Inclusive Growth, Financial Exclusion and Microfinance in the Republic of Korea*

Young Youn Lee**
(Kangwon National University, Korea)

and

Hyun-Hoon Lee
(Kangwon National University, Korea)

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Keywords: Inclusive Growth, Korean Economy, Financial Exclusion, Microfinance

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** Corresponding Author: Professor Young-Youn LEE, Department of International Trade and Business, Kangwon National University, 1 Kangwondaehagil, Chuncheon, 200-701, Republic of Korea, Email: yylee@kangwon.ac.kr.
ABSTRACT

Korea has achieved rapid economic growth and social development with relatively less inequality in the last 5 decades. But, since 1997 income inequality and polarization in the economy have been increased while potential growth rate has been decreased. Therefore, Korea faces two intertwined fundamental challenges of sustaining economic growth and ameliorating bipolarization. This paper analyzes the status of the Korean economy in terms of inclusive growth indicators and suggests some policy implications – productive employment, income inequality and poverty, human capital, and social protection for inclusive growth to respond those challenges. In addition, this paper explains financial exclusion and microcredit programs in Korea, and suggests policy implications for financial inclusion.

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I. Introduction

1. Background and Objective of Study

Korea has achieved rapid economic growth and social development in the last 5 decades, and has become one of the industrialized high-income countries from a poor agrarian country. Korea’s success in combining economic growth with relatively less inequality is paralleled by few other countries. So, Korea is often praised as one of the exceptional success in achieving “growth with equity” or “shared growth” (OECD, 2011). Per capita GDP has increased about 20 times from US$103.9 dollar in 1962 to US$20,540 dollar in 2010, and per capita GDP in purchasing power parity has increased from 2,376.4 dollar in 1980 to 28,797.5 dollar in 2010 and 30,253 dollar in 2011. Gini coefficients have shown relatively equal income distribution and there was no significant change in the size during the period of 1965 -1993. Korea’s Human Development Index (HDI) ranks at 15 out of 187 countries in 2011 with the life expectancy rose from 52.4 years in 1962 to 80.8 in 2010. The political structure also changed from an authoritarian one to a fully functioning democracy, so both industrialization and democratization are realized in Korea within half century.

However, after long period of rapid economic growth, Korea ran into serious economic difficulties in 1997 Asian financial crisis. Korean government implemented drastic reforms to correct the structural weakness inherent in the economy. As the result of the economic reforms of the corporate, financial, public sectors, and labor market, Korean economy strengthened global competitiveness. But economic and social inequality and polarization have widened since 1998. Therefore, Korea faces two intertwined fundamental challenges: First, Korea has to sustain economic growth in face of rapid population aging and lowering potential growth rate. Second, Korea has to achieve social cohesion by ameliorating inequality, bipolarization and disparity in economic and social areas.

Asian Development Bank (ADB, 2012a) identifies inclusive growth as its first development agenda, with environmentally sustainable growth and regional integration as its long term strategic framework 2008-2020. ADB details two key dimensions of inclusive growth: (i) achieving sustainable growth that will create and expand economic opportunities, and (ii) ensuring broader access to these opportunities so that member of society can participate in and benefit from growth. World Bank and UN also emphasize the necessity of inclusive growth in similar definitions.

Inclusive growth is one of three growth dimensions of the Europe 2020 strategy, accompanying sustainable and smart growth. European Commission defines inclusive growth is a high employment economy delivering economic, social and territorial cohesion. More concretely, it means (a) raising Europe’s employment rate – more and better jobs, especially for women, young people and old worker, (b) helping people of all ages anticipate and manage change through investment in skills & training, (c) modernizing labor markets and welfare
systems, and (d) ensuring the benefits of growth reach all parts of the EU. EU’s targets for inclusive growth include (i) 75% employment rate for women and men aged 20-64 by 2020, (ii) better educational attainment: reducing school drop-out rates below 10%, (iii) at least 20 million fewer people in or at risk of poverty and social exclusion.\(^1\)

Against backdrop of the Korea’s current socio-economic challenges and inclusive growth definitions and indicators, this study suggests policy implication for inclusive growth of the Korean economy. After defining the inclusive growth of various organizations, Korea’s inclusive growth achievements and problems during past decades will be analyzed based on inclusive growth indicators in chapter II. In chapter III, Policy implications for inclusive growth of Korea will be suggested. Paper concludes in chapter IV.

2. Definition of Inclusive Growth

Even though there is no agreed and common definition of inclusive growth, the concept is understood to refer to “growth coupled with equal opportunities.” It focuses on creating opportunities and making them accessible to all, not just for the poor. There is inclusive growth when all members of a society participate in and contribute to the growth process equally regardless of their individual circumstances. In the same way, inclusive growth is one which emphasizes that economic opportunities created by growth are available to all, particularly the poor to the maximum possible extent (Kanbur, R. and Ganesh Rauniyar. 2010).

ADB’s inclusive agenda can be interpreted narrowly or broadly. The narrow interpretation implies a focus on economic growth and broader participation in process and outcomes, within which expanding human capacities is regarded as instrumental to improving economic outcomes. A broad interpretation highlights inclusive development. This approach emphasizes non-income measure of well-being and valuing human capabilities, such as good health and literacy, primarily as human development outcome, not as instruments to accelerate economic growth.

The international Policy Centre for Inclusive Growth of the United Nations Development Program (IPC-IG/UNDP)’s work on inclusive growth starts from the premise that societies based on equality tend to perform better in development. Inclusive growth is both an outcome and a process. On the one hand, it ensures that everyone can participate in the growth process, both in terms of decision making for organizing the growth procession as well as in participating in the growth itself. On the other hand, it makes sure that everyone shares equitably the benefits of growth. Inclusive growth implies participation and benefit-sharing. Without benefit sharing will make growth unjust and sharing benefits without participation will make it a welfare outcome.\(^2\) The IPC-IG sets (a) social protection and promotion, (b) productive inclusion and generation of opportunities, and (c) territorial development and systemic competitiveness as three pillars of inclusive growth (UNDP, 2010).

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\(^2\) [www.ipc-undp.org](http://www.ipc-undp.org), 9/4/2012
Inclusive growth is different from the OECD-DAC’s “pro-poor growth” in the sense that it allows for growth to be pro-poor if the poor are important beneficiaries of growth even if they are not active participants. Also, the pro-poor growth approach explicitly considers poverty a multidimensional phenomenon. Therefore, the impact of growth on non-income dimensions of poverty is important, not only to the extent they affect growth but also to the extent they affect the well-being of the poor (Klasen, 2010).

This paper’s approach involves focusing on productive employment as an important element of inclusive growth. Sustained, high growth rates and poverty reduction can be realized only when the sources of growth are expanding, and increasing share of the labor force is included in the growth process in an efficient way. Inclusive growth is about raising the pace of growth and enlarging the size of the economy, while leveling the playing field for investment and increasing productive employment opportunities. Hence the focus is not only on employment growth but also on productivity growth. Especially, the equality of opportunity in term of access to markets, resources, and unbiased regulatory environment for business and individuals is important.

Inclusive growth approach takes a long term perspective as the focus on productive employment rather than direct income distribution, as a means of increasing income for excluded groups. Inclusive growth analysis focuses on ways to raise the pace of growth by utilizing more fully parts of the labor force trapped in low-productivity activities or completely excluded from the growth process. The main instrument for a sustainable and inclusive growth is assumed to be productive employment (Ianchovichina, E. and Susanna Lundstrom, 2009b).

Klasen (2010) propose to define an income growth episode “inclusive” when it (a) allows participation and contribution by all members of society, with particular emphasis on the ability of the poor and disadvantages to participate in growth (the “nondiscriminatory “ aspect of growth); and (b) associate with declining inequality in non-income dimensions of well-being that are particularly important for promoting economic opportunities, including education, health, nutrition, and social integration (the disadvantage reducing” aspect of inclusive growth). Klasen suggests more formally, an inclusive growth requires (a) positive per capita income growth rate, (b) primary income growth rates for predefined, disadvantaged groups (e.g., ethnic minorities, backward regions, the income poor, rural areas, women) at least as high as growth rates for per capita incomes, indicating that such groups have been able to participate in the growth process at least proportionately, (c) expansion of non-income dimensions of well-being that exceed the average rate for predefined, disadvantaged groups (P.10).

Some policies may have a positive effect on both growth and inequality. The empirical cross-country literature suggests that growth has neither a positive nor a negative effect on inequality. Lopez and Seren (2004) surveys the empirical literature and concludes that macroeconomic

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stability as well as education and infrastructure-related policies seemed to be win-win or ‘super pro-poor’ policies that have both positive effect on growth and a negative effect on inequality.

Inclusive growth links macroeconomic fundamentals such as macroeconomic stability (moderate fiscal and current account deficits, low debt to GDP ratio, moderate inflation), political stability - democratic institutions, progressive fiscal policies, social protection to vulnerable groups, openness to trade, promotion of direct investment in key sectors, vertical and horizontal industrial policies, and low population growth rate, with micro determinants such as investment in human capital (health, education, water and sanitation), investment in physical infrastructure, tackling horizontal inequalities in basic service provision, discrimination by gender, ethnicity, religion etc., facilitate access to finance (microfinance, SME finance, capital markets), support broad-based skill development and employment.

However, there is no rule of thumb for general inclusive policy, as it is a country-specific question. But, sustained growth patterns, structural transformation in finding country’s own competitive advantage, broad-base productive (and decent) employment opportunities, equal opportunities for all in terms of education and health, significant reduction of absolute poverty, and reduction in vertical and horizontal inequalities are important elements of inclusive growth (Addison, T. and Miguel Nino-Zarazua, 2012). The determinants are highly dependent on initial conditions such as level of income, poverty, and asset equality, but also a lot of other factors such as geography, demography, governance, politics, social considerations and the set of existing policies. These differ not only between countries, but also over time within the same country.

Based on the above discussion, the question arises whether indicators can be derived to monitor inclusive growth at the country and project/program level. In line with Klasen(2010), McKinley(2010) offers criteria and indicators that tend to be more consistent with measurable definition of inclusive growth in the areas of (i) growth, productive employment, and economic infrastructure; (ii) income inequality, poverty, and horizontal inequalities including gender and regional inequality; (iii) human capabilities; and (iv) social protection.

II. The Status of Inclusive Growth

In this chapter, we mainly apply the suggested indicators of inclusive growth by McKinley( 2010) and Addison,T. and Miguel Nino-Zarazua(2012) to analyzes the inclusive growth of Korea.

1. Economic Growth and Productive Employment
Enhancing the growth of income per person is fundamental in advancing inclusive growth, as this is the basis for creating and expanding economic opportunities. However, growth does not necessarily correspond to broad-based increases in productive employment. Sometimes the pattern of growth generates limited new employment opportunities, especially if a low-paid service sector expands but the growth of industry languishes. Both ADB and the World Bank have underscored the importance of decent employment opportunities as a critical aspect of inclusive growth.

The growth rate of GDP per person is a proxy for labor productivity. But it does not provide any real sense of the spread of productive employment, since high level of labor productivity could be driven mainly by advances in a minority of economic sectors. Employment-population ratio is not useful also, since it gives no indication of the quality of employment. So, one potentially viable candidate for a partial, approximate indicator of productive employment is the share of the employed or the economically active in industry or manufacturing. A third complementary indicator is the share of workers in non-agricultural paid employment. The share of own-account workers and unpaid family workers in total employment, which focus on the extent of low-quality employment, can be used as a measure of vulnerable employment. The lack of meaningful data on trends in productive employment is serious weakness in the monitoring and evaluation of such progress. In summary, a limited set of indicators is recommended for gauging progress on achieving economic growth, generation employment, and expanding access to economic infrastructure (McKinley 2010).

Figure 1. Annual rate of growth of GDP and of per capita GDP (1962-2010)

Source: databank.worldbank.org/data/home.aspx

1) Economic growth
Korea has recorded 5.79 percent of average annual growth rate of GDP during the 1962-2010 in spite of the negative growth in 1980, the Asian financial crisis in 1997, and the Global economic crisis in 2008 (Figure 1). Especially, during the 36 years from 1962 to 1997, Korea has achieved 8.01 percent of average annual growth rate of GDP. Average annual growth rate of the GDP per capita also has recorded 4.61 percent during the same period, recording highest growth rate of 7.3 percent during the period of 1988-1992 (Table 1).

