can be divided into five stages of development according to a different emphasis in government policy. We will see the

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2) For detailed discussion on the meaning and measurement of economic mobility, see Fields (2001).

3) Reliable time series data on employment is available only after 1963.

changes of GDP, employment, and wages in each stage or period. The first period, 1963-1972, was when the development of labor-intensive light industries, such as electronics and textiles, was the top priority in the government policy. Reflecting the policy priority, not only was the growth rate of GDP quite high but also the increased rate of non-farm employment was the highest during the five periods of development. GDP grew on average by 8.9% per year and non-farm employment increased by 8.0% per year during 1963 to 1972, as shown in Table 2. Real wages also rose rapidly to 9 % per year during the same period, suggesting a substantial improvement of living conditions.

The second period, 1973-1979, was when the government emphasized the development of heavy and chemical industries (hereafter, referred to as the HCIs), such as autos, ships, steel products, general machinery, and organic chemicals. GDP grew on average at a record high rate of 9.1 % per year during the period, but non-farm employment creation was relatively slow, 3.2 % per year, due mainly to the capital intensive character of the industries, (HCIs) promoted by the government. The combined effect of the high growth rate with low employment creation produced a high productivity increase, thus generating a record high wage hike, of approximately, 12.5 % real wage increase per year. President Park, who came into power following a military coup in 1961, was in charge during the above two periods.

<Table 2> Average Annual Growth Rate of GDP, Employment, and Real Wages: 1963 to 2000

	GDP	Labor Force	Employment		Real Wage (Manufacturing Wage/CPI)
			Total	Non-Farm	
1963-1972	8.9	3.1	3.6	8.01	8.95(1965~)
1973-1979	9.1	3.8	3.9	3.18	12.53
1980-1986	6.8	1.9	1.9	5.17	9.07
1987-1996	8.1	2.8	3.0	4.41	9.08
1997-2000	4.3	0.4	0.3	0.51	2.33
1963-1979	9.0	3.4	3.7	7.27	10.73
1980-2000	6.9	2.1	2.1	3.93	6.08
1963-2000	7.8	2.7	2.8	5.36	7.92

Source: National Statistical Office, *Korea Statistical Yearbook*(1965, 1985, 2000); Ministry of Labor, *Yearbook of Labor Statistics*, various issues.

### Chart 1. Average Annual Growth Rate of GDP, Employment, and Real Wages: 1963-2000

The third period, 1980-86, was when the government strenuously carried out the economic stabilization policy to put high inflation rates under control. Prices began to rise rapidly in the late 1970s and early 1980s mainly due to the expansionary fiscal and monetary policies to support heavy and chemical industries and partly also due to the second oil shock. But the government succeeded in curbing inflation. The average increase rates of CPI were 14.5% in 1978, 18.3% in 1979, and 28.7% in 1980, but dropped considerably to 7.3% in 1981, 3.4% in 1982, and 2.3% in 1983. Due to the government's overriding commitment, inflation was kept under control but the GDP growth rate was on average somewhat lowered to 6.8 % per year during the period. But real wages increased at an average rate of above 9 % per year. This impressive wage raise was, at least, in part attributable to the stabilized prices.

President Chun, another military man who succeeded President Park in 1980, mobilized economic and non-economic tools to slash the inflation hike.<sup>4)</sup> At the same time he tried to change the developmental strategy from a state-led one to a market-driven one through various liberalization policies, such as deregulation and

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4) In addition to the contractionary fiscal and monetary policies, the government introduced an income policy for the first time in Korea. One typical example of non-economic policy was organizing a nation-wide moral campaign against inflation.

privatization. He succeeded in the stabilization policy but not in the liberalization policy.

The fourth period, 1987-1996, was when the government pursued further the economic liberalization policy and begun to democratize Korean politics and society after almost 30 years of authoritarian control. The new government (1988- 93), was headed by President Roh, a democratically elected military man. He tried to liberalize Korean economy and to democratize Korean politics. These policy directions were reinforced and sped up by the following government (1993 1998), led by President Y.S. Kim, the first civilian government after 30 years of military rules. The government presented a comprehensive national reform blueprint called the *Segyewha* policy, meaning “reform for globalization”. It was a reform vision to change and make Korea’s existing socio-economic institutions more compatible with the coming age of globalization. Thus it covered not only economic policy reforms toward liberalization but also other social development reforms, such as education, welfare, and industrial relations reform. Form 1987 to 1996 the GDP growth rate recorded on average 8.1 % per year and non-farm employment increased by 4.4 % per year. The relatively high increase rate of real wages during the period, 9.1 % per year, was attributable, to some extent, to the democratization policy. This policy began, began in 1987 and has permitted active, and sometimes even militant, unionism.

The fifth and last period, 1997- 2000, was the period of the financial crisis and IMF’s supervision over Korea’s economic management. The financial meltdown took place at the end of 1997 and the new government, led by D.J Kim, entered in early 1998. The government vigorously strove towards corporate and banking sector reforms during 1998 to 1999. Reflecting the economic turmoil during this period, the GDP dropped to -6.7% in 1998, but quickly bounced back to 10.9% in 1999 and 8.8% in 2000, as shown in Table 3. the non-farm unemployment rate used to be approximately 2.2 % before the 1997 crisis, but it jumped to 7.6 % in 1998, 6.9% in 1999, and still remained relatively high at 4.4 % as of 2000. The real wage also declined to -9.9% in 1998 but jumped back quickly to 13.9% in 1999 and 6.1% in 2000.

〈Table 3〉 Recent Changes in GDP, Unemployment Rate, and Real Wages: 1995-2000

(unit: %)

	GDP	Unemployment Rate		Real Wage (CPI)	
		All	Non-Farm	Non-Farm All	Manufacturing
1995	8.9	2.0	2.2	6.4	5.2
1996	6.8	2.0	2.2	6.6	6.9
1997	5.0	2.6	2.8	2.5	0.7
1998	-6.7	6.8	7.6	-9.3	-9.9
1999	10.9	6.3	6.9	11.2	13.9
2000	8.8	4.1	4.4	5.6	6.1

Source: Ministry of Labor, *Yearbook of Labor Statistics*, various issues: 1995 to 2000.

In sum, the overall performance of Korean economic growth during the past four decades has been truly impressive. During 1963 to 2000, as shown in the Table 2, GDP grew at an average rate of 7.8% per year and the real wages at the average rate of 7.9% per year. Non-farm employment expanded at an average rate of 5.4 % per year during 1963 to 2000, far surpassing the average increase rate of the labor force, which was recorded as 2.7 % per year during the same period. Thus, the unemployment rate reduced substantially from 8.1 % in 1963 and 7.7% in 1969, to 5.6% in 1979, and further down to 2.2% in 1995. Recently it rose to 4.1 % in 2000, due to the after-effects of the 1997 financial crisis, but still the overall accomplishment has been remarkable.

Table 4 shows more detailed changes in the labor force and employment during 1963 to 2000. The labor force participation rate increased continuously from 55% in 1963 to 62 % in 1995. The change in the female participation rate was more conspicuous, from 36% in 1963 to 48% in 1995, an approximate 12 % point increase, although this is still relatively low compared to other OECD countries. Unemployment dropped substantially from 8.1% in 1963 to 2.0% in 1995, and the reduction of non-farm unemployment during the same period was even more dramatic, from 16.3% to 2.2%. However, even this change could be an underestimation if the discouraged workers effect did exist substantially in the early years of development.



It is because the discouraged workers effect could reduce the open unemployment rate in those years. To eliminate this possibility, we calculated the “employment rate” by the following formula:

Employment rate = number of the employed/ (population over 14 yrs those in schools.)

The employment rates, thus calculated, increased substantially from 54.7% in 1963 up to 69.2 % in 1995, more than a 14 % point rise, implying that the employment generation was undoubtedly magnificent.

**<Table 4> Population, Labor Force Participation Rate, Employment Rate, and Unemployment Rate: 1963 -2000**

(in thousands persons; %)

	Population (14 years & over)	Labor Force	Labor Force Participation Rate		Employ- ment	Employ- ment Rate	Unemployment Rate	
			Total	Female			Total	Non-Farm
1963	15,085	8,343	55.3	36.3	7,762	54.7	8.1	16.3
1965	15,937	8,859	55.6	36.5	8,206	55.5	7.7	14.3
1969	17,639	9,888	56.0	37.5	9,414	59.1	4.7	7.7
1970	18,253	10,199	55.9	38.5	9,745	59.6	4.4	7.4
1974	21,148	12,080	57.1	40.6	11,526	62.5	4.0	6.7
1975	21,833	12,340	56.5	39.6	11,830	62.3	4.1	6.6
1979	24,678	14,206	57.6	42.2	13,664	64.9	3.8	5.6
1980	25,335	14,454	57.1	41.6	13,706	63.3	5.2	7.5
1984	27,793	14,984	53.9	39.5	14,417	62.3	3.8	4.9
1985	28,489	15,554	54.6	40.6	14,935	63.3	4.0	4.9
1989	30,266	18,023	59.6	46.6	17,560	67.7	2.6	3.1
1990	30,887	18,539	60.0	47.0	18,085	68.1	2.4	2.9
1994	32,939	20,326	61.7	47.9	19,837	68.6	2.4	2.7
1995	33,558	20,797	61.9	48.3	20,377	69.2	2.0	2.2
1999	37,765	21,634	60.5	47.4	20,281	60.6	6.3	6.9
2000	36,139	21,950	60.7	48.3	21,061	66.0	4.1	4.4

Note: From 1989 the first column is number of population 15 years old and over

Source: National Statistical Office, *Annual Report for Economically Active Population Survey*, various issues, 1965 to 2000.

## Chart 2. Labor Force Participation Rate, Employment Rate and, Unemployment Rate

So far, we saw that the average annual growth rate of GDP, real wages, and employment were extraordinarily impressive during the past four decades. In other words, as far as quantitative aspects of growth are concerned, Korea has performed amazingly well. This then leads to the next question regarding the quality of growth. We will analyze the quality of growth from the following three aspects: quality of employment, income distribution, and industrial democracy.

### 2. Quality of Employment

Since the pervasive underutilization of human resources was a serious problem in most less- developed countries, employment creation has tended to be one of the top policy goals in those countries. However, what is more important is not the sheer number of jobs, but the quality of newly created jobs in the developmental process. In other words, what matters is number of “good jobs” created, not the number of “bad jobs”. Good jobs imply a high productivity-high paying job with job security and the possibility of promotion. Thus, the number of good jobs created can

approximate the degree of economic upward mobility. We used four statistics indicating the creation of good jobs, as shown in the Table 5.

The first is the change of agricultural employment as a percentage of total employment. It shows a continuous rapid drop over the whole period from 1963 to 2000. Agricultural employment occupied 63.1 % of total employment in 1963, but declined uninterruptedly down to 10.9 % by 2000. The second is the change of wage and salary employees as a percentage of total employment. It would be an indicator of industrialization as well as quality of employment. The proportion of wage and salary earners among the total population revealed a constant improvement: from 31.5 % in 1963 to 62.4 % in 2000.

