

ECONOMIC GROWTH AND INCOME DISTRIBUTION:  
A CASE STUDY OF KOREAN EXPERIENCE

by

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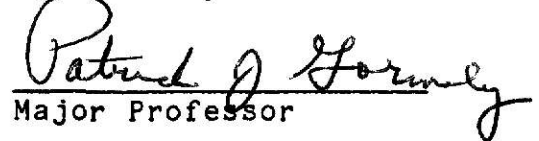
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## I. Purpose of Study

In recent years the topic of income distribution has been widely discussed in development economics. In the past aggregate growth was believed to solve every problem and most LDCs concentrated on achieving growth. But even when rapid growth has occurred many problems have arisen. Moreover, the problem is complicated by the question of trade-offs between growth, employment and equity.

Many studies have analyzed the contribution of economic growth to welfare and there have been conflicting views on the relationship between economic growth and income distribution in rapidly growing economies.

Though the general belief that economic development decreases the relative income of the poor is somewhat controversial, there is no question that the distribution of income--and especially the extent of poverty--has become a major issue both within the less developed countries themselves and within the international community. Many academicians, aid agencies and policy makers in less-developed countries have become aware of the severity of poverty and inequality and are now trying to deal with them.<sup>1)</sup>

The conspicuous failure of growth to eliminate poverty has led to a proliferation of studies on the cause of income

inequality in the course of economic development. Many factors have been found to be significantly related to income<sup>2)</sup> distribution.

The Korean economy has been characterized by the World Bank as "one of the success stories of international development". In addition to making dramatic progress in material and structural terms, Korea is also one of the few countries in the noncommunist world which has effectively sustained rapid growth without experiencing a significant<sup>3)</sup> deterioration in the pattern of income distribution.

However, in spite of its apparent success in achieving rapid growth with equality, the good relationship between economic growth and income distribution in Korea has recently been brought into question as a result of the experience of the 1970's.

Korea's Fifth Five-Year Economic and Social Development Plan(1982-1986) presented this emerging problem as<sup>4)</sup> following:

In the midst of the quantitative expansion of the economy, however, the basic needs of the people and the public facilities for daily life were left largely neglected, and income distribution distorted. Social and economic equity thus loomed large as an important issue of the Korean Economy, so beginning with the Fourth Plan, special attention has been paid to promoting social development.

Historically, there has been a definite relationship between economic growth and trends in the distribution of<sup>5)</sup> income within countries. Simon Kuznets presented the view

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that the level of economic development is a major determinant of the extent of income inequality. This has come to be known as the inverted-U shaped hypothesis--income inequalities widened in the early periods of growth of today's developed countries, and narrowed after higher levels<sup>6)</sup> of per capita income were achieved.

The pattern of greater relative income inequality in less-developed countries than in the developed countries was confirmed for eighteen countries in a subsequent paper by Kuznets. Since Kuznets's presentation, much research effort has gone into attempts to confirm or refute these findings.

There are two conflicting views of the effect of income distribution on economic growth. Until quite recently it was widely believed that a high degree of inequality in the distribution of income had a favorable effect on economic growth, through its impact on the saving rate. Thus some economists believe that there is a conflict between growth and income redistribution and hence a trade-off between them, because a policy of emphasizing income redistribution could<sup>7)</sup> reduce saving and thereby hinder economic growth.

None of the existing studies finds a statistically significant relationship between the level of inequality and the rate of short-run economic growth.

In summary, as much research suggests, the relationship between economic growth and income distribution might vary

from country to country, and growth itself does not determine a country's income distribution.<sup>8)</sup> Even though there are many cases of failure in income distribution in spite of economic growth, we can find some cases in which aiming at growth may sometimes achieve favorable redistributive results owing to growth and increasing employment.

We might tentatively conclude that an economic growth target (rapid or slow) can be achieved with a more equal distribution of income in developing countries with concomitant sound policy measures.

This paper aims at finding out the fundamental reasons why this favorable result might not occur, thereby shedding some light on development strategies and distribution.

First, this paper will review the Korean economic performance in terms of major indicators such as GNP, structural change in industrial origin, employment, export, and standard of living.

Secondly, the paper will examine distributive aspects of growth in Korea using the result of earlier studies and an official survey.

Thirdly, the paper will analyze the sources which contributed to the relatively equal distribution of income in the 1960's and early 1970's, focusing on the relevant historical background and policy measures.

Fourthly, an effort will be made to enumerate major

problems and to find out reasons for the deteriorating income distribution in the 1970's with regard to the role of development strategy.

And finally, an attempt is made to explore policy issues for more sound development which can harmonize economic growth and a more equal distribution of income.

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## II. Economic Growth in Korea

Korea's progress has been the result of a variety of mutually supportive factors: both socio-cultural and economic. Culturally, there are no language or racial barriers to hinder economic efficiency or efforts to marshall national unity. Koreans have traditionally placed a very high value on education and learning, which has enabled the economy to develop human resources rapidly. These socio-cultural prerequisites interacted with economic factors that directly contribute to growth in income, output and employment.

External and internal economic factors both were important, factors such as rapid growth in world trade and favorable circumstance for developing countries, substantial availability of foreign savings and introduction of economic planning and effective programs of relevant policy measures. In particular, in contrast to the more cautious approach adopted during that period by many developing countries, Korea committed itself to a bold outward-looking development strategy which called for the intensive development of exports from its still-primitive industrial sector.

## 1. Growth and Structural Change

### 1.1 Economic Growth

The rapid growth of the Korean economy was due mainly to the policy of export-oriented industrialization. The Korean people's determination to develop has helped increase exports and maintain a high investment ratio, both of which have been responsible for the high growth rate, averaging 8.4 percent annually between 1962 and 1980. The gross national product(GNP) increased from \$2.1 billion in 1961 to \$56.5 billion in 1980. In real terms GNP increased by a factor of 4.6, while the population grew at 2.1 percent annually to 38.1 million in 1980. Therefore, per capita GNP has risen from \$82 to \$1481 in current prices during the same period, as shown in Table 1.

Table 1. The Performance of Korean Economy

		Unit	1961	1975	1980
GNP	In 1975 bil. won		3,005	9,793	13,843
	In current bil. US dollars		2.1	20.2	56.5
Population	Million		25.8	35.3	38.1
Per capita GNP	In current US dollars		82	574	1,481
Export	In mil. US dollars		41	5081	17,504

Source : Economic Planning Board (E.P.B), Major Statistics of Korean Economy, Seoul: E.P.B, 1982.

The vigorous export promotion policy showed remarkable results, with export volume increasing, in current prices from only \$41 million in 1961 to \$17,505 million in 1980.

## 1.2 Structural Change

Concomitant with this growth has been a marked transformation in the structure of the economy. Measured at current prices, the share of the primary sector dropped from 40.2 percent of GNP in 1961 to 16.3 percent in 1980, while that of social overhead capital and other services increased from 44.6 to 53.5 percent and that of mining and manufacturing from 15.2 to 30.2 percent. This represents a striking change in only nineteen years.

Table 2. Sectoral Origin of GNP<sup>1)</sup>

	(In Percentage)		
	1961	1975	1980
Agr., For. & Fisheries	40.2	24.9	16.3
Min. & Mfg.	15.2	28.0	30.2
SOC & Other services	44.6	47.1	53.5
Total	100	100	100

Note: 1) At current price

Source: E.P.B, op. cit., 1982.

### 1.3 Employment

One of the most significant contributions of industrialization has been the reduction in underemployment and unemployment. There was a marked increase in Korea's economically active population, particularly since 1970. While the population as a whole grew between 1963 and 1980 at an average annual rate of 2.2 percent, the labor force grew at a rate of 3.1 percent and total employment expanded by 3.5 percent annually, from 7.7 million in 1963 to 13.7 million in 1980. The unemployment rate, is defined as the ratio of the unemployed to the economically active population 14 years old and over, declined from 8 percent to 5.2 percent, though the 1980 rate is higher than the 3 percent level attained in 1976.

During the period from 1963 to 1980, the number of people employed in the agricultural, forestry and fisheries sector decreased from 63 to 34 percent of the total, while the share of the mining/manufacturing and the services sectors increased from 8.7 to 28.2 percent to 22.6 and 43.4 percent.

Table 3. Employment Structure

	Unit	1963	1971	1980
Population	million	27.3	32.9	38.1
Labor Force (Economically active population)	"	8.3	10.5	14.5
Employment	"	7.7	10.1	13.7
Employment Structure	%			
Agr., For. & Fish.	"	63.1	48.4	34.0
Min. & Mfg.	"	8.7	10.8	22.6
SOC & Other	"	28.2	37.4	43.4
Unemployment Rate <sup>1)</sup>	"	8.2	4.5	5.2

Note: 1) in 1978 3.2 %

Source: E.P.B, op. cit., 1982.