Table 1. Average annual growth rate of GDP and of GDP per capita

<table>
<thead>
<tr>
<th>Period</th>
<th>Average annual growth rate of GDP (%)</th>
<th>Average annual growth rate of GDP per capita (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1962-1979 (Park Jung-hee)</td>
<td>8.46</td>
<td>6.20</td>
</tr>
<tr>
<td>1980-1987 (Chun Doohwan)</td>
<td>7.43</td>
<td>6.09</td>
</tr>
<tr>
<td>1988-1992 (Roh Tae-woo)</td>
<td>8.36</td>
<td>7.30</td>
</tr>
<tr>
<td>1993-1997 (Kim Young sam)</td>
<td>7.10</td>
<td>6.02</td>
</tr>
<tr>
<td>1998-2002 (Kim Dae-jung)</td>
<td>4.46</td>
<td>3.72</td>
</tr>
<tr>
<td>2003-2007 (Noh Mu-hyun)</td>
<td>4.34</td>
<td>3.90</td>
</tr>
<tr>
<td>2008-2010 (Lee Myung-bak)</td>
<td>2.97*</td>
<td>2.40</td>
</tr>
<tr>
<td>1962-2010 whole period</td>
<td>5.79</td>
<td>4.61</td>
</tr>
</tbody>
</table>


GDP per capita (current US$) has increased from 104 dollar in 1962 to 21,430 dollar in 2008. Rapid growth narrowed per capita income gap with United States from 62 percent in 1991 to 36 percent in 2010, reflecting progress in closing the productivity gap - from 72 percent to 52 percent\(^4\). The convergence in income levels continued despite a slowdown in Korea’s potential growth rate from 7 percent in 1995 to around 4 percent by 2010. Long-term trend growth, which had averaged 9.2 percent annually in 1971-1990, and 7.2 percent in 1991-1997, fell to 4.7 percent in 1998-2008 after Korea underwent its foreign exchange crisis, and it fell further to 3.8 percent in 2009-2011\(^5\). It is expected to decrease at 2.8 percent in 2021-2030. Korea as an advanced industrialized economy has moved to global technology frontier and has a rapidly aging population. The contribution from trend labor productivity fell from about five percentage points to three and the contribution from labor inputs has declined from two percentage points to one, as working age population growth halved from 1.4 percent to 0.7 percent (OECD, 2012a).

\(^4\) Difference from the United States is based on 2005 PPP exchange rates. Productivity is measured by GDP per hour worked.

\(^5\) SHIN Changmock, Causes of the Decline in Korea’s Long-term Growth Trend: Expenditures, SERI. Table 3.
Therefore, unless policies can help prevent the expected downtrend in productivity and labor inputs, the potential growth rate is expected to decline further.

The tremendous growth of Korean economy in the last 50 years has been accompanied by deep changes in its industrial structure. The Korean economy was dominated by agriculture and under-developed service sector accounting respectively 39.4 percent and 39.3 percent in 1965. Korea pursued an export-led industrialization as the main objective of the ‘First five year Economic Development Plan’ that started in 1962. Korea had a comparative advantage in exporting labor-intensive light manufacturing products with its abundant supply of a relatively well-educated and diligent labor force. But, the Korean government faced with severe economic and political environments such as increasing wage levels and national self-defense gradually emphasized the production of capital intensive ‘heavy and chemical industries’ as a major industry in 1970s. The share of manufacturing industry has increased from 14.3 percent in 1965 to 24.3 percent in 1979. Especially, the share of heavy and chemical industries has increased to 11.4 percent in 1971-1980 from 5.8 percent in 1961-1970, while the share of agriculture has decreased to 20.9 percent from 39.4 percent during the 1965-1979 (Figure 2 and Table 2).

Figure 2. Agriculture, Industry (Manufacturing), and Service Share of GDP (%), 1965 - 2010

![Graph showing the share of GDP by sector from 1965 to 2010.](databank.worldbank.org/data/home.aspx)

Source: databank.worldbank.org/data/home.aspx

Table 2. Share of GDP by sector (%), 1965 - 2010
<table>
<thead>
<tr>
<th>Year</th>
<th>Agriculture</th>
<th>Industry</th>
<th>Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>1965</td>
<td>39.4</td>
<td>21.3</td>
<td>39.3</td>
</tr>
<tr>
<td>1979</td>
<td>20.9</td>
<td>36.0</td>
<td>43.0</td>
</tr>
<tr>
<td>1987</td>
<td>10.8</td>
<td>41.5</td>
<td>47.8</td>
</tr>
<tr>
<td>1992</td>
<td>7.7</td>
<td>41.3</td>
<td>51.0</td>
</tr>
<tr>
<td>1997</td>
<td>5.4</td>
<td>41.1</td>
<td>53.4</td>
</tr>
<tr>
<td>2002</td>
<td>4.0</td>
<td>36.2</td>
<td>59.8</td>
</tr>
<tr>
<td>2007</td>
<td>2.9</td>
<td>37.1</td>
<td>60.0</td>
</tr>
<tr>
<td>2010</td>
<td>2.6</td>
<td>39.3</td>
<td>58.2</td>
</tr>
</tbody>
</table>

Source: databank.worldbank.org/data/home.aspx

The real growth rate by industrial sector shows that industry achieved the highest rate during the whole periods of 1960-2010, recording 12.03 percent in 1960-80 (period 1), 8.31 percent in 1980-2000 (period 2), and 5.32 percent in 2000-2010 (period 3) respectively. The service sector recorded 6.01 percent, 6.63 percent, and 3.59 percent, and the agriculture sector recorded 2.79 percent, 2.40 percent, and 1.35 percent respectively in the corresponding periods (Park, Donghyun and Kwanho Shin. 2012b).

Entering the 1980s, the role of the private enterprise has increased in research and development (R&D) to improve the high-productivity manufacturing. These efforts gradually bore fruit and productivity gap with advanced industries narrowed significantly in the 1990s. Korea leads globally in manufacturing of LCD (Liquid Crystal Displays), memory chips, and smartphones. It is the world’s largest shipbuilder and 5th largest globally in automobile manufacturing. The Korean government identified 17 sectors as possible high growth markets. These 17 sectors fall under three broad categories: green-tech, high-tech convergence technologies such as intelligence robotics, and value-added services in sectors such as telecommunications. The manufacturing industry’s share of GDP has decreased from 30.2 in 1987 and has stagnated at around 26 - 28 percent in the 1990s and 2000s until rise to 30.5 percent in 2010 - which is higher than peer average (18.3%).

2) Productive employment

The main instrument for a sustainable and inclusive growth is assumed to be productive employment. The ability of individual to be productively employed depends on the opportunities to make full use of available resources as the economy evolves over time. The analysis therefore look at ways to strengthen the productive resources and capacity of the individual on the labor supply side as well as the ways to open up new opportunities for productive employment on the labor demand side. If the main problem is related to the productive resources and capacity of individuals, an in-depth employability analysis is needed. If the main problem is low productivity or lack of employment opportunities for the individuals due to limited demand for labor, an analysis of the bottlenecks in the business environment is necessary. (Ianchovichina, E. and Susanna Lundstrom, 2009a)

Labor force participation in economic activities is one of the key factors for economic growth. Labor force (15-64) participation rate is 65.4 percent which is below the OECD average of 72.3 percent. Deloitte, Global Manufacturing Competitiveness Index 2013. Korea ranks at 5th among 38 countries.
percent. Overall labor force participation rate was 56.6 percent for population of 15 years and over, and that was 78.4 percent for male and 37 percent for female respectively in 1963. The participation rate has increased to 59.9 percent in 1978 by increasing the female participation rate - 43.3 percent - while the male participation rate decreased to 77.9 percent. The participation rate recorded highest - 62.5 percent in 1997 by continuous increasing of the female participation rate (49.8%), but it has decreased to 60.8 percent in 2010 with male participation rate of 72.8 percent and female participation rate of 49.2 percent. However, for women between the ages of 25 and 54, the rate was 62 percent in 2010, which is the third lowest in the OECD area. Also, Korea’s participation and employment rates for young people are one of the lowest in the OECD area reflecting the large share in tertiary education. The employment rate for the youth (15-24) was 22.9 percent in 2009, much lower than the OECD average of 40.6 percent.

The employment rates have shown similar trend as participation rates since the unemployment rates have been fluctuated within relatively small range during the 1963 - 2010 periods. Especially the unemployment rates were around 3 - 4 percent since 1970s (Table 3). However, the unemployment rate for youth is relatively high. The employment rate for the 15-64 ages group has been stagnant for more than ten years at around 63 percent. This is below the OECD average of 66.6 percent due to particularly low employment for women and youth. Female employment rate is 22 - 30 percent point below than that of male, even though it is increasing from 41.3 percent in 1980 to 48.9 percent in 2007. The persistence of a relatively low employment rate is worrisome, because Korea faces the most rapid population aging, reflecting its lowest birth rate in the OECD area.

Table 3. Labor force participation rates and employment rates (%), selected years (1963 - 2010).

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Participation rate</td>
<td>56.6</td>
<td>59.9</td>
<td>58.3</td>
<td>60.9</td>
<td>62.5</td>
<td>61.9</td>
<td>61.7</td>
<td>60.8</td>
</tr>
<tr>
<td>Male</td>
<td>78.4</td>
<td>77.9</td>
<td>72.5</td>
<td>75.7</td>
<td>76.1</td>
<td>74.8</td>
<td>73.9</td>
<td>72.8</td>
</tr>
<tr>
<td>Female</td>
<td>37.0</td>
<td>43.3</td>
<td>45.0</td>
<td>47.1</td>
<td>49.8</td>
<td>49.7</td>
<td>50.1</td>
<td>49.2</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>8.1</td>
<td>3.2</td>
<td>3.1</td>
<td>2.5</td>
<td>2.6</td>
<td>3.1</td>
<td>3.0</td>
<td>3.4</td>
</tr>
<tr>
<td>Youth (15-24)</td>
<td>-</td>
<td>10.0*</td>
<td>7.6</td>
<td>7.6</td>
<td>7.6</td>
<td>8.1</td>
<td>8.2</td>
<td>8.9</td>
</tr>
<tr>
<td>Employment rate</td>
<td>52.0</td>
<td>58.0</td>
<td>56.5</td>
<td>59.4</td>
<td>60.9</td>
<td>60.0</td>
<td>59.8</td>
<td>58.7</td>
</tr>
<tr>
<td>Male</td>
<td>-</td>
<td>71.7*</td>
<td>69.7</td>
<td>73.6</td>
<td>73.9</td>
<td>72.2</td>
<td>71.3</td>
<td>70.1</td>
</tr>
<tr>
<td>Female</td>
<td>-</td>
<td>41.3*</td>
<td>44.1</td>
<td>46.1</td>
<td>48.6</td>
<td>48.4</td>
<td>48.9</td>
<td>47.8</td>
</tr>
<tr>
<td>Youth (15-24)</td>
<td>38.2*</td>
<td>32.8</td>
<td>34.6</td>
<td>34.6</td>
<td>32.2</td>
<td>31.5</td>
<td>25.7</td>
<td>23.0</td>
</tr>
</tbody>
</table>


Rapid aging in the population has slowed in the working population. Productive population of 15 - 64 ages has increased in 1970 - 1995 by the average annual rate of 2.5 percent, but it has
decreased to 0.6 in 1996 -2010. Actually the annual average increase rate of core productive population of ages 25 to 49 has decreased to negative (-0.4%) in 2006 - 2010 from 2.8 in 1970 -1995 even though total number of employment has increased from about 8.1 million in 1965 to 23.8 million in 2010. Average weekly hours worked decreased from 54.1 in 1970 - 1995 to 46.0 in 2006 - 2010. It is expected to decrease further from 43.5 hours in 2012 to 41.6 hours in 2016. (Table 4).

Table 4. Annual Average Increase in the Production Population (%)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Core productive population (25 - 49)</td>
<td>2.8</td>
<td>1.0</td>
<td>-0.4</td>
</tr>
<tr>
<td>Productive population (15-64)</td>
<td>2.5</td>
<td>0.6</td>
<td>0.6</td>
</tr>
<tr>
<td>Average weekly hours worked</td>
<td>54.1</td>
<td>50.1</td>
<td>46.0</td>
</tr>
</tbody>
</table>

Note: Data for average weekly worked was available from 1980

The employment in agriculture has decreased continuously from 58.4 percent in 1965 to 6.6 percent in 2010, while the employment in service sector has increased continuously from 31.2 percent to 76.4 percent during the same period. The employment in manufacturing sector has increased from 9.4 percent in 1965 to 27 percent in 1987, but it has decreased continuously to 16.9 percent in 2010(Table 5).