The third statistic is the professional & technical, administrative & managerial, and clerical & sales employment as a percentage of total employment. The proportion of these occupations could suggest the upgrading of the industrial structure of the economy. These figures also exhibit an on-going progress from 16.7% in 1963 to 36.2 % in 1990. Since there was a reclassification of occupations in 1991, it is inappropriate to compare the figures before and after 1991 directly. But the trend after the reclassification also shows a rising tendency of those relatively good jobs. The proportion of only professional, administrative, and managerial occupations in total employment, which appeared in parenthesis in the last column in Table 5, rose sharply from only 3.2 % in 1963 to 18.6 % in 2000. Now roughly one out of five workers are engaged in professional and managerial jobs.

The fourth category is the change in the proportion of temporary and day workers as a percentage of salary and wage earners.<sup>5)</sup> The trend in change was a continuous decline from 61.0 % in 1963 to 41.9 % in 1995.

Though there was a change in classification in this category in 1986, the declining trend continued up to 1995. But an interesting and important finding is that the declining trend reversed at a time near the 1997 financial crisis.<sup>6)</sup> Namely, the pro-

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5) Temporary workers imply those whose contract period of employment is less than one year. And day workers are hired on a daily bases.

6) To be more precise, the rising trend of temporary and day workers started from 1996, one year before the 1997 crisis. What the underlying reasons of the change is not yet clear. What seems clear is that the trend has accelerated after the 1997 crisis and has still continued.

〈Table 5〉 Quality of Employment (1): 1963 to 2000

(unit: %)

	Agriculture/Total employment	Wage+Salary workers/Total Employment	Temporary+Day/ Wage+Salary workers	Professional. etc/Total Employment
1963	63.1	31.5	61.0	16.7(3.2)
1965	58.6	32.1	58.3	18.7(2.8)
1969	51.3	38.1	43.3	22.8(4.5)
1970	50.4	38.9	40.9	23.0(4.7)
1974	48.2	39.4	45.2	22.3(3.2)
1975	45.9	40.6	45.9	22.7(3.5)
1979	35.8	47.7	38.9	27.0(5.0)
1980	34.0	47.3	35.7	29.0(5.3)
1984	27.1	52.9	36.7	32.8(6.7)
1985	24.9	54.2	37.2	34.3(7.2)
1989	19.6	59.2	45.2*	35.3(8.2)
1990	17.9	60.5	45.8	36.2(8.7)
1994	13.7	62.1	42.1	27.7(15.4)**
1995	12.4	62.7	41.9	28.7(16.3)
1999	11.6	61.7	51.7	30.0(19.0)
2000	10.9	62.4	52.4	30.0(18.6)

Note: \* Temporary and day workers were reclassified in 1986

\*\* Professional etc was reclassified in 1991

Source: National Statistical Office, *Annual Report on Economically Active Population Survey*, various issues, from 1965 to 2000.

portion of temporary and day workers is on the rise these days. The proportion was 43.4% in 1996, rose to 45.9 % in 1997, 47.0 % in 1998, 51.7 % in 1999, and 52.4% in 2000. Comparing the years between 1995 and 2000, there was more than a 10% point increase of the proportion of temporary and day workers. This marginalization of employment seems to be a direct consequence of corporate restructuring and downsizing carried out after the 1997 crisis. These rising atypical workers deserve more policy attention of the government in the years to come.

Another set of statistics suggesting the quality of employment is shown in Table

### Chart 3. Quality of Employment

6. Average hours of work and the frequency or severity of industrial accidents could be other dimensions of employment quality. Long hours of work is a typical feature of employment in the traditional sector. Thus, we expect a gradual reduction in the hours of work as industrialization proceeds. However, interestingly enough, that was not the case for Korea at least until the mid 1980s. Average hours of work per week were about 55 hours in 1963, and it increased, rather than decreased, to 59 hours by 1985. But from the mid 1980s, it showed a sharp decline and reached 51.5 hours by 2000. One interpretation could be that the income effect of wage increases had dominated the substitution effect from the 1960s to the mid 1980s, but it has been reversed since then. But this interpretation does not explain why there was a reversal in the mid 1980s. One plausible account might be the impact of militant unionism on hours of work, which was unleashed from long repression in 1987 when President Roh declared a democratization policy.<sup>7)</sup> More details on the democratization policy

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7) A political turning point toward democratization took place in Korea in June 1987. This political reform was spurred by a series of anti-government demonstrations initiated in May and July 1987 by students and quickly followed and supported by many middle-class urban dwellers. Mr. Roh, who was the presidential candidate of the government party in the middle of 1987 and became the president in late 1987, promised a democratization reform

will be discussed later. However, it should be pointed out here that institutional factors, such as unionism, began to play an increasingly important role in the determination of working conditions, such as wages and hours of work, in Korea after 1987.

<Table 6> Quality of Employment (II) : 1963 to 2000

	Average hours worked per week	Proportion (%)		Industrial Accidents (%)		
		1~17 hours	54 hours & over	Frequency Rate	Severity Rate	Per 1000 person
1963	55.4	10.7	59.0	-	-	-
1965	57.0	8.1	62.1	-	-	-
1969	57.2	3.6	53.3	-	-	-
1970	56.1	3.6	50.9	15.50	3.20	48.88
1974	58.8	1.7	63.3	-	-	-
1975	59.1	1.1	64.8	16.76	3.29	43.88
1979	59.2	2.0	64.7	13.52	2.89	-
1980	58.5	2.0	61.5	11.12	2.58	30.21
1984	59.0	1.8	64.8	13.09	2.58	39.83
1985	58.6	1.8	63.3	11.57	2.68	31.55
1989	56.5	2.8	59.4	7.47	2.19	20.06
1990	55.7	2.5	57.6	6.70	2.30	17.62
1994	53.5	3.0	50.5	4.69	2.93	11.82
1995	53.3	6.4	50.0	3.90	2.82	9.89
1999	51.4	5.6	43.9	2.92	2.11	7.45
2000	51.5	5.1	44.7	2.9	1.9	-

Source: National Statistical Office, *Annual Report on Economically Active Population Survey*, various issues, from 1965 to 2000.

Ministry of Labor, *Yearbook of Labor Statistics*, various issues, from 1970 to 2000

in June 1987 and instituted reforms, including the adoption of a presidential election by direct vote. Along with political reform came a de-facto relaxation of the government's long-standing suppression of labor union activities.

**Chart 4. Quality of Employment(II) Average Hours Worked per Week**

**Chart 5. Quality of Employment(II): Proportion(%)**

## Chart 6. Quality of Employment (II): Industrial Accidents

Following the general pattern of change, those who worked more than 54 hours a week increased by 1985, but has since declined. And those who worked less than 17 hours a week showed the exact opposite trend, as expected. It is apparent that the average Korean worker has been working relatively long hours for the past four decades. Especially during 1960s and 70s, Korea had a bad reputation not only for her long working hours but also her high rate of industrial accidents.<sup>8)</sup> However, the industrial accident rates also began to fall from the mid 1970s and the declining trend was accelerated after President Roh's declaration of democratization in 1987. In view of the evidence revealed in Table 5 and 6, we can conclude that not only the quantity but also the quality of employment has substantially improved in Korea during the past four decades. It strongly suggests that the Korean people in general have been significantly better off. In other words, sharp upward economic mobility has taken place in Korea from the early 1960s to the present. Then how widely has this upward

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8) In 1970, the hours of work per week in the manufacturing sector was 52.3 in Korea, but the corresponding figure was 48.7 in Singapore, 47.3 in Thailand, 45.1 in Mexico, 43.3 in Japan and 39.8 in U.S.A. The industrial accident rate was on average two to five times higher than other LDCs, such as Hong Kong and Thailand. For details, see ILO Year Book of Labor Statistics (Geneva, 1975)



mobility been dispersed or shared by different segments of the population?

### 3. Income Inequality and Poverty Reduction

There are a number of estimates on the income inequality for Korea. However, available estimates vary in the length of years covered and use different data sources. Even in a case of the same data source, they employ different modifications and different methods of estimation. The most critical drawback of the available studies lies in the limitations of the data sources. The common limitations of data are that in all studies, the data sets do not include the one-person household and no-job household. Thus, those who are relatively impoverished tend to be excluded. Reliable income data on self-employed households are not available at all, so in most studies they are approximated from their expenditure survey. Of course, all studies excluded the incomes from capital gains and the underground economy and relied solely on gross income before tax.

With all the data constraints in mind, we will review the available estimates and will draw some provisional conclusions concerning the changes in income inequality in Korea over the past four decades. Table 7 is a summary of the available estimates on the income inequality measured by Gini coefficients.

There are not many estimates on the changes in Gini coefficients during the 1960s and 70s. However, available studies seem to suggest that income inequality decreased in the 1960s but increased in the 1970s. Cho(1993) estimated that Gini was 0.3439 in 1965, and improved to 0.3322 in 1970 and worsened to 0.3908 in 1976, and Kim and Ahn(1987) also showed a similar pattern of change, 0.3650 in 1965, 0.3460 in 1970, and 0.4080 in 1976. These findings match our expectations. During the 1960s, the Korean government implemented an outward-looking, labor-intensive development strategy with great success. As a result, there was a huge upsurge of industrial employment opportunities, which not only reduced absolute poverty but also raised the proportion of labor earnings in total income. Since the labor earnings tend to be more equally distributed than non-labor earnings (for example, capital incomes), we could expect that as the share of labor earnings goes up, the total income distribution is likely to be more equal.

<Table 7> Changes in Income Inequality (Gini Coefficient): From 1965 to 2000

	National Statistical Office	Choo (1993)	Kim & Ahn (1987)	Lee & Hwang (1998)	K.Yoo (1998)	H.Yoo (2001)	Chung (2001)
1965	-	0.3439	0.365				
1970	-	0.3322	0.346				
1976	-	0.3908	0.408				
1980	0.3065					0.3102	
1981	0.3059				0.366	0.3120	
1982	0.3092	0.3574	0.406	0.393		0.3113	
1983	0.3094					0.3139	
1984	0.3111				0.351	0.3148	
1985	0.3115		0.411	0.384		0.3162	
1986	0.3069	0.3368			0.340	0.3118	
1987	0.3065					0.3114	
1988	0.3006			0.365	0.327	0.3071	
1989	0.3039					0.3089	
1990	0.2948	0.3226			0.300	0.3000	0.2972
1991	0.2869			0.365	0.302	0.2925	0.2901
1992	0.2836				0.287	0.2881	0.2848
1993	0.2817				0.289	0.2854	0.2824
1994	0.2845			0.363		0.2890	0.2857
1995	0.2837					0.2886	0.2847
1996	0.2907				0.288	0.2954	0.2917
1997	0.2830				0.282	0.2871	0.2837
1998	0.3163					0.3213	0.3163
1999	0.3210					0.3274	0.3210
2000	0.3170					0.3226	0.3207

Source: National Statistical Office, *Survey on Urban Household Economy*, various issues.

Choo (1993), Hakchung Choo, "Income Distribution and Distributive Equity in Korea", I in *Social Issues in Korea: Korean and American Perspectives*, edited. Lawrence B. Kraus and Fun-Koo Park, Korea Development Institute, 1993.

Kim and Ahn(1987), Kim, D. and K.S. Ahn, *Korea's Income Distribution, its Determinants, and People's Consciousness about Distribution Problems*, Seoul: Jung Ang University Press, 1987(in Korean)

Lee and Hwang(1998), Lee, Joung-woo and Seong-hyeon Whang, "The Problems of I Income Distribution and Related Policy Issues in Korea", *The KDI Journal of Economic Policy*, 20 (1), (2), 1998 (in Korean).