## 2. The Standard of Living

Expanded employment opportunities and increased income have reduced the incidence of absolute poverty considerably. The proportion of the population with incomes below the minimum subsistence level, which is tentatively defined as 23,000 won (\$400) per person in 1981 price, decreased from 40.9 percent in 1965 to only 9.8 percent in 1980. As a result, the quality of life has been greatly upgraded for the whole nation over the past two decades.

Signs of a higher standard of living--opportunities

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for education, the supply of piped water, better nutrition and general health of the people, and wide spread supply of public goods and social overhead capital facilities--are visible.

Table 4. Major Social Indicators

	Unit	1962	1980
Middle School Enrollment Ratio	%	<del>54.4</del> <sup>52.3 *</sup>	96.8
College Enrollment Ratio	"	21.2	27.2
Housing Investment/GNP	"	1.6	3.1
Dwelling Space per Person	pyung <sup>1)</sup>	1.9	2.9
Piped Water Supply Ratio	%	18.2	59.0
Life Expectancy	years	52.4	65.9
Infant Mortality Ratio	per 1000 persons	59.9	<del>31.0</del> <sup>31.0</sup>
Telephone Subscribers	"	5	89
Automobil Owners	"	1.1	14.0

Notes: 1) Pyung = 3.3 square meters.

\* 1966., \*\* 1979., \*\*\* 1970.

Source: Government of the Republic of Korea, The Fifth Five-Year Economic and Social Development Plan: 1982-1986, 1981.

Social Indicators *covered*

(P82)

### III. Income Distribution in Korea

The emphasis on egalitarian growth has caught the attention of many economists. Yet, as is often the case in our profession, there does not seem to be any well-unified theory of income distribution which would clear the way for continuous research for many years to come.<sup>1)</sup> However, even without the benefit of a unified theoretical basis, in recent years a growing body of empirical studies on Korea's distribution has been published. What these authors have found in common is evidence which indicates the relative equality in Korean income distribution as compared not only to many developing countries but also to some developed countries, with little sign of its deterioration during the period of growth in the 1960's.<sup>2)</sup>

Although the evidence upon which they base their conclusions is more or less similar, these studies seem to pay little attention to the data problems of Korea's income distribution. In past Korean income distribution studies, the basic data were derived from city and farm household income and expenditure surveys, individual income tax records, wage and salary surveys and/or special survey. In constructing size distributions, these data were generally used separately, but occasionally using various assumption to estimate household income which could not be taken directly from existing data. Because of the deficiencies, both



implicit and explicit, in the basic data used and in the procedures adopted in the previous studies on Korean income distribution, new estimations were needed to study the distributive aspects of rapid growth over time and by sector since the 1960's.<sup>3)</sup>

Among several estimations, this paper introduces the estimation by Kim and Choo for the following reasons.

First, all the earlier studies have some problems in data and the results: the neglect of seasonality, the inadequate sample size, the omission of non-cash incomes, the exclusion of households receiving weekly or daily pay, and limitations on the upper and lower levels of income which are likely to be excluded from the survey.

Secondly, there is no estimation available for the period of the mid-seventies. Hence there is no information on the changes in the size distribution over the whole period of rapid growth and by sector.

Thirdly, thus far there is no special survey reliable enough to determine income distribution and widely quoted as an indicator of income distribution. (In 1980 the first official survey was carried out but this of course can not provide meaningful figures over time.)

Finally, as argued by Choo, though their (Choo and Kim) estimation procedures are not free from omission and errors, the estimated size distribution of income is the

result of an earnest effort to derive probable distributions over time and by sector, with due consideration for the deficiencies and constraints of the data.<sup>4)</sup>

### 1. Overall Distribution

Table 5 shows a slight tendency toward more equality during 1965-1970 and then a rapid move toward less equality of income distribution during 1970-1976. This trend is evident in all three distributive measures: Gini Coefficient, Theil Index and the Decile Distribution Ratio--here defined as the ratio of the income of bottom 40 percent over that of upper 20 percent. The Gini coefficient fell from 0.3439 in 1965 to 0.3322 in 1970 and then rose to 0.3808 in 1976. The Theil measure was 0.2263, 0.2049 and 0.2505, respectively, in 1965, 1970 and 1976. Finally, the decile distribution ratio changed from 19.34/41.81 in 1965 to 19.63/41.62 in 1970 and then to 16.85/45.34 in 1976.

Data for 1980 are the result of the Social Statistics Survey, conducted by National Bureau of Statistics, based on the household income by source. This is the first official indicator on income distribution and is based on the most reliable data. Although horizontal comparison of these 1980 results with previous ones is less meaningful, obvious change over time in Gini coefficient and decile ratio can be perceived.<sup>5)</sup>

Table 5. Size Distribution of Income and Measures of  
Inequality: 1965-1980

	(In Percentage)			
Decile	1965	1970	1976	1980
First	1.32	2.78	1.84	1.57
Second	4.43	4.56	3.86	3.52
Third	6.47	5.81	4.93	4.86
Fourth	7.12	6.48	6.22	6.11
Fifth	7.21	7.63	7.07	7.33
Sixth	8.32	8.71	8.34	8.63
Seventh	11.32	10.24	9.91	10.21
Eighth	12.00	12.17	12.49	12.38
Ninth	16.03	16.21	17.84	15.93
Tenth	25.78	25.41	27.50	29.46
Gini Coefficient	0.3439	0.3322	0.3808	0.3891
Theil Index	0.2263	0.2049	0.2505	-
Decile Distribution Ratio	19.34/ 41.81	19.63/ 41.62	16.85/ 45.34	16.16/ 45.39

Source: Data for 1965, 1970 and 1976 from Choo, Hakchung and Daemo Kim, Probable Size Distribution of Income in Korea: Over Time and By Sectors, Seoul : Korea Development Institute, 1978.

Data for 1980 from EPB, Social Statistics Survey, 1981.

## 2. Sectoral Distribution

Table 6 shows income distribution for agricultural and non-agricultural households. Agricultural household income is distributed more evenly than that of non-agricultural households, mainly because of the legal limitation on size of farm holding.

The Gini coefficient for agricultural households in 1965 was 0.2852, as compared to 0.3439 for all households and 0.4167 for non-agricultural households in that year. In the same year, the decile distribution ratio was 22.57/38.03 as shown in Table 6.

During the period from 1965 to 1970, the distribution of income did not change very much. However, after 1970 a trend toward widening income gaps within the agricultural sector has become noticeable. The Gini coefficient, the Theil index and the decile distribution ratio from 1970 to 1976 changed, respectively, from 0.2945 to 0.3273, from 0.1318 to 0.1708 and from 21.24/38.64 to 19.45/40.62. Not only did the rural income distribution become less equal, but also the relative importance of the agricultural sector declined due to rapid industrialization.

On the other hand, the trend of distribution of income among non-agricultural households is different from the overall and agricultural income distribution. The distributive indicators for 1976 show more equality than

those for 1965, although much less equality than in 1970.

Table 6. Size Distribution of Income and Measures of Inequality for Agricultural and Non-Agricultural Households  
(In Percentage)

Decile	<u>Ag-Households</u>			<u>Non-Ag Households</u>		
	1965	1970	1976	1965	1970	1976
First	2.60	3.17	2.46	0.22	2.56	1.64
Second	6.39	5.19	4.32	3.02	4.67	3.56
Third	6.67	6.00	6.05	4.98	5.33	4.61
Fourth	6.91	6.88	6.62	5.83	6.31	5.55
Fifth	7.16	8.10	7.81	7.36	7.45	6.56
Sixth	9.63	9.01	9.13	8.29	8.41	7.83
Seventh	10.83	10.59	10.48	10.43	10.02	9.52
Eighth	11.73	12.42	12.51	12.92	12.21	12.03
Ninth	15.61	17.87	16.79	18.56	16.29	18.56
Tenth	22.42	20.77	23.83	28.39	26.75	30.14
Gini Coefficient	0.2852	0.2945	0.3273	0.4167	0.3455	0.4118
Theil Index	0.1428	0.1318	0.1708	0.3398	0.2190	0.3027
Decile Distribution Ratio	22.57/ 38.03	21.24/ 38.64	19.45/ 40.62	14.05/ 46.95	18.87/ 43.04	15.36/ 48.70

Source: Choo, Hakchung and Daemo Kim, op. cit., 1978.

For the purpose of decomposition analysis, an effort was made to classify non-agricultural households into employee and employer households. The results of this are shown in Table 7. Most significant is the change in incomes among employer households, particularly when the share of the top 30 percent is compared to the bottom 40 percent. The income distribution of these households also improved slightly from 1965 to 1970, due to the relative increase in the share of the bottom 40 percent. However, a pronounced polarization of the income shares of the top 30 and bottom 40 percent of these households appears during the period 1970 to 1976.