Manufacturing sector has driven Korea’s rapid economic development, and its productivity is relatively high. In contrast, Korea’s service sector, which is dominated by SMEs, is markedly less productive. The Korea’s service sector productivity (value-added/hours) relative to manufacturing in 2007 was about 60 percent compared to 90 percent in OECD. In 2010, 16.9 percent of the manufacturing sector employment produced 30.5 percent of GDP, while 76.4 percent of the service sector employment produced 58.2 percent of GDP. However, service sector is important both in employment and in production share of GDP. During the period of 2001 -2010, manufacturing jobs created per hundred persons is -4.5 which is lowest among the peer countries.

Table 5. Number and Share in total employment by sector (Thousand, %), Selected years 1965 -2010
3) Quality of employment

Status of worker is important measure of quality of the employed person. Total employed persons are composed of non-salary workers and wage and salary workers, and the former are composed of business owner with employees and without employee, and un-paid family workers. The share of non-salary workers was 69.3 percent in 1965 reflecting high share of employment in agriculture (58.4%) in 1965. But its share has continuously decreased to 28.8 percent in 2010 along with the decreasing share of agriculture during the same period. Especially, the share of the unpaid family workers has decreased rapidly from 32.3 percent in 1965 to 5.3 percent in 2010. On the other hand, the share of wage and salary workers has continuously increased from 30.7 percent in 1965 to 71.2 percent in 2010 reflecting the industrialization and structural changes of the Korean economy (Table 1.6).

However, 28.8 percent of the national workforce in 2010 is fourth-highest percentage of self-employed in the 34-nation OECD, and they are mainly small business owners of the self-employed in traditional service industries such as wholesale and retail sales, transportation, restaurant and lodging, real estate and repairs. The share of self-employed in the service industry in Korea is 2.2 times that of OECD countries’ average, with the share in the traditional service sector at more than 2.5 times the OECD average. It is 2.9 times for the transportation and warehouse sector, and 2.3 times for lodging and restaurants as well as wholesale, retail sale and repair. In contrast, in financial services, business support and housekeeping, the share of self-employed Koreans is lower than the OECD average (Kim Sun-Bin, 2012).

The share of temporary employees has also increased from 17.4 percent in 1992 to 23.0 percent in 2010 - which is the fourth highest incidence in the OECD area - along with the increasing share of employment in service sector.

Table 6. Employed persons by Status of worker (Thousand, %), Selected years 1965-2010

<table>
<thead>
<tr>
<th>By status of</th>
<th>1965 (100)</th>
<th>1970 (100)</th>
<th>1979 (100)</th>
<th>1987 (100)</th>
<th>1992 (100)</th>
<th>1997 (100)</th>
<th>2002 (100)</th>
<th>2007 (100)</th>
<th>2010 (100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>8,112</td>
<td>9,617</td>
<td>13,602</td>
<td>16,354</td>
<td>19,009</td>
<td>21,214</td>
<td>22,169</td>
<td>23,433</td>
<td>23,829</td>
</tr>
<tr>
<td>Agriculture</td>
<td>4,742 (58.4%)</td>
<td>4,846 (50.4%)</td>
<td>4,866 (35.8%)</td>
<td>3,580 (21.9%)</td>
<td>2,667 (14.0%)</td>
<td>2,286 (10.8%)</td>
<td>2,069 (9.3%)</td>
<td>1,726 (7.4%)</td>
<td>1,566 (6.6%)</td>
</tr>
<tr>
<td>Industry</td>
<td>840 (10.4%)</td>
<td>1,337 (13.9%)</td>
<td>3,209 (23.6%)</td>
<td>4,602 (28.1%)</td>
<td>5,042 (26.5%)</td>
<td>4,564 (21.5%)</td>
<td>4,259 (19.2%)</td>
<td>4,137 (17.7%)</td>
<td>4,049 (17.0%)</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>764 (9.4%)</td>
<td>1,268 (13.2%)</td>
<td>3,099 (22.8%)</td>
<td>4,416 (27.0%)</td>
<td>4,986 (26.2%)</td>
<td>4,537 (21.4%)</td>
<td>4,241 (19.1%)</td>
<td>4,119 (17.6%)</td>
<td>4,028 (16.9%)</td>
</tr>
<tr>
<td>Service</td>
<td>2,530 (31.2%)</td>
<td>3,395 (35.3%)</td>
<td>5,527 (40.6%)</td>
<td>8,172 (50.0%)</td>
<td>11,301 (59.5%)</td>
<td>14,365 (67.7%)</td>
<td>15,841 (71.5%)</td>
<td>17,569 (75.0%)</td>
<td>18,214 (76.4%)</td>
</tr>
</tbody>
</table>

Source: Statistics Korea (http://kosis.kr)
<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total employed persons</td>
<td>8,112 (100)</td>
<td>9,617 (100)</td>
<td>13,602 (100)</td>
<td>16,354 (100)</td>
<td>19,009 (100)</td>
<td>21,214 (100)</td>
<td>22,169 (100)</td>
<td>23,433 (100)</td>
<td>23,829 (100)</td>
</tr>
<tr>
<td>Non-salary workers</td>
<td>5,500 (69.3)</td>
<td>5,872 (61.1)</td>
<td>7,124 (52.4)</td>
<td>7,163 (43.8)</td>
<td>7,099 (37.4)</td>
<td>7,810 (36.8)</td>
<td>7,988 (31.8)</td>
<td>7,463 (28.8)</td>
<td>6,858 (28.8)</td>
</tr>
<tr>
<td>- Independent business owner</td>
<td>2,984 (37.0)</td>
<td>3,286 (34.2)</td>
<td>4,571 (33.6)</td>
<td>4,994 (30.5)</td>
<td>5,171 (27.2)</td>
<td>5,901 (27.8)</td>
<td>6,190 (27.9)</td>
<td>6,049 (25.8)</td>
<td>5,592 (23.5)</td>
</tr>
<tr>
<td>- Unpaid family workers</td>
<td>2,516 (32.3)</td>
<td>2,586 (26.9)</td>
<td>2,553 (18.8)</td>
<td>2,169 (13.3)</td>
<td>1,928 (10.2)</td>
<td>1,908 (9.0)</td>
<td>1,797 (8.1)</td>
<td>1,413 (6.0)</td>
<td>1,266 (5.3)</td>
</tr>
<tr>
<td>Wage and salary workers</td>
<td>2,609 (30.7)</td>
<td>3,746 (39.0)</td>
<td>6,479 (47.6)</td>
<td>9,191 (56.2)</td>
<td>11,910 (62.7)</td>
<td>13,404 (63.2)</td>
<td>14,181 (64.0)</td>
<td>15,970 (68.2)</td>
<td>16,971 (71.2)</td>
</tr>
<tr>
<td>- Regular employees</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>6,838 (36.0)</td>
<td>7,282 (34.3)</td>
<td>6,862 (31.0)</td>
<td>8,629 (36.8)</td>
<td>10,086 (42.3)</td>
</tr>
<tr>
<td>- Temporary employees</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3,300 (17.4)</td>
<td>4,236 (20.0)</td>
<td>4,886 (22.0)</td>
<td>5,172 (22.1)</td>
<td>5,086 (21.3)*</td>
</tr>
<tr>
<td>- Daily workers</td>
<td>844 (10.4)</td>
<td>1,018 (10.6)</td>
<td>1,421 (10.5)</td>
<td>1,529 (9.4)</td>
<td>1,772 (9.3)</td>
<td>1,886 (9.3)</td>
<td>2,433 (11.0)</td>
<td>2,178 (9.3)</td>
<td>1,817 (7.6)</td>
</tr>
</tbody>
</table>

Source: Statistics Korea (http://kosis.kr). (OECD.StatExtracts)

* 23.0 % for all persons, total, dependent employment


Paid laborers = Full-time laborers + Temporary laborers + one-day laborers

A structural weakness in the Korean labor market is the severe and growing inequality, which is closely associated with the rising share of non-standard forms of work that involve lower pay, worse working conditions, and less covered by social insurance schemes than standard jobs. The share of non-regular workers - defined as temporary, part-time and atypical (such as workers dispatched by temporary agencies) employees - increased from 31 percent of employment in 2001 to 36 percent in 2007, before falling to 33 percent in 2010, as firms dismissed non-regular workers to reduce employment in the wake of the global economic crisis. The average wage of non-regular workers is 45 percent below that of regular workers, while their productivity is only 22 percent lower. In 2010, 38 percent of non-regular workers were covered by the National Pension Scheme, 41 percent by Employment Insurance Scheme and 42 percent by the National Health Insurance (OECD, 2011).
The share of non-regular workers among the wage and salary workers was over 50 percent in 2002, even though its share has decreased to 38.7 percent in 2010 by increasing the share of regular employees since 2003. The share of the part-time workers (1 -17 hours per week) has also increased from 0.4 percent of employment in 1981 to 4.4 percent in 2010.

The share of the business owner without employee - own-account workers - of employment decreased from 29.0 percent in 1980 to 17.2 percent in 2010, even though its number increased up to 4.6 million in 2002 after the Asian Financial Crisis in 1998 and decreased to 4.1 million in 2010. The high share of non-regular workers is driven primarily by firms’ need for employment flexibility and lower wage costs including the savings on welfare costs. As a group, non-regular workers tend to be older, less educated, employed in SMEs, have short tenure and work in the service sector. In addition, 42 percent of female employees are in non-regular employment compared to 28 percent of males.

2. Inequality and Poverty

1) Functional income distribution

According to modern Keynesian/Kaleckian theories, which posit that functional income distribution strongly depends on political factors, the occurrence of periods of stability should be considered as the result of a pause or balance in the “class conflict”, arising from a combination of political and economic factors. On the other hand, the neoclassical approach has treated the stability of functional income distribution as an empirical fact and as a prediction based on a strictly techno-economic explanation with substitutable factor of production.

The annual average growth rate of real wage in 1964 - 2008 is 6.3 percent by the high growth rates in the late-1960s and 1980s. The share of wages has shown upward trend since the late 1970s owing to a significant increase of real wages in manufacturing, in parallel with industrial upgrading, possibly related to changes in both labor market and political conditions (UNCTAD, 2012). However, Korea’s share of wage in GDP is 50.6 in 2010, which is far below compared to other advanced countries even though it is higher than those of South American countries. Real wage growth lagging behind the productivity gains has been a salient feature of economic development in most countries. The shares of wage in GDP in the United States and other developed countries show decreasing trend since 1970 (Table 7).

Table 7. Share of wages in GDP in selected countries, 1970 -2010

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<thead>
<tr>
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<tbody>
<tr>
<td></td>
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<td></td>
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<td></td>
<td></td>
</tr>
</tbody>
</table>
France  66.4  70.3  71.7  68.0  62.4  60.3  60.5  61.0  61.4  
United Kingdom  67.6  70.6  67.1  61.9  62.9  60.3  62.8  61.4  62.6  
United States  65.3  63.7  64.6  62.0  62.6  61.4  61.5  59.7  59.0  
Japan  43.0  55.0  54.6  55.0  54.1  57.3  57.0  54.8  55.0  
Republic of Korea  37.1  35.3  44.3  45.2  50.5  52.7  48.6  51.6  50.6  
Argentina  44.1  47.6  40.5  39.5  38.6  41.9  39.4  31.6  41.5  
Chile  47.8  45.3  43.3  42.4  38.7  40.9  46.5  42.5  44.1  

Source: UNCTAD, Trade and Development Report 2012. P.48  Note: Data refer to total compensation of employees as a per cent of GDP at factor costs.

2) Income Inequality and Poverty

The Gini coefficient gives a summary measure for the income distribution without providing direct information about the nature of changes within entire range. The poverty rate and the $5^{th}$ income distribution ratio of the population are used to measure vertical inequalities in income distribution as complements. In addition, horizontal inequalities between rural and urban areas, gender, and specific income groups are also considered.

Korea’s income inequality and relative poverty rate have been continuously deteriorated in terms of Gini coefficient, Relative poverty rate and $5^{th}$ income distribution ratio since Kim Young Sam administration (Table 8).

Table 8. Income Distribution and Poverty rates.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gini coefficient</td>
<td>0.253 (0.280)</td>
<td>0.279(0.291)</td>
<td>0.281(0.299)</td>
<td>0.292(0.317)</td>
</tr>
<tr>
<td>Relative Poverty Rate (%)</td>
<td>7.78 (8.44)</td>
<td>10.32 (11.29)</td>
<td>11.68 (13.44)</td>
<td>12.63 (15.00)</td>
</tr>
<tr>
<td>$5^{th}$ Ratio</td>
<td>3.716(3.836)</td>
<td>4.370(4.708)</td>
<td>4.528(5.190)</td>
<td>4.873(6.005)</td>
</tr>
</tbody>
</table>

Note: urban households above 2 persons, disposal income Base. ( ) is market income base.

