

Policy Implications for Inclusive Growth in the Republic of Korea*

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Korea has achieved rapid economic growth and social development with relatively less inequality in the last five decades. Since 1997, however, income inequality and polarization in the economy have increased while the potential growth rate has 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 five inclusive growth indicators — productive employment, income inequality and poverty, human capital, social protection, and financial exclusion. In addition, this paper explains microcredit programs in Korea and suggests policy implications for inclusive growth to respond to those challenges.

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1. INTRODUCTION

1.1. Background and Objective of the Study

Korea has achieved rapid economic growth and social development in the last five decades and has become one of the world's industrialized high-income countries after evolving from a poor agrarian nation. Korea's success in combining economic growth and egalitarianism is paralleled by few other countries. Korea is often commended for its exceptional success in achieving 'growth with equity' or 'shared growth' (OECD, 2011). Its per capita GDP has increased about 22 times from US\$103.9 in 1962 to US\$22,590 in 2012, and its per capita GDP in purchasing power parity increased to 30,722 dollars in 2012. Gini coefficients have shown relatively equal income distribution and there was no significant change in its size during the period of 1965-1993. Korea's Human Development Index (HDI) under the UNDP stood at 15 out of 187 countries in 2011 with its life expectancy rising from 52.4 years in 1962 to 80.8 in 2010. Its political structure also changed from an authoritarian one to a fully functioning democracy, so both industrialization and democratization were realized in Korea within half a century.

However, after a long period of rapid economic growth, Korea ran into serious economic difficulties in the 1997 Asian financial crisis. The Korean government implemented drastic reforms to correct the structural weakness inherent in the economy. As a result of the economic reforms of the corporate, financial, and public sectors and the labor market, the Korean economy strengthened global competitiveness. 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 the face of a rapidly aging population and lowering potential growth rate. Second, Korea has to achieve social cohesion by ameliorating inequality, bipolarization, and disparity in economic and social areas.

The Asian Development Bank identifies inclusive growth as its first development agenda, with environmentally sustainable growth and regional

integration as its long term strategic framework for 2008-2020 (ADB, 2012). 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 members of society can participate in and benefit from growth.

Inclusive growth is also one of three growth dimensions of the ‘Europe 2020’, accompanying smart and sustainable growth (European Commission Communication, 2010). The European Commission defines inclusive growth as fostering a high employment economy delivering economic, social, and territorial cohesion. More concretely, it means (a) raising Europe’s employment rates — more and better jobs, especially for women, young people, and old workers, (b) helping people of all ages anticipate and manage changes through investment in skills and training, (c) modernizing labor markets and welfare systems, and (d) ensuring that 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 the backdrop of Korea’s current socio-economic challenges and inclusive growth definitions and indicators, this study aims to suggest policy implications for inclusive growth in the Korean economy. For this purpose, after defining the inclusive growth of various organizations, Korea’s inclusive growth achievements and problems during the past decades will be analyzed based on inclusive growth indicators in section 2. In section 3, Policy implications for the inclusive growth of Korea will be suggested. The paper concludes in section 4.

1.2. Definition of Inclusive Growth

Even though there is no agreed upon definition of inclusive growth, the concept is understood to refer to ‘growth coupled with equal opportunities’.

¹⁾ http://ec.europa.eu/europe2020/priorities/inclusive-growth/index_en.htm.

It focuses on creating opportunities and making these accessible to all, not just the poor. There is inclusive growth when all members of a society participate in and contribute to a 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 and Rauniar, 2010).

The ADB's inclusive agenda can be interpreted narrowly or broadly. The narrow interpretation implies a focus on economic growth and broader participation in the 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.

The International Policy Centre for the 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 terms of 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 ensures 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 in growth 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).

Inclusive growth is different from the OECD-DAC's 'pro-poor growth' in

²⁾ "What is Inclusive Growth?," International Policy Center for Inclusive Growth (www.ipc-undp.org).

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 that they affect growth but also to the extent they affect the well-being of the poor (Klasen, 2010).

We put emphasis 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. Increasing the 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. The equality of opportunity in terms of access to markets, resources, and unbiased regulatory environment for business and individuals is important.

The 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. The 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 and Lundstrom, 2009b).

Klasen (2010) defines 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 disadvantaged to participate in growth (the 'nondiscriminatory' aspect of growth); and (b) associates 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' an aspect of inclusive growth). Klasen suggests

more formally that 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) to be 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.³⁾ Lopez and Serven (2004) survey the empirical literature and conclude that macroeconomic stability as well as education and infrastructure-related policies seem to be win-win or 'super pro-poor' policies that have both a positive effect on growth and negative effect on inequality.

Inclusive growth links macroeconomic fundamentals such as macroeconomic stability and political stability with micro determinants such as investment in human capital, investment in physical infrastructure, tackling horizontal inequalities in basic service provision, discrimination by gender, ethnicity, religion etc., facilitating access to finance, and supporting broad-based skill development.

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 a 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 and Nino-Zarazua, 2012). The determinants are highly dependent on initial conditions such as level of income, poverty, and asset equality, as well as other factors such as geography, demography, governance, politics, social considerations, and a set of existing policies.

³⁾ See Deininger and Squire (1996), Ravallion (2001), and Dollar and Kraay (2002).

These differ not only among 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; (iv) social protection; and (v) financial inclusion.