K.Yoo (1998), Yoo, Kyung-Jun, "Decomposition of Inequality in Wage Income and its Courses". *KDI Policy Studies*, vol.11, no.1, 1998 (in Korean).

H, Yoo (2001), "Estimation of Income Distribution Function and Inequality Index by Entropy Maximization", *Journal of Empirical Economics*, Vol.3, no.1, 2001 (in Korean).

Chung (2001), Jeong, "Jin-Ho, Recent Changes in Income Inequality and Its Decomposition by Income Sources", *Quarterly Journal of Labor Policy*, Korea Labor Institute, Vol.1, 2001 (in Korean).

During the 1970s, there were at least two reasons why we could expect an increase in income inequality. The first was the government's strong campaign for the development of HCIs (Heavy and Chemical Industries) during the 1970s. Massive government's subsidies for the capital-intensive HCIs must have deteriorated the overall income inequality during the period. The second reason may be the extremely high inflation rate experienced during the 1970s. The CPI rose on average 19.3 % per year during 1973 to 1980, while the corresponding figure was 11.1 % during 1965 to 1973. Government-induced massive investments in capital-intensive industries with soaring inflation attributed to the deterioration in income inequality during the 1970s.

For the period of the early 1980s to the middle of the 1990s, the findings of the available estimates are contradictory. The majority of studies supported the "improvement" hypothesis, while the minority of studies endorsed the "worsening" one. Cho (1993) and Lee and Hwang (1998) as well as the Bureau of Statistics all supported the fact that there had been a substantial decrease in income inequality. But Kim and Ahn (1987) maintained the opposite case. On the other hand, H. Yoo(2001) found out that there had been no significant change during the 1980s and only marginal improvement from 1990 to 1995. K. Yoo (1998) analyzed only the labor earnings of those working in an establishment of over 10 employees, and found out that there was a vivid improvement in the distribution of labor earnings during the same period. I tentatively support the "improvement" hypothesis for the following reasons. Firstly, mainly due to the aggressive stabilization policy vigorously pursued by the government from the early 1980s, inflation has been under control and kept relatively low during most of the period. The increase rate of CPI was 5.2 % per year on average during 1981 to 1995. Remember that the corresponding figure was 19.3 % during 1973 to 1980. Moreover, the various government subsidies, such as interest subsidies and export subsidies, for the HCIs have gradually been reduced during the period. Thus, we can conjecture that income inequality must not have increased if all else were equal.

Secondly, all wage differentials were substantially decreased during the period. The reduction in educational wage differentials was the most remarkable. College graduates earned 2.17 times more than senior high school graduates in 1980, but they

earned only 1.47 times more in 1995. The industrial wage differentials also narrowed. For example, those in financial and real estate industries earned about 1.9 times more than those in manufacturing industries in 1980, but they earned only 1.3 times more in 1995. The other wage differentials, such as male-female, occupational, size of firm wage differentials, all shrunk considerably during the same period. The major reason for the shrinking wage differentials was the relative scarcity of unskilled or semi-skilled workers with low educational backgrounds and relative abundance in the supply of highly educated workers. There was an enormous educational explosion in Korea during 1960s to 2000. We will discuss this in detail later.

Thirdly, the year 1987 was not only a turning point for Korean democracy but also a turning point for Korean industrial relations. Union activities have almost completely been released after the decades-old tight control of the government in 1987. The increased union activism must have greatly influenced the improvement of income distribution.

In view of these reasons, I conjecture that the income inequality must have decreased in Korea during the 1980s and early 1990s. Now then what has happened to the income inequality during 1995 to 2000. All available estimates unanimously agreed that the income inequality was increased substantially during the period mainly due to the financial crisis of 1997. The 1997 crisis required a sweeping restructuring and downsizing of the financial as well as the corporate sector, thus generating massive lay-offs. These massive lay-offs have concentrated more on the small and medium sized industries because of the high interest policy and fiscal austerity enforced right after the crisis.<sup>9)</sup> Therefore there is little doubt that the financial crisis was the major cause for the increase in income inequality during 1995 to 2000. However, there are three additional reasons underlying the recent increase in income inequality.

The first concerns the rising tendency toward the nuclear family system and the

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9) In 1998, one year after the 1997 crisis, the total number of unemployed was 1,196 thousand. Among the unemployed only 5.7 % represented those who left jobs from firms with 300 or more employees. Those from firms with less than 20 employees accounted for more than 74.2 % of the unemployed. The unemployment effects of the recession of 1998 have most severely hit workers in smaller firms. For a detailed explanation of the reasons behind this phenomenon, see Park, Se-II (1999).

second is related to the aging of the population. It is a well-known fact in Korea that the income distribution of households with more family members tends to be more equal than those with fewer family members. And the older households tend to be more unequal than younger households in income distribution.<sup>10)</sup> Thus, we can say that the observed rising tendency towards a nuclear family system with a rapidly aging population in Korea must have contributed to the worsening in income distribution.<sup>11)</sup> The third reason is the technological revolution associated with IT and BT etc., which has been sweeping the global economy from the late 20th century. The new technologies tend to disfavor the unskilled and low educated workers and favor the skilled and knowledge oriented workers, thus, deteriorating the income distribution at least in the early period of its introduction.

These three additional factors leading to increasing income inequality are all structural in nature so that they may have long-run effects. The Korean government has relied on the assumption that rapid growth would take care of equity issues and it has worked rather successfully up to now, but that might not be the case in the future.

Now let us examine what has happened to the least advantaged people during the 1960s to 2000. To gauge the degree of poverty eradication, we will examine the changes in the poverty headcount ratio, calculated as a percentage of the households under the poverty line to the total number of households.<sup>12)</sup>

Table 8 shows the changes in the poverty headcount ratio from 1965 to 2000, calculated by three different studies. Each study relied on different absolute poverty

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10) For example, in 1996, the Gini coefficient of income distribution in the single-family household was 0.3743, but that of the household with two family members was 0.2779 in Korea. In the same year, the Gini coefficient in the household with household heads under 30 years old was 0.2519, but that with household heads over 65 years old was 0.4519.

11) The index of aging, calculated as number of population over 65 of age divided by the number of population under 14 years old, was 11.2% in 1980, but rose to 20.0% in 1990, 34.3% in 2000, and is expected to be 45.9% in 2005 and 62.0% in 2010. The aged dependency ratio, calculated as the number of population over 65 of age divided by the number of population between 15-64 of age, was 6.1% in 1980, and 7.4% in 1990, and 10.1% in 2000, and is expected to be 14.8 % in 2010 and 21.3% in 2020. Both figures show vividly the rapid speed of the ageing problem in Korea.

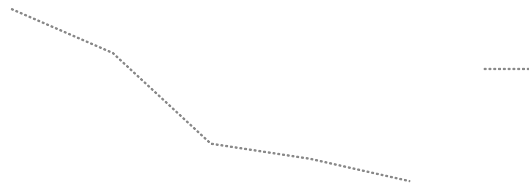
12) The poverty line is decided and announced every year by the Ministry of Health and Welfare.

<Table 8> Trends in the Incidence of Absolute Poverty (Poverty Headcount Ratio)

Study 1.

	Total	Urban	Farm
1965	40.9	54.9	35.8
1970	23.4	16.2	27.9
1976	14.8	18.2	11.7
1980	9.8	10.4	9.0
1984	4.5	4.6	4.4

Chart 7. Incidence of Absolute Poverty: Study 1



Study 2.

	Total	Large Cities	Medium-Small Cities	Farm
1993	13.4	9.7	11.3	44.6
1994	13.9	9.5	14.4	35.6
1995	10.0	6.4	9.4	31.9
1996	8.7	5.6	8.3	21.1
1997	7.3	4.6	7.8	18.0
1998	13.1	11.8	11.9	22.9

## Chart 8. Incidence of Absolute Poverty: Study 21

## Study 3.

1998	1/4	7.4
	2/4	8.9
	3/4	8.9
	4/4	7.9
1999	1/4	10.5
	2/4	9.1
	3/4	7.6
	4/4	7.1
2000	1/4	7.4
	2/4	5.9
	3/4	5.5
	4/4	5.6

Source: Study 1: Suh, Snang-Mok and Ha-Cheong Yeon, *Social Welfare during the Structural Adjustment period in Korea*, KDI Working Paper 8604, Korea Development Institute, 1986.

Study 2: Lee, Jung-woo and Sung-Rim Lee, Economic Crisis and Poor-Rich Gap: Income Distribution and Poverty before and after the 1997 Crisis, *Journal of International Economics*, vo.7, no.2, 2001(in Korean).

Study 3: Hwang, Deok Soon, Poverty Dynamics in Korea since the Economic Crisis, *Quarterly Journal of Labor Policy*, Autumn, 2001 (in Korean).

lines, estimated by different methods and different data sets. Therefore, we cannot compare the ratios across these studies. But within each study, the changes in ratios can suggest a consistent trend in the incidence of poverty during the period covered by each study. The first study was frequently criticized because the absolute poverty line estimated and used for the study were unrealistically low. Even though we do not believe in the absolute level of the ratios, by observing their changes over time, we still can draw some general conclusions about the changes in absolute poverty during 1965 to 1984. The study shows that poverty reduction was most striking during 1965 to 1970, especially in urban areas. Absolute poverty, estimated by the poverty headcount ratio, declined in urban areas from 54.9% in 1965 to 16.2% in 1970. And the declining trend of absolute poverty has continued to 1984.

The second study shows a mixed picture. Absolute poverty had fallen significantly from 13.4% in 1993 to 7.3% in 1997, but it bounced back to 13.1 % in 1998, presumably due to the financial crisis of 1997. One interesting finding in this study is that absolute poverty is more likely to happen in rural areas than in cities during the 1990s, while the opposite was true during 1965 to 1984, as shown in the first study.<sup>13)</sup>

The third study discloses that absolute poverty has sharply increased after the 1997 crisis but returned to the previous level rather quickly. The poverty headcount ratio started from 7.4% in the first quarter of 1998 and reached the highest level, 10.5%, in the first quarter of 1999, then thereafter gradually reduced to 5.6 % in the last quarter of 2000.

All three studies unanimously show that absolute poverty has substantially been eradicated in Korea during the past four decades. Even though there was a sharp rise in absolute poverty after the 1997 crisis, the normal trend of reduction has resumed

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13) One plausible explanation is that the informal sector was growing in urban areas due to massive rural-urban migration during the 1960s and 70s and it produced a large income gap between the modern and informal sector, thereby resulting in more unequal income distribution in urban than in rural areas during that period. But, by the 1990s, rural-urban migration has significantly decreased because the labor surplus has already been exhausted in rural areas. The continued successful industrialization centered around the urban areas has substantially narrowed the income gap between the modern and informal sector in urban areas, thereby resulting in more equal income distribution in urban than in rural areas.



rather quickly.

## 4. Industrial Relations

Industrial democracy is not only an important aspect of the quality of employment or quality of working life, but also a sign or manifestation of upward social mobility. This should go hand in hand with upward economic mobility to arrive at a fully developed and mature society. Therefore, to examine industrial relations is of vital importance in studying the quality of economic development.