Source: Korea Statistics office

In terms of Gini coefficient, Korea’s income distribution is not so bad compared to OECD countries even though its increasing trend is problem. But, Korea’s relative poverty rate after taxes and transfers for the entire population - was 14.3 percent in 2006, ninth highest in the OECD, and increased even more to 15.2 in late-2000s compared to the OECD average of 11.2 percent. Korea’s $5^{th}$ income distribution ratios also show that income inequality has been deteriorated since 1997. The $5^{th}$ ratio has increased from 3.97 in 1997 to 6.02 in 2010.\(^7\)

\(^7\) For the urban households above 2 persons (market income, before taxes and transfers). KOSIS
Most of the advanced OECD countries have high level of income inequality before taxes and transfers compared to Korea, but tax and welfare systems have greater effects on income redistribution especially in France, Germany, and Sweden. The poverty rates before taxes and transfers for the OECD (26.3%) including advanced countries are also very high compared to that of Korea (17.5%) in late 2000s. This results show that Korea’s tax/benefit system is not effective in reducing inequality and poverty, even though Korea’s income distribution before taxes and transfers is relatively more equal compared for OECD countries. For example, Korea’s Gini coefficient before taxes and transfers in late-2000s is 0.344 compared to 0.457 for OECD average, and poverty rate is 17.5 percent compared to OECD average of 26.3 percent (Table 9).

Table 9. Levels of income inequality and poverty rates of Korea and OECD countries

<table>
<thead>
<tr>
<th>Gini Mid-2000s</th>
<th>Gini Late-2000s</th>
<th>Poverty Mid-2000s</th>
<th>Poverty Late-2000s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Canada</td>
<td>France</td>
<td>Germany</td>
</tr>
<tr>
<td>0.315 (0.465)</td>
<td>0.317 (0.436)</td>
<td>0.288 (0.485)</td>
<td>0.285 (0.499)</td>
</tr>
<tr>
<td>0.336 (0.468)</td>
<td>0.324 (0.441)</td>
<td>0.293 (0.483)</td>
<td>0.295 (0.504)</td>
</tr>
<tr>
<td>13.2 (28.8)</td>
<td>11.7 (24.5)</td>
<td>7.2 (33.0)</td>
<td>8.3 (32.7)</td>
</tr>
<tr>
<td>14.6 (27.2)</td>
<td>12.0 (24.7)</td>
<td>7.2 (32.6)</td>
<td>8.9 (32.5)</td>
</tr>
</tbody>
</table>

( ): Gini coefficient before taxes and transfers / Poverty rate before taxes and transfers. The poverty rates are defined as the share of individuals with equivalent disposal income less than 50% of the median for the entire population.


On average, Korean households receive just 4 percent of their income from the government in the form of cash benefits and pay not more than 8 percent of their income in taxes and social contributions. These are by far the lowest level in the OECD. In a typical OECD country, cash benefits constitute some 22 percent of income and taxes paid some 29 percent (OECD.2011). However, Korea introduced an earned income tax credit (EITC) in 2008, which would help better target the tax/benefit system on low-income households.

In connection with the income inequality of Korea, Korea had to pay much more attention to questions of equity and poverty alleviation because of its position of competition with North Korea at the early stage of economic development. However, at the beginning of economic development in 1960s, South Korea had already very equalized income and assets due to land reform and total destroy of industrial facilities during the Korean War in 1950-53. So the most important objective was increase in income. And Korea succeeded in reduction of absolute poverty to 5 percent in mid-1980s from 23 percent in 19708. Rapid poverty alleviation in Korea was brought about by a number of factors as follow (OECD/World Bank. 2004);

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First, the President Park regime’s strong leadership and commitment of economic development at the top its priorities. Powered by the military coup 1961, Park regime pursued economic development by initiating the first five-year economic development plan from 1962. President Park, in addition to strengthening the planning process, laid great emphasis on carrying out announced policies through a rigorous structure of rewards and punishments including compulsion and administrative discretion.

Secondly, market economic system and outward-looking industrialization strategy. Recognition of property rights and free market system was a base of South Korea economy in contrast with North Korea’s communist planned economic system, even though the Korean government intervened in the economy by economic planning and industrial policies. So, private entrepreneurs played active role in export-led industrialization process along with government policies. During the period of 1962 - 80, Korea’s GNP grew at an annual rate of 8.5 percent in real term, especially the value-added in manufacturing increased at an average annual rate of 18 percent. Korea’s export grew from US$55 million to US$22 billion, giving an annual growth rate of nearly 40 percent.

Thirdly, there were continuous enhancements of human resources and productivity through education. Under relatively equal income and wealth distribution base at the beginning, education was the major factor of human capacity building and getting better economic opportunity in rapidly growing economy. There were no discriminations in terms traditional class, ethnic races, religion, and any other categories in Korea. Therefore human capacity building, that is education, was the most important determinant of success in life. High education fever of parents for their children was matched by the government’s investment in schools and training institutions. The continued expansion of education provided avenues of upward social mobility for even the lower middle classes.

The fourth important impetus to poverty alleviation, particularly in the rural areas, came from the land reform. Korea was able to undertake land redistribution between 1945 -1950. Moreover, since the 1970s the government encouraged and supported the introduction of new, high yielding varieties of rice (the “green revolution”), which increased rice yields per acre by almost 50 percent. The government also launched the New Community Movement (NCM) in 1971 for rural development with the spirit of ‘diligence’, ‘self-help’, and ‘cooperation’. In mid-1970, almost 10 percent of total national investment was allocated annually to rural areas through the NCM, so the income of rural and urban households became equal in 1975.

The fifth important factor was the expansion of employment. The strategy of high growth based on exports created demand for employment, and the expansion of educated human resources supplied labor force needed in the manufacturing industry. Unemployment rate dropped from 8.2 percent in 1963 to only 2.4 percent in 1991. The expansion in employment was a major factor in increasing income and reducing poverty.
The sixth important factor was the county’s capacity to implement plans and projects expeditiously and within budgeted costs. This ability derived from the structure of economic decision-making and the quality of the administrative services that carried out the policies. Economic policies were effectively implemented by well-trained civil services.

Despite Korea’s high economic growth with relatively equal income distribution until mid-1990s, certain measures of inequality such as Gini coefficient, the relative poverty ratio, and the L-H ratio have been trending upward since 1997 Asian financial crisis, indicating deteriorating socio-economic conditions. There are many potential factors responsible for rising inequality, including those related to technological progress and globalization. In the case of Korea, a key factor was the structural change in economy, including a shift from high-paying jobs in manufacturing to lower-paying job in services. Labor market dualism, which results in large wage gaps between regular and non-regular workers, is another dimension of inequality (Elekdag. 2012). The low wages of non-regular workers has been a key factor in the rise in the Gini coefficient and relative poverty. According to recent survey (Lee, 2011), 20 percent of non-regular workers are in relative poverty.

3) Gender inequality

UNDP constructed the Gender Inequality Index (GII) which reflects gender-based inequalities in three dimensions - reproductive health, empowerment, and economic activity. Reproductive health is measured by maternal mortality and adolescent fertility rates; empowerment is measured by the share of parliamentary seats held by each gender and attainment at secondary or higher of education by each gender; and economic activity is measured by the labor market participation rate for each gender.

Korea has a value of 0.111, ranking it 11 out of 146 countries in the 2011 Gender Inequality Index (GII). In Korea, 14.7 percent of parliamentary seats are held by women, and 79.4 percent of adult women have reached a secondary or higher level of education compared to 91.7 percent of their male counterparts. For every 100,000 live births, 18 women die from pregnancy related causes; and the adolescent fertility rate is 2.3 births per 1000 live births. Female participation in the labor market is 50.1 percent compared to 72.0 percent for male (Table 10

However, according to the Global Gender Gap Index (WEF, 2012)\(^9\), which examines the gap between men and women in four fundamental categories - economic participation and opportunity, educational attainment, health and survival, and political empowerment, Korea ranks 108 out of 135 countries. Especially, the rank of the Economic and Participation and Opportunity sub-index is 116 reflecting low female to male ratio in ‘labor force participation’ (0.73), ‘wage equality to similar work’ (0.54), ‘estimated earned income’ (0.44), ‘legislators, senior officials and managers’ (0.11), and ‘professional and technical workers’ (0.69).

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\(^9\) The index is designed to measure gender-based gaps in access to resource and opportunities in each country.
Table 10. Korea’s GII for 2011 relative to selected countries and groups

<table>
<thead>
<tr>
<th></th>
<th>GII value</th>
<th>GII Rank</th>
<th>Maternal mortality ratio</th>
<th>Adolescent fertility rate</th>
<th>Female seats in Parliament (%)</th>
<th>Population with at least secondary education (%)</th>
<th>Labor force participation rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sex</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Korea</td>
<td>.111</td>
<td>11</td>
<td>18</td>
<td>2.3</td>
<td>14.7</td>
<td>79.4</td>
<td>91.7</td>
</tr>
<tr>
<td>Japan</td>
<td>.123</td>
<td>14</td>
<td>6</td>
<td>5.0</td>
<td>13.6</td>
<td>80.0</td>
<td>82.3</td>
</tr>
<tr>
<td>France</td>
<td>.106</td>
<td>10</td>
<td>8</td>
<td>7.2</td>
<td>20.0</td>
<td>79.6</td>
<td>84.6</td>
</tr>
<tr>
<td>Very high HDI groups</td>
<td>.224</td>
<td>-</td>
<td>16</td>
<td>23.8</td>
<td>21.5</td>
<td>82.0</td>
<td>84.6</td>
</tr>
</tbody>
</table>

Source: UNDP, Human Development Report 2011, Republic of Korea, P.3 Table B

Sex ratio at birth (female/male) is 0.93 which positions its rank at 121, while both the rank of the ‘literacy rate’ and the ‘health life expectancy’ is 1 reflecting high female to male ratio - 1.0 and 1.09. Korea’s gender gap in median earnings of full-time employees is 38.9 in 2009, which is highest among the OECD 26 average of 15.8, even though the trends in gender wage gap are decreasing from 51.8 percent in 1985 to 38.5 percent in 2005\(^\text{10}\). Average earning of females as a percentage of males of tertiary education in 35-44 age cohort is 84 in 2007, which is higher than that of the OECD average 71(OECD. 2012b).

4) Regional inequality

Regional disparities and polarization have also been major concern for Korea, as during the period of rapid industrialization and export-led growth. Seoul metropolitan area and Seoul - Busan development belt have attracted the most share of the national investment. Governments tried to promote balanced regional growth through curbing the concentration of population and economic activities in the capital region and promoting equal opportunities in terms of income, jobs and education in all regions. Measures included the designation of greenbelts to prevent Seoul’s urban expansion; the imposition of taxes; restriction on the number of universities and students in the capital region; relocation of government institutions to the province; and the transfer of power from the central government to local governments. However, government efforts to check the growth of capital region or to promote regional development have not been very successful. The population in the capital region continued to rise, as the benefits of large markets overwhelmed policy actions. Some people argue that attention should be given to the increasingly important role of big cities in the era of globalization and knowledge-based economies (Gill and Kharas, 2007).

In the mean time, per capita GRDP has grown rapidly in the areas outside the capital region. Some region notably Chungcheong and Gyeongsang, have higher per capita GRDP than capital

\(^{10}\) The gender wage gap is unadjusted and is calculated as the difference between median earnings of men and women relative to median earnings of men.
region (Table 11). With the wide-spread increase in economic activities, the gap in economic and living conditions between the capital region and other areas has narrowed significantly over the decades. The index\textsuperscript{11} for economic and living conditions for Capital region to other areas was 2.9 in 1970, but it decreased to 1.3 already in 1990 (Joh, Jung Jay et al., 2010).

