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**Country Overview Paper No. 5**  
**Development Strategies, Welfare Regime**  
**and Poverty Reduction in the Republic of**  
**Korea**

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## 1. Introduction

Although the quality of life we enjoy is higher than ever before, a billion people in the world still live in absolute poverty. In order to fight against poverty, it is necessary for developing countries, where the majority of poor people live, to endeavour for both economic and social development. The difficult question from this observation is about the development strategies that developing countries should adopt in their pursuit of development. A number of development strategies have been tried for the last half century; some were successful while others only produced disappointing outcomes. This research will examine the Republic of Korea's development strategy that transformed one of the poorest countries in Asia in the 1950s into an industrialized nation with low levels of poverty and a high reserve of human resources. Through this research, we will try to find out a set of mechanisms able to combine economic development and successful poverty reduction.

In order to tackle the task, this paper will first examine the Republic of Korea's development strategy in which the state has played a leading role in economic and social development. In order to capture such policy orientation, this paper will take the perspective of the developmental state but it will elaborate the conception further in order to analyze the institutional dynamics between economic and social policy. The International Financial Institutions (IFIs) such as the World Bank and IMF still maintain that market-driven economic growth is the most efficient way to economic development while the state should only underwrite market institutions. The IFIs continue to argue that market solutions could also meet the social needs of the majority of the population, and that social policy should target the marginal section of society whose needs cannot be met by the market. Considering such arguments, this paper will examine the way in which the developmental state in the Republic of Korea has constructed the policy regime that has been facilitating economic growth and social development.

For many developing countries, the effective state is often one of the important missing components for development (Gough & Wood 2004). Nevertheless there are many cases of successful economic growth where the state has played a pivotal role in organizing key components for economic growth and social development. As Gerschenkron (1962: 358) has made clear, what matters in the advancement of the economy is not the necessity of certain prerequisites but the strategy (or capacity) to organize key components or devices in meaningful pattern according to the degree of economic backwardness. One of the typical examples of the development strategies that the late industrializers took is the strategy of the developmental state, in which the government plays a strategic role in economic development with a bureaucracy that is given sufficient scope to take initiatives and operate effectively (Johnson 1999; Woo-Cumings 1999). It is true that not only the Republic of Korea but also many other developing countries in Latin America and sub-Saharan Africa tried to experiment with the strategy of the developmental state (Kohli 2004; Riesco 2007). While the performance of the developmental states in many developing countries was varied, the Republic of Korea is one of the successful countries with such development orientation, contrary to some observation that the state intervention in economic development would result in failure (Kruger 1974). What are the underlying dynamics that made the Korean experience of

the developmental state successful? In this context this paper will examine the development strategy in historical perspective in the Republic of Korea while paying attention to the state-society nexus and bureaucratic capacity of the state in the Republic of Korea.

Secondly, it is of great interest to explore the development trajectories, such as that of the Republic of Korea, which achieve both economic development and low inequality. The classic argument on economic growth and inequality is that while inequality rises in the early period of economic growth, it would come down once the growth is consolidated (Kuznets, Epstein, & Jenks 1941). While this argument is still subject to debates in economic history with respect to developed economies, it is certainly true that economic growth often leads to greater inequality in many developing countries. Income inequality and poverty incidence increase with economic development instead of decreasing. Because of, *inter alia*, rising inequality and poverty incidence, many developing countries which experienced initial economic success could not sustain economic development for a longer span of time. It still remains an elusive task for many fast growing economies, for example China and Viet Nam, to combine economic growth and low inequality.

Thirdly, this paper will look into social protection in the Republic of Korea. Social protection is an essential element of development that protects people from social contingencies and allows individuals to enhance their life chance (Sen 1999). Social protection is provided by a range of collective agencies' efforts, which will include the state's social policies, firm-level welfare programmes, community welfare efforts and family self-help. In terms of social policy, the Republic of Korea has established a welfare state that has been instrumental for economic development while families have been regarded as a main site of welfare provision. Nevertheless welfare developmentalism has changed its complexion in the wake of economic crisis in East Asia. We will follow the change in welfare developmentalism in the Republic of Korea as one mechanism of the Korean developmental regime.

In fact, welfare developmentalism has long been promoted by prominent development scholars (e.g. Midgley 1995; Mkandawire 2004; Myrdal 1974) and United Nations agencies (UN Millennium Project 2005; UNDESA 1971; UNRISD 1980). Improved health conditions for the population through public health care is a great advantage for productivity increase for business. Social insurance for industrial workers protects not only workers themselves but also their employers, liable for compensation for industrial accidents, from financial contingency. More importantly, social policy programmes such as training and retraining develop and preserve human resources and skills of workers in particular. Development of human resources is a vital resource for sustained economic development as well as contributing to broad-based economic development which would in turn reduce poverty and inequality. In this context, it is important for the developing countries as well as developed ones to establish a welfare state that can contribute to economic development while fulfilling its intrinsic goal of social protection, equity and poverty reduction (Hall & Midgley 2004). There are, however, different variations of welfare developmentalism: selective vs. inclusive forms of

welfare developmentalism (Kwon 2005).<sup>1</sup> Kwon argues that while the welfare state in the Republic of Korea took the selective form of the developmental welfare state in the beginning, it moved toward the inclusive form in its recent welfare reform. What is the underlying logic of this change?

In order to understand such dynamics, it is necessary to look into other components of social protection. Particular relevant in the context of the present study is social protection provided by private firms. Private firms, whether in manufacturing or services, are the producers of goods and services, the engine for economic development. They are also producers of social welfare particularly for their employees, when it is consistent with their economic interest. But the main purpose of the firms as organizations is not consistent with the provision of social protection for society at large, although such social protection would serve the economic and social needs of the society in general, which may in turn benefit organizations in the end. Nevertheless organizations may provide these services depending on the rules and regulations that shape the relationship between economic interests and firm-level welfare. As we will discuss later, the developmental state brought about such rules and regulations to force firms to carry out functions of social protection.

## **2. The Policy Regime and the Developmental State**

This study will adopt a policy regime approach in order to tackle these tasks since economic development and poverty reduction are outcomes of a range of policies and institutions in different domains of political economy (Bangura 2006; Hall & Soskice 2001). The policy regime approach emphasizes the inter-connectedness and complementary nature of policy choices in different spheres of public policy. In other words, this research will approach the policy regime as a whole, considering the economic and social institutions (and policies) that interact with each other. It will also assume that politics is the medium of inter-connection between policy spheres.

There has been a growing body of literature analyzing economic and social policy from regime perspectives. Hall and Soskice's work on *Varieties of Capitalism* illustrates how economic actors compete and coordinate in order to achieve success according to their respective markets. For instance, Hall and Soskice contrast the liberal market economies with coordinated market economies (Hall & Soskice 2001). Firms coordinate their activities differently depending on the type of market in which they operate. In the liberal market economies, firms interact each other in the medium of competition, while in the coordinated market economies firms coordinate their activities with other firms in the market in order to maintain their competitiveness (Hall & Soskice 2001: 31). According to this approach, the nature of social policy fits the way the firm solves the

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<sup>1</sup> Kwon (2005) divides the developmental welfare state into two types: selective and inclusive types. The key principles of the selective welfare state are productivism, selective social investment and authoritarianism while the inclusive developmental welfare state is based on the principles of productivism, universal social investment and democratic governance. One of typical example of the first type is the Bismarckian welfare state and the welfare states in the Scandinavian countries fall under the second type.

coordination problems with other actors. Liberal welfare states, for example, maintain the flexibility of labour market with means-tested and low levels of benefits by which the firms of the liberal market economy manage their labour force. In contrast the coordinated market economy by and large has established firm-based welfare systems that aim to secure the employees' loyalty and to build the workforce with firm-specific skills.