2. THE STATUS OF INCLUSIVE GROWTH

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

2.1. 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 the 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 levels of labor productivity could be driven mainly by advances in a minority of economic sectors. The employment to population ratio is not

useful also since it gives no indication of the quality of employment. Thus, 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 a serious weakness in the monitoring and evaluation of such progress. In summary, a limited set of indicators is recommended for gauging the progress on achieving economic growth and generation employment, and expanding access to economic infrastructure (McKinley, 2010).

2.1.1. Economic growth

Korea has recorded a 5.79 percent average annual GDP growth rate during 1962-2010 in spite of the negative economic growth in 1980, 1997, and 2008. During 36 years from 1962 to 1997, in particular, Korea achieved an 8.01 percent average annual GDP growth rate. The average annual GDP growth rate per capita also registered 4.61 percent during the same period, recording a maximum 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

	1962-1979 (Park Jung-hee)	1980-1987 (Chun Doo-hwan)	1988-1992 (Roh Tae-woo)	1993-1997 (Kim Young-sam)	1998-2002 (Kim Dae-jung)	2003-2007 (Noh Mu-hyun)	2008-2012 (Lee Myung-bak)	1962-2012 Whole Period
GDP (%)	8.46	7.43	8.36	7.10	4.46	4.34	2.92	6.81
GDP per Capita (%)	6.20	6.09	7.30	6.02	3.72	3.90	2.34	5.43
Exports	25.59	13.46	7.10	17.34	11.02	13.20	4.86	16.39

Note: () represents the name of the president of Korea.

Source: World Development Indicators, databank.worldbank.org/data/home.aspx.

The GDP per capita (currency: US\$) increased from 104 dollars in 1962 to 22,590 dollars in 2012. Rapid growth narrowed the per capita income gap with the 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 growth fell further to 3.8 percent in 2009-2011.⁵⁾ It is expected to decrease to 2.8 percent in 2021-2030. Korea as an advanced industrialized economy has moved to the global technology frontier and has a rapidly aging population. Its contribution for trend labor productivity fell from about five percentage points to three and its contribution for 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). 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 the 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 underdeveloped service sector accounting respectively 39.4 percent and 39.3 percent in 1965. Korea pursued an export-led industrialization from early 1960s and recorded a remarkable average annual export growth rate of 16.4 percent during the 1962-2012 period. The 'First Five-year Economic Development Plan' 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.

However, the Korean government faced severe economic and political

⁴⁾ This is based on 2005 PPP exchange rates. Productivity is measured by GDP per hour worked.

⁵⁾ Shin (2012), p. 4.

Table 2 Share of GDP by Sector (%), 1965-2011

	1965	1979	1987	1992	1997	2002	2007	2011
Agriculture	39.4	20.9	10.8	7.7	5.4	4.0	2.9	2.7
Industry	21.3	36.0	41.5	41.3	41.1	36.2	37.1	39.2
(Manufacturing)	(14.3)	(24.3)	(30.2)	(26.6)	(26.6)	(26.2)	(27.3)	(31.2)
Service	39.3	43.0	47.8	51.0	53.4	59.8	60.0	58.1

Source: World Development Indicators, databank.worldbank.org/data/home.aspx.

environments involving increasing wage levels, with national self-defense gradually emphasizing the production of capital intensive ‘heavy and chemical industries’ as a major industry in the 1970s. The share of the manufacturing industry increased from 14.3 percent in 1965 to 24.3 percent in 1979. The share of heavy and chemical industries increased to 11.4 percent in 1971-1980 from 5.8 percent in 1961-1970, while the share of agriculture decreased to 20.9 percent from 39.4 percent during 1965-1979 (table 2).

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

Entering the 1980s, private enterprises’ research and development (R&D) programs developed and improved high-productivity manufacturing. These efforts gradually bore fruit, and the productivity gap with advanced industries narrowed significantly in the 1990s. Korea leads globally in manufacturing Liquid Crystal Displays, memory chips, and smart phones. It is the world’s largest shipbuilder and the 5th largest automobile manufacturer globally. 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 before rising to 30.5 percent in 2010, which is higher than its peer average

(18.3%).⁶⁾

2.1.2. Productive employment

The main instrument for a sustainable and inclusive growth is assumed to be productive employment. The ability of individuals to be productively employed depends on the opportunities that allow the full use of available resources as the economy evolves over time. The analysis therefore looks 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 the capacity of individuals, an in-depth employability analysis is needed. If the main problem is low productivity or lack of employment opportunities for individuals due to the limited demand for labor, an analysis of the bottlenecks in the business environment is necessary (Ianchovichina and Lundstrom, 2009a).

Labor force participation in economic activities is one of the key factors for economic growth. As for the labor force for the 15-64 age bracket, the participation rate is 65.4 percent which is below the OECD average of 72.3 percent in 2010. For women between the ages of 25 and 54, the rate was 62 percent in 2010, which was 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 trends as participation rates since the unemployment rates have been fluctuating within relatively small range during the 1963-2010 periods. However, the unemployment rate for youth is relatively high. The employment rate for the 15-64 age 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. The female employment rate is 22-30 percentage points

⁶⁾ Global Manufacturing Competitiveness Index 2013. Korea ranks 5th among 38 countries.