The changes in the income shares of employee households during these years conform with the changes in the overall size distribution. The remarkable gains by the lowest 20 percent were made during the period 1965 - 1970. However, in later years the income of the top decile employee households increased relatively more than that of the other deciles.

Table 7. Size Distribution of Income and Measures of Inequality for Employee and Employer Households

(In Percentage)						
Decile	<u>Employee</u>			<u>Employer</u>		
	1965	1970	1976	1965	1970	1976
First	0.28	2.59	2.08	0.24	2.58	1.15
Second	1.90	5.39	4.50	3.44	4.06	2.41
Third	5.31	6.32	5.53	4.06	4.59	3.36
Fourth	7.00	6.46	6.40	5.48	6.39	4.43
Fifth	7.68	8.85	7.50	6.93	6.96	6.01
Sixth	9.72	8.94	8.59	8.85	9.26	7.79
Seventh	11.00	10.16	10.15	10.44	10.59	9.91
Eighth	13.32	12.19	11.89	15.47	13.55	16.57
Ninth	16.67	14.84	15.48	17.95	18.01	22.27
Tenth	27.13	14.26	27.87	25.14	24.02	26.11
Gini Coefficient	0.3993	0.3043	0.3553	0.3838	0.3528	0.4490
Theil Index	0.3005	0.1747	0.2229	0.2856	0.2503	0.3302
Decile Distribution Ratio	14.49/ 43.80	20.94/ 39.10	18.51/ 43.35	15.22/ 43.09	17.62/ 42.03	11.35/ 48.38

Source : Choo, Hakchung and Daemo Kim, op. cit., 1978.

### 3. International Comparison

There is a close link between the level of income and distributive equality in the international comparison of distribution. From Table 8 it can also be noted that there exists considerable diversity even among countries of similar income levels. Still Korea, as well as other East Asia and the Pacific countries, is relatively more equal than other regions and countries. However, it is evident that the distributive pattern of an economy over time can deviate from the general pattern in the past.

### 4. General Trend

To sum up, along with the rapid economic growth since 1960's, the Korean economy has demonstrated relative equality in income distribution. Income distribution seems to have become more equal from 1965 to 1970. It is, however, evident from all the measures of inequality, that the distribution of income became less equal from 1970 to 1976, to reach a level in 1976 even worse than that of 1965. With sustained economic growth Korean income distribution shows a tendency towards less equality, although income distribution in Korea is still relatively equal by international standards and in view of the level of development.



Table 8. International Comparison of Income Distribution :  
Percentage share of household income by percentile groups of  
households

Country	Year	Lowest 20%	Highest 10%
Low Income Countries			
India	1975-76	7.0	33.6
Sri-Lanka	1969-70	7.5	28.2
Middle Income Countries			
Korea	1976	5.7	27.5
Peru	1972	1.9	42.9
Malaysia	1973	3.5	39.8
Turkey	1973	3.5	40.7
Mexico	1977	2.9	40.6
Chile	1968	4.4	34.8
Hong Kong	1980	5.4	31.4
Costa Rica	1971	3.3	39.5
Brazil	1972	2.0	50.6
Argentina	1970	4.4	35.2
Yugoslavia	1978	6.6	22.9
Venezuela	1970	3.0	35.7
Industrialized Countries			
Spain	1974	6.0	26.7
Italy	1977	6.2	28.1
U.K	1979	7.3	23.8
Japan	1969	7.9	27.2
Netherlands	1977	8.1	22.1
France	1975	5.3	30.5
Australia	1966-67	6.3	23.7
Germany	1974	6.9	28.8
Canada	1977	3.8	26.9
U.S.A	1972	4.5	26.6
Norway	1970	6.3	22.2
Sweden	1979	7.2	21.2

Source : World Bank, World Development Report, 1983.

Endnotes for Chapter III

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1. Frank, C. R. and Webb, R., "Theories of Income Distribution, Economic Growth and Relevance to Policy Issues" A mimeography.  
  
Choo, H. J., "Some Sources of Relative Equity in Income Distribution: A Historical Perspectives" in Kim, C.K. et al., Industrial and Social Development Issues, Seoul: KDI, 1977, pp. 303-330.
2. See Oshima (1970), Adelman (1973), Chenery and IBRD (1974), Mizoguchi, Kim and Chung (1976), Choo and Kim (1978), and Mason and Kim (1980)
3. Choo, H. J., Income Distribution and Determining Factors in Korea (in Korean), Seoul: KDI, 1979, pp. 75-82.
4. Ibid., p. 86.
5. In presenting income distribution data the Korean government used Choo and Kim's measure in the 1960's and compared them to the 1980 survey result.

#### IV. Sources of and Policy Measures for Relative Equality in Korea in the 1960's

In the course of economic growth many socio-economic factors affect income distribution change. Researchers have suggested various hypothesis and have conducted empirical tests. At present we know too little about these matters to be able to generalize and no systematic pattern of change appears.

Without the benefit of well-established theories of income distribution, it is impossible to relate these causes and conditions and to demonstrate their interactions in a causative and quantitative manner. What we attempt here is to document the historical conditions unique to Korea and the various policies toward income distribution pursued during the 1960s.

The causes for the relative equality in Korean income distribution are many, but certain unique historical factors seem to have enabled the government to pursue policies after liberation from the Japanese aimed at fostering economic growth which at the same time reinforced equality.

##### 1) 1. Historical and Cultural Factors

A number of historical socio-economic factors have played a significant role in laying the foundation for Korea's present growth and its pattern of income

distribution.

Historically and culturally, Korean society is more homogeneous and fluid than most other parts of Asia, and there is little social limitation on the mobility and adaptability of labor. The process of economic development also has been supported in no small measure by Korean society's acceptance, to an unusual degree, of an identity between individual economic advancement and national economic advancement. This adds the strength of patriotic sanction to that of private gain as an underlying motive force of the economy.

#### 1.1 Japanese Colony

Because Japan monopolized almost all industrial and commercial activities during the colonial period, Korea in 1945 was not characterized by great inequality of entrepreneurial wealth. Assets which did exist became the property of the Korean Government when Korea became independent. The government, reasoning that a slow disposal of these assets would lead to relatively less concentration, took more than 10 years to disperse ownership to the population. Consequently Korea inherited a very favorable basis for relatively equal distribution of income.

#### 1.2 Land Reform

The radical reforms conducted in 1947 and 1950

greatly reduced disparity in the ownership of the agricultural land which at the time constituted a significant portion of wealth for a large segment of the population. Since the Land Reform Law which places limits on the maximum ownership of arable land is still effective, the favorable effect has remained essentially the same over time. The technical details of these reforms have been discussed in various papers and will not be reiterated here.<sup>2)</sup> Suffice it to say that in 1955 only 0.2 percent of farm households owned more than 3 hectares, and they accounted for only 1.0 percent of the cultivated area. Ten years earlier, 10 percent of households owned more than 3 hectares, and they accounted for well over 50 percent of cultivated land.

### 1.3 Extent of Korean War Destruction

The tragedy of the Korean War and its resulting damage further reduced the variance and the skewed wealth distribution within the private sector. Approximately 20 percent of the net capital stock was destroyed during the war.

The war had at least two significant impacts on asset and income distribution.<sup>3)</sup> First, the properties of upper income classes were lost and/or damaged. Secondly, especially during the years of the war and the year immediately following the truce, the terms of trade favored agricultural commodities. But as the result of the land

reforms, there were no big farmers. Thus, an urban to rural redistribution of tangible assets occurred, which modified the distribution of tangible assets and that of income for the following years.

#### 1.4 Monetary Reform and Cash Distribution

Since the Korean War there have been three monetary reforms, in 1950, 1953 and 1962. The main purpose of the monetary reform in 1953 was to absorb excessive liquidity; the reform had significant negative effect on the upper strata of wealth and income distribution while the benefits of relative stabilization were felt especially by the lower income groups.

At the beginning of the First Five-Year Plan the third monetary reform was decreed in 1962. This reform aimed to curb inflation and to mobilize domestic investible resources for economic development. Contrary to the expectations of planners who had expected a greater inequality in cash holdings, the distribution was relatively equal. Since the third reform did not cause any transfer in wealth distribution in cash holdings it more or less supports the idea of relative equality in Korean income distribution in the early 1960s.