In the studies of social policy, it is a well-established argument that there are at least three different welfare regimes in capitalist economies: social democratic, conservative and liberal welfare regimes (Esping-Andersen 1990). Three main components of the welfare regime—family, market and the welfare state—share the welfare responsibility according to the type of regime. The predominant political forces that have shaped the prevailing order of the welfare regimes are different. In the liberal welfare regime, it is the political force for free enterprises that maintains the regime; the coalition of the social democratic party and working class is the force behind the social democratic welfare regime; and in the conservative regimes, those who want order and stability are the backbone of the regime. In short, political meaning of social policy is different depending on the welfare regime.

What we can draw from these two strands of literature is that there must be a variety of combinations of production and welfare regimes. It can also be suggested that a set of social policies which can work very well in contributing to economic development under a particular type of policy regime may not do so in other regimes. In other words, one size does not fit all. Further we can set up a hypothesis that in order to bring about synergy effects for economic growth, social policy choice must be compatible with and complementary to the overall policy regime. Huber and Stephens (2001) argue that there is a clear link between the production regime and the welfare regime that a country may have developed. They also argue that countries with different production regimes tend to respond to economic challenges with different social policy reforms. The policy regime we will use in this paper refers to a combination of production and welfare regimes.

For many developing countries where economic and social institutions are often not well-established and functionally differentiated, their types of policy regimes must be different from what have been identified in Europe and North America. In the developing countries where the developmental state strategy is adopted in order to pursue rapid economic development, the state may strongly influence the nature of the policy regime. By definition the developmental state sets economic development as an overriding policy goal and its bureaucracy implements policy programmes to achieve this goal. Nevertheless, adopting the developmental state strategy does not guarantee success. In order to examine the performance of the developmental state, there are three aspects we may have to look into.

First, it is necessary to examine the relationship between the state and society since the developmental state needs to have a high degree of autonomy to pursue its policy goal of economic development (Evans 1995). The state elite might decide to adopt the developmental state strategy, but social forces such as the land-owning class, business

or trade unions can frustrate its efforts in order to protect their economic interests. In some developing countries strong social forces which gained their power base under colonial rule may take on the state while in other countries the state may be the only actor that shapes the overall direction of public policy.

Secondly, we need to look into the presence of capable bureaucracy and the environment in which the capable bureaucrats effectively operate. The state bureaucracy needs to have certain a degree of organizational strength: full-time and salaried civil servants with professionalism with a clear hierarchical structure (Weber 1968). It is true that most developing countries are not likely to have an ideal-typical Weberian bureaucracy, but it needs at least a decent corps of bureaucracy to launch an ambitious economic development project. It is not unusual to find people in many developing countries without the necessary competence who have nonetheless obtained jobs in the government by virtue of their political connections. Some bureaucrats moonlight because their salaries are not adequate. In such circumstances, it would be hard to expect the bureaucracy to implement developmental policy effectively.

Thirdly, the state needs to possess the ability to coordinate multiple and sometimes contradictory functions of various institutions in order to achieve goals of economic development. The state should play a key role in setting out the road map of a medium and long-term economic plan and providing the economic actors with an facilitating environment to engage them in the national development process. In other words, the state needs to maintain a certain degree of cohesion among different economic actors (Kohli 2004). But there is sometimes resistance from institutions against certain public policies which may contradict or fall outside their economic and political objectives. It depends on the ability of the developmental state to persuade these institutions to carry out the tasks which fall outside their function, but which are necessary for the overall framework of economic development. Indeed, the ability of the state to coordinate and mobilize institutions for policy objectives would be the key to maintaining coherence of the policy regime, and connecting the production and welfare regimes within it. In the following sections, we will attempt to answer the questions raised in the first section by considering these three aspects of the developmental state.

In terms of the time-span of the research, we will cover the four decades since the Republic of Korea embarked on industrialization, but will focus on a number of discrete points in time when important changes took place. In particular this study will set out the four periods in modern Korean history of development, which will run through this paper: first the post-independence era of 1945-1960 when the land reform, Korean War and the subsequent recovery efforts took place after the liberation from the Japanese occupation; secondly, the launch of state-led economic development and the formation of a number of developmental social policies in the early 1960s though to the 1970s; thirdly, the adoption of stabilization policies with mounting democratization pressure in the 1980s; fourthly, neo-liberal economic reform and the strengthening of the welfare state after the economic crisis of 1997; and finally the adoption of redistributive policies by the present government (2003-). This paper will not describe these periods of development, which have been done by previous work, but will focus on the issues discussed above against the background of these developmental experiences.

### **3. Society and the Developmental State Nexus**

#### ***Overview of the trajectory of development strategies***

There has been a large body of extensive research on the Republic of Korea's development strategies, and a series of debate on the role of the government in economic growth. For the present purpose of this paper, we will first provide an overview of the historical trajectories of development strategies according to the above mentioned four periods of the Korean modern development history. The paper will then discuss the nature of the development state from the perspective of regime approach as we have discussed so far.

The Korean governments in the post-liberation period found it difficult to implement meaningful economic policy not only because of the industrial vacuum that the Japanese had left in 1945 but also because of the destruction of the Korean War. The main aim of economic policy was import substitution industrialization, but the economic outcomes were not impressive. Nevertheless, the Rhee government (1948-1960) laid the important grounds for economic development in the 1960s with the land reform. In the next section of this paper, we will discuss the nature and outcome of the land reform in this period.

After the short-lived Chan Myon government (1960-1961), the Park government (1961-1979) launched the state-led economic development policy. The Park government shifted economic policy from import substitution industrialization to export-led development in the middle of the 1960s. During this period, the economy started to record impressive growth, and poverty reduction took place. Later in this paper we will argue that poverty reduction was not only due to the economic growth but also as a result of the developmental state's ability to coordinate various agencies and mobilize them to perform multiple functions for poverty reduction. From the early 1970s, the Park government implemented economic policy aimed at the establishment of heavy and chemical industry while his grip on power was strengthened by the constitutional reform, moving further away from democracy.

The Park government's new focus on capital-intensive heavy and chemical industry coincided with the labour supply from rural areas reaching a limit in the early 1970s, and the beginning of US military withdrawal from the Republic of Korea. The government gave a range of special favours to large conglomerates. Social policy programmes such as public pensions and health insurance were either considered or introduced in the context of the development of heavy and chemical industry. This strategy, however, faced tough challenges. First, a large amount of capital spending together with the sudden rise in oil prices led to high inflation. Secondly, it also led to rising inequality in income distribution, while there was increasing social demand for democratization.

After the sudden downfall of the Park government in 1979, another military general took over power amid political turmoil. The Chun government (1980-1987) implemented stabilization policies, enforcing structural adjustment in the heavy and



chemical industries expanded by the previous government. His government tried to control public spending. President Chun later conceded constitutional reform to the democratization movement, but was able to oversee the transfer of political power to his chosen successor following the elections in 1987. As a result, trade unions were allowed to organize more freely and to go on strike. In this period, public health insurance was extended to a wider section of the population and the National Pension Programme was introduced.

The government of Kim Youn-sam (1993-1998) tried to transform the Korean economy into a technology-oriented economy in order to compete in the globalizing world. The government implemented various economic liberalization measures that would open the Korean economy to the world market. It also attempted to carry out labour market reform considered a prerequisite to economic transformation, which ended in failure in February 1997. At the end of 1997, the Korean economy was hit severely by the Asian financial crisis that had started from the fall of the Thai Baht. The Kim Dae-jung government (1998-2003) implemented labour market reform based on IMF conditionality while strengthening the welfare state under the banner of 'Productive Welfare'. This policy orientation led to the policy regime that mixes the liberal orientation of the labour market policy with the inclusive trend of social policy. The present Rho government maintained continuity in policy orientation, but it placed more emphasis on redistributive social policy.