**Table 3 Number and Share in Total Employment by Sector
(Thousand, %) for Selected Years 1965-2012**

	1965	1970	1979	1987	1992	1997	2002	2007	2012
Total	8,112 (100)	9,617 (100)	13,602 (100)	16,354 (100)	19,009 (100)	21,214 (100)	22,169 (100)	23,433 (100)	24,681 (100)
Agriculture	4,742 (58.4)	4,846 (50.4)	4,866 (35.8)	3,580 (21.9)	2,667 (14.0)	2,286 (10.8)	2,069 (9.3)	1,723 (7.4)	1,528 (6.2)
Industry	840 (10.4)	1,337 (13.9)	3,209 (23.6)	4,602 (28.1)	5,042 (26.5)	4,564 (21.5)	4,259 (19.2)	4,031 (17.2)	4,120 (16.7)
Manufacturing	764 (9.4)	1,268 (13.2)	3,099 (22.8)	4,416 (27.0)	4,986 (26.2)	4,537 (21.4)	4,241 (19.1)	4,014 (17.1)	4,105 (16.6)
Service	2,530 (31.2)	3,395 (35.3)	5,527 (40.6)	8,172 (50.0)	11,301 (59.5)	14,365 (67.7)	15,841 (71.5)	17,679 (75.4)	19,033 (77.1)

Source: Statistics Korea (<http://kosis.kr>).

lower than that of males, even though it increased 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.

The rapid aging of the population has slowed the working population. The productive population covering individuals aged 15-64 increased in 1970-1995 by an average annual rate of 2.5 percent, but it decreased to 0.6 in 1996-2010. Actually the annual average increase rate of the core productive population aged 25-49 decreased to negative (-0.4%) in 2006-2010 from 2.8 in 1970-1995 even though the total number of employment increased from about 8.1 million in 1965 to 23.8 million in 2010.

The employment in agriculture decreased continuously from 58.4 percent in 1965 to 6.6 percent in 2010, while the employment in the service sector increased continuously from 31.2 percent to 76.4 percent during the same period. The employment in the manufacturing sector increased from 9.4 percent in 1965 to 27 percent in 1987, but it decreased continuously to 16.9 percent in 2010 (table 3).

The 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 Korean service sector's productivity (value-added/hours) relative to manufacturing in 2007 was about 60 percent compared to 90 percent in the 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. The service sector is important both in the employment and in the production share of GDP. During the period of 2001-2010, manufacturing jobs created per hundred persons were -4.5 which was the lowest among the peer countries.

2.1.3. Quality of employment

The status of a worker is an important measure of the quality of the employed person. Employed persons are composed of non-salary workers and wage and salary workers, and the former are composed of business owners with employees, without employee, and unpaid family workers. The share of non-salary workers was 69.3 percent in 1965 reflecting a high share of employment in agriculture (58.4%) in 1965. But its share continuously decreased to 28.2 percent in 2012 along with the decreasing share of agriculture during the same period. The share of the unpaid family workers decreased rapidly from 32.3 percent in 1965 to 5.1 percent in 2012. On the other hand, the share of wage and salary workers continuously increased from 30.7 percent in 1965 to 71.8 percent in 2012 reflecting the industrialization and structural changes in the Korean economy (table 4).

However, 28.8 percent of the national workforce is self-employed in 2010 which is fourth highest 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 the 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

Table 4 Employed Persons by Status of Worker (Thousand, %) for Selected Years 1965-2010

By Status of Workers ¹⁾	1965	1970	1979	1987	1992	1997	2002	2007	2012
Total Employed Persons	8,112 (100)	9,617 (100)	13,602 (100)	16,354 (100)	19,009 (100)	21,214 (100)	22,169 (100)	23,433 (100)	24,681 (100)
Non-salary Workers	5,500 (69.3)	5,872 (61.1)	7,124 (52.4)	7,163 (43.8)	7,099 (37.4)	7,810 (36.8)	7,988 (36.0)	7,463 (31.8)	6,969 (28.2)
Independent Business Owners	2,984 (37.0)	3,286 (34.2)	4,571 (33.6)	4,994 (30.5)	5,171 (27.2)	5,901 (27.8)	6,190 (27.9)	6,049 (25.8)	5,712 (23.2)
Unpaid Family Workers	2,516 (32.3)	2,586 (26.9)	2,553 (18.8)	2,169 (13.3)	1,928 (10.2)	1,908 (9.0)	1,797 (8.1)	1,413 (6.0)	1,251 (5.1)
Wage and Salary Workers	2,609 (30.7)	3,746 (39.0)	6,479 (47.6)	9,191 (56.2)	11,910 (62.7)	13,404 (63.2)	14,181 (64.0)	15,970 (68.2)	17,712 (71.8)
Regular Employees	-	-	-	-	6,838 (36.0)	7,282 (34.3)	6,862 (31.0)	8,629 (36.8)	11,097 (45.0)
Temporary Employees	-	-	-	-	3,300 (17.4)	4,236 (20.0)	4,886 (22.0)	5,172 (22.1)	4,988 (20.2)
Daily Workers	844 (10.4)	1,018 (10.6)	1,421 (10.5)	1,529 (9.4)	1,772 (9.3)	1,886 (8.9)	2,433 (11.0)	2,178 (9.3)	1,627 (6.6)

Notes: 1) employed persons = non-paid laborers + paid laborers, nonpaid laborers = business owners + unpaid family workers, business owners = business owners with employees + business owners without employee, paid laborers = full-time laborers + temporary laborers + one-day laborers.