The history of the Korean industrial relations system can be divided into four different stages of development.<sup>14)</sup>

### Stage 1: Market-driven Repression (1962-71)

The first stage covers the period from 1962 to 71, in which Korean labor unions were relatively free to function as collective bargaining units. When compared to other periods, the 1960s was a time when the legal rights of workers to organize, bargain, and engage in collective action were relatively respected.<sup>15)</sup> This did not mean that the government was not interested in securing low cost, disciplined labor. On the contrary, the government was anxious to pursue its developmental goals, rapid growth, export promotion, low wages, and industrial peace. What characterized this period were the governmental means employed to achieve these goals.

The government relied more on market forces rather than direct intervention. Cheap and disciplined labor could be easily obtained through the market system because the labor market was marked by an unlimited supply of labor during the 1960s. When an economy is in a labor surplus, the market works against labor. It weakens labor's bargaining position. Though labor may be organized, unions can hardly be effective

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14) A more detail discussion on the role of the state in Korean industrial relations, see Park, Se-II (1994).

15) Many commentators will argue that real union autonomy did not exist during the 1960s. My contention is that real autonomy did not prevail in a strict sense, but union autonomy was relatively respected, especially when compared to other periods of Korean history in industrial relations.

and strong. Additionally, the labor-management relations tend to be paternalistic at best or authoritarian and exploitative at worst. Since the Korean economy suffered from severe underutilization of human resources during the 1960s, not only the government but also the workers were more concerned with securing employment opportunities than with achieving better working conditions.

Consequently, under such labor market conditions, the government did not have to intervene or suppress union activities in order to maintain its cheap labor policy. In short, labor repression through market mechanisms worked rather effectively in Korea during the 1960s. But this period came to an end as the economy moved to a limited labor supply in the early 1970s.

#### Stage 2 : Authoritarian Corporatistic Repression (1972-1987)<sup>16)</sup>

From the early 1970s, the Korean economy slowly entered into a new stage of development, characterized by a semi-limited or limited supply of unskilled labor. The unemployment rate dropped sharply from 8.2% in 1963 to 4.5% in 1970 and 4.0% in 1973, as seen in the above. There was a wide consensus that an Arthur Lewis-type economic turning point, a movement from an unlimited to limited labor supply, took place in Korea sometime in the early or mid 1970s.<sup>17)</sup> Accordingly, the market mechanism could no longer guarantee low-wage disciplined labor.

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16) Theoretically speaking, in relation to the role of the state in the developmental process, there could be three models of industrial relations. In the first model, **pluralism**, the state does not attempt to determine substantive outcomes of industrial relations, but limits itself to the establishment of fair procedural rules that balance power between labor and management. In the second model, **liberal corporatism**, the state plays an active role in promoting so-called national interest, in close cooperation with unions and employers' organizations, but with full recognition of the importance of conflicts of interests and countervailing powers. In the third model, **authoritarian corporatism**, the state assumes full authority to represent the collective interests of the parties, labor and management, and usually suppresses independent representation of organized interests, particularly those of labor. According to this theory, Korea, especially during the period of 1972 to 1987, could be classified as an example of authoritarian corporatism.

17) See Watanabe(1982) and Bai(1982) for details, Watanabe argues it was sometime between the late 1960s and early 1970s that the Korean economy passed the "turning point", while Bai argues that the turning point took place sometime in the middle or late 1970s.

Against this backdrop, the Special Presidential Degree on National Security was introduced in December 1971 and the labor scene suddenly changed.<sup>18)</sup> Accordingly, collective union actions were all completely prohibited. This decree lasted for a decade and was formally lifted in December 1981, but in December 1980 all labor legislations were substantially amended in advance to keep union activities under the government's supervision. Thus, the government could maintain authoritarian repression until 1987.

Even though collective action was banned during the period, the government did not restrict union organizing activities. Thus, union members continued to grow during the 1970s and 1980s, as shown in Table 10. However, the changes in the labor legislation effected in December 1980 produced a sharp decline in membership, which rose again steeply with the government policy change in 1987.<sup>19)</sup>

Unions were allowed to grow, but not allowed to act as an effective instrument to improve working conditions. Thus, this period was frequently called "unionism without free collective bargaining".

However, an interesting feature of the government's industrial relations policy during this period was that labor was excluded politically but included economically. The government did not allow the union a voice in political matters, such as the determination of working conditions and revision of labor laws, but the government pursued every effort to benefit labor in the process of economic development. The major mechanism for economic inclusion of labor was through the rapid creation of employment opportunities and through active investments in educational and vocational training.<sup>20)</sup> In this regard, the government was politically repressive but economically paternalistic.

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18) The major content of the decree as follows: (1) unions were required to secure government approval prior to engaging in collective negotiation, (2) when disputes arose, government intervention would be automatic and its decision would be both final and binding, (3) strikes and lockouts were prohibited.

19) A sharp decline of penetration ratio, revealed in 1984 and 1985, suggests that the labor laws amended in 1980 had many anti-union elements in its contents.

20) Another mechanism for the economic inclusion of labor is through legal paternalism. The Korean labor laws were enacted in 1953 and since then there have been several amendments, but interestingly enough, the direction of amendments has always been to discourage union activities but to strengthen labor standards. In other words, the collective

**<Table 9> Union Membership and Penetration Ratio: 1963 to 1999**

	Membership(Thousands)	PR(%)
1963	224	20.3
1965	272	23.3
1969	445	21.3
1970	473	20.0
1974	656	22.1
1975	750	23.1
1979	1,088	23.6
1980	948	20.1
1984	1,011	16.8
1985	1,004	15.7
1989	1,932	23.3
1990	1,887	21.5
1994	1,659	16.3
1995	1,615	15.2
1999	1,481	14.9

Note: PR = number of union membership/non-farm regular workers.

Source: Ministry of Labor, *Yearbook of Labor Statistics*, 1965 to 2000.

### Stage 3: Immature Pluralism (1987-1992)

We observed that the economic turning point (a Lewis-type) toward a limited labor supply occurred in the early or mid 1970s, but the political turning point toward democratization took place in Korea in 1987.

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rights of workers, such as the right to organize unions, to bargain with employers, and to go on strike, have been curtailed significantly over the decades before 1987's democratic reform. But, in contrast, the individual rights of workers, such as the right to severance pay, to avoid wrongful dismissal, and to safe and healthy working environment, etc., have substantially been improved over the same period. So one of the problems associated with the Korean labor laws has been having an under-protected labor union act with an over-protected labor standards act. This problem was tackled in the 1996 labor law reforms.

## Chart 9. Union Membership

## Chart 10. Union Membership Penetration Ratio

The long-standing suppression of labor union activities was completely lifted, so that the political space was created for a wave of labor disputes and unions' organizing drive. As shown in Table 10, until 1986 the average number of labor

strikes had approximately been 200 a year. However, in 1987 the number skyrocketed to more than 3,700. Not only in the number of disputes but also the militancy of the conflicts increased as well. Furthermore, union membership almost doubled from 1,004 thousand in 1985 to 1,932 thousand in 1989 as shown in the Table.

In the rising conflicts, development deserved a special policy attention was that the labor demands was quite far reaching, calling not only for wage increases but also for union autonomy, reform of labor laws, and participation in management, etc. It implies that the problems were not simply bread and butter issues, but instead went to the heart of authoritarian corporatism, which had marked Korean industrial relations over the 1970s and 80s.

<Table 10> Changes in the Number of Labor Disputes: 1963-1999

	Number of Labor Strike		Number of Labor Strikes
1963	89	1981	186
1964	126	1982	98
1965	113	1983	98
1966	104	1984	113
1967	105	1985	265
1968	112	1986	276
1969	70	1987	3,749***
1970	88	1988	1,873
1971	101*	1989	1,616
1972	n.a	1990	322
1973	n.a	1991	234
1974	58	1992	235
1975	133	1993	144
1976	110	1994	121
1977	96	1995	88
1978	102	1996	85
1979	105	1997	78****
1980	407**	1998	129
		1999	198

Note: \* Presidential Decree on National Security (12-6-1971)

\*\* President Park was assassinated (10-26-1979)

\*\*\* President Roh's Declaration of Democratization (6-29-1987)

\*\*\*\* Asian Financial Crisis (11-1997)

Source: Ministry of Labor, *Yearbook of Labor Statistics*, 1965 to 2000.

## Chart 11. Changes in the Number of Labor Disputes

Immediately after 1987, the government followed a hands-off or a *laissez-faire* policy towards labor. Consequently, for the first time in the history of the Korean labor movement, unions enjoyed complete freedom to organize, bargain, and strike. However, mainly due to the lack of experience in free collective bargaining, negotiation at the workplace did not proceed smoothly. Collective bargaining was frequently regarded as a war that one party would win or lose. Collective bargaining was free but industrial relations became increasingly confrontational and antagonistic. Two years of complete free industrial relations came to an end in the middle of 1989 when the government returned to a selective intervention policy to moderate overheated militant unionism. However, more serious reform attempts to change the fundamental paradigm of Korean industrial relations was tried after a new civilian government came into power in 1993.

### Stage 4: Transition toward Mature Industrial Relations (1993 to the present)

The few years of experience after 1987 clearly indicated that union liberalization

did not necessarily guarantee the emergence of matured industrial relations. Rather it became more and more confrontational and adversarial and did not show any signs of improvement in restoring mutual trust between employers and employees. Employers regarded the unions' strength as a threat to management's prerogative and unions capitalized on the improved freedom to attain excessive demands by bullying management. So it became clear that Korea needed more than simple union liberalization. Korea needed joint efforts of labor, management, and the government to implement a series of industrial relations reforms specially designed to change the present confrontational industrial relations into more cooperative and productive ones. Thus, the new government, headed by President Y.S. Kim, organized a Presidential Commission for Industrial Relations Reform, composed of representatives from labor, business, and academics in May 1996. It was an attempt, for the first time in Korean history, aimed at a political inclusion of labor in the decision making process. The Commission accomplished a comprehensive amendment of the Korean labor laws in order to make them more compatible to, and more sustainable in the new environments brought by "globalization"<sup>21)</sup>

The following government, headed by President D.J Kim, also set up a Tripartite Commission in 1998, which consisted of labor, business, and the government, to implement necessary industrial relations reforms for more successful industrial and corporate restructuring. However, industrial relations reform is not only a matter of institutional and legal rearrangement. It is more fundamentally a matter of cultural change, in which people's mindsets and ways of thinking should be altered. Thus, Korea may need more time for trial and error to truly reach mature industrial relations, which is more participatory and cooperative as well as more trustworthy and dependable.

In sum, industrial democracy, which is an important aspect of quality of employment, is a recent development in Korea. Up until 1987, the right to organize unions was allowed but the right for effective collective bargaining was not permitted.

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21) Korean labor laws were enacted in 1953, right after the Korean War, modeled after the U.S.'s Wagner Act of 1935. So generally their contents were very outdated. To see in detail the background of labor law reforms and its process as well as its policy lessons from the Korean experience, see Park, Se-Il (2000-1).



However, since 1987, unions have enjoyed full-fledged labor rights (to organize, to bargain, and to strike) without any limitations. Especially after 1995, unions have been invited to take part in the government's decision-making process of public policies related to labor issues. Now labor becomes an important partner at the national level in discussing labor issues and related public policies. Rapid economic growth for the past four decades has finally brought about a corresponding development in industrial democracy, even though there are still many areas to be improved in the future.