### ***Land reform***

Land reform has been one of the controversial issues in the development debate. Some argue that land reform is a prerequisite to successful economic development while others argue that land reform which inevitably brings about political turmoil would disrupt economic development. A body of literature in development studies has pointed out that successful land reform in the late 1940s in the Republic of Korea as well as Japan and Taiwan Province of China is strongly related to economic development and poverty reduction (e.g. World Bank 2006). The access to even small amount of land can provide an important safety net, a source of self-employment and an insurance substitute to economic contingencies over the life course (Dasgupta & Ray 1987; Deininger & Binswanger 1999). Land ownership also affects economic growth through investment in soils and establishment of perennials. Owners are much more likely to work on soil improvement than tenants. Consequently this contributes to the asset accumulation of land owners.

Despite such a positive relationship between equitable landownership and agricultural productivity, it does not lead us to conclude that there has been a direct positive relationship between land reform and economic development in respect to the Korean case. In the Korean case, land reform in the late 1940s did not contribute to economic development directly since economic development in the Republic of Korea was not mainly based on the growth of the agricultural sector. For example, the share of the agricultural and fishery sector in GNP in 1961, when the Republic of Korea launched the First Economic Development Plan, was 47.1 percent but it went down 16.3 per cent in 1981, while the share of industrial product increased from 10.0 to 24.3 per cent in the

same period (Adelman 1997). Some scholars see the land reform as failure since it did not create an agricultural sector that consists of middle class farmers (Hwang 1985).

The importance of the land reform in economic development in the Republic of Korea is not so much the development of the agricultural sector as the structural changes in the relationship between society and the state that it brought about. The land reform, which took place in three waves from 1946 to 1955, first created small independent farmers who used to be tenants for the Korean and Japanese landlords under Japanese rule (1910-1945). The American military government (1945-1948) after the Second World War took the first step toward land reform in 1946. It limited the peasants' land rents to one third of its annual production, which was a drastic reduction. In 1948, the American military government sold land which used to belong to the Japanese Oriental Development Company (later New Korea Public Company) to tenants with the price equivalent to production for three years. The sovereign Korean government, which was established in 1948, promulgated a series of laws regarding the land reform in 1949 and implemented them from 1949 to 1955, which included three basic principles: first only those who are actually farming can own farm land; secondly, land can be owned up to the limit of three *Chungbos* (3 hectares); thirdly farmers cannot contract out their land to others for farming (Sin 1988). Based on these principles, the government bought the land from those who owned more than the limit or did not farm themselves, and sold it to those who farmed with the price equivalent to one and a half times the annual production.<sup>2</sup>

Although some landowners sold their land before the implementation of the land reform, more than 60 per cent of the land was bought by government. Landowners were paid with government bonds, while tenant farmers paid the price equivalent to one and half times the annual production. This could be paid over a three year period (Kim 1997: 307). After the land reform in 1951, tenant farming land was only 8.1 per cent compared to 65 per cent in 1945 before the reform. It would be fair to say that the land reform in the Republic of Korea was successful in that it created self-owning farmers. The inequality of land ownership was reduced sharply. For example, in *Yongmun* village in *Chungnam* Province, the Gini index came down from more than 0.63 to less than 0.50 (Seokgon Cho 2003: 297), while the productivity of farming increased. Families in rural areas who now had their own land with higher productivity were able to send their children to school instead of to work in the paddy field (Seokgon Cho 2003). The effect of the land reform on the educational sphere was sustained by the government policy which made education the biggest item in the budget, next to defence, and resulted in the "astonishing record" compared to other developing countries. The number of students with both rural and urban background increased by 370 per cent for liberal art secondary school, 299 per cent for vocational high school and 1,292 per cent for higher

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<sup>2</sup> There are three major explanations of the political rationale of the land reform. The first stresses that it was peasants who suffered most from Japanese rule, while the landlords were seen as collaborators with the Japanese. In other words, it was an historic imperative at the time. The second explains that President Rhee wanted to undermine the economic basis of the conservative political elite many of whom were landlords. Lastly, the land reform was a US counter-revolution against the communist threat of socialist revolution. The US recommended the land reform not only to the Koreans but also to the Taiwanese government (Jungwon Kim 1976).

education from 1945 to 1959, and the literacy rate reached almost 90% of the total population in the late 1950s (Cho & Oh 2003: 283; USAID 1959). In short, the land reform not only redistributed land leading to a significant reduction in the inequality of landownership, but it was also a powerful social policy in that it reduced poverty and increased the level of education in the rural population. As Cho argues (2003), the rural population with higher level of education constituted a huge reservoir of well-educated labour that would play a salient role in the industrialization in the 1960.

The land reform also led to the demise of the landowning class as a dominant social force. It is true that the land reform could also have been an opportunity for the landowning class to transform themselves into a new capitalist class. Indeed they were paid a good sum of money for their land, but most of them failed to transform themselves into capitalists partly because of their lack of entrepreneurship, which resulted from the Japanese colonial policy excluding Korean businessmen from light and heavy industry. The former landlords also suffered from the super inflation during the Korean War, which reduced the value of government bonds significantly. It is also worth mentioning that the Rhee government was not able to create the economic environment in which the former landlords could transform themselves into entrepreneurs.<sup>3</sup> The demise of the landowning class created a vacuum in the class structure and subsequently allowed the developmental state considerable state autonomy while pushing industrialization.

### ***Effective bureaucratic system and economic development***

It is an essential requirement to have an effective bureaucratic system in order to launch a developmental state strategy. The military coup d'état by Park Chung Hee was the beginning of the state-led drive for economic development in 1961. Before Park's military government, the First and Second Republics were not able to carry out any explicit economic development strategies because of the Korean War and political wrangling among political elites. Nevertheless it is noteworthy that the First Republic government of President Rhee (in office 1948-1960) did carry out the land reform effectively and in a short span of time, which laid ground for the developmental state to implement economic development. It shows that the Rhee government had a high degree of effectiveness in a certain field. Kohli argues that the Korean bureaucracy inherited the system and personnel from the Japanese colonial government, which had been very much like a developmental state (Kohli 2004). It is certainly true that the Japanese colonial government brought in modern bureaucratic machinery in order to exploit the Republic of Korea effectively, but bureaucratic penetration of the central authority had also been in place for many hundred years in the Republic of Korea before

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<sup>3</sup> Another factor worth mentioning is the business clientelism formed from the beginning of the Republic of Korea. Those who managed to accumulate wealth and establish big companies in the 1950s had to collaborate with the political authority by providing the ruling party with kick-backs in return for the favourable treatment. The expansion and survival of businesses entirely relied on the government which had a power to distribute the enemy (Japanese) property and allocate foreign aid to business (Nam 1995: 360; Woo 1991: 66). The symbiotic relationship between the government and big business narrowed the space for newcomers in business. Most *chaebols* in the 1970s had accumulated their wealth during the 1950s but they were based not on wealth from the land but from the favourable treatment of the government (Cho 1997).

Japanese rule. The merit-based bureaucratic system had been in place in the Republic of Korea for more than six hundred years. The principle of merit-based recruitment continued after the establishment of the Republic and the strength of the Korean bureaucratic system was its openness to any social classes. It recruited young talent from the entire population if they passed the examination, not just from a particular social class which had political influence. Given that the education system was open to most young people, those with a poor background could compete with those with better-off conditions, if they worked hard at college. According to Yoo's survey, 47.5 percent of the high-rank officials came from families of small farmers while 15.5 percent had a father with a job in the public sector (Yoo 1966).

During the first twelve years of the independence, however, the top policy makers of the government did not set out clear policy goals for the bureaucracy to pursue. Without clear goals and purposive activities, the bureaucracy can be a bed for rent-seeking behaviour. It is noteworthy, however, that USAID pointed out that in the late 1950s "a group of responsible young officers with professional training and skill" increased in the various government ministries and agencies and they found "pride and satisfaction in their capacities to present objective views to their politically appointed ministers with increasing success" (USAID 1959: 12). This observation suggests that a small but increasing number of bureaucrats became the spearhead of the industrialization during the 1960s and 1970s when the clear goals of the development was set and pursued.