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

financial services, business support, and housekeeping, the share of self-employed Koreans is lower than the OECD average (Kim, 2012). The share of temporary employees 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 the service sector.

A structural weakness in the Korean labor market is the severe growing inequality which is closely associated with the rising share of non-standard forms of work that involve lower pay, worsening working conditions, and lack of coverage by social insurance schemes compared to 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.

In 2010, the average wage of non-regular workers was 45 percent below that of regular workers, while their productivity was only 22 percent lower. In 2010, 38 percent of non-regular workers were covered by the National Pension Scheme, 41 percent by the 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 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) also increased from 0.4 percent of employment in 1981 to 4.4 percent in 2010, due to structural changes in the overall economy.

The share of the business owner without employee own-account workers 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 was driven primarily by firms' need for employment flexibility and lower wage costs including the savings on welfare costs. As a group, non-regular workers tended to be older, less educated, employed in SMEs, had short tenure, and work in the service sector. To be specific, 42 percent of female employees were in non-regular employment compared to 28 percent of males.

2.2. Inequality and Poverty

2.2.1. Functional income distribution

According to modern Keynesian theories, the functional income distribution strongly depends on political and economic factors. On the other hand, the neoclassical approach has treated the stability of functional income distribution as an empirical fact based on a strictly techno-economic explanation with the substitutable factor of production.

Table 5 Share of Wages in GDP in Selected Countries, 1970-2010

	1970	1975	1980	1985	1990	1995	2000	2005	2010
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

Note: Data refer to total compensation of employees as a percentage of GDP at factor costs.
Source: UNCTAD (2012b), p. 48.

The annual average growth rate of real wage in 1964-2008 was 6.3 percent of the high growth rates in the late 1960s and 1980s. The share of wages had shown an 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, 2012b). However, Korea's share of wage in GDP was 50.6 in 2010, which was significantly lower compared to other advanced countries even though it was higher than those of South American countries. Real wage growth lagging behind the productivity gains had been a salient feature of economic development in most countries. The shares of wage in GDP in the United States and other developed countries showed a decreasing trend since 1970 (table 5).

2.2.2. 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 the entire range. The poverty rate and the 5th income distribution ratio of the population are used to measure vertical inequalities in income distribution as

**Table 6 Income Distribution and Poverty Rates,
Selected Years 1992-2012**

	1992	1997	2003	2007	2012
Gini coefficient	0.245 (0.254)	0.257 (0.264)	0.270 (0.283)	0.295 (0.321)	0.285 (0.311)
Relative Poverty Rate (%)	6.5 (7.4)	8.2 (8.7)	10.6 (12.1)	12.9 (15.5)	12.2 (24.3)
5th Ratio	3.52 (3.71)	3.80 (3.97)	4.22 (4.66)	5.95 (6.05)	4.69 (5.79)

Notes: Urban households above 2 persons, disposal income base. () is market income base before transfers and taxes.

Source: Korea Statistics Office.

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 the Gini coefficient, relative poverty rate, and 5th income distribution ratio since 2003 (table 6).

In terms of the Gini coefficient, Korea's income distribution was not so bad compared to OECD countries even though its increasing trend was a problem. However, Korea's relative poverty rate after taxes and transfers for the entire population was 14.3 percent in 2006, ninth highest in the OECD, which increased even more to 15.2 in the late 2000 compared to the OECD average of 11.2 percent. Korea's 5th income distribution ratios also showed that income inequality had been deteriorating since 1997. The 5th ratio increased from 3.97 in 1997 to 6.02 in 2010,⁷⁾ then it decreased to 5.79 in 2012.

Most of the advanced OECD countries had a high level of income inequality before taxes and transfers compared to Korea, but tax and welfare systems had greater effects on income redistribution especially in France, Germany, and Sweden. The poverty rates before taxes and transfers for the OECD (26.3%) including those of advanced countries were also very high

⁷⁾ This is for urban households with over 2 residents (market income, before taxes and transfers), Korean Statistical Information Service (kosis.kr).

compared to that of Korea (17.5%) in the late 2000. These results showed that Korea's tax/benefit system was not effective in reducing inequality and poverty, even though Korea's income distribution before taxes and transfers was relatively more even compared to OECD countries. For example, Korea's Gini coefficient before taxes and transfers in the late 2000 was 0.344 compared to 0.457 for OECD average, and the poverty rate was 17.5 percent compared to the OECD average of 26.3 percent.

On average, Korean households received 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 constituted some 22 percent of income, and taxes paid some 29 percent of income (OECD, 2011). However, Korea introduced an Earned Income Tax Credit (EITC) in 2008, which would help better target the tax/benefit system for 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 the economic development in the 1960s, South Korea had already very equalized income and assets due to land reform and had totally destroyed the industrial facilities during the Korean War in 1950-1953. Its most important objective was an increase in income, therefore. Korea succeeded in the reduction of absolute poverty to 5 percent in mid-1980s from 23 percent in 1970.⁸⁾ Rapid poverty alleviation in Korea was brought about by a number of factors as follows (World Bank, 2004).

They are: (i) the President Park regime's strong leadership and commitment of economic development at the top its priorities; (ii) market economic system and outward-looking industrialization strategy; (iii) continuous enhancements of human resources and productivity through education; (iv) land reform in 1945-1950, the 'green revolution', and the

⁸⁾ Kwon (1998).