Table 11. Gross Regional Domestic Product (GRDP) by Region

<table>
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<tr>
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<tbody>
<tr>
<td>Capital region</td>
<td>11.5</td>
<td>5.8</td>
<td>3.9</td>
<td>6.7</td>
<td></td>
</tr>
<tr>
<td>Gangwon</td>
<td>6.8</td>
<td>4.1</td>
<td>2.6</td>
<td>4.4</td>
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</tr>
<tr>
<td>Chungcheong</td>
<td>10.4</td>
<td>6.7</td>
<td>5.0</td>
<td>7.4</td>
<td></td>
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<tr>
<td>Jeolla</td>
<td>9.8</td>
<td>5.5</td>
<td>2.6</td>
<td>5.6</td>
<td></td>
</tr>
<tr>
<td>Gyeongsang</td>
<td>9.9</td>
<td>6.1</td>
<td>3.3</td>
<td>6.2</td>
<td></td>
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<tr>
<td>Jeju</td>
<td>8.7</td>
<td>5.2</td>
<td>2.6</td>
<td>5.3</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>10.5</td>
<td>5.9</td>
<td>3.7</td>
<td>6.4</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Per capita GRDP (capital region=100)</th>
<th>Regions</th>
<th>1985</th>
<th>1990</th>
<th>2000</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital region</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Gangwon</td>
<td>80.0</td>
<td>82.7</td>
<td>85.9</td>
<td>86.5</td>
<td>113.8</td>
</tr>
<tr>
<td>Chungcheong</td>
<td>72.8</td>
<td>80.3</td>
<td>95.5</td>
<td>95.7</td>
<td>102.8</td>
</tr>
<tr>
<td>Jeolla</td>
<td>66.9</td>
<td>75.8</td>
<td>91.9</td>
<td>95.7</td>
<td>75.7</td>
</tr>
<tr>
<td>Gyeongsang</td>
<td>79.8</td>
<td>83.7</td>
<td>96.4</td>
<td>102.8</td>
<td>75.7</td>
</tr>
<tr>
<td>Jeju</td>
<td>76.2</td>
<td>74.7</td>
<td>81.1</td>
<td>75.7</td>
<td>101.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>85.0</td>
<td>89.1</td>
<td>97.0</td>
<td>101.0</td>
<td></td>
</tr>
</tbody>
</table>

Note: 1) Capital region = Seoul + Gyeonggi + Incheon.  2) Chungcheong = North and South Chungcheong + Daejeon. 3) Jeolla = North and South Jeolla + Gwangju. 4) Gyeongsang = North and South Gyeongsang + Busan + Ulsan + Daegu

Source: Korea National Statistical Office (http://www.kosis.kr), (Joh, Jung Jay et al., 2010), P.219.

3. The Human Capital

So far, inclusiveness has been addressed in terms of productive employment opportunity and inequalities. Thus, the attention has primarily been on the demand side of the achievement of equitable access to opportunities and outcomes. However, even if inclusive growth is defined narrowly, the supply side of such access, that is, whether the working population possesses the human capabilities necessary to be productively employed to take advantage of available economic opportunities needs to be addressed.

Good outcomes in nutrition, health, and education are development goals in themselves, because they directly improve people’s lives. But they also equip people for productive

\textsuperscript{11} The index was calculated based on eight factors (i.e., employment in manufacturing sector, the service sector and professional services, number of college students, number of physicians, amount of per capita deposits, number of flush toilets, and availability of clean water supply), with the national average set at 100 (KRIHS, 1999: 46).
employment and job opportunities - and through this channel, human capital drives economic and social advances. Together, nutrition, health, and education combine to form human skills and abilities that link powerfully to productivity growth and poverty reduction.

1) Health

Mortality rates are often used to identify vulnerable populations. Moreover, they are among the indicators most frequently used to compare socioeconomic development across countries. The under-five mortality rate\(^\text{12}\) of Korea was 100.3 in 1962, but it has decreased continuously to 4.9 in 2010 - which is less than OECD average of 8.1. Per capita total expenditure on health has continuously increased from 480 dollar in 1995 to 2,023 dollar in 2010. Total expenditure on health as a percentage of GDP also has continuously increased from 3.8 percent in 1995 to 6.9 percent in 2010. As government’s national health insurance coverage expands, general government expenditure on health as percentage of total government expenditure increased to 12.4 percent in 2010 from 7.1 percent in 1995 (Table 12).

Table 12. Expenditure on Health

<table>
<thead>
<tr>
<th></th>
<th>1995</th>
<th>2000</th>
<th>2005</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Per capita total expenditure on health (PPP, int. US$)</td>
<td>480</td>
<td>771</td>
<td>1,291</td>
<td>2,023</td>
</tr>
<tr>
<td>Total expenditure on health as a percentage of GDP (%)</td>
<td>3.8</td>
<td>4.5</td>
<td>5.7</td>
<td>6.9</td>
</tr>
<tr>
<td>General government expenditure on health as percentage of total government expenditure (%)</td>
<td>7.1</td>
<td>9.7</td>
<td>11.3</td>
<td>12.4</td>
</tr>
</tbody>
</table>

Source: WHO, Republic of Korea, country statistics

During the past five decades Korea’s ‘life expectancy at birth’ increased greatly. It indicates the number of years a newborn infant would live if prevailing pattern of mortality at the time of its birth were to stay the same throughout its life. It was 53 years (male - 51.9, female - 57.2) in 1963, but it increased to 80.8 years (male - 77.4, female - 84.3) in 2010 - which is a little higher compared to OECD members’ average of 79.3 years.

2) Education

Generally, education can empower men and women by providing them with better economic opportunities. Most of the Korean strived to improve human ability through education since the

\(^{12}\) Under-five mortality rate is the probability per 1,000 that a newborn baby will die before reaching age five, if subject to current age-specific mortality rates.
human capacity is the major determinant for higher income and social upgrading. Parents have higher educational desire for their children’s better future achievements. The expansion and improvement of primary and secondary education contributed to attaining a more equal income distribution. So, Korea’s high level of education contributed not only to its rapid economic growth but also to equitable income distribution. OECD (2011) commends Korea that economic growth promoted social progress, creating a virtuous circle of rising living standards for an increasingly healthy and well-educated labor force, thus favoring further prosperity increases.

Net primary school enrollment rate was already 96.5 percent in 1971, whereas net secondary school enrollment rate was 36 percent. Secondary education aims at laying the foundations for lifelong learning and human development, by offering more subject- or skill-oriented instruction. But, by both demand and supply side emphasis of education, net secondary school enrollment rate has increased continuously to 64.9 percent in 1979, 94.2 percent in 2002, and 96 percent in 2010—which is above the OECD member’s 87.7 percent. Almost 80 percent of the students passing high school enroll for tertiary education and the country’s education spending is among the highest in OECD countries (Figure 3).

Figure 3. Infant mortality rate, Secondary school enrollment rate, and Life expectancy

Source: databank.worldbank.org/data/home.aspx

In 2011, 72.5 percent of high school graduates advanced to tertiary education, but in recent years only about half of university graduates have found regular jobs. Consequently, 25 percent of tertiary graduates under age of 30 in 2009 were inactive, engaged in neither in employment, nor in education, double the OECD average of 12.5 percent.
Korea has expanded public outlays for early childhood education and care (ECEC) by broadening the eligibility for tuition subsidies from bottom 10 percent of households in the income distribution to the lower 70 percent. Nevertheless, spending on pre-primary education was only 0.2 percent of GDP in 2008, the second lowest in the OECD area (OECD. 2012a).

Korean students have achieved high performances in Reading, Mathematics, and Science in PISA, but widening gab in private tutoring results gab in SAT scores. Private tutoring expenditure accounts 2.1 percent of GDP while public education expenditure accounts 4.2 percent of GDP, which is low compared to OECD average of 5.2 percent in 2007.

4. Social Protection

ADB usually incorporates social protection as an additional dimension of its inclusive growth strategic framework. ADB has defined it as “the set of policies and programs designed to reduce poverty and vulnerability by promoting efficient labor markets, diminishing people’s exposure to risks, and enhancing their capacity to protect themselves against hazards and the interruption/loss of income.” Social protection is defined as comprising five major kinds of activities: labor market policies and program, social insurance programs, social assistance programs, micro/area-based schemes, and child protection. Among the labor market programs, direct employment generation (microenterprise development and public works), labor exchanges and other employment services, and labor legislation (including minimum wage, wage levels, health and safety, etc.) are included, but skills development and training are excluded unless targeted at particular groups. Microfinance is seen as an important aspect of social protection in the micro/area-based schemes.

1) Social spending

Social spending in Korea is low when compared to OECD countries. Korea has second lowest level of public social spending next to Mexico as 9.4 percent compared to OECD average of 22.1 percent in 2009. In particular, public social spending in Korea was lower than the OECD average in each of the following major areas: health care, pensions, and income support to the working-age population such as unemployment benefits. And both family- and old age-related expenditures of Korea rank at relatively low.

But, public social spending tripled its share of GDP to 9.4 percent in 2009, from 2.8 percent in 1990. It increased at an 11 percent annual rate in real terms between 1990 and 2009, the fastest in OECD area. Especially, health, family, active labor market, and unemployment related expenditure increased rapidly since the 1997-98 Asian financial crisis. Public social expenditure in percentage of total general government expenditure also doubled to 28.4 percent in 2009 from 14.4 percent in 1990 (Table 13).

13 ADB, Social protection Strategy, P.13, Manila, 2001
Table 13. Public social expenditure by major categories in percentage of GDP

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>2.8</td>
<td>3.2</td>
<td>4.8</td>
<td>6.5</td>
<td>9.4</td>
</tr>
<tr>
<td></td>
<td>(3.1)</td>
<td>(3.7)</td>
<td>(5.7)</td>
<td>(7.2)</td>
<td>(10.3)</td>
</tr>
<tr>
<td>old age</td>
<td>0.6</td>
<td>1.1</td>
<td>1.3</td>
<td>1.5</td>
<td>2.1</td>
</tr>
<tr>
<td>health</td>
<td>1.5</td>
<td>1.4</td>
<td>2.2</td>
<td>3.0</td>
<td>4.0</td>
</tr>
<tr>
<td>family</td>
<td>0.0</td>
<td>0.1</td>
<td>0.1</td>
<td>0.3</td>
<td>0.8</td>
</tr>
<tr>
<td>active labor</td>
<td>0.0</td>
<td>0.0</td>
<td>0.4</td>
<td>0.1</td>
<td>0.4</td>
</tr>
<tr>
<td>market</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>0.2</td>
<td>0.4</td>
</tr>
<tr>
<td>unemployment</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: OECD, StatsExtracts. [www.oecd.org/els/social/expenditure](http://www.oecd.org/els/social/expenditure). ( ) public and mandatory private social expenditure in percentage of GDP

Besides its low level, Korea’s social spending is not well targeted, as only a quarter of total cash benefits from government go to the poorest 20 percent of the population. The problem of poor targeting is partly due to blind spots in coverage, particularly among the self-employed and non-regular workers (OECD, 2012a).

According to the analysis of Elekdag (2012), Korea’s social spending gap with respect to the OECD average narrows to about 3.4 percentage point instead of 11.7 percent point considering the low unemployment rates, low dependency ratios, and per capita income levels of Korea compared to other OECD countries. He suggests that social spending can promote sustainable longer-term growth in Korea, by focusing on three related challenges: (i) increasing labor market participation against the backdrop of rapidly aging population, (ii) reducing duality in the labor market, and (iii) boosting productivity in the service sector.

2) Social assistance

The Basic Livelihood Security Program (BLSP) - Korea’s major welfare program provides cash and a package of in-kind benefits, including housing, medical and educational benefits, to those living under the absolute poverty line. Although BLSP benefits have increased at a double-digit rate, they amounted to only 0.9 percent of GDP in 2009. Benefits are provided to only 3 percent of population, half of those below the absolute poverty line and far below the 15 percent households living in relative poverty.

The earned income tax credit (EITC) is another important tool for reducing poverty. Korea introduced this in-work tax credit in 2008, targeting the 7.4 million daily and temporary workers. The government estimated that only 0.6 million households (8.1% of targeted workers) received the EITC in 2009, with total payment of KRW454 billion (0.04% of GDP). The average payment is thus around US$680 per household in 2009. Given the average wage of the 5.8 million non-regular workers is around KRW16 million per year, there would be large potential recipients.
3) Pensions

Public spending on old-age benefits was 1.6 percent of GDP in 2007, a quarter of the OECD average, reflecting the fact that the National Pension Scheme (NPS) was introduced in 1988. Only one-fifth of the elderly receive pensions, which are only partial. The basic Old-Age Pension System, introduced in 2008, provides assistance to elderly people who meet the income and asset criteria. At present, around 70 percent of the elderly receive benefit, which is set at only 5 percent of the average wage, implying that the benefit spreads out resources very thinly over a large segment of the older population (OECD. 2012a).

Beginning in 2028, retirees will begin to receive NPS benefits, although the replacement rate will be only 40 percent, well below the OECD average of 58 percent (OECD, 2011). In addition to low replacement rate, 30 percent of the working-age population did not contribute to public pension programs in 2010, even though participation is mandatory. And lack of transparency about income of self-employed and family workers limit their contributions.