The Park government (1961-1979) which came to power by the coup in 1961 set economic development and poverty eradication as the first priority of their 'revolution' and took advantage of the bureaucratic system. The Park government brought a sense of clear purpose, discipline and rationalism to the bureaucracy. This is typical of the developmental state, establishing economic growth as fundamental goal, developing a coherent strategy and mobilizing resources to achieve it. It is noteworthy that the first economic development plan launched had been prepared by the previous government which did not have time to carry it through (Satterwhite 1994). The idea of the state-led economic development did not suddenly become a national policy agenda. Economic development was reflecting the Korean policy discourses as well as international policy discourse, in particular the US aid policy orientation at the time (Park 2003; Woo 1991: 69-71).

What made the Park government effective as a developmental state was the discipline the state exercised over the private sector. At the beginning of the import substitution industrialization period in the early 1960s, private enterprises needed a guarantee underwritten by the government in order to secure a foreign loan. Through this and other similar regulatory mechanisms, the government was able to intervene in market decisions without actually producing goods through state-own enterprises. The government imposed performance standards on private firms, and once these standards were met, it provided various kinds of subsidy, for example, low-interest capital and a licence to enter a new market. In this way the government was subsequently able to pick up winners in the market who would later become big businesses.

The state was also highly influential in the structure of the financial market. The Korean financial system was a credit-based system in the 1960s and 70s, in which private firms, especially the *chaebols*,<sup>4</sup> had a high debt to equity ratio that forced them to depend heavily on the banks (which were either owned or controlled by the government), rather than on the stock market. Through this credit-based system, and big business dependence on the banks, the government and the Economic Planning Board, as the central guidance agency, implemented the economic development policy.

The other side of this government-big business alliance was the oppression of the trade unions. For three decades from the 1960s to 1980s, workers employed in the manufacturing, mining and service sectors grew fast, consisting of 75.06 per cent (in 1985) while the agricultural and fishery sector declined from 57.89 (in 1966) to 24.94 per cent (in 1985) (National Statistical Office 1966). In this period, although their members steadily increased because of the growth of heavy and chemical industries, trade unions had no right to negotiate or to go on strike. Trade union movements were harshly dealt with as they were treated as a matter of national security. The Special Decree for National Security introduced in 1971 aimed to suppress any possible labour unrest in the wake of switching from import substitution to heavy and chemical industry as the main engine for export-led economic growth (Kwon 1999: 46).

#### **4. Poverty Reduction and Multi-Functional Institutions within the Developmental State**

##### ***Poverty reduction and economic growth***

It has been argued that the welfare state in the Republic of Korea has been instrumental to economic development (Goodman, White & Kwon 1998; Holliday 2000; Kwon 2005). In fact, social policy did indeed prove to be one of the most effective policy instruments during the period of rapid economic growth in the Republic of Korea. For example, the Industrial Accident Insurance scheme was introduced as the first compulsory welfare programme to be introduced in the Republic of Korea in 1964. It started with large scale enterprises with more than 500 workers, and subsequently expanded to the smaller workplaces. It was chosen as the Republic of Korea's first welfare programme for two reasons. First, the government saw it as the most necessary welfare programme in the wake of the launch of an ambitious industrialization plan (Ministry of Labour 1981). Secondly, it would be easier to implement than the alternative programmes, as under the Labour Standard Law of 1953, employers were already liable for industrial accidents at work regardless of their cause. In other words, the government did not have to finance the programme since such responsibility fell to employers. The medical insurance programme, which later became National Health Insurance, was introduced in 1977 and had a similar financial arrangement in which employers and employees paid their contributions to insurance funds which then paid to hospitals and clinics for their members' health care. Government subvention was limited to support for the administration cost for the initial period. Kwon (1997) calls this role

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<sup>4</sup> A *chaebol* is a large capitalist organization, usually based on a single family having controlling interests in a variety of companies, similar to the Japanese *Zaibatsu*.

of the state in financing social policy as that of a regulator, which shows that the developmental state exploited the instrumental role of social policy in the effort of industrialization.

The main beneficiaries were mostly those workers, and their family members, working in large scale enterprises in the 1970s. The small and medium-scale firms joined in the scheme throughout the 1980s. Those who were covered by medical insurance account for only 35.6 percent of the total population in 1987 (Ministry of Health and Social Affairs 1990: 214). In short, they were salaried workers with stable jobs. The unemployed, the urban informal sector workers and farmers were left outside the welfare state until the late 1980s. Other components of the welfare regime, in particular the family, played the main role in the provision of social protection. The rationale behind emphasis on the family was the Confucian ethics which remained strong during the rapid industrialization period. Nevertheless, considering the poor tended to have poor family members, its impact on poverty reduction should be limited. Kwon, based on 1996 national income survey, shows that private transfers to the elderly between family members, which were larger than public transfers, were only less than half of the relative poverty line (Kwon, 2001). For instance, among single, elderly households, 72 per cent of income of people in the poorest decile came from private transfers but it made up only 40 per cent of the relative poverty line (Kwon 2001: 91).

The most explicit poverty reduction measure was the public assistance programme. It was introduced in 1965, based on very strict means-testing, and was subsequently reformed in 2001, to which we will come back later in this paper. The poverty line was defined in terms of an absolute concept. It divided people into three categories, and only the first and second categories of people, who had no earning ability, were eligible for income support. These were people with disabilities and illnesses without family support, the first being under institutional care and the second staying at home. People aged between 18 and 64 were automatically regarded as having earning ability. Therefore, the third category consisted of people who were aged between 18 and 64 and who were not eligible for income support but were eligible for medical and educational support.

Table 1: Number of people covered by the Public Assistance Programme, 1965-1990  
(in thousands)

	Benefit categories			Percentage of total population
	1st	2nd	3rd	
1965	288	72	3563	13.66
1970	306	63	2116	7.71
1975	375	52	904	3.77
1980	339	47	1500	4.96
1985	282	63	1928	5.52
1990	340	81	1835	5.26

Source: (National Statistical Office 1966, 1990; Suh 1981)

Table 1 shows that only a small fraction of the officially identified poor people got income support. The overall rise of the number of people benefiting from the public assistance programme in 1980 was not because of the increase in poverty incidence but due to official poverty line set relatively higher than before. One interesting point worth mentioning is that people aged between 18 and 64 were eligible for income support under the headings of training support, food support and family allowances if they took job training programmes.

Notwithstanding the stringent public assistance programme, poverty incidence was rapidly reduced. As table 2 shows, it was 40.9 per cent of all households in 1965 and was reduced to 23.4 in 1970, 9.8 in 1980 and 7.6 per cent in 1991. Although these are official figures produced by the government based on the absolute concept, the reduction was remarkable.

Table 2: Incidence of absolute poverty (in per cent)

	1965	1970	1976	1980	1991
Urban households	54.9	16.2	18.1	10.4	8.7
Rural households	35.8	27.9	11.7	9.0	2.8
All households	40.9	23.4	14.8	9.8	7.6

Note: the absolute poverty line: 121,000 *won* (1981 price) a month for a five person household.

Source: recited from (Kwon 1998: 34)

How did this poverty reduction take place despite the very limited public assistance programme? Kwon clearly contends that the Republic of Korea's success in reducing poverty was not due to explicit poverty reduction policies. He maintains that it was rather due to the indirect effect of high economic growth (Kwon 1998). While agreeing with this observation, we insist that it was not the outcome of trickle-down effects, but consequence of two main factors: first, the social structure that allowed the widest section of the population to participate in the change of society to industrialization; secondly, the developmental state's ability to mobilize and coordinate institutions to reduce poverty.