New Community Movement (NCM) for rural development in the 1970s; and (v) expansion of employment in the manufacturing sector by private entrepreneurship.

Despite Korea's high economic growth with relatively equal income distribution until mid-1990s, certain measures of inequality had been trending upward since the 1997 Asian financial crisis, indicating deteriorating socioeconomic conditions. There were 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 the economy, including a shift from high-paying jobs in manufacturing to lower-paying job in services. Labor market dualism, which resulted in large wage gaps between regular and non-regular workers, was another dimension of inequality (Elekdag, 2012). The low wages of non-regular workers had been a key factor in the rise in the Gini coefficient and relative poverty. According to a recent survey (Lee, 2011), 20 percent of non-regular workers were in relative poverty in 2010.

2.2.3. Gender inequality

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. The rank of the economic opportunity sub-index was specifically 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).

Sex ratio at birth (female/male) was 0.93 which positioned its rank at 121, while both the rank of the 'literacy rate' and the 'health life expectancy' was 1 reflecting high female to male ratio (-1.0 is to 1.09). Korea's gender gap in

⁹⁾ The index is designed to measure gender-based gaps in access to resource and opportunities in each country.

median earnings of full-time employees was 38.9 in 2009, which was the highest among the OECD 26 countries' average of 15.8, even though the trends in gender wage gap were decreasing from 51.8 percent in 1985 to 38.5 percent in 2005.¹⁰⁾ The average earnings of females as a percentage of males in tertiary education in the 35-44 age cohort was 84 in 2007, which was higher than that of the OECD average 71 (OECD, 2012b).

2.3. 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 employment and job opportunities. 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.

2.3.1. 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 rate¹¹⁾ of Korea was 100.3 in 1962, but it decreased continuously to 6.0 in 2010

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.

¹¹⁾ 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.

Table 7 Expenditure on Health

	1995	2000	2005	2011
Per capita total expenditure on health (PPP, int.US\$)	480 (1,554)	771 (1,974)	1,291 (2,491)	2,181 (3,174)
Total expenditure on health as a percentage of GDP (%)	3.8 (6.8)	4.5 (7.6)	5.7 (8.2)	7.2 (9.3)
General government expenditure on health as percentage of total government expenditure (%)	7.1 (15.5)	9.7 (16.2)	11.3 (18.3)	13.7 (18.2)

Note: () represents the figures of the Japan.

Source: World Health Organization, country statistics, Republic of Korea.

which was less than the OECD average of 8.1. Per capita total expenditure on health continuously increased from 480 dollars in 1995 to 2,181 dollars in 2012. Total expenditure on health as a percentage of GDP also continuously increased from 3.8 percent in 1995 to 7.2 percent in 2012. As government's national health insurance coverage expanded, general government expenditure on health as a percentage of total government expenditure increased to 13.7 percent in 2012 from 7.1 percent in 1995 (table 7).

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 the prevailing pattern of mortality at the time of its birth were to stay the same throughout its life. It was 53 years (51.9 for males, 57.2 for females) in 1963, but it increased to 80.8 years (77.4 for males, 84.3 for females) in 2010, which was a little higher compared to the OECD members' average of 79.3 years.

2.3.2. Education

Generally, education can empower men and women by providing them with better economic opportunities. Most Koreans have strived to improve human abilities through education since the human capacity is the major determinant for higher income and social upgrading. Parents have a higher desire for their children to be academically accomplished. The expansion and improvement of primary and secondary education contributed to

attaining a more equal income distribution. Thus, Korea's high level of education contributed not only to its rapid economic growth but also to equitable income distribution. OECD (2011) commends Korea for its economic growth's promotion of 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. However, by both demand and supply side emphasis on education, net secondary school enrollment rate increased continuously to 64.9 percent in 1979, 94.2 percent in 2002, and 96 percent in 2010, which was above the OECD member's 87.7 percent. Almost 80 percent of the students passing high school enrolled for tertiary education, which was the highest in OECD countries.

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 neither in employment nor in education, doubling 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 the 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 private tutoring results gap has widened 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 the OECD average of 5.2 percent in 2007.

2.4. Social Protection

ADB usually incorporates social protection as an additional dimension of its inclusive growth strategic framework. Social protection is defined as consisting of five major kinds of activities: labor market policies and programs, social insurance programs, social assistance programs, micro/area-based schemes, and child protection.¹²⁾ Among the labor market programs, direct employment generation, labor exchanges and other employment services, and labor legislation are included.

2.4.1. Social spending

Social spending in Korea is low when compared to OECD countries. Korea has the second lowest level of public social spending next to Mexico at 9.4 percent compared to the OECD average of 22.1 percent in 2009. In particular, public social spending in Korea is 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. Further, both family- and old age-related expenditures of Korea rank relatively low.

However, public social spending tripled its share of GDP to 9.6 percent in 2009, from 2.8 percent in 1990, even though it is less than half of 22.1 percent of the OECD-total (table 8). It increased to an 11 percent annual rate in real terms between 1990 and 2009, the fastest in the OECD area. In particular, health, family, active labor market, and unemployment expenditures increased rapidly since the 1997-1998 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.

Besides its low level, Korea's social spending is not well-targeted, as only a quarter of total cash benefits from the 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

¹²⁾ ADB (2011), p. 13.