### III. Private Sector Development and the Mechanism of Upward Mobility

#### 1. Two Private Sector Development Strategies

Private sector development is usually defined as tapping private initiative for socially useful purposes. In other words, it implies (1) to invent a market in which private initiative is working freely and (2) to make the market transparent, fair, and competitive so that it can function towards a socially desirable direction.<sup>22)</sup> As a matter of fact, rapid economic development cannot be achieved without private sector development, namely, without a well-functioning market mechanism.

So the challenge is how to do it. What kind of private sector development strategy should we create to structure the market to better serve the interests of society? To be more concrete, the issue is what strategy will provide more freedom and incentives for private economic agents to work and realize their full potentials and at the same time to develop an institutional or regulatory framework in which efforts of private agents are to be channeled in socially desirable directions. Thus, in fact, the choice of a private sector development strategy can be narrowed down to what role the state

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22) Or to put it differently, private sector development is an effort to narrow the gap between the private rate of return and the social rate of return of people's socio-economic activities.

should play in relation to the market. Or to put it somewhat differently, it is about how to invent a proper relationship between the state and the private sector (i.e., market).<sup>23)</sup> Different countries usually adopt different strategies for private sector development. The choice depends on many factors, such as history, culture, and institutions, as well as the vision of leading elites. Even in the same country, different strategies can be selected, depending on the different stages of development.

Korea adopted two different strategies for private sector development in harmony with two different stages of development in the past four decades. During the 1960s and 1970s, the dominant strategy was to build “Government-Business Coalition” (hereafter referred to as GBC) for an export maximization and risk-sharing in investment. During the 1980s and 1990s, the major strategy was to replace the GBC strategy by “Market Liberalization Strategy”(hereafter referred to as MLS). MLS comprises such efforts as trade liberalization, deregulation, and privatization.

#### (1) Government-Business Coalition Strategy(1960s -1970s)

In the early 1960s, the government, led by President Park, started a series of institutional as well as policy reforms to prepare for the “take-off” of the Korean economy. The GBC model has emerged through the implementation of the following institutional and policy reforms.

Firstly, the government started a series of institutional reforms to equip itself with sufficient power to influence resource allocation in the private sector directly. The Economic Planning Board was created in July 1961, which was in charge of government budgeting, devising and implementing the Five-Year Economic Plans, and coordinating all economic policies. In fact, it was a bona fide super-ministry, which centralized decision- making on all economic policies, and was headed by the deputy prime minister. In 1962, the Bank of Korea Act was amended and the

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23) There is frequently some misunderstanding that the private sector development strategy is about indiscriminate privatization or retrenching the state. Quite on the contrary, it is about keeping a good balance between the complementary functions of the state and the private sector. Sound government policies are absolutely required for a successful private sector development strategy.

monetary policy authority as well as foreign exchange control was moved to the Ministry of Finance. All commercial banks were de facto re-nationalized. Thus, the government had all critical means to lead and control the course of economic development. The government could directly influence the allocation of financial resources in the private sector.

Secondly, the government launched “Getting the Prices Right” reforms during 1964 to 1965.<sup>24)</sup> (1) During the 1950s the exchange rate was artificially overvalued, thus encouraging both imports and capital by undervaluing the price of imported capital goods. As a result, not only exports, but also the use of domestic inputs, especially of labor-intensive ones was discouraged. In 1964, the government devalued the Korean currency significantly from 130 to 255 Won per U.S. dollar. This was designed to eliminate the distortion in relative prices, thereby increasing the incentive for exports and for labor-intensive domestic inputs. (2) During the 1950s and early 1960s, the interest rates were kept artificially low to promote the expansion of domestic investment. However, these low interests not only discouraged private savings but also encouraged the adoption of capital-intensive technology because the relative price of capital was undervalued.<sup>25)</sup> In 1965, the government raised the one-year time deposit rate from 15% to 30%, about a 20% in real term, considering a 10 % inflation rate. It was designed to bring the interest rate near the market price, thereby boosting domestic savings for the investment fund.<sup>26)</sup> Through these reforms the price and market distortion was substantially corrected. Key macro prices started to reflect the real scarcity values in the market.

Thirdly, the government set “export maximization” as a top national goal. The government expected the exchange rate reform to provide a strong incentive for an export drive. In addition, the government offered various other export incentives. (1)

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24) For details, see Gilbert T. Brown(1973) and Charles R. Frank et al.(1975)

25) Although the policy of low interest rates was originally designed to promote industrial investment, the actual result was the expansion of the unofficial credit market. Since small firms did not have easy access to cheap bank credit, they paid higher interest rates in the unofficial credit market. Only large firms could use cheap bank credit and take advantage of windfall profits because of this dualism in the credit market.

26) As a result, the overall domestic savings ratio, which was negative in 1958-62 and had stood at only 5.8 % in 1962-64, jumped to 13.6% in 1968 and 22.1 % in 1973.

Particular emphasis was placed on an expansion of credit incentives. The preferential interest rates on export credits was reduced from 8% to 6.5% in 1965, and to 6.0% in 1967, whereas the interest rate reform of 1965 raised ordinary bank loan rates to 26 % per annum. (2) Exporters were given automatic rights to import raw materials duty free up to a certain limit. The limits were based on a technically determined ratio of required raw materials to output, plus a wastage allowance. This wastage allowance was determined administratively and varied from time to time. Since it could be sold locally, the export industries were able to reap large monopolistic profits out of the wastage allowance.<sup>27)</sup> (3) Various tax concessions for export industries were introduced. For example, a 50% reduction in taxes was offered to corporate and individual business income earned from export. A study revealed that export subsidies, explicit and implicit, amounted to 12.7 cents per dollar exported in 1964, and raised to 27.8 cents per dollar exported in 1970. Since 1972, some export incentives have been reduced but even in 1976 export subsidies were estimated as 19.6 cents per dollar.<sup>28)</sup> (4) An export targeting system was introduced, in which export performance was checked regularly against its targets. Even President Park chaired the Monthly Export Promotion Conference and strong performers were given medals and national recognition on Export Day.

Fourthly, the government decided to rely primarily on private entrepreneurship for export promotion and economic development. They chose not to use state-owned enterprises (SOE) as major vehicles for these purposes. The number of SOEs was 36 in 1960 and increased to 119 in 1971, but accounted for less than 14% of non-agricultural output. Since then, they have not grown much. As of 2000, the SOEs are numbered as 182 and are employing 288 thousand persons, which is approximately only 2.7% of all wage and salary employees.<sup>29)</sup> Thus, SOEs have not

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27) Most raw materials were generally limited by import controls or subject to high duties. Thus the markups between import prices and domestic prices were quite large.

28) See Charles R. Frank Jr. et al (1975) and Dong-A Il Bo (Newspaper), December 30, 1976.

29) Data on the SOEs are quite limited. A study shows that the number of SOEs was 83 in 1972, 72 in 1981, 90 in 1984, 125 in 1991, 136 in 1993, and 123 in 1996. And the number of employees in SOEs was 374 thousands persons in 1996. see Kye-Sik Lee and Hyung-Pyo Moon (2001).

played a significant role in the development of the Korean economy. By contrast, in Taiwan, SOEs have played a much more critical and important role in the economy, especially in carrying out investments in HCIs (Heavy and Chemical Industries). Singapore also relied heavily on “government-linked companies” in building infrastructure.<sup>30)</sup> But in Korea, not only HCIs but also infrastructure industries have relied mostly on the private big business sector and much less on SOEs.

In addition, an international comparison study on government spending discovered that (1) the size of the Korean government, captured by absolute government spending and relative shares in GDP, has been relatively very small compared to other countries, (2) government spending has been oriented more towards investment than other activities, (3) government activities involving direct income transfer has been small, (4) government has been active in providing economic services to the private sector (5) government spending has been very much centralized.<sup>31)</sup>

In short, even though the power of the government has been overwhelming, the economic size of the government and SOEs has been relatively small in Korea.<sup>32)</sup>

Fifthly, the government has built a risk-sharing coalition or partnership with the private sector to maximize exports and economic growth. To build a “risk-sharing coalition,” a number of policies were implemented.<sup>33)</sup>

(1) During the 1960s, the government decided to permit state-owned banks to guarantee the private sector’s foreign borrowing. In an early stage of development, it is imperative to mobilize fully domestic savings and /or foreign savings to finance high rates of investment required to achieve rapid economic growth. Korea also needed foreign saving to finance rapid growth because of limited domestic savings.

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30) There have been two engines of growth in Singapore, one is state-owned enterprises in infrastructure-related sector and the other is foreign multinationals in the manufacturing sector. See Low(1991).

31) For details, see J.Lee (1990).

32) The number of public servants was 283,057 in 1963, which accounted for approximately 11.7% of total salary and wage earners. However, the corresponding figures were 574,831 and 8.8% in 1980, and 859,555 and 6.5% in 2000. Not only have the absolute number of public servants been small, but its relative share has also been shrinking over the decades.

33) The analysis in this section is indebted to an excellent paper by Dr. Lim, see Lim(2000) for further details. A similar views on government-business interface in the Korean development history appears in another excellent paper by Dr. Yoo(2001).

But unlike Latin American countries at the time, the government decided not to rely on Foreign Direct Investment (FDI), but rather on foreign loans because they did not trust in foreign multinationals. However, the domestic firms did not have enough credit in the international market to raise capital on their own, thus the government decided to guarantee foreign borrowings along with close and tight monitoring over its business accomplishments. The business accomplishments were judged mainly by export performance. Since the export performance was relatively objective and easily observable criterion, by closely monitoring this export performance, the government could reduce the potential risk of moral hazard associated with the public guarantee on private foreign borrowings. In this respect, the GBC (Government-Business Coalition) was relatively efficient during the 1960s.

(2) During the 1970s, the government decided to promote HCIs (Heavy and Chemical Industries) vigorously. There were three reasons for the government promotion of the HCIs. Firstly, the development of HCIs was considered inevitable for the purpose of constructing domestic defense industries. To enhance a nation's self-defense capability, it was essential to build defense industries. Secondly, nation's industrial policy was inevitably shifted to the construction of HCI because Korea faced increasing trade barriers in advanced countries against her labor-intensive products and at the same time the domestic wage-rental ratio was rising rapidly. Third, Korea needed to improve her balance of payments since the past strategy emphasizing light industry exports tended to increase imports for both capital and intermediate goods, and thus was ineffective in reducing the current account deficit.<sup>34)</sup>

To promote the HCIs the government extended the so-called "policy loan" with extremely generous interest rates.<sup>35)</sup> In 1973 the government established the National

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34) Although Korea's rapid growth depended largely upon export promotion, it should be noted that import substitution was not neglected at all. Import substitution was promoted on a very selective basis in the 1960s, but from 1973, it was pushed on to an expanded scale by implementing for the construction of HCIs. Of course, the construction of HCIs has contributed to realize structural improvement, thereby enhancing the export capacity in the long run, but definitely, it had a strong feature of import substitution policy in the short run. For details, see Cha et al.(1997) and especially Chapter 1.

35) Of course, various tax incentives were provided and several new government-sponsored research institutes were established to support R&D in the HCIs fields. And total enrollment in engineering and technical schools was greatly expanded to meet the rising

Investment Fund to finance the long-term investment in the HCIs. The fund interest rate was at 9%, while the prevailing 3- year interest rate on bank loans was 15.5%.<sup>36)</sup> During the late 1970s, investment on the HCIs accounted for almost 80% of all investment in the manufacturing sector. This over-ambitious promotion of the HCIs resulted in the misallocation of resources and caused economic difficulties, including rising inflation and overcapacity issues, in the early 1980s. The government drive for the HCIs has greatly favored the large business groups, frequently called Chaebuls, because only large groups could effectively carry out these big projects. As a result, the shares of the top 46 Chaebol groups in GDP increased sharply from 9.8% in 1973 to 24.0% in 1981.