The economic growth in the period of the 1962-1967, when the developmental state strategy was in full operation, was based on import substitution industrialization. Its impact on employment was huge. During this period GNP increased rapidly and unemployment falls sharply as table 3 shows. The import substitution industrialization absorbed labour effectively: employment increased by ten per cent despite the increase of the economically active population by twelve per cent (Adelman 1997: 514). In the period of 1967-1971, when the Republic of Korea shifted its strategy from import substitution to export-oriented industrialization, labour-intensive industries still absorbed labour, together with the growing service sector, which then raised the income of the working population (see table 4). In particular, poverty in urban areas was reduced.

Table 3: Major Economic Indicators in the Republic of Korea

	1961	1966	1972	1981	1987	1993
GNP/Capita (\$)	90	125	306	1,741	3,218	7,513
Growth rate	1.6	6.8	16.1	21.3	10.7	15.2
Unemployment rate <sup>1</sup>	17 <sup>2</sup> (7)	15 (6)	10 (4)	10 (4)	5 (3)	4 (3)

<sup>1</sup>: Include both unemployed and working less than 18 hours a week. Figures in parentheses are full time unemployed. <sup>2</sup>: 1963 figure.

Source: recited from (Adelman 1997: 535)

Table 4: Employees by Industry

	Agriculture & Forestry	Manufacturing & Mining	Service
1966	57.89	10.48	31.27
1971	48.44	14.19	37.37
1978	38.41	23.15	38.44
1985	24.94	24.44	50.62
1990	18.25	27.32	54.42

Source: National Statistical Office (1966; 1986; 1990)

In short, the effective poverty reduction in the 1960s was strongly due to successful labour-intensive industrialization led by the developmental state. Here it is necessary to see such economic development from a structural point of view as well. The developmental state was enjoying policy autonomy without strong opposition from powerful social forces, in particular the landowning class. The absence of such a class is conspicuous if one compares the Korean developmental experience with other countries such as Brazil and the Philippines. As we have already discussed, the land reform in the late 1940s laid the structural ground for the developmental state to pursue economic development. More importantly the land reform created self-owning farmers, who then began to educate their children. These children participated in the rapid industrialization process, and such broad-based economic growth was the key of poverty reduction and relatively equal distribution of income. In other words, the land reform was a very effective social policy programme enabling the developmental state to carry out only a very limited explicit poverty reduction policy in the 1960s.

### ***Multi-functional institutions and the welfare regime***

We pointed out that the developmental state exploited the potential multiple functions of social policy. It also mobilized economic institutions to perform functions for poverty reduction. One such example was the measure to clear away the usurious loans in rural areas in 1961. Usury was a prevalent economic activity embedded in the production pattern in which farmers conducted self-sufficiency agriculture. Whenever they had a bad harvest of crops, they had to borrow money from either money lenders or, in some cases, other farmers who had a little more money than themselves in order to purchase the necessities of life and fertilizer. This debt compounded their financial difficulties.



The military government, shortly after it took power in 1961, enacted the measure to force such loans to be registered and unavailable from that time onwards. Those farmers who had registered their debt with higher interest could move their debt to the Agricultural Cooperatives with a long-term grace period and cheaper interest, while the lenders received the bond from the Agricultural Cooperatives. In fact it was a partial cancellation of the debt and the extension of the debt service period on favourable terms (SCNR 1963: 1104). The role of the Agricultural Cooperatives, a nationwide financial organisation, is noteworthy since it signifies the establishment of the formal rural credit market where loans are traded competitively and effectively. It could respond to the income shock of specific regions or specific crop growers with its diversified portfolio of loans. It also had an effect of reducing delinquent borrowers since the farmers had to consume more wisely than under the usury system where the borrowing procedure was lax. It is true that such extraordinary measures were only possible under the military government, which took over the pledge of poverty reduction. Nevertheless it gave momentum to the Agricultural Cooperatives to be a focal point of rural development, functioning as agricultural financing institutions.

The government purchasing system of rice was also a clear case in point, which lasted through the 1970s. Rice production, the main staple of the country, has had a tremendous effect on the living standards of those in both rural and urban areas and the macro-economy in general. Rice accounts for more than a third of the total income of rural households and more than 40 percent of total agricultural products throughout the 1960s, the 70s and the 80s. Rice prices were the main factor affecting overall consumer prices and subsequently the main concern for the government in its efforts to control inflation (Hyungwha Kim & Kim 1984: 25-28). From 1961 the government established the rice purchasing scheme which aimed both to control prices and subsidize the farmers. Within the Economic Planning Board, the spearhead of economic planning, the department of consumer price established the Special Account for the Purchase of Rice in 1961.<sup>5</sup>

From 1962 and 1967 the policy priority of this rice purchasing scheme was the control of the rice price, which had had a big seasonal fluctuation, rather than the support for farmers. The government selling price was normally higher than the purchasing price. The government paid more attention to support for the farmers in 1968 when it increased the purchasing price far higher than the production costs. From the early 1970s when the new breed of rice with higher productivity was introduced to farmers by the government, the rice purchasing policy started benefiting both urban and rural households. The new breed of rice purchased far higher than the production costs was sold to urban households at lower than the purchasing price. The conventional breed with high quality was freely traded and consumed by the higher income groups. The dual price policy, for the new breed of rice and the free trade of the conventional breed benefited both urban and rural households, in particular rural households. The income gap between the urban households and the rural households began to decrease and

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<sup>5</sup> The government rice purchasing scheme was carried out briefly between 1954 and 1957 in order to support the rice farmers. It was, however, effective since the purchasing amount was small and the purchasing price was lower than the market price. See Chapter 6, Hyungwha Kim & Kim (1984).

briefly in 1974 and 1975 the income of rural households surpassed that of the urban households (Hyungwha Kim & Kim 1984: 40).

These policy efforts were combined with the nationwide campaign aimed at mobilizing human resources and changing attitudes. Because of the rapid industrialization in the 1960s, income of the rural households started to fall behind that of their urban counterparts around 1967. From 1971, the government initiated a rural development programme which was called *Saemaul* (New Village) Movement. The basic framework of this programme was that the government provided a small amount of start-up subvention for projects that would be necessary for the economic development of communities. For example, the government provided material for the construction of village bridges, roads, infrastructure for electrification and storage houses, which would be instrumental for communities' economic development. Then the village people provided labour for the construction of such projects without receiving payment. A study estimates that the government subventions accounted for between twenty and thirty percent while village people labour and other contributions accounted for thirty to sixty percent, with private donations and bank loans making up the rest of the expenditure (Kim 1991). The government spent 2.5 percent of GNP on average, which was a huge amount of social spending, given that there was only a very strict means-tested public assistance programme.

While the *Saemaul* Movement was clearly an effort to boost the level of incomes in rural areas, it certainly had an overtone of political mobilization for maintaining political power of President Park. He changed the constitution in order to stay in power for life. The *Saemaul* Movement represented the political mobilization in rural areas, where political support for President Park was stronger than in urban areas. In 1972, the Park government also announced Presidential Emergency Measure No. 3, which temporarily waived income tax for low-income households. It also strengthened regulations on unfair practices by employers in the workplaces (Kwon 1999: 41).

### ***Mobilization of institutions in public health***

Public health deals with the health of the population as a whole, which is different from the medical health care that addresses individual ailments. Public health is more focused on preventative activities rather than the treatment of illnesses. It is also focused on community-based activities rather than medical practice to individual patients (Winslow 1920) Therefore the implementation of public health requires an administrative system which is quite different from that of the provision of the medical care to an individual. It needs human and material resources, and administrative capacities for tackling often nationwide public health issues.

The developmental state under the President Park established the system of public health and mobilized it for developmental purposes as well as public health. The public health sector for the control of communicative and chronic diseases showed a drastic development under the colonial regime and the American military government after 1945. However the sector was weakened after the administrative reform from 1948 to 1960. Just after the coup d'état in 1961, it became one of policy priorities to establish a

comprehensive system of public health. In particular the government placed strong emphasis on expansion of public health facilities in rural areas, and improvement of health conditions to provide the poor with medical care. It established a plan to reduce the number of rural areas without public health facilities from 1,033 to none in 1963 (SCNR 1963: 422).