**Table 8 Public Social Expenditure by Major Categories
in Percentage of GDP**

	1990	1995	2000	2005	2009
Total	2.8 (3.1)	3.2 (3.7)	4.8 (5.7)	6.5 (7.2)	9.6 (10.5)
▪ OECD-Total	17.6	19.5	18.9	19.7	22.1
Old Age	0.6	1.1	1.3	1.5	2.1
Health	1.5	1.4	2.2	3.0	4.0
Family	0.0	0.1	0.1	0.3	0.8
Active Labor Market	0.0	0.0	0.4	0.1	0.6
Unemployment	-	-	0.1	0.2	0.4

Note: () public social expenditure and mandatory private social expenditure in percentage of GDP.

Source: OECD.StatsExtracts (www.oecd.org/els/social/expenditure).

workers (OECD, 2012a).

However, according to the analysis of Elekdag (2012), Korea's social spending gap with respect to the OECD average narrows to about 3.4 percentage points instead of 11.7 percent point considering lower unemployment rates, low dependency ratios, and per capita income levels of Korea compared to other OECD countries.

2.4.2. 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 the population, half of it to those living below the absolute poverty line and far below 15 percent of 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 a total payment of KRW454 billion (0.04% of GDP). The average payment was thus around US\$680 per household in 2009. Given that the average wage of the 5.8 million non-regular workers is around KRW16 million per year, there will be large potential recipients.

2.4.3. 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 to 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 was mandatory. Further, the lack of transparency about the income of self-employed and family workers limits their contributions.

2.4.4. Health care

The National Health Insurance (NHI) coverage of medical treatments has been limited as it focused initially on achieving the 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 is 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 were not covered by any of the three major social security systems, compared to only 4.6 percent at firms with more than 100 workers (OECD, 2012a). In 2010, 30 percent of the working-age population did not contribute to public pension programs even though participation was mandatory.

2.5. Financial Exclusion

Household debt and bipolarization of capital supply are major challenges to the Korean economy as well as to inclusive growth. Around 1.96 million people are estimated to have difficulty accessing loans from financial institutions in Korea (Lee, 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 rating (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 1.0-1.2 times higher income than minimum cost of living.¹³⁾ In addition, the Korean government considers those households with an annual income of less than KRW 40 million as potential clients for financial supports even though they are 5 or 6 credit rating 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 and a valuable measure to ensure low-income households' access to loans and government-pronounced

¹³⁾ Minimum cost of living per month (2012): 1 person household: KRW553,354; 2 persons: KRW942,197; 3 persons: KRW1,218,873; 4 persons: KRW1,495,550 (US\$1,360).

expansion of resources for the microcredit programs (table 9).

The Smile Microcredit Bank was established in 2009 by the dormant account deposits and insurances of financial institutions and donations from six leading multinationals and five key domestic banks¹⁴⁾ with a 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 to start a business, Smile Credit bank not only supplies funds but also conducts business management consultation.

Sunshine Loans are commerce-based but government-guaranteed loans from cooperatives and savings banks and started on July 2010. Sunshine loan providers consist of various commercial financial firms such as community credit cooperatives, community unions, mutual savings banks, and agricultural, fishery, and forest cooperatives.

Commercial banks launched New Hope Loan on November 2010, which was the expanded version of 'Hope Loan' started in 2009. The New Hope Loan was a client-tailored loan meant for low-income/low-credit rating individuals and a wider range of lower income households based on specific loan process.

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 sum, Korea's microfinance programs are mainly microcredit programs for low-income/low-credit ratings individuals having business purpose. Saving and insurance products are only a small fraction of the programs. Non-profit organizations such as the Smile Microcredit Bank and its affiliated organizations, saving banks, community unions and cooperatives,

¹⁴⁾ Total fund is KRW1,172 billion (dormant deposit: 398.4; dormant insurance: 192.3; donations: 581.3) as of 2011.

Table 9 Microcredit Programs for Low-income/Low-credit Rating Persons

	Smile Microcredit Loan (Micro-insurance excluded)	Sunshine Loan (common brand)	New Hope Loan	Switching Loan (loan modification program)
Microfinance Providers or Credit Guarantee Institutions	Smile Microcredit Bank: 162 (76 companies, 53 banks, 33 Regional branches)	Mutual savings bank, Community unions and Cooperatives (3,750)	Commercial Banks, Specialized Banks (16)	KAMCO Credit Recovery Fund (credit guarantee)
Application Qualification (Individual/household) (KRW)	<ul style="list-style-type: none"> •Credit ratings: 7-10 •Low income households* 	<ul style="list-style-type: none"> •Credit ratings: 6-10 (Income ≤ 40 million) •Income ≤ 26 million - small business owners - farmers - temporary workers 	<ul style="list-style-type: none"> • Credit rating: 5-10 (Income ≤ 40 million) •Income ≤ 30 million 	<ul style="list-style-type: none"> • Credit rating: 6-10 (Income ≤ 40 million) •Income ≤ 26 million
Annual interest rate, %	2.0 -4.5	<ul style="list-style-type: none"> •Cooperatives: 9.04 •Savings banks: 10.69 	11.0-14.0	8.0-12.0
Maximum Loan limit (KRW)	<ul style="list-style-type: none"> • Operation fund: 20 million •New business fund: 70 million •Non-registered business owner: 5 million 	<ul style="list-style-type: none"> •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)	<ul style="list-style-type: none"> • 713.4 billion • 83,046 cases (2008.7-2012.10.31) 	<ul style="list-style-type: none"> • 2,288.9 billion • 258,119 cases (2010.7.26-2012.10.31) 	<ul style="list-style-type: none"> • 3,019.2 billion • 344,624 cases (2010.11.18-2012.9.30) 	<ul style="list-style-type: none"> • 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**

Notes: * National Basic Livelihood Security recipients and household income are 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 = KRW1,108), ** For Sunshine loan and Switching loan, the rates are reimbursement rates of the credit guarantee institutions.