#### 1.5 Settlement of Rural Usurious Loans

Historically, an unorganized money market was

extensive in Korea. These money markets are generally recognized as a basic obstacle to rural development and to improving the share of farm disposable income. With the zeal of the military revolution, "a special act for the settlement of rural usurious loans" was drafted and enforced to settle the so-called "curb loans" in rural areas. During the period, rural curb market interest rates were known to often exceed 100 percent and the amount of usurious debt reported was 4807.2 million won. As a result of the act, only 61 percent of the reported amount was judged to be qualified, and the sum was paid back in four-year installment payments following a one-year of grace period at an annual interest rate of 20 percent.<sup>4)</sup> The effect of the cancelled debt on disposable income of the indebted farmers and farm workers was very important from a redistributational viewpoint. It represented a direct redistribution from the upper middle (major creditors) income groups to lower income debtors in rural area.

#### 1.6 Confiscation of Illegally Accumulated Wealth

The issue of wealth accumulated illegally by tax evasion, profiteering, bribery, preferential treatment and monopoly was forcefully raised after the revolution in 1961 and 1962. By December of 1962, 30 big businesses had been accused and found culpable, and they were assessed fines totalling 4.2 billion won. The magnitude of the fines drove 5 of the 30 firms from the ranks of big business.<sup>5)</sup> The

confiscation of illegally accumulated wealth obviously affected the position of the upper income class and had equalizing distributive effects.

## 2. Human Capital and Education

Education contributes to the human capital in a society and the wide spread of educational opportunities increases equality in every field. Many studies have found that redistributional effects are greatest if emphasis is placed on primary education. And education is positively related to equality in terms of income share of the lowest middle group.<sup>6)</sup>

However, others argue that education exacerbates inequality by perpetuating economic status across generations, by acting as a mechanism for "cultural imperialism" and by taxing everyone regressively to pay for the education of the rich.<sup>7)</sup> In spite of these cautious views, we find in Korea the positive effect of education, particularly in the accumulation of human capital and highly qualified production factors.

During 1953-1961 there was a dynamic redistribution phase,<sup>8)</sup> characterized by an education explosion of major proportions which saw Korea's literacy rate rise from 30 percent to over 80 percent, and which reflected increased



educational opportunity and the traditional importance of education.

Thanks to the high aspiration for education of the Korean people and the support of the government, education in Korea has achieved remarkable growth. The traditional value system of Confucianism places scholar-official at the top of the Sa, Nong, Kong, Sang (scholar-official, farmer, artisan, merchant) status hierarchy and thus education has been given top priority by every family. And this cultural background still remains strong. One of the significant results is the enormous increase in school enrollments as shown in Table 9.

Table 9. School Enrollments, 1945-1980

(In Thousand Persons)				
Type of School	1945	1960	1970	1980
Elementary Schools	1,366 (100)	3,623 (265)	5,749 (421)	5,658 (414)
Middle Schools	292 (100)	529 (181)	1,319 (452)	2,472 (848)
Academic High Schools	50 (100)	164 (327)	315 (626)	933 (1853)
Vocational High Schools	33 (100)	99 (299)	275 (829)	764 (7310)
Higher Education Schools	8 (100)	101 (1292)	194 (2476)	606 (7756)

Note : Numbers in parentheses are indices, with 1945=100.

Source : E. P. B, op. cit., 1982.

This strikingly large school enrollment growth has been a significant factor contributing not only to rapid economic growth but also to the better distribution of the benefits of economic growth; education prepared a large segment of the population for the enterprunerial and employment opportunities which arose during the succeeding period of rapid growth. It has promoted economic growth by providing a better educated labor force, as well as furthered the socio-political development of the country.

In short, the Korean educational system and its distribution of educational opportunity contributed both to less inequality in the size distribution of income and to a perception of those differentials that remain as being "fairer" than they otherwise would be perceived.

Thus in the early 1960's Korea had a relatively equitable social and economic base from which to launch its development and a much higher human resource potential than the great majority of countries with comparable per capita income levels.

### 3. Economic Development

In the developing countries a GNP real growth rate of at least five to six percent appears necessary to absorb the increase in the urban labor force and to provide the minimum necessary conditions for equitable growth. Economic growth will increase employment and reduce income inequality by providing more jobs. A high rate of national growth, however, is not in itself sufficient for substantial increases in the share of income received by the poor. Among those less developed nations which are in fact experiencing this minimal necessary growth, the economic processes underlying the present status of equality can be described in two general cases: one in which development is capital-intensive, and the other in which it is labor-intensive. While capital-intensive growth can hardly be described as contributing to equality, in the case of labor-intensive development the prospects for equality are considerably more hopeful.<sup>9)</sup>

The distribution of income is firmly rooted in the structure of the economy and the path of income distribution over time depends on the fundamental development strategy chosen by the society. A "good" development strategy in an

economy in which the appropriate initial conditions are present, can have a favorable effect on distributional equality. A labor and skill intensive export-led development strategy can improve the distribution of income when the ownership of human capital is widespread and when land is reasonably equally distributed. The essence of this view is that better distribution is concomitant with higher employment. This appears to be supported by cases such as Korea and Taiwan, both of which have followed the export-led industrialization growth strategy.<sup>10)</sup>

Korea's subsequent development has been the result of a variety of mutually supportive factors. Among these, however, the key role played by an outward-looking development strategy and by export expansion stands out. Korea committed itself to the intensive development of its primitive industrial sector, and more specifically, of labor intensive export-led industry. Korea's income distribution and economic performance during the past two decades of industrial development clearly indicate the advantages of the labor-intensive approach, for which Korea in fact serves as a major model.

#### 4. Rural Development Policy

Changes in the relative importance of different sectors cause changes in the national income distribution. Experience and theory indicate that even while the size of income within the economy as a whole tends to be relatively stable, the sectoral distribution of income in a rapidly developing economy can tend to become less equal in the absence of policy intervention: the rich are increasingly to be found in the urban sector: the poor are increasingly<sup>11)</sup> rural.

Among the factors affecting sectoral distribution the most significant are land reform (this effect is in a sense more comprehensive and broad), agricultural terms of trade, rural-urban migration and, in the long run, changes in skill<sup>12)</sup> composition of the labor force. In this regard, implementation of measures to improve these factors can counterbalance sectoral inequality, reinforce the sectoral interchange of growth benefits and, eventually, positively affect the nation's increasing income.

Rural and urban incomes in Korea and the differences between them have varied from year as a result of crop yields, inflationary pressure, government grain price supports and other factors. A major source of the increase

in the real income of rural households in recent years has been the massive increase in the government's support price of rice,<sup>13)</sup> steady increase in the agricultural output, and the Saemaul Movement, a comprehensive nationwide economic self-help program.

The policy measures aimed at eradicating the urban-rural income gap combined with the relative equality in agricultural sector have been the main factors accounting for the suprising harmony between growth and equality thus far in Korea. Indeed, as of 1974, average farm household income was greater than wage and salary household income.

## 5. Fiscal Structure and Other Policy Measure

Tax system and fiscal policy have not contributed much to changes in income distribution in Korea. Direct taxes increased as a share of total revenue during the latter half of the 1960's, but have declined in importance since then.<sup>14)</sup> However, indirect tax increased gradually. The personal income tax has received most attention because the continuing inflation required frequent adjustments of the exemptions and bracket tax rates. This, in some sense, can be regarded as a minimum consideration or merciful device only to prevent the income distribution situation worsening further.

In contrast to revenues, the incidence of government expenditure benefits is, to a very limited degree, progressive, although estimates of expenditure benefits rest on even less solid foundations than do estimates of revenue incidence. The progressivity in expenditure benefits in the 1960's largely resulted from a growth in the budgeted share of economic and social services as contrasted to a decline in the share of defence and general services. But given the rigidity of government expenditure pattern not much room is left for direct transfer of income. When the impacts of the revenue and expenditure sides are combined, the net effect is to make the budget a modest influence for reducing inequality in both the urban and rural sectors. Of greater significance is that the government budget causes important intersectoral transfers from the urban to the rural population and between generations.<sup>15)</sup>

Some policy measures expanded in the early 1970's--the use of incentives to mobilize savings from wage or salary income, promotion of the growth of the stock market, licensing of owner-operated taxies, and a primitive minimum wage. These measures would be considered as contributive factors to prevent concentration of material wealth and the subsequent concentration of non-wage income, if they measure succeed as intended.

#### Endnotes for Chapter IV

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1. This part of paper greatly depends on the studies of Choo, Adelman, and the analysis of Korean economy by Economic Planning Board.

Choo, H. J., op. cit., 1977, pp. 310-327.

Adelman, I. and Robinson, S., Income Distribution Policy in Developing Countries: A Case Study of Korea, Stanford: Stanford University Press, 1978.

Economic Planning Board, op. cit., 1976, pp. 7-9.

2. Among these, Ban's study is often referred to.

Ban, S. H., Growth of Korean Agriculture: 1918-1971, Seoul: Jang Mun Kag, 1974.