Public health facilities played a role in combining the public health and primary medical care on the one hand, and the population control which was employed as a policy tool to reduce the poverty on the other. Like other developing countries, a population size that exceeded the level of economic affordability was one of the major reasons for poverty in the Republic of Korea. From the perspective of the military government, which had the goal of population control through family planning, public health facilities could be the perfect institutions with their national network and medical expertise. The military government actively established public health facilities across the country and used them for population control in addition to the prevention of communicative and chronic disease.

In order to maximize the institutional synergy, Korean governments constructed new public health facilities in 1,340 *Myons* (villages) with financial support from the Agricultural Cooperatives from 1974, established the Health Assistance Programme in 1977 aiming at those receiving benefits from the Public Assistance Programme and introduced a law, which would allow the graduates of the medical schools to serve at the public health facilities instead of military service in 1980 (Son 1999). The latter was a noticeable boost in rural villages in terms of medical service delivery since public health facilities were able to provide medical services to individuals in rural areas almost for free. With these series of policy attempts, health inequality, in terms of access to health care facilities, was greatly reduced.

### ***Human resource development***

Since the Korean War, the only abundant resource the Republic of Korea has had has been human resources. The government made an effort to re-establish infrastructure destroyed during the War, particularly elementary schools. The number of elementary schools increased from 3,942 in 1950 to 4496 in 1960. All levels of schools in both public and private sector increased. The public sector expanded at elementary school level while the private sector took a lead role at middle and high school level. The share of the budget for education increased rapidly from 4.2 percent in 1954 to 9.4 percent in 1955 and reached the level of more than 17 percent on average by the end of 1970s. The series of government efforts in the education field paid off and the enrolment rate in elementary schools reached 96.5 percent in 1959 (KEDI 2005a: 34-35).

Table 5: Enrollment Rate and Advancement Rate at Schools

	Elementary School Enrollment Rate	Advancement Rate of Elementary School Graduates	Advancement Rate of Middle School Graduates	Advancement/Employment Rate of High School Graduates	
				Rate of Advancement*	Rate of Employment**
1959	96.1				
1965	97.7	54.3	69.1	32.3	37.5
1975	105.0	77.2	74.7	25.8	39.9
1985	99.9	99.2	90.7	36.4	42.1
1990	101.7	99.8	95.7	33.2	51.0
1995	100.1	99.9	98.5	51.4	69.3
2000	98.7	99.9	99.5	68.0	66.1
2003	99.5	99.9	99.7	79.7	66.3

\* Rate of Advancement = (University Entrants /the Number of Graduates) X 100

\*\* Rate of Employment = (Number of Employed / (Number of Graduates – (University Entrants + Number of Army Enlisted))) X 100

Source: (KEDI, 2005a, 2005b)

In order to industrialize the country, there was a need for labour with particular skills. In the 1950s, although there were some secondary schools where vocational training accounted for more than 30 percent of the total teaching hours, there were not many specialized vocational schools.<sup>6</sup> The educational reform of the Park government in 1963 was an effort to reorganize the educational structure for developmental purposes. Instead of the rationale of liberal arts education of the previous government, the Park government emphasized the importance of skill-oriented education.

The vocational schools were under a separate administrative system from the liberal arts secondary schools, and in the vocational system, education on practical skills accounted for more than 50 percent of the total teaching hours (Kang *et al.* 1998: 30-34). Enrolment in vocational high schools increased dramatically during the period between 1973 and 1979 when the government established the Policy for Promotion of the Vocational High School as a result of the increased opportunity for university education for the graduates, a waiver for military service, the issue of vocational licences and scholarships. It was met by an increase in applicants to the vocational schools (Kim 1993). The government took the initiative for vocational training since 1967 when the Vocational Training Act was established. With a loan from the ADB and IBRD the government established public vocational training schools and established subsidies of more than 50 percent of the cost for the in-house vocational training which were given to the companies to the vocational training. Under the government programmes those who received vocational training from the public facilities and in-house training facilities increased from 1,502 in 1967 to 11,840 in 1970, and from 3,890 of 15 companies in 1967 to 14,300 of 81 companies in 1971 respectively (Kim 2002: 88).

<sup>6</sup> In 1958 8 agricultural courses, 23 manufacturing courses, 1 commercial courses, 3 fishing courses and 6 household management courses were operated (Kang, Na & Chong 1998).

## 5. The Developmental Welfare State and Democratization

### *The developmental welfare state*

The change of the constitution in 1972 turned Korean politics back to authoritarianism, after the Park government won two presidential elections under the democratic Constitution of the Third Republic (Lee 1997). From the point of political economy, the developmental state strategy reached a critical junction in respect to the transformation of class structure in the Republic of Korea. The labour supply from rural areas reached its limit and political and economic pressure from the urban workers who had worked hard under very tough working conditions built up (Im 1987). There were protests about inhumane working conditions while workers demanded wage increases. While the Park government could have compromised with labour giving them better economic rewards and working conditions, its choice was the authoritarian one. First, the government announced the Special Decree for National Security in 1971, which would deal with trade union movements as matter of national security. Secondly, the constitution was changed so that President Park could stay in power for his life time. This reform resulted in a political system which could be described as a bureaucratic authoritarian regime in O'Donnell's words (O'Donnell 1973).

Park government changed the focus of the economic development plan from the labour-intensive industries towards the capital-intensive, heavy and chemical industries, while the export-oriented strategy remained. The government gave special favours to the large conglomerates, *chaebols*, who could operate the large-scale capital intensive industrial plants. Such a strategy inevitably generated a large transfer to the very rich, making distribution of income and assets more unequal.

Two major social policy programmes, the National Pension Programme and National Health Insurance were introduced in the 1970s in this context, favouring workers in large-scale enterprises. The National Pension Programme was prepared by the government think tank, the Korea Development Institute, in 1972 and was due to be introduced in 1973. It was first considered to be an effective measure of raising domestic capital, which could be used for the construction of heavy and chemical industries. The programme was postponed because of the high inflation induced by the sudden rise in oil prices at that time.

National Health Insurance was introduced in 1977, first in the enterprises with more than 500 workers. The programme was gradually extended to smaller scale companies during the 1980s. It provided health care coverage to most employees in the industrial sectors, while farmers, the self-employed, informal sector workers and the unemployed were left outside of the programme. In 1978 a separate health fund under National Health Insurance was set up to cover civil servants and school teachers. National Health Insurance was seen by many ordinary citizens and policy experts as the clear symbol of social inequality in which those with stable jobs in large scale enterprises and public sector workers were protected while the vulnerable were left unprotected. The strict means testing of the public assistance programme, as well as the selective coverage of the Industrial Accident Insurance and National Health Insurance set the basic features of

the developmental welfare state in a selective form (Kwon 2005). Income distribution under the capital intensive industrialization and the developmental welfare state deteriorated as is shown in table 6.

Table 6: Trends in Gini Index

	1965	1970	1976	1982	1988	1990	1993
Gini	0.344	0.332	0.391	0.357	0.337	0.323	0.310
Decile Ratio	0.463	0.472	0.372	0.437	0.466	0.507	0.520

Decile Ratio: ratio of income of the poorest 40 percent to riches 20 percent

Source: National Statistical Office, Social Indicators (various years)

The government also mobilized companies into efforts for human resource development. As a result of the shift to heavy and chemical industries as the focus of the economic development plan, it was necessary to build up labour with necessary skills in these industries. Companies again were initially lukewarm at the prospect of training workers in the skills necessary for the heavy and chemical industries, behaviour that may be anticipated due to a collective action problem. The government introduced the Basic Law for Vocational Training through which the companies not operating vocational training would be fined and any resulting income would be used for public vocational training scheme. Facing the sanction, companies reconsidered their manpower policy and chose in-house training rather than paying fines since it would be more efficient and cost effective than contributing to public vocational training which was beyond their control. Under the new institutional logic, in-house training was drastically increased until 1982 when the heavy and chemical industries began to suffer from overcapacity due to the international recession (Yi & Lee 2005: 150-151). The law imposed a new set of preferences on the companies and they changed their institutional logic conforming to economic growth and human resource development.