4) Health care

The National Health Insurance (NHI) coverage of medical treatments has been limited, as it focused initially on achieving universal coverage of the population. Meanwhile, the volume of health care has been restrained by co-payments that are highest in the OECD area. Consequently, the private sector’s share of health spending was 41 percent, the fourth highest in the OECD area. High out-of-pocket payments are inequitable and regressive because they do not depend on the income, resulting in inequality in the economic burden of illness, boosting poverty and reducing necessary health care.

In 2010, around 40 percent of non-regular workers were covered by the NPS, NHI, and the Employment Insurance System (EIS). More than half of employees at firms with less than ten workers are not covered by any of the three major social security systems, compared to only 4.6 percent at firms with more than 100 workers (Table 14)(OECD. 2012a). In 2010, 30 percent of the working-age population did not contribute to public pension programs, even though participation is mandatory.

Table 14. Participation rates of employees in the NPS, NHI and ELS

<table>
<thead>
<tr>
<th>Share of employees participating in</th>
<th>Total (%)</th>
<th>By firm size (number of workers)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>1-9</td>
</tr>
<tr>
<td>All three programs</td>
<td>64.5</td>
<td>39.2</td>
</tr>
<tr>
<td>One or two programs</td>
<td>5.4</td>
<td>5.3</td>
</tr>
<tr>
<td>None</td>
<td>30.1</td>
<td>55.5</td>
</tr>
<tr>
<td>Total (%)</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

5. Financial exclusion and Microfinance

Financial development may not automatically lead to the poor having greater access to finance provides justifications for public sector interventions in the forms of various microfinance schemes and SME credit programs. Theoretically, there are good reasons why the availability (and cost) of credit may be more adverse for smaller enterprises and the informal sector. Fixed costs associated with loan appraisal, supervision, and collection are nontrivial. From the perspective of lender, it is preferable to provide large amount of credit to large enterprise than small amount of credit to small enterprises.

SMEs and microenterprise are also less able to provide collateral against their loans, further diminishing lenders’ incentive to lend to them when considering adverse cost implications associated with possible loan defaults. Because of these, governments often put in place policies that support various forms of Microfinance Institutions (MFIs) and SME credit programs to ensure that a widest possible segment of population have access to finance (Juzhong, et al., 2009). Supporting microfinance schemes and small and medium enterprise credit programs has also been a key focus of development assistance.

Microfinance programs of various forms have been implemented in many countries in the past few decades to help reduce poverty by improving access to finance by the poor. Many impact evaluation studies find that microfinance programs have positive impacts on households’ economic and social welfare and contribute to poverty reduction. For example, Zaman (2004), Montgomery (2005), Cotler and Woodruff (2007) have found positive impacts of microfinance on poor households. But, a number of more recent studies using the experiment approach have produced mixed results on the effectiveness of microfinance programs in poverty reduction (Coleman 2006, Banerjee et al. 2009, Roodman and Morduch 2009).

Some have questioned whether access to finance is the only constraint that microenterprises and SMEs face. Other constraints might be included such as access to information and markets, access to skills, technologies, and land, and other market failures. It is widely believed that to make microfinance and the SME credit programs work better, these nonfinancial constraints also need to be addressed by the government. It also been argued that for microfinance to benefit the ultra-poor, programs should be targeted and designed, and should be supplemented with training, social endowment programs, and other safety net measures following an integrated approach (Juzhong et al. 2009).

Household debt and bipolarization of capital supply are big challenges to Korean economy as well as to inclusive growth. As of end-March 2011, Korea’s household debt reached KRW801.4 trillion with annual growth rate of 13 percent on average since the Asian financial crisis, exceeding the nominal GDP growth rate of 7.3 percent over the same period. Korea’s both debt of households and Non-profit institutions serving households (NPISHs) as a percentage of gross disposal income (GDI) and private sector debt as a percentage of GDP are 150.85 and 245.78
respectively as of 2010, which are higher compared to the G7 countries\textsuperscript{14}. Household debt has continuously increased to KRW 911.9 trillion as of end 2011 with recording household debt to GDP and GDI are 89.2 percent and 163.7 percent respectively. According to the “2011 Household finance Survey”, 62.8 percent (1,099 thousand households) of total 1,750 thousand households has household debt with median amount of KRW30.8 million.

Around 1.96 million people is estimated to have difficulty accessing to loans from financial institutions in Korea (Lee, Soonho, 2011). However, 7 to 8 million persons, about one-fifth of the adult population, are not eligible for bank loans by lack of appropriate collateral or credit guarantee. Most of them are low-income households or low-credit ratings (7-10) individuals. There are 1.5 million National Basic Livelihood Security (NBLS) recipients and 4 million next-upper low income households who are excluded from the NBLS because of their 1.0 - 1.2 times higher income than minimum cost of living\textsuperscript{15}. In addition, the Korean government considers those households with annual income less than KRW 40 million as potential clients for financial supports even though they are 5 or 6 credit ratings persons.

Therefore, Korea has to respond to increasing household debt problems and at the same time to ensure low-income households’ financial inclusion - which is an important gateway to social inclusion. Korean government announced several financial policy measures on household debt and financial supports to disadvantaged people aiming to keep household debt growth at a manageable pace, to enhance the soundness of household debt, and to strengthen consumer protection. And especially as measures to ensure low-income households’ access to loans, government pronounced expansion of resources for the microcredit programs, extension of repayment period for low-income borrowers, and strengthening other supportive measures in order to ease their financial burden (FSC, 2011).

1) Smile Microcredit Bank

The bipolarization of capital supply is enabling easy access to low interest capital for corporations and individuals with high credit ratings, but aggravating capital accessibility for the people with lower credit ratings. The Microfinance Foundation was created at March 2008 according to the “Act of Establishment of Microfinance Foundation to help the unprivileged with financial supports by initiative of the Lee Myung-bak administration. And it reorganized and expanded into the Smile Microcredit Banks at September 2009. The dormant account deposits & insurances of financial institutions and donations from six leading multinationals (Samsung, Hyundai, LG, SK, POSCO and LOTTE) and five key domestic banks (Kookmin Bank, Shinhan Bank, Woori Bank, Hana Bank, Industrial Bank of Korea)\textsuperscript{16} are used to establish the Smile

\begin{itemize}
  \item \textsuperscript{14} Canada146.46 (198.54), France 96.06 (218.50), Germany 90.47 (170.05), Italy 85.19 (188.45), Japan 121.33 (237.04), UK 158.11 (223.28), USA 121.41 (211.29) as of 2010, (OECD statistics)
  \item \textsuperscript{15} Minimum cost of living per month(2012): 1person household -KRW553,354  2 persons – KRW942,197 3 persons – KRW1,218,873  4 persons – KRW1,495,550 (US$1,360).
  \item \textsuperscript{16} Total fund is KRW 1,172 billion (dormant deposit; 398.4, dormant insurance; 192.3, donations;581.3) as of 2011.
\end{itemize}
Microcredit Bank with primary business aim to provide very small business loans (microloans) to people who find it difficult to use financial institutions, who lack collateral, or are in poverty. Designed to spur entrepreneurship among those in the low-income/low-credit category with little to no collateral and help them start business, Smile Credit bank not only supplies funds but also conducts business management consultation. The participating multinationals and banks have their own microcredit branches along with the regional branches of the Smile Microcredit Bank.

Potential clients of the Smile Microcredit Bank are individuals of low credit ratings, 7-10 class or low-income households who are NBLS recipients and the next-upper low income households. According to the Korea Credit Bureau (KCB), about 6.5 million is belonging to 7-10 credit rating class, which is 16 percent of total credit rating individuals (42 million) in 2011. Annual interest rate is 2 ~ 4.5 percent, which is lower than the interest rate for the superior clients of financial institutions. Maximum amount of loan varies from KRW5 million for the unregistered business owners to KRW70 million for funds to start a franchise. Accumulated total loan from the beginning (2008.7) to the end of October, 2012 is KRW713.4 billion in 83,046 individuals with average loan of KRW8,590 thousand (US$7,800) (Table 17).

Indirect support is provided to individuals in the low-income bracket through social welfare organizations such as the Social Solidarity Bank, the Joyful Union, and the Happy World Welfare foundation, and through social enterprises such as Work Together Foundation. Smile Microcredit Bank assists low-income individuals in purchasing an insurance policy for their children, and supports the purchase of insurance policies by welfare facilities for the disabled. Microcredit is provided to low-income and small business owners who need emergency funds for accidents, disease and disasters through the Credit Consulting & Recovery service. Smile Microcredit Bank also launched the business of providing small loans to traditional markets in connection with local governments. The bank provides financial resources to merchant associations of traditional market as a kind of group loan with zero interest rate. A merchant association independently decides on manages loan conditions based on set guidelines.

2) Sunshine Loan

Sunshine Loans are commerce-based, but government guaranteed loans from cooperatives and savings banks, started at July 2010. Sunshine loan providers are many commercial financial firms such as community credit cooperatives, community unions, mutual savings banks, agricultural, fisheries, and forest cooperatives. Therefore, the Sunshine loan is a common loan brand which loan with 10 percent level interest rates to low-income/low-credit rating individuals who usually borrow in 30 ~ 40 percent. The participating financial institutions loan to non-registered small business owners, temporary workers, and farmers who belong to 6 - 10 credit scores or earn annual income of less than KRW26 million on the condition of payment guarantee up to 95 percent by the credit guarantee foundations. So, the financial institutions risk only 5 percent on their loans. Maximum annual interest rates are 9.04 percent for cooperative financial
institutions and 10.69 percent for savings banks, which is well below the maximum annual interest rate of 39 percent for private money lenders.

Types of the loan are business operation fund (KRW20 million), new business fund (KRW50 million), switching loan (KRW30 million) for all relevant clients, and emergency fund (KRW10 million) for temporary workers. An accumulated total loan from beginning to October 2012, is KRW2,288.9 billion to 258,119 individuals with average loan of KRW8,870 thousand. Among the financial institutions, community credit cooperatives account 34.5 percent, agricultural cooperatives account 27.7 percent, credit unions account 23.4 percent, savings banks account 12.7 percent, fisheries cooperatives account 1.3 percent, and forest cooperatives 0.5 percent respectively in terms of loan amount (FCS, 2012).

3) New Hope Loan

Commercial banks launched New Hope Loan at November 2010, which is expanded version of “Hope Loan” started in 2009. The objective of New Hope Loan is for client-tailored loan to low-income/low-credit ratings individuals and to more wide range of lower income households based on specific loan process. The 16 commercial banks (nationwide and regional) and specialized banks are providers of this 5 years limited period microcredit product. New Hope loan includes the next-upper low-income group as application qualification and applies lower interest rate than before. Therefore, 5-10 credit ratings individuals with annual income less than KRW40 million could apply for the loan as well as any individuals with annual income below KRW30 million. Maximum amount of the loan is KRW20 million and annual interest rate of each case is determined in range of 11 ~ 14 percent by each bank’s own loan assessment process. Interest rate reduction favor is applied to faithful repayment borrowers and individuals in low-income households. Types of the loan are livelihood expense and business operation fund. An accumulated total loan from December 2010 to September 2012 is KRW 3,019.2 billion to 344,624 individuals with average loan of KRW 8,760 thousand. Low-income (below KRW 26 million) and low-ratings (7-10) individuals account 74.6 percent of the total loan, which is satisfactory level.