3. Choo, H. J., op. cit., 1977, pp. 318-320.

4. Op. cit., pp. 323-324.

5. Op. cit., pp. 325-327.

6. Ahluwalia, M. S., "Income Inequity: Some Dimension of the Problem," Finance and Development, September, 1974-a, pp. 3-7.

Lee, S. Y., "Income Distribution, Taxation and Benefits of Singapore," The Journal of Developing Areas, October, 1979, pp. 71-98.



7. Fields, G. S., Ibid., p. 96.
8. This concept is suggested by Adelman and Robinson and accepted by the Korean government.
9. E.P.B., op. cit., 1976, p. 7.
10. This optimistic viewpoint of export-oriented industrialization on the relationship between income distribution and economic growth has been suggested by many studies.  
See, for examples, Balassa (1970), Chenery (1973), Adelman (1973), Bhagwati and Krueger (1973), Ranis (1973), Rao (1978), Westphal (1978), Fields (1980 and 1984), and Mason and Kim (1980).
11. Lee, S. Y., op. cit., p. 72.
12. E.P.B., op. cit., 1976, p. 16.
13. This government support price for rice has resulted in huge deficits in the Grain Management Fund (GMF) and consequently is one of the big sources of extra money supply, that is, inflationary pressure.
14. This will be discussed more in Chapter V.
15. Mason, E. S. and Kim, M. J. et al., The Economic and Social Modernization of the Republic of Korea, Cambridge: Harvard University Press, 1980, p. 439.

## V. Income Inequality and Its Causes

### 1. Inequalities in Income

Since Korea adopted the outward -looking industrialization growth strategy, it has enjoyed both successful quantitative expansion and qualitative improvement. Thus far, as indicated in the previous Chapters, Korea has been regarded as a successful model of economic growth with a relatively equal distribution of income. Yet, contrary to the strong belief, much of the early optimism seems to have faded away in the process of economic growth. The recent experience of Korea raises strong questions about the creditability of this assertion. Occasionally studies have suggested that there remains some serious problems and that some additional policy measures are required for better distribution.<sup>1)</sup> There exists a surprisingly high degree of public distrust in the available income distribution data.

On the one hand through the 1970's all of the factors considered fundamental for more equal distribution of income gave indications of moving in favorable directions. The population growth rate sharply declined from 2.5% in the 1960's to 1.8% in the 1970's. Educational opportunities were expanding very rapidly, as indicated by school enrollment rates. The rapid growth of the economy brought per capita GNP

to the \$700 - \$900 range of 1978 which the World Bank has identified as the turning point in the Kuznets' U-shaped<sup>2)</sup> curve. The number of those employed was also rising rapidly while the real wage rate was growing substantially. The incidence of absolute poverty was reduced considerably and signs of better standard of living were visible. Nevertheless, as shown in Chapter III, the most recent estimates confirm that the distribution appears to have become less equal since 1970. How can this situation be explained?

In the late 1970's and early 1980's the Korean economy stood at an important turning point and faced some difficulties which can be traced to the fact that the Korean government failed to properly reorient its economic management strategy to the changing economic and social environment. This failure brought about a number of undesirable consequences such as a chronic inflationary spiral, inefficiency in economic management, and inequalities between income classes and regions. Officially, The Fifth<sup>3)</sup> Five-Year Plan noted the problem as follows:

Income distribution in Korea used to be considered rather equal when compared to other developing countries, but rapid economic growth has tended to cause deterioration in this situation. During the 1965-80 period the share of total national income received by households in the top 20 percent grew from 41.8 to 45.4 percent, while the share of the bottom 40% fell from 19.3 to 16.1 percent. Although the incidence of absolute poverty was greatly reduced in the course of economic

development, relative income distribution has become more unequal and urban concentration of population has increased. At the same time, the basic needs of the people have not been adequately met, and public facilities for daily life have been overly strained. This has led to the rise of strong demand for more balanced growth, and renewed aspirations for a welfare state shared by people of all social standings.

## 2. Some Causes of Inequality

Apart from overall policy failure noted above there have been few analyses of the factors affecting income distribution in the 1970's. Therefore this paper seeks to explain the change toward a less equal income distribution.

Several factors which were responsible for the earlier growth with equality reversed their influence significantly in the late 1970s. These factors are : "rules of the game", financial system, the concentration of economic power, inflation and speculation, wage gap, fiscal policy and educational opportunity.

### 2.1 Overview

From the macro point of view we can see two major factors. First, the adverse effect of the past development strategies, which placed heavy emphasis on rapid growth, failed to exploit the internal balance. These strategies placed relatively little emphasis on the field of social development which could contribute to improving income

distribution in the long run.

Secondly, the decline of the agricultural income share is an unfavorable factor. The distribution of income in the agricultural sector is more equal than in the non-agricultural sector. But during the last two decades the agricultural income share of total income has declined as a result of the structural change mentioned earlier. Until recently the relatively equal income distribution in the agricultural sector had been an important reason for the relative equality in Korea.<sup>4)</sup> The difficulty of improving farm incomes through price supports, subsidies, and increasing agricultural productivity is increasingly apparent due to inflationary pressure caused by fiscal deficits.

## 2.2 Changed "rules of the game"

Generally it is thought that in developing countries most factor and product markets are imperfect, that is, that market forces do not work efficiently. Up to now, though there have been conflicting views on the role of government intervention in the free market mechanism, most governments in developing countries play important roles in actual economy. Moreover, in a country like Korea which adopted a national planning system and in which government played a central role in economic development, from planning to implementing, and in some cases deeply participating in the investment project itself, government intervention is

justified for more efficient allocation of scarce resource and successful accomplishment of rapid economic growth. It is also inevitable for government to provide various incentives or direct support and to have the power of allocating scarce (or given) resources. In the course of government intervention or participation there is likely to occur "unfair" distributions of incentives or "unfair" resource allocation, including provision of opportunity to obtain these benefits.<sup>5)</sup> Under these circumstances those who can easily obtain scarce resources and have easy access to information will be playing the economic "game" under easier rules than those who are not able to enjoy such privileges. The negative effect of such a different set of rules of game may cause a heavy concentration of wealth and property earnings or both. In this context, Korea's basic development policy combined with its financial and fiscal system and concentration are good examples of a case in which the rules of game are easier for the rich and powerful at the cost of the poor and weak.

### 2.3. Concentration

Ahluwalia found that the concentration of wealth (including agricultural land) and mechanisms perpetuating this concentration, and various institutional and market mechanisms that discriminate against low-income groups were the most important factors among the explanatory variables

6)  
affecting income distribution.

In reality there are likely to be some policies which implicitly or explicitly stimulate concentration of financial and physical resource in the hands of a small number of big business groups, instead of spreading them over a large number of participants. This often leads to monopolies or oligopolies in major manufacturing sectors.

In the Korean context, concentration results from the systematic attempt to channel economic resources into the hands of the big business groups which are predominant in the export-related manufacturing and construction industries. In the wake of rapid growth interrelated with the above-mentioned government intervention, concentration was justified under the name of producing economics of scale, growth locomotion, and the overcoming of the narrow domestic market.<sup>7)</sup> These benefits allegedly required toleration or possibly a stimulation of monopoly or oligopoly. In fact not only has there been no legal or institutional mechanism to regulate this kind of concentration, but the economic system has worked in favor of concentration in harmony with unfair rules of game, and rapid industrialization has necessarily been accompanied by structural changes which have shifted the center of gravity of the economy toward the heavy and chemical industries.

Since the late 1960's, these changes have proven the

merits of economics of scale for business groups and conglomerates. In some sense it was advantageous, at an earlier point in time, to promote the growth of business conglomerates so as to further efforts at rapid economic growth and expanded employment opportunities. Since the Korean government put top priority on economic growth, the government exhibited a discriminatory use of incentives and disincentives and command procedures that left a high degree of discretion in the hands of the administrative bureaucracy. Policy implementation required close cooperation between government agencies and business enterprise. Although many devices were used to persuade, cajole, and command business compliance with government objectives, the most powerful instruments were undoubtedly the taxing power, the control of credit from the government-owned banks, and control of access to foreign loans. A substantial number of firms have grown into large conglomerates popularly known as Jaebul, which conglomerates are each owned and controlled by a single family.<sup>8)</sup>

This trend was accelerated by the government's intent to promote the so-called heavy and chemical industrialization from early 1970's. Various incentives and arrangements were provided. In this process the most attractive incentives were extremely generous loans (a kind of preferential loan



named Heavy and Chemical Industry Fund) with a government-<sup>9)</sup> subsidized interest rate. In this regard concentration is very closely related with financial and tax system and nearly every new project was undertaken by an existing Jaebul group. And the main reason for concentration is discretionary credit allocation. As a result, the share of the Jaebul group in national income has increased year by year.