### ***Stabilization and democratization***

The policy regime that was intended to promote the heavy and chemical industries, while using social policy as policy instrument, faltered in the end of the 1970s. The sudden rise in oil prices twice hit the country which was entirely dependent on imported oil for industry, which placed, in turn, a strong pressure on the price of Korean products. Within the government, particularly the Economic Planning Board which had been sidelined by the economists of the Blue House (the Presidential Office) during the heavy and chemical development plan period expressed a strong concern about the whole structure of the economy under the developmental regime (Haggard 1994). Gradual credit squeeze, one of the government policies to respond to the economic situation, was particularly hard on those small and medium size export oriented companies.

In terms of industrial relations, the reservoir of cheap labour dried up, and labour began to organize trade unions and demanded higher wages and better working conditions. Industrial disputes led to political turmoil since they were treated as a matter of national

security. Harsh control can effectively silence trade unions when successful, but when they are not, disputes are likely to become political rather than labour issues. This is precisely what happened in April 1979 just before implementing the structural adjustment programme; the whole country plunged into political chaos beginning with the YH Trading Company's textile workers' stand-off at the headquarters of the opposition party calling on the party to help them to resolve the labour disputes. In the National Assembly the opposition parties gained strength after the general election in 1979.

The mounting economic pressure went off after President Park was killed by his security chief in 1979. Political turmoil ended in another military government led by Chun Doo-hwan. His government pursued a strong structural adjustment policy aiming at stabilization and applied a heavy handed policy toward trade unions (Haggard & Moon 1990). The monetary and fiscal control became strict, which led to deflation in the period of 1979-1981. The Chun government's economic policy appeared successful with the help of favourable international economic conditions such as the high value of the Japanese Yen and low oil price, which gave Korean products a competitive edge in the international market.

Notwithstanding the fair economic performance, the Chun government was not able to shun democratic movements. Throughout the 1980s, political confrontation continued between the authoritarian government and opposition movements for democratization. Eventually the constitution was amended in order to pave the way for the democratic election of the President. In this period social policy programmes such as National Health Insurance and the National Pension Programme became politically contentious issues and were extended to the wider population as political parties tried to gain political support.

Taking over power, the Chun government promised that it would establish a welfare state during its tenure. The first policy introduced in this context was to strengthen the public assistance programme. As in table 1, the number of beneficiaries of the public assistant programme increased because of the new official poverty line set relatively higher than the previous one. Nevertheless the welfare rhetoric was only short-lived since the Chun government prioritized stabilization policies. Along with political confrontations between the government and opposition movements with respect to democratization, social grievances of those left outside national health insurance emerged as one of the contentious political issues. Civil society groups pressed the government for universal coverage (Jaekwan Kim 1992). In the run up to the first competitive presidential election in over fifteen years, the governing party's candidate, Chun's hand-picked successor, promised that he would extend National Health Insurance to all the population. Such a decision clearly showed that social policy decisions were no longer taken by a handful of top policy makers in the government.

The National Pension Programme conceived by the Chun government was the last swansong of the authoritarian regime. It was promised by every major candidate during the election campaign in 1987 and was implemented by a much more democratized regime for whom the parliament became the effective decision-making point in 1988

(Kwon 1999: 21). Under the National Pension Programme implemented in 1988, all employees of companies with more than 10 employees were covered initially. From 1992 coverage was expanded to include companies with more than 5 employees. The funding method was the same as the National Health Insurance with contributions by employers and employees. According to the funding schedule, the combined contribution rates of employers and employees had been fixed at 3 percent of the average wage for five years from 1988 and would be increased to 4 percent for the next five years and finally reach 6 percent of the average wage after 1998. From 1993 there was a concern about the deficit of pensions from 2030, which led the government to attempt to increase the contribution rate of both employees and employers. Companies started complaining about the financial burden and the government made a compromise by allowing the company to pay 33 percent of its contributions (3 percent of the standardized average wage) from the funds reserved for retirement allowances, which employers should set aside according to the labour law. This system to convert the reserved fund to the contribution lasted until 1999 (Yi 2007: 181-2). From April, 1999 the total contribution to the pension fund comprised the contributions from the employees and employers, worth of 4.5 percent of the standardized average wage respectively.

## **6. Economic Crisis and Welfare Reform**

The Asian economic crisis of 1997-8 exposed critical weaknesses in the Republic of Korea's development policy regime. It is true that the Korean economy had taken advantage of the world market through its export-led economic growth. Nevertheless, the Korean economy was ill-prepared to open its domestic market to international capital. It could not respond to the sudden withdrawal of short-term international capital from the country's financial sector, which was triggered by the collapse of the Thai currency, Baht, in 1997. The crisis was not, however, simply caused by the international financial movement but triggered by it with underlying structural weakness in the political economy of the Republic of Korea.

The developmental state under Presidents Park and Chun closely monitored, if not tightly controlled, transactions of foreign exchange reserve, but such a policy stance was relaxed during the tenure of President Kim Youngsam (in office 1994-1998). As one of the leading opposition leaders during the 1970s and 1980s, President Kim Youngsam took a neo-liberal leaning policy stance, suggesting the developmental state strategy was outdated. He also declared globalization as one of his main policy programmes and stating that he would open the Korean financial market to competition. The government also undertook public sector reform, following the line of new public management. More importantly the government abandoned various policy instruments that proved to be effective under the developmental state.

It is worthwhile to note at this point that since the late 1980s trade unions, which had been subject to harsh oppression during the 1970s and the early 80s, were allowed to organize wage-bargaining and to go on strike. It is important to remember that Korean firms had provided various company welfare benefits to their workers in order to



maintain their loyalty. Furthermore, the lifetime employment and seniority-based remuneration system had been an implicit contract between employers and employees. Such company welfare benefits were arranged on the basis of low wages and weak trade unions. However, once trade unions were allowed to mobilize workers and successfully increase the level of wages from the late 1980s, the existing formula of company welfare benefits could not be sustained. As productivity could not match the wage increase, the Korean economy began to lose rapidly its international competitiveness during the 1990s.<sup>7</sup>

The Korean government saw that the country would need to develop a high-technology based economy with a flexible labour market, and in 1990 launched the 'Seven-year Development Plan for High-tech Industry'. The aim of this plan was to bring high technology into the Korean economy and make it competitive (Ahn 1998: 134). The Korean government also set in place institutional arrangements necessary for structural adjustment. The inevitable corollary of structural adjustment was to lay off workers and staff in sectors that were no longer competitive. This was harder to do because the National Assembly would not pass the controversial programmes, while the top policy makers were unwilling to exercise leadership over economic policy. Nevertheless, the government did not have an alternative policy paradigm to the developmental state strategy. The collapse of the government bill of labour market reform in March 1997 was a clear sign that the government could not carry through its neo-liberal reform.