However, unlike in the 1960s, the government support could not be contingent on objective criterias such as export performance, because most HCIs had an import substitution character. In addition, in the 1960s, the government uniformly supported all export industries solely based on their export performance. All exporters were given various government subsidies under the same conditions. But during the 1970s the government tried to “pick winners” to promote the HCIs. Therefore, inefficiency in resource allocation and the possibility of corruption has enhanced to a great extent in the 1970s.<sup>37)</sup>

Thus, monitoring the business accomplishments became increasingly difficult, economically as well as politically. On the other hand, each project was “too big to fail”, so the government had to bail out, in the name of “rescue” financing, when some of them were failing. As a result, the GBC began to be increasingly inefficient and to create serious moral hazard problems associated with the risk sharing arrange-

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manpower requirements of the HCIs.

- 36) In real terms, the interest rate to the HCIs was negative because the inflation rate was over 10% in those years.
- 37) It has frequently been pointed out that one of the reasons underlying the successful economic development in Korea was the high quality of public servants, especially those technocrats who were in charge of economic policies. They were not only professionally competent but also morally clean and uncorrupted. This statement might be true in the 1960s, but not necessarily true in the late 1970s. The authoritarian President Park was in office almost 18 years from 1961 to 1979. The eighteen years of absolute power must have produced some forms of corruptions, since absolute power tends to be corrupted absolutely.

ments between the government and business.

In short, the government policy decisions in the 1960s and 1970s were, in general, efficient ones, especially so during the 1960s, given the condition of Korea's resource endowment. "Getting the Prices Right" was a correct policy and "Export Promotion" was another correct choice. Relying on private entrepreneurship for industrialization was also a right decision. The GBC arrangement must have been inevitable, in the early stage of development, for speeding up private investment, thereby generating rapid growth. When the private sector is immature or fragile, the reduction of investment risk by sharing with the government must have been a powerful incentive for the private sector to expand. In addition, various government subsidies must have helped in stimulating and mobilizing the so-called "animal spirits". So the GBC worked relatively efficiently during the 1960s, but it went too extreme during the 1970s. Thus, it began to generate not only short-term inefficiency, but also the long-term structural weakness of the Korean economy, such as the concentration of economic power (Chaebol), over-leveraged corporate sector, and high non-performing loans in banking industries, etc..

## (2) Market Liberalization Strategy (1980 to the present)

In 1980, a new government came into power and attempted a dramatic change in the developmental strategy, from state-led to market-driven one. In fact, much had changed since the 1960s. The domestic savings ratio had more than doubled and successful firms could raise capital in the international market on their own. It also became increasingly difficult for the government to identify profitable investment opportunities, to pick up the right winners, and to monitor the performance of individual firms objectively.

Moreover, in the 1960s, the benefit of GBC (Government-Business Coalition) strategy, i.e., high investment rates induced, seemed to outweigh the costs, i.e., un-monitored moral hazard. But, in the 1970s, the cost of the GBC strategy seemed increasingly to exceed its benefit because of the government's excessive drive for HCIs with declining monitoring effectiveness. The GBC model definitely encouraged high investment conducive to rapid economic growth, but it also resulted in a highly



leveraged corporate sector and banking industries with huge non-performing loans. Thus, if profitability declines, then the whole system becomes very vulnerable and easy to collapse.

In addition, the inflation rates started to soar up from the late 1970s mainly due to the expansionary fiscal and monetary policy to support massive investment for HCIs and also due to the second oil shock. The CPI rose 14.5% and 18.3 % in 1977 and 1978, but jumped to 28.7% and 21.3 % in 1979 and 1980.

Thus, the new government adopted two goals in economic policy; one was to curb inflation under the name of stabilization policy and the other was to shift the developmental strategy from the GBC to market liberalization, which was carried out in the name of structural adjustment.

The government slashed expenditures and deterred some public investment projects, following a zero- based budgeting principle, and also reduced the money supply sharply, from 30 % of M2 increase per year during 1976-82 to 15% during 1983-86. And bank interest rates were adjusted slightly upward. And these stabilization efforts proved very successful. However, market liberalization policy did not progress on smoothly.

The top policy makers in the new government believed that, instead of providing business directions and public insurance to private firms, the government should limit its role to setting “competitive rules of games” in the market and then let the market work on its own. Instead of allocating financial resources according to the priorities set by the industrial policy, the government should allow the market to pick up the right industries and right potential winners. So from 1981 to 1983, commercial banks underwent privatization and the interest gap between “policy loans” and the ordinary bank loans were eliminated. Export credit was also decreased and the size of the National Investment Fund, exclusively for HCIs, was also reduced. The government restriction on FDI was also relaxed. It was now recognized that FDI could be beneficial especially through the transfer of advanced technology. Import liberalization also expanded in 1984 as the nation’s external imbalance was nearly corrected.<sup>38)</sup>

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38) The degree of import liberalization, measured by the ratio of automatic approval items to total tradable items, was raised from 80% in 1983 to 95% by 1988.

The Monopoly Regulation and Fair Trade Act was introduced in 1980, in part to check the expansion of the Chaebol and for the most part to maintain “free and fair competition” in the markets. Along with competition policy, deregulation and privatization were considered to be two major reform agendas toward market liberalization. The first round of deregulation was attempted in 1988 and more serious attempt was carried out in 1993. However there was always some confusion about the policy objective of deregulation. The business group wanted to interpret deregulation as a measure to reduce only the administrative red tape—cumbersome government intervention of the past—without correcting anticompetitive regulations, such as entry barriers and price regulations. What the Korean economy needed most were more pro-competitive deregulations, but not much progress could be found in this area. Privatization has a longer history in Korea than deregulation. The first round of privatization came in 1968 and the second in 1980, but more ambitious programs were drafted in 1987 and in 1993. However, the plans were only partially implemented for one reason or another.<sup>39)</sup>

The policy shift toward market liberalization, including deregulation and privatization, has continued to the present day. There have been some progress and accomplishments, but overall reform is still far from being satisfactory. There has always been “some big plans with small achievements”.

There are two reasons why market liberalization reform has been less successful. One is theoretical and the other is political. The first one is that from the early 1980s Korea has pursued market liberalization policies, but they were implemented without preparing for new proper governances. In fact, “liberalization without governance” is not only ineffective but also very misleading and dangerous. A market cannot function in a vacuum. A market needs an appropriate institution or governance structure in order to ensure its best performance. The government tried to eliminate the old institutions, which had repressed the market, but it failed to develop new institutions, which would revitalize the market. To destroy old institutions and governance is rather easy but to construct new and effective ones is very difficult and sometimes very time consuming.

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39) For a more detailed discussion on the deregulation and privatization issues, see Yoo(2001).

For example, the government can liberalize the capital market, but it can easily fail to develop a new and prudent monitoring system to watch over socially undesirable activities.<sup>40)</sup> The government can also reduce many regulations, but frequently it fails to replace the old anti-competitive regulation by new pro-competitive regulations. Then, the sheer absence of regulation tends to produce many unexpected as well as undesirable side effects, thus resulting in a serious backlash and finally complete retreat.<sup>41)</sup>

The second reason was related to political economy. The GBC model produced an alliance of economic players who were more interested in maintaining the old coalition model. Politicians, bureaucrats, and business leaders, all wanted to consolidate the status quo and preserve the vested interests associated with it. An in-depth study on the issue correctly concluded as follows; “The most important reason behind unsuccessful privatization has been strong opposition and political pressure from the vested interest groups, including managers and workers in public enterprises, and government officials and politicians.”<sup>42)</sup>

In sum, Korea adopted two different strategies for private sector development. During the 1960s and 1970s, the dominant strategy was to build a “Government-Business Coalition” for export maximization and risk-sharing associated with private investment. During the 1980s and 1990s, the primary strategy was “Market Liberalization Strategy”, composed of trade and financial liberalization, anti-trust and competition policy, deregulation, and privatization. The first strategy was successfully and efficiently implemented, especially so during the 1960s and less so during the 1970s. However, the market Liberalization Strategy, which started from the early 1980s, has yet to be completed and is still underway. Without a successful completion of Market Liberalization Strategy, the Korean economy could not become a fully advanced one.

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40) It was, in fact, one of the causes of the 1997 financial crisis in Korea.

41) If the side effects, even temporary ones, become controversial socially, then the public opinion shifts to support the re-regulation rather than de-regulation. Then the bureaucrats are more than happy and ready to re-introduce anti-competitive regulation.

42) See Yoo(2001) p.375.

## 2. Generating Upward Mobility: Its Causes and Limits

As examined in the above, Korea has achieved truly impressive growth and, at the same time, substantial improvement in living standards. Major channeling (conveying) mechanism of growth to living standards (or upward mobility) was through employment creation. What was impressive was not only the quantitative expansion of employment opportunities but also the qualitative improvement of employment contents during the past four decades.

As frequently observed in the experience of less developed countries (LDCs), rapid economic growth does not necessarily guarantee high employment creation. Growth can be concentrated in a relatively limited part of the economy, thereby causing rising unemployment with an unequal distribution of income.

There once appeared a debate in development literature on whether or not there is a necessary conflict between growth in output and employment creation. And “employment pessimism” has once emerged in literature. But, Korea, during 1963 to 1979, has not only achieved rapid GDP growth of approximately 9 % per year but also fast employment creation of 5% per year in total employment, and 7% per year in non-farm employment. How has Korea achieved “more growth with more employment”?

Firstly, Korea has correctly chosen the policies of export promotion of manufactured goods, rather than traditional import substitution or primary goods export. An important advantage of export promotion policy of manufactured goods is that it can exploit the unlimited size of the global market. The size of the market determines the degree and possibility of division of labor and the degree and possibility of division of labor determines the labor productivity. Economic growth means high productivity and high productivity means more specialized and sophisticated division of labor, which is determined ultimately by the size of the market. Therefore, market size is a critical determinant in economic development. The import substitution policy has little possibility for productivity increase mainly due to a narrow and limited domestic market. But the export promotion policy can enjoy an unlimited global market, thus exploit vast possibility of division of labor, thereby resulting in rising

productivity and rapid GDP growth. Even in export promotion policy, exports of manufacturing goods is more preferable to exports of primary goods simply because the former has more potential for division of labor, thus, more possibility for productivity increase.

Secondly, “Getting the prices right” reform, which took place in the early 1960s, was a right policy decision. Correcting the two important distorted macro variables, the exchange rate and interest rate, not only boosted export expansion, but also induced the export industries to become more labor-intensive, thereby contributing to rapid employment creation. The exchange rate reform encouraged export and discouraged import of capital-intensive machinery and intermediate goods. The interest rate reform encouraged private savings as well as the adoption of labor-intensive technology because the price of capital became expensive.

The correction of these two variables was a meaningful sign of showing that the Korean government was determined to utilize the market mechanism or price signals, to achieve its developmental goals.