While such policies have contributed to export-led growth, another effect has been an accelerated concentration of industrial activity in the hands of nationally-owned conglomerates.<sup>10)</sup> All of the largest business conglomerates increased the number of firms they controlled as well as their share of non-agricultural GDP. It should also be noted that the growth of the number of firms controlled is positively related to the size classification of the conglomerates. That is, the average annual growth of number of firms controlled was 19.0 percent for the top 5 firms, whereas it was only 7.5 percent for the top 46. Between 1973 and 1978, the economy grew at an average annual rate of 9.9 percent, whereas the rate for the top 46 business conglomerates was 22.8 percent in real terms. The larger conglomerates grew at an even faster rate. While the average annual growth of value added in manufacturing was 17.2 percent during this period, the top 5 conglomerates grew at more than double this rate.

Table 10. Indicators of Concentration of Industrial Activity  
in Business Conglomerates

No. of Business Conglomerates	Factor	Year			Avg. Annual Growth	
		1973	1975	1978	A	B
Top 5	a	43	54	111	19.0	—
	b	270	n.a.	1007	30.1	9.9
	c	140	n.a.	646	35.7	17.2
	d	4.8	6.4	10.7	—	—
Top 10	a	80	104	165	14.5	—
	b	393	n.a.	1351	28.0	9.9
	c	221	n.a.	822	30.0	17.2
	d	7.3	9.7	14.4	—	—
Top 20	a	152	199	284	12.5	—
	b	550	n.a.	1739	25.9	9.9
	c	347	n.a.	1167	27.5	17.2
	d	10.0	13.3	18.5	—	—
Top 46	a	290	329	421	7.5	—
	b	760	n.a.	2122	22.8	9.9
	c	507	n.a.	1509	24.4	17.2
	d	13.8	16.9	22.6	—	—

Source : Il Sa Kong, "Economic Growth and Concentration of  
Economic Power", The Korea Development Review,  
Seoul: KDI, March, 1980.

Note : a = Number of firms controlled by business conglomerates  
b = Value added, in constant 1975 won  
c = Value added in manufacturing by business  
conglomerates, in constant 1975 won  
d = Value added of business conglomerates as proportion of  
non-agricultural GDP  
A = Average annual growth rate  
B = Average annual growth rate of GDP

The Jaebul's activities are predominantly in the manufacturing and construction industries, as Table 11 indicates. Among the manufacturing sectors it is the dominant type of institution in the heavy and chemical industries.

Table 11. Composition of Jaebul's Value-added by Industry (1978)

(In Percentage)

Sector	<u>Number of Jaebul</u>			
	1-5	1-10	1-20	1-46
Agriculture, Forestry & Fishery	.14	.10	.14	.12
Mining	.88	.66	.62	.51
Manufacturing	54.05	51.31	56.65	59.91
Social Overhead Capital (Construction)	27.55 (17.54)	34.05 (24.73)	28.76 (20.77)	26.54 (19.85)
Trade, Finance & Other services	17.38	13.88	13.93	12.87
Total	100.00	100.00	100.00	100.00

Source: Jones, L.P., Jae-Bul and the Concentration of Economic Power, Seoul: KDI, 1980.

The impact of this pattern has been most serious on small business. The shortage of capital available to small firms has resulted in relatively low growth in productivity. Thus they have fallen farther and farther behind in growth of

value added. This has been compounded by a regional imbalance in growth. Income opportunities have become centered on major urban areas such as Seoul, Pusan and Daegu. A maldistribution of productive assets, although different from the previous one in which the asset was land, seems to have been re-established. This has eventually resulted in adverse effect on the income distribution, because there exist no appropriate redistribution schemes such as heavy property tax and progressive income tax.

#### 2.4. Financial System

The financial sector, together with real sector, plays an important role in the course of economic development. Many studies, most popularly Shaw and McKinnon, claim that the financial sector profoundly affects the course of development of less developed countries.<sup>11)</sup> They argue that we should pay more attention to the role of the financial sector and government's attitude toward business in the process of economic growth. A financial repression strategy is a set of policies which not only fragments the financial market, but also causes real financial assets to stagnate by keeping interest rates arbitrarily low, thus constantly calling for government control and intervention in order to ration scarce financial resources. In this context Korea's financial system might be a "textbook" example of financial repression<sup>12)</sup> strategy discussed by Shaw.

In Korea the credit market is the most important imperfect market. The fragmentation of the financial market under the financial repression strategy implies not only differential financial costs but also different availability of financial resources to various economic units. We examine three points: artificially low interest rates, various kinds of preferential loans and government intervention in allocating financial resources.

#### 1) Interest Rates

We can see clear differences in the financial policies of the 1960s and the 1970s. The 1960s were guided by relatively high positive interest rate policy, especially following the monetary reform in 1965. Though there are some negative opinions on the effect of the monetary reform,<sup>13)</sup> the general consensus on this reform of 1965 was that it was largely responsible for the increase of the private saving rate from an average of 5 percent of GNP in 1955-1965 to 10 percent in 1966-1970, and that it contributed to higher levels and more efficient allocation of investment and<sup>14)</sup> furthermore prevented speculative investment.

In contrast to the 1960s, the 1970s were dominated by a negative interest rate policy except for a few years. This happened when the government maintained low nominal interest rates in the midst of high inflation rates. And in the 1970s various types of preferential loan facilities were added and

they became increasingly more common. This facility was installed for the purpose of giving incentive and accelerating growth, particularly growth in the export and heavy and chemical industries, and the amount reached nearly 40 percent of the total credit in the middle of the 1970s. In addition to the apparent low interest rate the facility applied a subsidized interest rate and it lowered the cost of capital for the privileged sector relative to the less privileged one. Owing to the low interest rates charged for credit, the more one is able to borrow, the less would be the real user cost of capital and so the big business sector would be induced to become increasingly more capital intensive at the expense of employment of labor, against the initial basic thrust of the labor-intensive development strategy.

In this situation it probably is more profitable for the entrepreneur to utilize cheap credit, possibly even recycling it in the curb market to capture an interest margin, than to have many workers sweating in the factory.<sup>15)</sup>

In addition to the inducement to be capital intensive, the mandatory low interest rates on financial savings and the very limited choices of financial assets prevented the majority of people from receiving adequate returns to their savings.<sup>16)</sup> The mirror image of this is that there must be a group of people who are benefiting by this

virtual tax on others. As mentioned earlier, the group who  
benefits is likely to be the wealthy and powerful.<sup>17)</sup>

Table 12. Trend of Real Interest Rates,<sup>1)</sup> 1964-1980

Year	Real lending rate <sup>2)</sup>	Real interest rate on time deposits	GNP deflator
1964	-16.0	-15.0	30.0
1965	17.8	23.8	6.2
1966	9.5	15.5	14.5
1967	8.4	14.4	15.6
1968	9.9	9.1	16.1
1969	9.8	8.0	14.8
1970	8.4	7.2	15.6
1971	13.2	12.5	8.8
1972	-3.7	-6.6	19.2
1973	2.3	-0.6	13.2
1974	-14.1	-14.6	29.6
1975	-9.2	-9.7	24.7
1976	-0.7	-1.5	17.7
1977	-1.3	-1.9	16.3
1978	-2.6	-2.0	20.6
1979	-1.3	-0.7	19.3
1980	-2.8	-2.8	25.8

Notes: 1) The real interest rates are calculated by  
subtracting GNP deflator from nominal interest  
rate.

2) These represent commercial bank interest rates  
charged on the discount on commercial bills.

Source: E.P.B, op. cit., 1982.

## 2) Preferential Loans

Besides extraordinary low interest rates, financial costs vary widely depending on the type of funds. Among the several sources of preferential loans three major ones have dominated: the Korea Development Bank (KDB), the National Investment Funds (NIF), and long-term foreign loans.

KDB loans serve to finance investment in so-called strategic industries. Major fund sources for the loans consist of borrowings from the government and issuance of debentures to the public, as well as to other financial institutes. The debentures usually bear higher interest rates than the KDB's lending rates by virtue of the government's compensation of the differential.

The NIF was established in 1974 in order to augment the savings flow into investment in the major industries. The sources of the fund are debenture issues, forced deposit of the commercial banks, transfers from the government budget, and forced deposits of various pension funds. KDB, as well as other commercial banks, is responsible for the handlings of the NIF under the firm control of the government, which oversees allocation decisions.

Foreign loans are similar to the above mentioned two long-term facilities. They are not only controlled strictly by the government but also require repayment guarantees of the KDB or other commercial banks, and of the Korean Exchange



Bank for their inducements. All of these loans are at very low interest rates and have long amortization periods. It is not surprising that it requires special favor from the government to have access to these loan facilities.

Table 13 shows the nominal interest rates by type of loan.