The economic crisis produced a surprise winner in the presidential election at the end of 1997: the long-time opposition leader, Kim Dae-jung. It gave the Korean government another opportunity to carry out labour market reform. In February 1998 the President-elect Kim Dae-jung established a tripartite committee, the Employees-Employers-Government Committee, to forge a social consensus for reform. It is worth noting that the Korean Confederation of Trade Unions, which had been subject to harsh suppression by the government, participated in this committee as did the Korean Federation of Trade Unions. In other words, this committee was able to produce a broad-based social consensus for reform (Kwon 2003). The committee agreed to the labour market reform, but also recommended that the government implement a package of social protection measures for the unemployed, which was later called the 'Master Plan for Tackling Unemployment'. The Master Plan included, *inter alia*, the swift extension of the Employment Insurance Programme, the implementation of public works projects, and the reinforcement of employment services

In this context, the Employment Insurance Programme introduced in 1995 was extended in its coverage and strengthened its benefits, which included job-training schemes as well as unemployment benefits. Another major breakthrough towards an inclusive social policy was the reform of the public assistance programme. During the economic crisis, the existing public assistance programme, based on a strict means testing, did not help the poor. The newly-introduced the Minimum Living Standard Guarantee recognized the right of every citizen to a decent living as a social right. It abolished the so-called family test in order to cover the poor regardless of the presence of a kinship network

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<sup>7</sup> As Park (2001) shows, the average increase in wages was 14.3 percent, while labour productivity increased by 10.4 percent during the 1990s.

that they could rely on, and increased the level of benefits based on the concept of relative poverty (Kwon 2003). It is worth noting that the reform of the programme was also part of Kim Dae-jung's political strategy to win a majority in the National Assembly in the 2000 general election. The new public assistance programme also includes a range of workfare and training programmes as well as cash benefits. The catchword, 'productive welfare state', used by the Kim Dae-jung government for the general election (Presidential Office 2000), summarized the nature of welfare reform after the economic crisis. This led to a new definition of 'developmental social policy' and a significant change in social policy: providing benefits to those who are not working, and training them outside companies. What remains essentially the same is the state's effort to utilize social policy as an instrument of economic policy.

What should also be noted in the social change after the economic crisis is that social inequality has increased despite the expansion of the welfare state. Table 7 shows that income inequality has been deteriorating. This is mainly because the series of economic policies for the last decade aimed at neo-liberal market reform. Among those policies, it was labour market reform that underlies the trend. The labour market reform aimed at flexibility led to an increase in the proportion of irregular workers, which in turn increased job insecurity (see table 8). It also undercut the wage bargaining power of those workers, while the number of high income earners increased.

Table 7: Trend in Income Inequality

	2003	2004	2005	2006
Gini index	0.341	0.344	0.348	0.351

Source: National Statistical Office, ([www.kosis.kr](http://www.kosis.kr))

Table 8: Employment Status by Gender

		1990	1995	1997	1998	2000	2005
Men	Regular	64.5	67.6	64.6	64.7	59.2	62.3
	Irregular	35.5	32.4	35.4	41.9	40.8	37.7
Women	Regular	37.6	42.8	38.4	34.8	31.1	38.2
	Irregular	62.4	57.2	61.6	64.2	66.9	61.8

Source: National Statistical Office, ([www.kosis.kr](http://www.kosis.kr))

Chun's study (2003) shows that job insecurity has also increased among workers with regular jobs. In other words, the risk of falling to the lower brackets of the job market have increased. He and his colleague also point out that new jobs being created tend to be either at the low end of the labour market with low levels of remuneration (in first and second deciles in terms of the level of wage) or in the high end with high levels of income (ninth and tenth deciles) while the proportion of middle income jobs has decreased (Chun & Kim 2005). Although further research is required regarding the underlying dynamic of such polarization in the labour market, the sluggish performance

of the middle and small enterprises in terms of production and productivity rate is likely to be one of the reasons. These middle and small size enterprises are the main source of middle income jobs and their performance should be improved in order to avert the trend.

The present government in the Republic of Korea was elected with policy programmes aimed at the redistribution of income and higher tax, while maintaining the neo-liberal economic policy. The Rho Muhyuun government also promised that it would not exercise the government's leadership over market entities in the economic domain, which had been a hallmark of the developmental state. Since coming to power, the Rho government raised tax rates, in particular on earnings from real estate, and increased the level of welfare benefits. Although it would be necessary to evaluate such effort, the Rho government tried to establish a policy regime based on the neo-liberal rationale with an inclusive welfare state. It is an effort to divorce economic policy from social protection while divorcing social policy from economic policy. Notwithstanding such policies, the Rho government popularity plummeted and his party disintegrated. In short, it remains to be seen whether such a policy regime will be maintained in the next government.

## **7. Concluding remarks: Korean Development Experience and Policy Implications**

This paper has shed light on the historical experience in which the developmental state in the Republic of Korea exercised a strong leadership over economic development and carried out successful poverty reduction. We argued that the initial success in economic development in the 1960s was strongly related to the social equality created by land reform and human resource development. In this and subsequent periods, although the developmental state introduced a minimum range of social policy programmes, this paper maintains that the developmental state was able to reduce poverty effectively by mobilizing and coordinating various economic institutions and policies to perform social policy functions for poverty reduction and social protection. For sure, it was not a simple outcome of trickle-down effects. It was not only social policies that have been used as instruments for economic development. Economic and rural development policies were also mobilized to perform functions of social protection. Within the context of the economic growth and the poverty reduction the developmental state could modify organizational missions, invent the developmental missions of various institutions, and manufacture developmental desires through a set of appropriate incentives and sanctions and the symbolic system.

With this capacity the developmental state was able to set economic growth as the policy rationale for almost all institutions, and economic growth rose to the top of the value hierarchy of institutions in each field. In other words, social policies and other economic policies that performed poverty reduction served the overall goal of economic development. Under such arrangements, the developmental state created a policy regime in which public institutions such as, *inter alia*, public health facilities, formal education institutes, and price purchasing schemes, could perform a complementary role for social policy. In turn, social policy programmes such as Industrial Accident Insurance and

National Health Insurance were part of the industrialization strategy. In other words, the developmental state in the Republic of Korea successfully managed to establish the new set of preferences and choices for the existing institutions to mobilize for development.

Reflecting the last six decades of the developmental state strategy in the Republic of Korea, it would be fair to say that its performance has been outstanding among other countries with developing experience after the Second World War. Indicators of equality such as the Gini index shows that the Republic of Korea maintained a relatively low level of inequality throughout the 1960s and the early 1970s when the developmental characteristics were most apparent. The subsequent periods manifested an increase in income inequality but it is fair to say that this is not so bad in comparison with the experience of other countries. It should also be pointed out that the Korean development strategy in the period leading up to the late 1980s excluded social sectors such as trade unions, farmers and urban poor from decision making. It is argued that the democratization that followed further consolidated economic development and poverty reduction, in addition to the intrinsic value of democracy. However, it is not very useful to engage in the debate as to whether authoritarianism is a necessary condition for a developmental state. Rather we need to look further into how democracy and economic development can come hand in hand.

Since the social policy reform after the economic crisis, the Republic of Korea has witnessed an expansion of the welfare state. The citizenship right to welfare has slowly but steadily been established. But it is true that everything is not rosy. While the developmental welfare state has become more inclusive, there has been a growing concern over its financial sustainability. It is necessary to rescale the level of benefits and financial responsibility of the welfare state, in particular the National Pension Programme and National Health Insurance, two mature programmes introduced in the 1970s and 1980s. The expenditure of recently introduced programmes such the Minimum Living Standard Guarantee and Employment Insurance Programme has increased rapidly. How will Korean society set priorities among these programmes in its effort to make the welfare state financially sustainable?

The other concern is the increasing inequality in the labour market. As the number of irregular workers has increased, the income gap between employed people has widened. Such a trend may be common across countries in a globalizing and ever competitive market. It is, however, also related to the policy orientation of the government in economic policy in recent years that leans toward neo-liberalism. It remains to be seen whether the Korean government will once again exercise its strategic role to avert the trend of income inequality.

The Korean development experience can be useful for many developing countries in considering their development strategy. It is, however, worth noting that such experience cannot be easily transferred to other countries since policies that work in one type of policy regime may not work in others. Nevertheless it would be a valuable contribution to establish the formation of the policy regime that has proved successful in economic and social development. In particular the policy regime will provide a complete picture of the Korean development experience not only in terms of economic

but also social and political development. This study will provide fresh insight in contrast to conventional wisdoms that often highlight one particular aspect of development, namely the economic one. This study will shed light on the interconnectedness between poverty reduction policy, and social development and democratization.

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