Table 17. Microcredit Programs for Low-income/Low –rating persons

<table>
<thead>
<tr>
<th></th>
<th>Smile Microcredit Loan (Micro-insurance excluded)</th>
<th>Sunshine Loan (common brand)</th>
<th>New Hope Loan</th>
<th>Switching Loan (loan modification)</th>
</tr>
</thead>
</table>


### Microfinance Providers or Credit guarantee Institutions

<table>
<thead>
<tr>
<th>Providers</th>
<th>Smile Microcredit Bank: 162 (76 companies, 53 banks, 33 Regional branches)</th>
<th>Mutual savings bank, Community unions and Cooperatives (3,750)</th>
<th>Commercial Banks, Specialized Banks (16)</th>
<th>KOMCO Credit Recovery Fund (credit guarantee)</th>
</tr>
</thead>
</table>

### Application Qualification (Individual/household) (KRW)

- **Credit ratings: 7-10**
- **Low income households**

- **Credit ratings: 6-10**
  - Income ≤ 40 million
  - Income ≤ 26 million
  - Small business owner
  - Farmers
  - Temporary workers

- **Credit rating: 5-10**
  - Income ≤ 40 million
  - Income ≤ 30 million

### Annual interest rate, %

- **2.0 ~ 4.5**
- Cooperatives: 9.04
- Savings banks: 10.69
- **11.0 ~ 14.0**
- **8.0 ~ 12.0**

### Maximum Loan limit (KRW)

- **Operation fund:** 20 million
- **New business fund:** 70 million
- **Non-registered business owner:** 5 million

- **Emergency fund:** 10 million
- **Business operation fund:** 20 million
- **New business fund:** 50 million
- **Switching loan:** 30 million

- **20 million**
- **30 million**

### Accumulated Total Loan (KRW)

- **713.4 billion**
- **83,046 cases (2008.7 – 2012.10.31)**

- **2,288.9 billion**
- **258,119 cases (2010.7.26 -2012.10.31)**

- **3,019.2 billion**
- **344,624 cases (2010.11.18-2012.9.30)**

- **1,349.3 billion**
- **130,140 cases (2008.12.18 -2012.10.31)**

### Average Loan (KRW)

- **8,590 thousand**
- **8,870 thousand**
- **8,760 thousand**
- **10,370 thousand**

### Delinquency rate, % (2012.9)

- **5.2**
- **9.6**
- **2.6**
- **8.5**

* National Basic Livelihood Security recipients and household income is less than 1.2 times of the Minimum Cost of Living set by the government. KRW: Korean currency unit, Won (2011 average exchange rate: US$ 1.00 = KRW 1,108), ** For Sunshine loan and Switching loan, the rates are reimbursement rates of the credit guarantee institutions.


4) Switching Loan
Switching loan is a loan modification program that helps indebted low-income/low-credit ratings households (individuals) to switch their high-interest loans borrowed from money lenders, mutual savings banks, and other non-bank financial institutions to low-interest loans and to provide loan brokerage services tailored to low-income households’ needs. In order to ease the burden of high interest payment, KAMCO Credit Recovery Fund provide 100 percent guarantee for the loans so that borrowers can switch their over 20 percent high-interest loans to loans with 8.0 ~ 12.0 percent interest rate. Low-income individuals with annual income less than KRW 26 million or 6 -10 credit ratings individuals with annual income less than KRW 40 million could apply the switching loan at the KAMCO Fund. Maximum amount of loan guarantee is decided according to the current amount of high-interest loan under limit of KRW 30 million. An accumulated total loan from the beginning on December 2008 to October 2012 is KRW 1,349.3 billion to 130,140 individuals with average loan of KRW 10,370 thousand.

Total accumulated loan of above 4 major microcredit programs is KRW 7,370.8 billion and total recipients are 815,929 persons as of October 2012. However, recent slowdown of the real sector economy and rising household debt amounting KRW 934 trillion, 89.3 % of GDP in 2011, cause continuous increasing of the delinquency rates of the microcredit programs. The delinquency rates for the Smile Microcredit and New Hope loan are 5.2 percent and 2.6 percent respectively as of September 2012. Even though the delinquency rates of those also are increasing trend from 2.5 percent and 1.2 percent as of June 2011, they are still not bad considering 11.3 percent delinquency rate of the household debts of the savings banks as of June 2012. But, the reimbursement rates of the Sunshine and Switching loans by the credit guarantee institutions are 9.6 percent and 8.5 percent respectively as of September 2012, which are high and increasing trend because of the worsening economic conditions and weakness of repayment ability.

In sum, Korea’s microfinance programs are mainly microcredit programs to low-income/low-credit ratings individuals for business purpose. Saving and insurance products are only small fraction of the programs. Non-profit organizations such as the Smile Microcredit Bank and its many affiliating organizations, saving banks, community unions and cooperatives, commercial and specialized banks, and credit guarantee institutions are participating in the programs. All types of loan are individual base, not group loan. Smile Microcredit Bank supply loan fund to traditional market merchants’ association and social welfare institutions, but they still loan and manage it in individual base. Collateral or personal credit guarantor is not required for the loans except credit guarantee institutions’ credit guarantee with small amount of fee.

III. Policy Implications for Inclusive growth
1. Economic and Social Policies

Ali and Zhuang (2007) argue that given that inclusive growth focuses on both creating economic opportunity and ensuring equal access, an effective inclusive growth strategy should have three policy pillars: (i) high, efficient, and sustained growth to create productive jobs and economic opportunity; (ii) social inclusion to ensure equal access to opportunity- investing in education, health, and other social services to expand human capacity especially disadvantaged, and eliminating market and institutional failures and social exclusion to level the playing field; (iii) social safety nets to mitigate the effects of transitory livelihood shocks and to prevent extreme poverty. Finally, all three policy pillars need to be supported by good governance and institutions.

Lee Myung-bak administration started policy initiatives for inclusive growth: (i) Fair Society initiative (2010.8) • Presidential initiative for fair society • equal opportunity, fair competition, rule of law (ii) Commission on Shared Growth (2010.9) • Non-government organization • Win-win growth for large companies and SMEs (iii) Presidential Commission on Social Cohesion (2009.12) • Fair and transparent policy recommendations for conflict settlement.

1) Economic growth and productive employment

Korea has achieved inclusive growth in terms of high economic growth, high per capita income, and transformation of industrial structure. However, Korea has to continue sustainable growth on facing rapid population aging and expected down trend in productivity in the future. Under condition of the upward shares of the service sector in GDP (58% in 2010) and in total employment (76% in 2010) is expected to continue, addressing the downward trend of productivity in service sector is very important for inclusive growth. Labor productivity growth in services decelerated from an annual rate of 2.6 percent during the 1980s to 1.2 percent between 1997 and 2007, in contrast to nearly 9 percent growth in manufacturing since 1990. Productivity in services fell from 76 percent of that in manufacturing in 1997 to 60 percent in 2005, the largest gap in the OECD area, where productivity in manufacturing and services is roughly equal (Jones, 2009). The productivity gap widened more to 53 percent in 2008, which is far below OECD average 87 percent. This implies that more well-developed services can contribute a lot to whole productivity increase and economic growth as well. The central challenge for Korea in the post-industrial phase is thus to overhaul and upgrade its service sector so that a productive, high value-added, modern service sector can become a engine of growth (Park and Shin, 2012b)

Studies suggest that strengthening competition through regulatory reform, upgrading competition policy and promoting structural transformation to post-industrial economy policies, more R&D expenditures, and lowering barriers to trade and FDI can increase the level and rate of productivity growth by stimulating business investment and promoting innovation ( Nicolletti and Scarpetta.2005, Jones. 2009, Park and Shin.2012b). Enhancing competition and business
environments in key services sectors such as telecommunications, financial services, and business services are very essential. In addition, government should provide fiscal and other incentives to promote high value-added services such as design at the beginning of the global value chain (GVC) and marketing and branding at end of GVC. And so-called MICE (Meeting, Incentive tourism, Convention, and Exhibition) industries should be developed as new areas of service sector in Korea. The government’s 2009 plan to develop services included healthcare, education, green financing, software and tourism.

The amount of labor input in economic activities is one of the key factors for economic growth, and it depends on the number of productive population, participation rate, employment rate, and average working hours. Korea’s exceptionally fast population aging by lowest fertility rate will result the country at the second oldest by 2050. The labor force participation rates for women and youth are very low compared to OECD countries. And average working hours is decreasing trend as with other advanced countries.

Therefore, increasing the female and youth participation rate and youth employment rate are important for inclusive growth. Studies suggest that expanding the availability of affordable, high-quality child care, promoting the use of maternity and parental leave, encouraging family-friendly workplaces and reducing labor market dualism to increase the female participation rate. For increasing youth participation rate and employment rate, improvement of the quality of vocational education and upgrade the quality of tertiary education are suggested (OECD. 2012b).

Korea has two challenges in terms of the employment status. The first is high share of non-salary workers, and most of them are small business owner of the self-employed in traditional service areas with low productivity. The second is high share of non-regular workers and their low wage and social insurance coverage. Indeed, non-regular workers earned 57 percent as much as regular workers in 2010, and only around 40 percent of non-regular workers were covered by NPS, NHI and employment insurance system (EIS) (OECD. 2012b). The structural weakness in Korean labor market is closely associated with growing income inequality, lack of social protection, and gender inequality.

The problems of high share of the self-employed small business owner - overcrowd markets, new start-ups by senior groups, high debt burden, should be handled with policy measures of decreasing its share itself. The problems are related to those of the service sector with low productivity, tax and social welfare systems including insufficient pension system, and mandatory retirement system etc.. Kim Sun-Bin(2012) suggests i) restructuring, ii) control entry, and iii) support to create dynamic self-employment environment; Realizing economies of scale and high added value by establishing cooperatives and networks , nurturing knowledge service industries, and fostering innovative small businesses. Improve the mandatory retirement system and promote reemployment and social safety net to curtail involuntary self-employment. Provide social jobs suitable for seniors, support for career change, and setting up a self-employment tax deduction system and voluntary unemployment insurance registration system to control entry.
And to promote stability and rehabilitation of livelihood for the self-employed, diverse financial policy support and microfinance measures are suggested (P.11-12). Innovation should be fostered by a pro-competitive business environment providing ready access to information, essential business services, and finance.

Labor market dualism create serious equity problems as a significant portion of the labor force works in precarious job at relatively low wages and with less protection from social insurance. OECD studies show that stricter protection for regular worker have a higher incidence of temporary employment (Grubb et al., 2007). Reducing dualism requires weakening the incentives that encourage firms to hire non-regular workers. OECD (2012b) suggests relaxing employment protection for regular workers, increasing the coverage of non-regular workers by the social safety net, and expansion of training opportunities for non-regular workers to enhance their employment prospects. The solution of the non-regular workers’ problem hinges on how and to which degree we can properly harmonize the security and flexibility of employment. So, one of the legal issues related to non-regular workers is the possibility and limit of the employment enforcement. Korea has to take more active measures to increase the security of employment for non-regular workers.

2) Inequality and Poverty

Economic and social inequalities are increasing even though there is no absolute poverty in Korea. Functional distribution of GDP for wage is deteriorating since 1995. Vertical income inequalities measured by Gini coefficient, relative poverty ratio, and 5th ratios show worsening trends as well as horizontal equalities.

The causes of inequality and of changes in equality can be various. Globalization and financial liberalization, technology advancement, economic reform and industrial restructuring, market imperfection, government policies and institutions in distribution and others can be presented as causes. From the policy-making perspective, it is useful to differentiate inequality due to differences in individual circumstances from that due to difference in individual efforts (Romer, 2006). Inequalities due to differences in circumstances often reflect social exclusion arising from institutional weaknesses, market failures, or policy deficiencies, and thus should be addressed through public policy intervention (Zhuang, 2008).

Real wage growth lagging behind productivity gains is one of causes of falling labor share in GDP. In developed countries, the share of labor income fell by 5 percentage points or more between 1980 and the onset of the global financial crisis in 2008 (UNCTAD,2012). The share of wage in GDP in Korea also decreased to 50.6 percent in 2010 from 52.7 percent in 1995. Real wage rise rate recorded negative in 2008 and 2009, and the real minimum wage rate increased only 1.4 percent in the period of 2008 -2011, which was lowest since it introduced in 1988.

17 Real minimum wage rate increased 3.1% in 1993-97 (Kim young sam ), 5.5% in 1998-2002(Kim Dae jung), 7.7 % in 2003-2007(Roh mooHyun).
Rebalancing income distribution must be a leading policy objective for Korea. Higher wages and lower inequality can stimulate demand and output growth, which in turn can provide incentives for increased investment in productivity capacity, with attendant effects on employment creation and productivity gains.

Government should resist the mantra of “flexible labor market” and instead enact active income policies. A comprehensive income policies linking wage and productivity growth and including legal minimum wages and a tight social safety net for poor families would favor investment dynamics and monetary stability (UNCTAD, 2012). Flexible labor market policy should be at least accompanied with corresponding well developed social safety net programs, so-called flex-security policies. Leveling-up the minimum wage level should be enacted considering the low real rise rate in the past years. Legal minimum wages and their regular adjustments can provide an important reference for wage negotiations in the private sector.

Korea’s income inequality before taxes and transfers was relatively good because of the “shared-growth” until mid-1990s. However, Korea’s relative poverty rate after taxes and transfers was high and has increased even more in late 2000s. This shows that Korea’s taxes and transfers system has not been effective in reducing inequality and relative poverty. And as explained above, labor market dualism and the low wages of non-regular workers are key factors in the rise of inequality.