Source: Korea Finance Service Commission (<http://www.fsc.go.kr>).

commercial and specialized banks, and credit guarantee institutions participate in the programs. All types of loans are individual-based, not group loan. Smile Microcredit Bank supplies 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 a small amount of fee for the Sunshine Loan.

3. POLICY IMPLICATIONS FOR INCLUSIVE GROWTH

3.1. Economic and Social Policies

Ali and Zhuang (2007) argue that given if 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 that expand human capacity especially that of the 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.

3.1.1. Economic growth and productive employment

Korea has achieved inclusive growth in terms of high economic growth, high per capita income, and industrial structure transformation. However, Korea has to maintain sustainable growth while facing rapid population aging and expected down trend in productivity in the future. Under the condition of the high shares of the service sector in GDP (58% in 2010) and in total employment (76% in 2010), addressing the downward trend of productivity

in the 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 was roughly equal. 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. 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 an engine of growth (Park and Shin, 2012).

Studies suggest that strengthening competition through regulatory reform, upgrading competition policy, promoting structural transformation to post-industrial economic policies, increasing 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 (Nicoletti and Scarpetta, 2005; Park and Shin, 2012). Enhancing competition and business environments in key service sectors such as telecommunications, financial services, and business services are essential. In addition, the government should provide fiscal and other incentives to promote high value-added services such as design at the beginning and the end of the global value chain. So-called Meeting, Incentive Tourism, Convention, and Exhibition (MICE) industries should be developed as new areas of service sector in Korea.

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 low fertility rate is predicted to make the country the second oldest by 2050. The labor force participation rates for

women and youth are very low compared to OECD countries. The average working hours is seeing a 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 policy measures such as 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 upgrading the quality of tertiary education are suggested (OECD, 2012b).

Korea has two challenges in terms of employment status. The first is the high share of non-salary workers, most of which are small business owners or the self-employed in traditional service areas with low productivity. The second is the high share of non-regular workers and their low wage and social insurance coverage. 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 the NPS, NHI, and employment insurance system (EIS) (OECD, 2012b). The structural weakness in the 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 are overcrowded markets, new start-ups by senior groups, and high debt burden, which should be handled with policy measures decreasing its share. The problems are related to those of the service sector with low productivity, tax, and social welfare systems including insufficient pension system, mandatory retirement system, etc. Kim (2012) suggests (i) restructuring, (ii) control entry, and (iii) support to create a dynamic self-employment environment.

To promote stability and rehabilitation of livelihood for the self-employed, diverse financial policy support and microfinance measures are suggested (pp. 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 creates serious equity problems as a significant portion of the labor force involved in precarious jobs giving relatively low wages and less protection in terms of social insurance. Stricter protection for regular workers has a higher incidence of temporary employment. 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 expanding 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. Thus, one of the legal issues related to non-regular workers is the possibility and limit of the employment enforcement. Policies should work to secure increased social insurance participation, greater human and career development opportunities and stable income for non-regular workers (Keum and Yi, 2013).

3.1.2. Inequality and poverty

Economic and social inequalities are increasing even though there is no absolute poverty in Korea. Functional distribution of GDP for wages has been deteriorating since 1995. Vertical income inequalities measured by the 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 differences in individual efforts (Roemer, 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 the 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, 2012a). 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 the lowest since it was introduced in 1988.¹⁵⁾ 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.

The government should resist adopting a 'flexible labor market' and instead enact active income policies. A comprehensive income policy linking wage and productivity growth including legal minimum wages and a tight social safety net for poor families would favor investment dynamics and monetary stability (UNCTAD, 2012a). 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 'shared growth' until the mid-1990s. However, Korea's relative poverty rate after taxes and transfers was high and had increased even more in the late 2000s. This shows that Korea's taxes and transfer system have not been effective in reducing inequality and relative poverty. As explained above, labor market dualism and the low wages of non-regular workers are

¹⁵⁾ Real minimum wage rate increased 3.1% in 1993-1997 (Kim Young-sam), 5.5% in 1998-2002 (Kim Dae-jung), and 7.7 % in 2003-2007 (Roh Moo-hyun). Minimum real wage is KRW4,580 in 2012.

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 an 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 the Gender Inequality Index, Korea ranked 11 out of 146 countries in 2011. However, according to the Global Gender Gap Index of the WEF, Korea ranked 108 out of 135 countries in 2011. Women's labor force participation rate is low, and most of the working women are concentrated in low-paying service sector as non-regular workers. Gender gap in median earnings of full-time employees is highest among the OECD countries, and discrimination against women in hiring and promotion (glass ceiling) exists even though an equal employment law has been enacted since 1987. 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 persists today.

3.1.3. Human capital

Health and education are themselves directly related to people's well-being. In addition, they build the human capital that boosts productivity growth. Korean health status has improved greatly during the past 5 decades.