Thirdly, so far we have examined the demand side, but the supply side was also extremely favorable. Human resource conditions were truly advantageous to the rapid expansion of labor-intensive manufactured goods. In the early 1960s, Korea was characterized not only by its abundance in labor supply but also by its relatively high level of educational attainment of its population. After 1945, a system of compulsory primary school education was introduced and secondary and higher education also grew rapidly. As a result, the literacy rate already reached 90% by the early 1960s, from a level of 22% in 1945. In the 20 years following 1945, the number of college students increased approximately 20-fold, and middle and high school about 15-fold, so that by 1965 Korea’s human resource development had exceeded the norm for a country with three times its median per capita GNP.<sup>43)</sup>

The education explosion continued during the 1960s and 70s and no sign of slow down or leveling off has appeared up to the present. By 2000, among the total population, one out of four is either a college student or a college graduate and one

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43) Harbison and Meyers (1964) pp.31-48.

out of three is either senior high school student or graduate.<sup>44)</sup> And, as of 2000, those who have either senior high school diplomas or college degrees account for 71.8% of the population over the age of 25. In recent years, some commentators even began to talk about over-education or excessive education in Korea.

In addition, after a long period of colonial exploitation (1910-45) and the Korean War (1950-53), people's aspirations and eagerness to improve their living conditions were very strong in the 1960s and 70s. They were willing to work hard with full dedication. The abundant supply of labor with a relatively high educational background and strong motivation not only provided very favorable initial conditions for the Korean economy to take off, but has also continued to be the primary source of growth in the Korean economy thereafter.

Fourthly, the GBC (Government-Business Coalition) strategy to boost rapid investment increase and fast export expansion during the 1960s was an efficient policy choice. Without GBC strategy, the Korean economy could not have produced such a high employment creation. The GBC greatly improved the investment climate of the private sector during the 1960s, which is an indispensable prerequisite for rapid employment creation, especially in its early stage of development. Without a high investment rate, there is no rapid employment creation.

GBC helped the private sector to have easy access to foreign capital and also made the private sector invest more aggressively by sharing risk between the government and business. The private sector became bolder in risky and long-term investments. In addition, GBC invented the policies for various export subsidies, which also induced high investment rates in export industries.

On the other hand, the moral hazard problem associated with risk sharing was not great in the 1960s. The performance of business could be rather objective by the export record. When export performance turned out to be below the initial expectation, the government could easily withdraw its coalition relationship, namely,

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44) To be more precise, the number of college students (including two-year and four-year colleges as well as graduate schools) was 3,071 thousand and college graduates was 7,920 thousand in 2000. Since total population was 42,169 thousand in 2000, the ratio of college students and graduates to total population was 26.06%  $(=(3,071+7,920)/42,169)$ . So we can say that one out of four is either a college student or a college graduate. The corresponding figure is 34.62% in case of senior high school students and graduates.

the guarantee of foreign borrowings through the government-run banks as well as various government subsidies extended to the export industries. So there were always sticks available to discipline the assisted industries.

However, the GBC was less efficient in the 1970s. The government pushed HCIs (Heavy and Chemical Industries) projects too single-mindedly in bureaucratic and sometimes even in autocratic ways. The government supported the designated big business groups in constructing HCIs though preferential long-term credit and tax incentives, etc.. But the government did not have an effective means to discipline the assisted industries. The performances of the industries were not easily detected only through export records because HCIs have an import-substitution character in its nature. And also the most HCIs were all “too big to fail.” Therefore, in fact, there were no useful sticks to discipline the subsidized industries, so that the moral hazard problem became increasingly serious in the 1970s. In short, GBC has contributed greatly to the rapid economic growth as well as fast expansion of employment in the 1960s, but definitely less so in the 1970s.

Fifthly, during the 1960s and 1970s, either export maximization or growth maximization have been the top priorities in the government’s economic policy. However, employment maximization has never been so important. Mainly due to the labor-intensive character of the Korean export industry, Korea’s performance of employment generation seems fairly impressive. But, as a matter of fact, Korea could have done much better if the government chose employment maximization as one of its major developmental goals. Two problems should be pointed out in this regard.

The first is the problem of small and medium sized industries. The development of small and medium sized industries is of vital importance in generating employment and in improving income distribution. Small and medium industries tend to use more labor-intensive techniques of production. They also rely more on indigenous inputs and the domestic market, thus generating stronger backward and forward linkages. Since they do tend to require less capital per unit of output, a given amount of capital would produce apparently more employment. In addition, they tend to use more marginal and traditional laborers, such as women and the old, who are largely inappropriate for large capital-intensive industries. Thus, the development of small and medium sized industries is extremely valuable both for employment creation and

for better income distribution.

However, the government policy towards small-scale economic units has been characterized by benign neglect or active discrimination in Korea for the past four decades. Government subsidies and assistance to industries have always been scaled according to the export volume during the 1960s and according to the capacity to run huge HCIs during the 1970s, the small and medium sized industries have been always disfavored. On the other hand, the large scale industries have always obtained direct benefits from easy access to cheap credit, foreign exchange concessions, tax reductions, monopolistic rights to import raw materials, etc.. In short, Korea could not have succeeded in capitalizing fully on the potential of further employment creation in small and medium sized industries in the past four decades.

Another problem is the problem of capital subsidies. As already examined, the Korean government raised the interest rate to the market level in the early 1960s to induce domestic savings, but at the same time it extended various capital subsidies, in the form of preferential credit at discounted rates. This was frequently negative in real terms but it increased private investment in export industries and HCIs . However, to a greater extent, high investment and high growth can be achieved not through capital subsidies, but through labor subsidies too. Labor subsidies, such as subsidies of wages, of training costs, or cost of recruitment, can greatly encourage not only output growth but also employment creation. In addition, labor subsidies also stimulate R&D activities in inventing more labor-using and capital-saving technology. In contrast, capital subsidies are much less likely to increase employment, even though encouraging output growth, and also are stimulating R&D in more capital-using and labor-saving areas.<sup>45)</sup>

The policy option to maximize employment has never been tried in Korea. If the government had paid proper attention to the small and medium sized industries and had tried to capitalize on labor subsidies, then the Korean economy could have

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45) Hong agreed that Korean economy have not been creating employment as much as they would otherwise have because of the extensive capital subsidization, but he raised a question whether Korea could have expanded its exports (and GNP) so rapidly if it had insisted upon using less capital intensive production techniques. Theoretically it is an interesting question but empirically almost impossible to prove or disprove. Of course, he did not take any conclusive position to the question. See for details, Hong (1979).



created more employment opportunities than it did. In addition, more upward mobility could have been realized in Korea.

Lastly, as already observed, from the mid 1990s and especially after the 1997 crisis, income inequality has drastically increased, unemployment has soared, and the marginalization of employment has been accelerating. Thus, there is a rising concern whether the Korean economy could maintain the high employment creating capacity, which it has enjoyed for the past four decades, in the future. But if in the future, productivity rises too quickly in only certain segments of the economy and if industrial upgrading moves too rapidly towards a labor saving structure prematurely, then there would be the danger of losing high employment creating capacity in the Korean economy.

This undesirable consequence could occur when there is a price distortion in the input market and monopolistic elements in the output market. Thus, in order to maximize employment, all the price distortions and market imperfections should be reduced and hopefully eliminated. Artificially- set high wage rates as well as industrial policy-induced low interest rates are all detrimental to employment creation. Various government subsidies, related to industrial policies, towards the capital-intensive industries as well as towards large-scale industries are all harmful and hazardous to employment creation.

We have to keep in mind the simple fact that, in a textbook level labor market diagram, employment is to be maximized only at the point where the wage is set by supply and demand. So we have to have a free and competitive input and output market to attain employment maximization, which means that Korea should change her developmental paradigm from the GBC model to the Market Liberation model, as soon as possible, even for the purpose of realizing maximum employment potentials. It should be emphasized again that employment creation is the best way to achieve both growth and equity at the same time, namely “shared growth”.

In sum, the major channeling mechanism of rapid economic growth to higher upward mobility was through the rapid creation of productive employment in Korea. For rapid employment creation, Korea has correctly chosen the policies of export promotion of labor-intensive manufacturing products, rather than traditional import

substitution or primary product export. Korea was also extremely lucky on the supply side, for its abundance in a highly motivated labor supply with a relatively high level of educational attainment. In addition the GBC strategy during the 1960s and 1970s successfully promoted fast export expansion as well as rapid private investment increases, thereby generating high employment creation, which became the basis for “shared growth” in Korea.

## IV. Moving Forward to The Future

How can Korea continue “shared growth” in the future? What policy package should Korea choose to obtain both high growth and high upward mobility? The surest way to achieve the two goals simultaneously is to produce to maximum level of high productivity-high paying jobs. The maximization of “good jobs” will depend on the successful implementation of the following policy as well as institutional reforms.

### 1. Market Liberalization Reform

The old developmental model, GBC (Government-Business Coalition) model, must be resolved and replaced by a new model based on the market liberalization principle. The “strong government” was an important asset in Korea during the 1960s and less so in the 1970s. But it turned into a liability from the 1980s. What Korea needs is a “strong market”, robust and dynamic, not an interventionist government.

As a matter of fact, the policy reform to market liberalization has started from the early 1980s. There have been several attempts in such fields as trade liberalization, competition law, deregulation, and privatization, for the purpose of constructing “a strong market”. But many attempts were distorted and frustrated in the implementing process. The government advocated the importance of private initiatives and promised to rely on market mechanisms in dealing with economic issues, but their deeds always deviated far from their words. Overall, the government accomplished some

progress but is still lagging very far behind our expectations.

This was because the politicians, government technocrats, and business groups all shared a common interest in preserving the old GBC model. Politicians could demand a kickback from the business groups in exchange for special favors in various government subsidies. Technocrats could maintain their power in the management of economic affairs. Business could enjoy various privileges and benefits from the government. So nobody really wanted real change.

But the old GBC model could not last long for the following reason.

The old model was, in fact, a product of political and economic variables. However, two variables are changing very rapidly. In the political arena, the democratization movement, started from 1987, increased the number of political players or participants significantly. In the old model there were only two dominant players: the government and the industries. Now many new participants have appeared and joined in the political game, such as labor unions, consumer movement, taxpayers, various NGOs, intellectuals, and the medias, Thus, the government cannot serve and protect solely the interest of the industries at the expense of other participants. In addition, democratization has also led to more frequent occasions of splits in opinion within the government and between the parliament and the administration. Business has also experienced divisiveness, for example, between large and small- scale industries.

In the economic arena, a significant development appeared, that is, the economic power possessed by the private sector has increased considerably during the past four decades. So it became increasingly impossible for the government to control the private sector as effectively as before.<sup>46)</sup> And the rapidly expanding trend of globalization has produced more leverage to businesses vis- a- vis the government. If businesses are not happy with the government they can invest in the overseas rather easily.

The above is the reason why the old model is not sustainable. But there is another reason why it should not continue. During the 1960s and 1970s, the government had

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46) The total assets of the 30 largest Chaebul was 425 trillion Won in 1996, and total sales of them were 385 trillion, while total government spending, including local governments, was only 127 trillion Won.

a longer time horizon and better-qualified staff than private sector. Thus, they could suggest a long-term vision to the private sector in the form of 5-year economic development plans. These plans were taken seriously by the private sector when they were settling their own investment decisions. As Korean democracy and economy have grown, the situation has reversed. In designing the future, the private sector now has a longer time horizon and better-qualified staff and professionals than the government. Thus, inevitably, the role of the government should be drastically redefined.