Korea’s low tax burden - 25.1% of GDP 2010 compared to 33.2 percent of OECD average - will need to rise to finance the expansion of welfare programs and to reduce inequality. However, pro-growth tax policy calls for limiting any increase in the tax wedge on labor income and keeping a low corporate tax rate. Base-broadening of subject to income tax from around one half at present toward the OECD average of more than 80 percent, and raising the value-added tax (VAT), which is 10 percent, far below the OECD average of 18 percent are suggested. Using the VAT to raise revenue while relying on the earned income tax credit, which was introduced in 2008, and well-targeted social spending to achieve income distribution goals would be the best approach (OECD, 2012b). Environmental taxes and raising the property-holding taxes are other options to raise revenue.

In terms of Gender Inequality Index – a composite measure reflecting inequality in achievements between women and men-, Korea ranks 11 out of 146 countries. However, according to the Global Gender Gap Index of the WEF, Korea ranks 108 out of 135 countries. Women’s labor force participation rate is low, and most of working women are concentrated in low-paying service sector as non-regular workers. Gender gab in median earnings of full-time employees is highest among the OECD countries, and discrimination against women in hiring and promotion (“glass ceiling”) exist even though equal employment law has been enacted since 1987. The gender inequality is multidimensional.
It is inter-related with labor market dualism and employment structure, cultural background, human capacity, welfare system including child care and health, education, law and institutions, and many others. Despite the obvious gains Korean women have made in education, labor force participation, and access to formal power, discrimination against women persist today.

Regional inequality has been major concern for Korea. But the gap in economic and living conditions between regions has narrowed significantly by various regional development policies, even though there exist discrepancies among regions in income and living conditions. According to the 2012 household finance and welfare survey results, average household income of Ulsan city is KRW 50.90 million is 1.5 times higher than KRW 33.76 million of Gangwon province. Korea is pursuing regional balanced development strategy through various policies including the construction of new administration capital city and innovation cities with dispersing the public institutions and SOEs regionally.

3) Human Capital

Health and education are themselves are directly related to people’s wellbeing. In addition, they build human capital that boosts productivity growth. Korean health status has improved greatly during the past 5 decades. Most health indicators including the mortality rate, the life expectancy rate, and total expenditure on health as percentage of GDP have increased. Korea’s healthy life expectancy is 71 years which ranks at 30th in the world.

However, health risk factors such as alcohol liters (14.8) and smoking percent (male -53.3) show high risks ranking 7th and 15th respectively in 2010. And as major cause of death, stomach cancer (21.36 per 100,000population) and liver cancer (19.52), and suicide (20.05) are high compared to other countries recording 10th, 10th and 13th in the world respectively. So, Korea should tackle more to reduce those risks of health and causes of death. Not only for physical health but only for mental health of population, government should increase expenditure on various mental treatment programs including addiction to drugs, games and internet.

Korea has achieved high level of education which contributed to its rapid economic growth and to its relatively equitable income distribution. The economic growth promoted social progress, creating a virtuous circle of rising living standards for an increasingly healthy and well-educated labor force, thus favoring further education increases. However, overemphasis on tertiary education and its mismatch between education and employment, low government supports for ECEC, and high dependence on private out of school education are major issues to be handled.

OECD(2012b) suggests following: • Improve the quality of vocational education, thereby helping to resolve the issue of overemphasis on tertiary education and mismatch problems that limit the labor participation rate for young workers. • upgrade the quality of tertiary education by

\footnote{18 www.worldlifeexpectancy.com, 2012-12-20}
ensuring adequate accreditation procedures, enhancing transparency and promoting internationalization. • enhance the contribution of higher education to innovation by promoting links with government and business research institutes and increasing the share of government R&D funding that is allocated competitively. • Expand investment in ECEC to achieve the objective of free education for children aged three to five and upgrade its quality, in part by mandatory accreditation and by relaxing fee ceilings on private childcare centers. Indeed, outlays per student in kindergarten were only 37 percent of that in primary and secondary schools, well below the OECD average of 70 percent. After school study and care programs should be also expanded to reduce the burden of private education expenditure of households.

4) Social Protection

Korea’s social spending is low and is not well targeted albeit it has been increasing at fastest rate in OECD area since 1997. The BLSP- Korea’s social assistance program - benefits are provided only 3 percent of population, which should be expanded to include more low-income households. Relaxing the eligibility conditions for the BLSP is a priority. There are about 4.3 million next-above low-income households who earn less than 1.2 times of the minimum standard of living. The EITC is another important tool for low-income working people. But only 8.1 percent of targeted 7.4 million workers received the EITC, and average payment is relatively small. The goal should be extend the EITC include a large share of low-income workers.

The limited scale of pension provision and social welfare for elderly explain why nearly one-half of the elderly live in relative poverty, the highest proportion among OECD countries. Considering that 37.5 percent of the elderly were in absolute poverty with income below the minimum cost of living (Bae, 2011), a larger benefit that is more targeted at low-income elderly would be more effective in reducing poverty. Both replacement rate and participation rate in NPS is low compared to OECD area. But the pension amount is expected to increase fast by rapid population aging. Therefore, contributions have to be increased to finance even this low replacement rate with gradual raising of the pension eligibility age from its current level of 60. Measures to increase compliance with the NPS and to enhance transparency about income are needed. And NPS should be supplemented by greater private savings for retirement including company pension schemes. To further accelerate the transition to company pensions, the government should remove tax preferences for retirement allowances (OECD, 2012b).

NHI’s Weak coverage of medical treatments and high out-of-pocket payments of patients are inequitable and regressive. Ceilings on co-payments were introduced and revised to take of patients’ ability pay, co-payments are still high. It is important to ensure that ceilings on patient copayments are as low enough and NHI’s coverage of treatments are as wide enough to provide adequate access to care for low-income households and those with chronic health problems. Korea also needs to increase the efficiency of its health-care system to offset the intensifying spending pressure (OECD, 2012b).
Labor market dualism creates serious equity problems as a significant portion of the labor force works in precarious jobs at relatively low wages and with less protection from social insurance. Reducing dualism requires weakening the incentives that firms to hire non-regular workers. One priority is to relax employment protection for regular workers. A second priority is to increase the coverage of non-regular workers by the social safety net, thus reducing the gap in labor costs. Finally, training opportunities for non-regular workers should be expanded to enhance their employment prospects (OECD, 2012b).

According to the social protection index (SPI) study of ADB (Baulch et al. 2008), Korea achieves second highest value of SPI (1.03) next to Japan (1.55) in Asia with an overall coverage level of 77 percent of key target groups. Korea’s target group coverage is relatively low in social assistance (58%), disabled (73%), children (52%), and microcredit (0.0%) area. This implies that more target-oriented social protection programs are needed. Korea’s HDI index ranks at 15 out of 187 countries in 2011, but inequalities in income and education area should be ameliorated.

5) Microfinance Programs

Finance matters for inclusive growth because it determines the realization of economic opportunities of individuals and firms. There is a consensus that financial development plays a pivotal role in facilitating economic growth. Financial development can reduce poverty through economic growth indirectly and the poor and disadvantaged are benefiting directly from accessing financial services.

Inclusive financial systems allow broad access to the poor and disadvantaged to finance services without price or non-price barriers to their use. Financial access enables them to save and borrow for building assets, investing in education and business, and thus for improving their livelihood. There is strong correlation between inequality in the use of formal accounts and general income inequality.

In Korea, the bottom 40 percent income group has relatively lower percentage (89.3%) of an account at formal institution compared to total adults, and the share of those who borrow from family and friends is 17 percent which is higher compared to G7 countries. Korea faces bipolarization in financial access between high credit rating groups (1-5) and low credit rating groups (6-10). Around 1.96 million people is estimated to have difficulty accessing loans from financial institutions. Therefore, Korea has introduced microcredit programs for low-income/low credit ratings individuals – which are also important for social protection.

Role of microcredit in Korea is different from developing countries. The microcredit programs aim to contribute the expansion of financial access opportunities and rehabilitation of livelihood for the low-income/low-credit rating individuals including the self-employed. The impact of Korea’s microcredit programs could be analyzed in terms of business results (profit, income), asset creation, empowering human capacity (entrepreneurship, human capital, women),
repayment rates, delinquency rate or reimbursement rate, saving and consumption, change of living attitudes (work hour, trust), and social participation in the supply side.

There are risks for moral hazard of borrowers in the Korea’s microcredit programs. How to solve the moral hazard problem is one of key issues in microcredit programs in Korea. Korea has long tradition of community cooperative compacts called “Kye” for various purposes, such as pooling capital and lending it to members in rotation. And there have been several systems with similar role as microfinance such as community credit cooperatives and credit unions in Korea. But they have several different aspects from the microcredit programs. Especially they are not exclusive for the low-income households. However, cooperative spirit of the previous community based systems should be adopted and encouraged in the current microcredit programs. In addition, individual customer tailored microcredit product should be guided, and clients be managed with various incentive systems and flexibility, education for entrepreneurship, and risk management system including just execution of rule of law to prevent moral hazard problem. As incentives for faithful clients, interest rate favor, flexibility of repayment within certain range, matching fund for asset accumulation, compensation for education are some examples.

Some effects of microfinance can lead to deterioration in the situation of a segment of poor people. Three effects can contribute to an increase in disparities: over-indebtedness, excessive attention paid to micro-entrepreneurship and the financing of high loan amounts using the savings of the poorest. Participation in the programs as microfinance providers, supporters, and volunteers is important not only for the success of the program but also for the social capital formation and social cohesion. Participation of people is itself a process of inclusive growth.

An access to finance is not the only constraint that microenterprises and SMEs face. Other constraints, such as access to market, access to know-how and technologies, and other market failures, are included. An ADB study (2009) on SME argues that (i) access to finance is often only one of the major constraints to growth of these enterprises, and other constraints include weak access to new technologies and dynamic markets; (ii) if SMEs were to increase productivity and employment, they must innovate, including adopting new technology and diversifying into new markets; and (iii) government should assist SMEs, and such assistance should include providing information services on technology and markets, vocational training, and technical support services, and fostering linkages between SMEs and large enterprises, in addition to facilitating access to finance, that is, following an integrated approach or “credit plus approach.”

IV. Concluding Remarks
Korea has achieved rapid economic growth and social development in the last 5 decades, and has become one of the industrialized high-income countries from a poor agrarian country. Korea also has achieved political democratization as well as certain degree of “shared growth” until late 1990s. However, currently Korea faces two fundamental challenges: First, Korea has to sustain economic growth in face of rapid population aging and lowering potential growth rate. Second, Korea has to achieve social cohesion by ameliorating income inequality and economic bipolarization, and by strengthening social protection.

To respond these challenges, this paper adopt the inclusive growth as Korea’s economic growth strategy: (i) create efficient productive economic opportunities and ensure broad access to process and outcomes (benefits) equitably, (ii) reduce income inequality and economic bipolarization, (iii) improve human capacities especially in health and education, and (iv) strengthen social protection. Each of these are complements and functions a factor of virtuous circle for the prosperous and harmonious society in Korea.

Economic growth itself does not necessary reduce inequality and bipolarization. Flexible labor market is not mantra for full-employment. So, government’s active income policies are needed through wage determinations, taxes, and subsidies. Social spending can promote sustainable longer-term growth in Korea by focusing following areas: (i) increasing labor market participation especially for women and youth by improving working environments, (ii) reducing duality in labor market by improving the status of non-regular workers and self-employed business owners, (iii) boosting productivity in the service sectors. Social spending can increase labor force participation, human capacity, social cohesion, and domestic demand.

Around 76 percent of total employment is employed in service sector, and most of SMES are in service sector. Productive employment creation is most related to service sector and SMEs. Therefore, boosting productivity in service sector is important for jobs creation and reducing economic inequality. Enhancing competition and business environments in key services sectors are very essential. Design and MICE industries should be developed as new areas of service sector in Korea.

Rebalancing income distribution should be one of the leading policy objectives for Korea. Higher wages and lower inequalities can stimulate demand and output growth with attendant effects on employment creation and productivity gains. The minimum wage and EITC schemes should be improved. Social safety nets including BLSP and old age pension program should be strengthened.

Financial development matters for economic growth and poverty reductions. But, Korea faces bipolarization in financial access, and around 2 million people is estimated to have difficulties in financial access. Korea has introduced microcredit programs for low-income/low credit ratings individuals. Korea’s microcredit programs have characteristics of ‘individual base lending’, ‘no-personal guarantee or collateral’, and ‘low interest rates’, and ‘relatively large
amount of loan.’ Korea’s microfinance programs should be improved and reduce the risk of moral hazard.

In sum, Korea needs inclusive growth strategy for sustainable development with social equity and trust. Inclusive growth policies should be pursued in avoiding the risks of moral hazard and unfairness. Any policies could not compensate for deteriorating the spirit of ‘honesty’, ‘self-help’, and ‘cooperation’ of people.

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