Most health indicators including mortality rate, life expectancy rate, and total expenditure on health as a percentage of GDP have increased. Korea's life expectancy is 71 years, ranking 30th in the world in 2011.

However, Korea's health risk factors such as alcohol liters (14.8) and smoking percentage (male –53.3) show higher risks, ranking 7th and 15th respectively in 2010. As a major cause of death, stomach cancer (21.36 per 100,000 populations), liver cancer (19.52), and suicide (20.05) are high compared to other nations, with the country ranking 10th, 10th, and 13th in the world respectively.¹⁶⁾ Thus, Korea should work further to reduce those risks of health and causes of death. Improving the physical health as well the mental health of the population should be addressed by the government through increasing its expenditure on various mental treatment programs including addiction to drugs, games, and the Internet.

Korea has achieved a 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 support for early childhood education and care (ECEC), and high dependence on private out-of-school education are major issues to be handled.

OECD (2012b) suggests the following: (i) 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. (ii) upgrade the quality of tertiary education by ensuring adequate accreditation procedures, enhancing transparency, and promoting internationalization. (iii) 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. (iv) expand the investment in ECEC to achieve

¹⁶⁾ www.worldlifeexpectancy.com, 2012-12-20.

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 among households.

3.1.4. Social protection

Korea's social spending is low and is not well-targeted albeit it has been increasing at the fastest rate in the OECD area since 1997. Elekdag (2012) 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.

The basic livelihood security program (BLSP) benefits are provided to only 3 percent of the 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 which earn less than 1.2 times of the minimum standard of living. The earned income tax credit (EITC) is another important tool for low-income working people but only 8.1 percent of the targeted 7.4 million workers received the EITC, and the average payment was relatively small. The goal should be to extend the EITC to 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 are 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 national pension scheme (NPS) are 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 the 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. 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).

National Health Insurance (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 while co-payments were still high. It is important to ensure that ceilings on patient copayments are low enough and NHI's coverage of treatments are 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 provide 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 the ADB (Baulch *et al.*, 2008), Korea achieved the 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 15 out of 187 countries in 2011, but inequalities in income and education area should be ameliorated.

3.2. Microfinance Programs

Finance matters for inclusive growth because it determines the realization of the 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. Financial access enables them to save and borrow for building assets, invest in education and business, and thus improve their livelihood. There is a strong correlation between inequality in the use of formal accounts and general income inequality.

In Korea, the bottom 40 percent income group has a relatively lower percentage (89.3%) of an account at a 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 are 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.

The role of microcredit in Korea is different from developing countries. The microcredit programs aim to contribute to 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 Korea's microcredit programs. How to solve the moral hazard problem is one of the key issues in microcredit programs in Korea. Korea has a long tradition of community cooperative compacts called 'Kye' for various purposes such as pooling capital and lending it to members in rotation. There have been several systems with a similar role as microfinance institutions such as community credit cooperatives and credit unions in Korea but they exhibit several different features compared to the microcredit programs. They are not exclusive for the low-income households. However, the cooperative spirit of the previous community-based systems should be adopted and encouraged in the current microcredit programs. In addition, individual customer tailored microcredit products should be guided, and clients must 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 a certain range, matching fund for asset accumulation, and 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 poor. Participation in the programs as microfinance providers, supporters, and volunteers is important not only for the success of the program but also for 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 the 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 by 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’.

4. CONCLUDING REMARKS

Korea has achieved rapid economic growth and social development in the last 5 decades and has evolved from a poor agrarian country to one of the world’s industrialized high-income countries. Korea also has achieved political democratization as well as a certain degree of ‘shared growth’ until the late 1990s. However, Korea currently faces two fundamental challenges: First, Korea has to sustain economic growth in the 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 to these challenges, this paper suggests inclusive growth as Korea’s new economic growth strategy. It covers the following: (i) the creation of efficient productive economic opportunities, ensuring broad access to process and outcomes (benefits) equitably, (ii) the reduction of income inequality and economic bipolarization, (iii) the improvement of human capacities especially in health and education, and (iv) the strengthening of social protection. Each of these are complements and functions as a factor of virtuous circle for a prosperous and harmonious society in Korea.

Economic growth itself does not necessarily reduce inequality and bipolarization. Flexible labor market is not a mantra for full-employment. Thus, 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 on the following areas: (i) increasing labor market participation especially for women and youth by improving working environments, (ii) reducing duality in the labor market by improving the status of non-regular workers and self-employed business owners, and (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 concentrated in the service sector, and most of the SMES are in the service sector. Productive employment creation is most related to the service sector and SMEs. Therefore, boosting productivity in the service sector is important for job creation and reducing economic inequality. Enhancing competition and business environments in key service sectors are essential. Design and Meeting, Incentive Tourism, Convention, and Exhibition (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. However, Korea faces bipolarization in financial access, and around 2 million people are estimated to face difficulties in financial access. Korea has introduced microcredit programs for low-income/low credit ratings individuals. Korea's microcredit programs have such characteristics as individual base lending, no personal guarantee or collateral, low interest rates, and relatively large amount of loan. Korea's microfinance programs

should be improved and should reduce the risk of moral hazard.

In sum, Korea needs an inclusive growth strategy for sustainable development with social equity and trust. It will create a virtuous circle of economic growth and social cohesion as well as increasing aggregate demand and supply. However, inclusive growth policies should be pursued in avoiding the risks of moral hazard and disparity.

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