There should be three major roles of the government in the future. The first role will be setting the rules of competition in the market and enforcing them strictly with no exceptions. Economic freedom must be guaranteed to the maximum as far as competition rules allow. Any regulation of the private sector should be rule-based and not discretion-based any more.

The second role will be developing proper governance and institutions in which market liberalization can flourish. As pointed out already, for example, financial liberalization should be accompanied by more a prudent regulatory regime. Otherwise, financial liberalization may lead to a financial meltdown, as experienced in many Asians nations in the 1997 crisis. One of the major reasons why many market liberalization reforms have failed in emerging markets as well as in transitional economies was that liberalization reforms proceeded without preparing a new governance or regulatory regime in which market forces were working in a more orderly fashion.

The third role is preparing for efficient as well as effective social safety nets. The market liberalization reforms and competition laws could solve the problems facing about 80 to 90 % of the total population. They cannot solve the problems confronting the rest of the 10 to 20%. We need an effective social safety net for those who cannot compete in the market, either temporarily or permanently. Globalization, accompanied by new technologies, such as IT, BT, ET, NT, tends to produce a new social divide and to increase the gaps among different socio-economic groups. Thus, a proper safety net must be prepared, otherwise, economic globalization can not be sustainable socially. In short, for the future of Korea, we do not need a “strong government”. What we need is a “strong market”, but a strong market should come

with a “strong society”, if not, both will fail.

## 2. Education Reform

To continue “shared growth” in Korea, the top policy priority should be restructuring education. Investment in education is the best way to guarantee both economic and social development, and this is especially true in the coming age of knowledge economy and globalization. High productivity-high paying jobs can be produced only in a society in which people have outstanding educational excellence. Education, as already discussed, has been one of the biggest assets in Korea’s development. It has been an important supportive force, but now it is becoming a bottleneck for further economic development. As far as quantity is concerned, there is no problem in Korea. The problem is related to the quality of educational performance.

Currently Korea’s education system has many problems<sup>47)</sup>, but I will focus on only two of the most serious issues. One is the so-called “equalization policy” in the secondary schools and the other is the under-investment problem at the tertiary level.

Equalization policy is a policy to allocate students to schools by administrative decision. Students are not allowed to make a choice in the schools they would like to attend. The rationale was to make educational opportunities more equal to everyone. If private choices are allowed, then inequality in educational opportunities would occur because of the differences in family background. In other words, only rich or smart students would monopolize the limited number of prestigious schools. However, the equalization policy has brought about two undesirable consequences. One is the continuing deterioration of academic achievements in secondary school students. The other is a prevailing private market for education, namely, the private tutoring system, which means a rising financial burden to the students’ families. Under the equalization policy, those students, who are fast and smart, cannot be satisfied in the formal school setting, so they must get private tutoring. Those who

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47) Korea has launched a comprehensive educational reform in 1995, as part of a “Reform for Globalization”. What was the background of the reform, what problems the reform tried to tackle, what the hurdles were on the way, and what lessons the reform left for us: those issues were examined and discussed in Park (2000-2).

are slow in learning, also cannot be taken care of at the formal school, thus inevitable go to private tutoring.<sup>48)</sup> This equalization policy, which had gradually been introduced from 1970s, has served to choke the Korean secondary school educational system.

The second problem is related to the teaching quality of undergraduate schools and the research quality of graduate schools. Both are the consequences of two things: under-investment and inappropriate school governance. The number of colleges and universities has expanded quite rapidly, but it was not followed by adequate teaching staffs and teaching facilities. The problem of under-investment is most acute at research activities in the graduate schools. Only very few universities have the capacity to carry out world-class research. Most others fall far short behind world levels. The poor research capacity at universities has begun to retard the technological progress of the Korean economy. It will be a more serious problem in the future because university-industry linkage in R&D activities will play a more critical role in upgrading the national innovation system in the 21st century.

Under-investment is one reason underlying the lagging quality of tertiary education. But there is another reason, that is, the lack of appropriate university or college governance. Presently, in most colleges and universities, the president and dean are elected by a direct vote among professors. They are elected for a relatively short term, mostly, 4 years for president and 2 years for dean and only for a single term. Therefore, campus politics plays a more important role, rather than educational reform or restructuring, in university management. In addition, the short-term service of the president and dean makes it almost impossible to establish and implement a long-term vision and strategy.<sup>49)</sup> Moreover, there is no mechanism through which the president or dean would be responsible for and responsive to the needs of educational consumers, such as students, parents, industries and communities.

Even though the changing economy requires substantial restructuring or a complete renewal of the current college and university system, there is neither effective

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48) As of 2000, 70.8% of all junior and senior high school students were receiving private tutoring.

49) The average length of presidential service was 2.5 years in Seoul National University, while it was 21.0 years in Harvard, 10.5 years in Michigan, and 9.6 years in Stanford. The length of service was calculated as an average term of the recent 5 presidents, excluding the current one.

leadership nor an incentive structure to carry out necessary changes and reforms. Many commentators argue that the government's excessive regulations to college and university education must be blamed for causing all the problems in tertiary education. But this is only half true. Under the current school governance, deregulation does not necessarily produce expected reforms in higher education. Without constructing proper school governance, thereby having effective and responsible leadership, the deregulation policy could easily exacerbate the present problems of low quality education. Therefore, what Korea needs is a sweeping educational reform and restructuring at both secondary and tertiary school. Only then can Korea construct a "developmental society", not a developmental state, a precondition to meet the challenge of the knowledge economy in the 21st century.

### 3. Industrial Relations Reform

"Good jobs" mean not only high productivity-high paying jobs, but also highly fulfilling- highly satisfying jobs. "Good jobs" should provide a sense of participation and accomplishment, as well as self-esteem, and self-realization, etc. These quality elements associated with "good jobs" can be attained through industrial democracy especially at the workplace level.

Remember that the GBC was built on the exclusion of labor from political as well as the economic decision- making process. Labor did not have a chance to speak out on political and economic matters before 1987. Effective wage negotiation was not permitted and the union could not participate in the government policy-making process. Only after 1987, unions began to bargain effectively for the first time, and only after 1996, unions started to participate in the government's decision- making process. Thus, the history of industrial democracy is rather short in Korea. It is just about to start.

However, the dilemma facing Korea is that, on the one hand, Korea is in an early stage of industrial democracy, but, on the other hand, a less favorable attitude or sentiment to the labor movement is growing in society as globalization intensifies.<sup>50)</sup>

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50) Remember that the union penetration ratio has been declining sharply from early 1990s, as shown in Chart 10. There are many socio-economic factors behind this big decline. This

As is well known, current globalization tends to favor capital and disfavor labor, especially unskilled workers, and also tends to prefer cooperative industrial relations and dislike confrontational industrial relations. Therefore, the fundamental dilemma confronting Korean policy makers is how to harmonize or balance the rising demand for more industrial democracy, more voice and participation, with the rising demand for a more flexible labor market, less voice and more compromising. In this regard, the recent experiences of the small open economies in Europe, such as Austria, Denmark, Ireland, and Netherlands, would provide many good lessons and examples to the Korean policy makers.<sup>51)</sup> They tried to combine and integrate the social democrats' values and heritage, which emphasize participation, democracy, and solidarity, with the rising demands of neo-liberalism, which stress flexibility, competition, and efficiency. And to a great extent, they succeeded in obtaining two goals, which were seemingly conflicting with each other. They have accomplished rapid economic growth with active social dialogue, improved competitiveness with responsible participation.

In sum, a complete transition of the development paradigm, from the GBC strategy to the MLS, a drastic overhaul of the education system towards world-class quality, and harmonizing of industrial democracy with labor market flexibility are the major challenges Korea is currently confronted with. If Korea can meet these challenges successfully, then she can continue her march toward sustainable "shared growth" even in the 21<sup>st</sup> century.

## V. Conclusion

Korea has achieved remarkably rapid economic growth as well as high economic upward mobility for the past four decades. High upward mobility has been revealed in Korea by the rapid creation of productive employment, sharp rises in real wages,

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declining tendency of union membership is, of course, a serious challenge to the industrial democracy in Korea.

51) For an excellent study on the policy successes of those countries, see Peter Auer(2000).



dramatic reduction of absolute poverty, and moderate decreases in income inequality.

Korea's real GDP grew at an average annual rate of 7.8% from 1963 to 2000. Real wages increased at an average annual rate of 7.9% during the same period. Non-farm employment expanded at an average rate of 5.4% per year, far surpassing the average increase rate of labor force, recorded as 2.7% per year during 1963 to 2000. Thus, the unemployment rate decreased substantially from 8.1% in 1963 to 2.2 % in 1995. Agricultural employment accounted for 63% of total employment in 1963 but has now been reduced to approximately 10%. Absolute poverty has been substantially eradicated in Korea during the past four decades and various estimates also show that income inequality has been gradually reduced during the same period.

In Korea the dominant channeling mechanism of high growth to high mobility was through the rapid creation of productive employment. For rapid employment creation, Korea has correctly chosen the policies of export promotion of manufactured products, rather than import substitution or primary products export. In addition, the government produced the right market signals to the private sector. It did so by correcting the overvalued exchange rates and the artificially lowered interest rates, towards the adaptation of labor- intensive technology, which also accelerated rapid employment generation. The favorable supply condition of highly educated cheap labor also contributed greatly to the rapid expansion of exports as well as productive employment.

For export promotion and employment creation, Korea decided not to use state-owned enterprises as a major vehicle for these purposes. Instead, Korea chose to rely primarily on private enterprises. The government, by sharing investment risk with the private sector, encouraged the private sector to invest more aggressively and boldly, not only for short-term but also for long-term projects. In this sense, the GBC (Government-Business Coalition) was a very effective tool to boost private investment and rapid export expansion, thereby resulting in rapid employment generation. The GBC was particularly successful during the take-off period of the 1960s and the 1970s. However, to continue "shared growth" in the future, Korea should have changed its development paradigm from the state-led to the market-driven one from the 1980s and afterwards. Still the paradigm shift is progress and more vigorous efforts are greatly required. In the market-driven paradigm, the

role of the state in economic policy and management should be as follows: the first role is to set the rules of free and fair competition in the market and allow maximum economic freedom within the rules, rather than to intervene into the market and try to “pick up the winners”. The second role is to develop proper governance and appropriate institutions in which the market can flourish. This is because market liberalization should accompany a proper regulatory regime, otherwise, it could result in a market meltdown, thereby resulting in an economic crisis. Note that the absence of prudent regulations was one of the major reasons underlying the Asian financial crisis in 1997. The third role is to prepare efficient and effective social safety nets for those who cannot compete in the market, either temporarily due to unemployment or permanently due to old age and other physical constraints.

In addition, to maintain high growth as well as high upward mobility in the future, Korea should restructure its educational system and make it a world-class one. It is because high upward mobility comes from the rapid creation of high productivity-high wage jobs and they can be produced rapidly only in a society in which people have outstanding educational excellence. This is especially true in the coming age of knowledge economy and globalization. Another area of highest policy priority is to reform industrial relations. Korea should rebuild industrial relations and change it from the current one of confrontation with much distrust between labor and management into cooperative relations based on mutual trust and respect between the two. Besides, Korea should find its method to balance and harmonize the increased demand for industrial democracy with the rising pressure for labor market flexibility arising from economic globalization. If Korea can answer these challenges successfully, then its economy can sustain “shared growth” even in the coming decades.

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