Table 13. Nominal Interest Rates by Type of Loan: 1971-1980

Type of loan	(In Percentage)				
	Year				
	1971	1974	1975	1978	1980
KDB loans	12.4	9.7	11.2	11.0	17.0
NIF loans	-	9.0	12.0	15.0	20.0
Private foreign loans	6.3	8.2	7.3	n.a	n.a
Public foreign loans	3.0	3.9	4.4	n.a	n.a

Source: Hong, W.T., Trade, Distortions and Employment Growth in Korea, Seoul: KDI, 1977.

E.P.B, op. cit., 1982.

Note: In 1980 there happened a big increase in interest rates and a devaluation of the won.

These preferential loans, as shown in Table 14, became increasingly more common in the 1970's. Because these

loans were handled by the commercial banks at the expense of other general type of loans, these consequently resulted a very uneven allocation of a most important source of wealth.

Table 14. Subsidized Credit from Commercial Banks and KDB

(In Billions of Current Won)		
Credit Source	Period	
	1965-1970	1971-1975
Banking funds	136.9	536.9
Government funds	66.3	56.5
NIF funds	-	53.4
KDB funds	94.4	391.4
Total subsidized loans(A)	297.6	1038.2
Total loans & credits(B)	968.1	2409.3
(A/B) * 100	30.7	43.1

Source: Lee, S.C., op. cit., 1981.

The expanded supply of money played a major role in the higher inflation. During the 1960's the supply of money increased 27 percent (M1) and 40.8 percent (M2) annually, compared to 30.1 and 30.5, respectively, in the 1970's.

The rapid expansion of the money supplies are shown in Table 15.

Table 15. Money Supply, 1961-1980

	(In Billion Won)			
	M1	M2	M1/GNP	M2/GNP
1961	35.8	41.3	0.103	0.118
1965	65.6	97.1	0.081	0.121
1970	307.6	897.8	0.115	0.335
1975	1181.7	3150.0	0.121	0.322
1980	3807.0	12534.5	0.111	0.365
1) 62-70	27.0%	40.8%	/	/
71-80)	30.1%	30.5%		

Note: 1) Average annual rate of increase.

Source: E.P.B, Op. cit., 1982.

## 2.5 Fiscal Structure

Unlike many developing countries, Korea has been able to collect taxes successfully. However, from the distributive point of view, the obvious questions arise as to who bears the tax burden and who benefits most from government expenditure. The existing tax data in Korea do not permit a quick analysis. Despite the limitations of the available data, a couple of observations can be made. As Bahl indicated, the tax structure is slightly regressive particularly in the urban area and there has been no

significant trend toward greater progressivity during the past decade of rapid growth; the major portion of tax revenue comes from indirect taxes.<sup>18)</sup> As shown in Table 16 the proportion of direct tax in total revenue steadily increased during the 1960's but declined in the 1970's. From an income distribution point of view, regressiveness of the increasingly-important indirect taxes leads to the conclusion that the tax structure in Korea is ineffective and perhaps even adversely affects distributive equality. Direct taxes, including income tax, have provided only about 30% of total government revenue for the past 20 years, and the major relative portion of income tax stems from wages and salaries.

Table 16. Direct and Indirect Tax Revenue, 1962-1980

	(In Percentage)						
	Direct Taxes			Indirect Taxes			Defence Taxes
	Income Tax	Corpora-Tax	Sub-total	VAT	S.E.T	Sub-total	
1962	16.2	7.2	33.4	—	—	39.4	—
1965	21.4	10.4	42.6	—	—	32.0	—
1970	25.2	12.7	50.7	—	—	33.0	—
1975	15.8	10.4	46.1	—	—	29.5	5.0
1977	14.7	9.8	33.9	10.1	4.2	34.1	14.2
1980	12.5	9.2	22.3	27.8	11.0	45.4	16.2

Source : E.P.B, Op. cit., 1982.

Just as a taxpayer's income and consumption expenditure are considered indicators of his ability to pay income and value-added taxes, respectively, wealth should also be treated as an important measure of the ability to pay tax under an equitable tax system. Until now, capital gains from various forms of assets and interest income from long-term deposits have received preferential tax treatment under various special provisions introduced to achieve specific policy objectives.<sup>19)</sup> In this regard, tax exemptions for wealth (land, assets, inheritances and gifts) and delays in introducing global income tax have been blamed for preventing<sup>20)</sup> more generous income tax exemptions and welfare programs which could contribute to the low income class. In addition, government expenditure did not do much for better distribution mainly because of the rigidity of budgetary expenditure and inflationary pressure.<sup>21)</sup> In the absence of broader welfare program, distributive contribution was confined to a very limited range as noted in chapter III.

## 2.6 Inflation and Speculation

In general, besides some adverse effect on socio-economy, inflation depresses the real income of large groups of low-income workers and affects the relative real incomes of various socio-economic groups: wage earners versus farmers, the private sector, rentiers versus employee and so<sup>22)</sup> on.

In developing countries inflation may cause a more unequal distribution of income, because rising prices may cause an increase in business profit and a decline in real income of workers and the rentier class such as old age pensioners and other people with fixed incomes.<sup>23)</sup>

The rapid growth of Korean economy in the 1970's, particularly between 1975 and 1978, created bottlenecks in the economy and led to strong inflationary pressure. While suppressed by price controls in some sectors, inflation became painfully obvious in areas such as housing and agricultural products. As mentioned earlier, the rapid growth of money supply and domestic credit associated with subsidized credit directed by government led to a sharp rise in the price level. This inflation continued over time and the expectation of further inflation became a serious social and economic problem. And the most damaging effect on income distribution came from inflation.<sup>24)</sup> Thanks to the overseas construction and export boom, Korea has enjoyed the most abundant period in its economic history in spite of the inflationary period since 1976. Nevertheless, low interest rates and inflationary expectations led to surplus disposable income flowing to the speculative market. Under strong inflationary expectations everybody who held surplus money wanted to preserve its real value, and this desire showed up as speculative investment in real estate, particularly

luxurious apartment and commercial building in metropolitan area where lack of housing has become important.<sup>25)</sup> There were numerous gainers of "windfall" profits from speculation, and this eventually accelerated the price of housing. Inflation and speculation are believed to have distorted resource allocation, and worsened income distribution and now they are perceived as the source of many social ills.

Table 17. Price Indices, 1961-1980

	(1975 = 100)		
	W.P.I	C.P.I	GNP Deflator
1961	14.8	15.3	9.8
1966	31.4	32.3	23.7
1971	45.7	55.5	45.4
1975	100.0	100.0	100.0
1976	112.1	115.4	117.7
1977	122.2	127.2	136.9
1978	136.5	145.5	165.1
1979	162.1	171.8	197.0
1980	225.2	221.3	247.9

Source : E.P.B, Op. cit., 1982.

During these extraordinary periods untaxed capital gains accrued to the already relatively better-off households who had the opportunity to take part in this speculative game with their accumulated money or wealth. Moreover there were no appropriate taxes on that type of windfall gain. Considerable capital gains have thus accrued to the relatively rich class.

## 2.7 Educational Opportunity

In the past, as described earlier, educational opportunity was available to everyone. Though fees and other costs put pressure on the families of students from low-income groups, enrollments at all levels increased rapidly and the gifted were able to continue schooling irrespective of social class. But as time went on competitive mood became stronger and the inequality in the number of years of schooling become significant mainly due to the educational costs. The educational aspirations of the population are high and school enrollment rates increased gradually as incomes increase. But adequate places in upper-level education, which most of the population regard as a necessary ingredient to the attainment of higher social prestige and as the best way to enter the higher income class, are lacking. In 1975 only 37 percent of the applicants for higher education actually could enter colleges or universities. In this highly competitive situation the lack of sufficient places has led to rationing by non-scholastic factors like price, and whether a prospective student has received extra private tutoring which costs double the regular educational expenditure, and thus access to which is limited to students from wealthier households. In addition, the rate of increase in educational cost for higher schooling has risen faster than, while government expenditure on education was limited



by expenditure on defense and economic development.

Professor Bae analyzed educational expenditure by income class and stimulated some important questions on educational opportunity.<sup>26)</sup> Table 18 shows the ratio of educational expenditure to household income. These ratios increased significantly from 1966 to 1974 and the ratio for the low income level is very high. This implies that students of lower income household have less opportunity to enroll in university compared to students of higher income household.

Table 18. Educational Expenditure/Income Ratio Per Student  
by Income Level (University)

	(In Percentage)			
Wage Income(000 Won)	1966	1968	1970	1974
240	49.1	58.7	64.5	70.2
600	21.5	25.3	28.2	32.9
1200	14.1	18.9	16.9	20.6
2400	7.0	11.8	11.1	11.9
Education expenditure per Student (in 1975 Won)	110	127	143	148

Source: Bae, M. K., op. cit., 1979.

Another analysis shows similar result which implies uneven opportunity of higher education. Nearly half of the students in university are from higher income families and

the difference is greater in urban household.

Table 19. Proportions of student in Universities by Income Level (1974)

(In Percentage)			
Income (000 Won)	Whole Nation	Urban Area	Rural Area
0	13.1	16.2	0
Less than 30.	1.6	3.3	0.8
30. - 60.	4.9	8.7	1.2
60. - 100.	11.1	17.3	2.6
100. - 150.	24.4	33.8	4.6
More than 150.	41.8	53.5	7.1

Source: Bae, M. K., op. cit., 1979.

These results show that the educational system has experienced institutional changes that have led to a reduction in the role it traditionally had played as the prime factor in social mobility. By no means are these phenomena unique by international standards, but they do represent a significant departure from the historical development of Korea.

## 2.8 Wage Gap

Simon Kuznets suggested that changes in income distribution can be brought about by changes in industrial structure.<sup>27)</sup> Generally speaking, in the course of economic growth, demand for labor between industries is different, and

28)

the structure of employment and wages are different.

Structural transformation and the redeployment of labor in Korea have inevitably changed the wage structure. Unfortunately there were no official statistics on wage rates until 1970. However, we know the general situation of the labor market in 1960's. During the 1960's there existed absolute unemployment and with economic growth there would be increase in income of lower class. Once to some extent, this situation improved then wage gap is likely to widen.

Wage rates are determined by the market and the rapid rise in wages since 1965 has been entirely a market phenomenon unassisted by government or union action. Since workers move relatively freely among various types of employment, there are few wage disparities to suggest an inefficient allocation.<sup>29)</sup> Tables 20, 21, and 22 show the wage differentials in the 1970's, and these differentials imply inequality in income distribution. According to professor Kim, there is an obvious relationship between these wage differentials and income distribution in the 1970's.<sup>30)</sup> There is considerable debate on why these wage differentials by level of schooling, occupation, and industry arise. Though no clear answers can be attained, several factors would be responsible for these wage differentials.

The structural change and the expansion of firms have broadened the organizational hierarchy, resulting in wider

wage and salary differentials. In addition they have bid up, at least in the short-run, wages for skilled and technical manpower, despite the abundant supply of semi-skilled and unskilled labor, again widening wage and salary differentials. This tendency of widening differentials has been evident since 1975 when the export-drive and overseas construction revitalized the economy and created an unbalanced labor market in some sectors.<sup>31)</sup> Consequently, without the intervention of appropriate policy measures intersectoral inequality among employee may be expected to further increase.

Table 20. Wages by Occupations, 1971-1980

(Production Workers = 100)					
Year	All workers	Pro. Tech.	Managerial	Clerial	Sales
1971	128.1	230.4	347.1	194.2	115.6
1975	134.0	265.4	457.8	214.5	123.4
1980	127.6	225.1	370.4	149.9	92.0

Source : E.P.B, op. cit., 1982.

Table 21. Wages by Industry, 1971-1980

(All Industries = 100)					
Year	Manufac- turing	Elec., Gas and Water	Construc- tion	Financing Insurance Real Estate	Social and Personal Services
1971	80.7	230.0	129.5	214.7	141.1
1975	83.4	226.9	133.8	209.2	145.3
1980	84.6	131.8	166.7	159.9	148.3

Source : E.P.B, Op. cit., 1982.

Table 22. Wages by Level of Education, 1971-1980

(Primary School = 100)				
Year	Middle School	High School	College	University
1971	120.3	178.8	—	313.2
1975	118.2	190.9	240.5	409.3
1980	112.5	162.8	240.2	375.5

Source : E.P.B, op. cit., 1982.

Endnotes for Chapter V

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1. See Gupta (1977), Rao (1978), Choo (1978), EPB (1978), and Mason and Kim (1980).

2. World Bank, World Development Report, 1980, p. 40.

Ahluwalia, M. S., "Income Distribution and Development: Some Stylized Facts", American Economic Review: Papers and Proceedings, May, 1974-b, pp. 128-135.

-----, "Inequality, Poverty and Development", Journal of Development Economics, December, 1976, pp. 307-342.

3. Government of the Republic of Korea, Ibid., pp. 10-11.
4. The traditional large family system can be preserved in the rural area and this unique system could greatly contribute to equal distribution.
5. Mason and Kim(1980), and Lee,S.C.(1981) analyzed general behavior of the government's attitude to the business in the course of implementing development policy.

Lee, S. C., Growth Strategy and Income Distribution: Analysis of the Korean Experience, Seoul: Korea Development Institute, 1981, pp. 21-23.

Mason and Kim, Ibid., Ch. 8.

6. Ahluwalia, M. S., op. cit., 1974-a, p. 7.
7. Lee, S. C., op. cit., p. 13.
8. Mason and Kim, Ibid., pp. 263-297.
9. This will be discussed more later in this chapter.
10. For the purpose of export promotion in the middle of 1970's the Korean government encouraged the inducement of "Chong-Hap-Sang-Sa" (a kind of comprehensive company system) by big business groups which was usually based on export or overseas construction business and necessarily expanded to the financial services.
11. Shaw, E. S., Financial Deepening in Economic Development, New York: Oxford University Press, 1973.  
  
Mckinnon, R. I., Money and Capital in Economic Development, Washington: Brookings Institution, 1973.
12. Shaw, E. S., Ibid., pp. 7-9.
13. Mason and Kim quoted the studies of Jones H.(1968) and Williamson. J. (1979)  
  
Jones, H., Korean Financial Problems, Seoul: 1968.  
  
Williamson. J., "Why Do Koreans Save So Little?" Journal of Development Economics, October, 1979, pp. 343-362.

14. Mason and Kim, Ibid., pp. 239-240.

Frank, C. R, Jr., K. S. Kim, and L. Westphal,  
Foreign Trade Regimes and Economic Development: South Korea, New York: National Bureau of Economic Research, 1975, pp. 239-240.

15. This type of misused loan, which primarily is aimed at interest rates margins in curb market, have been frequently critisized by public opinion.

16. Williamson argued that the low interest rate was a major reason for low savings in Korea.

Williamson, J., op. cit., pp. 343-362.

17. Lee, S. C., op. cit., p. 17.

18. Mason and Kim, Ibid., p. 436.

Bahl, R. W., "The Distributional Effect of the Korean Budget During the Modernization Process", A mimeography.

19. Korean Development Institute, Long-Term Prospect of Economic and Social Development, Seoul: KDI, 1978, p. 43.

20. Tax Law provides global income tax system but there are many exemptions and exceptions.



21. Many studies argue that government expenditure did not contribute much to an equal income distribution except for the rural income support policy.
22. Adelman, I., "Growth, Income Distribution and Equity-Oriented Development Strategies", World Development, February-March, 1975, pp. 67-73.
23. Thomas, L. B. suggests similar views on the effect of inflation on income distribution in general.  
  
Thomas, L. B., Money, Banking and Economic Activity, Englewood Cliffs: Prentice Hall, 1982, pp. 508-511.
24. Stern, T. et al., The Korean Economic "Miracle" Yesterday, Today and Tomorrow, Washington: Korea Economic Institute of America, 1983, p. 71.
25. This speculative investment can be explained in terms of the lack of stock market and negative real interest rates on savings.
26. Bae, M. K., "Education Investment and Income Distribution", in Choo, H. J. et al., Income Distribution and Determining Factors in Korea (in Korean), Seoul: Korea Development Institute. 1979, pp. 323-411.

27. Kuznets, S., "Quantitative Aspect of the Economic Growth of Nations: VIII. Distribution by Size", Economic Development and Cultural Change, January, 1963, pp. 1-80.
28. Kim, D. M., "Structural Change, Wage and Income Distribution", in Choo, H.J. et al., Ibid., 1979, pp. 251-319.
29. Mason and Kim, Ibid., p. 487.
30. Kim, D. M., op, cit., pp. 260-264.
31. In reality during 1976-1978 there were competitive wage increases among the big business groups because of sudden lack of higher skilled workers in some rapidly growing sectors such as overseas construction, electronics, and trade, while most other sectors still remained at low level.

#### IV. Summary and Conclusion

In the past two decades the Korean economy has been regarded as a model of rapid economic growth with relatively equal income distribution. However, this general belief regarding the good relationship between economic growth and income distribution in Korea should be modified. Though the basic export-led development strategy is correct, such a strategy can never be final goal nor solution for every problem.

The distribution of income is rooted in the structure of the economy and its time path depends on the fundamental development strategy chosen by the society.<sup>1)</sup> Rapid economic growth could improve income distribution by creating employment and by contributing to increasing income of the poor. However, an increasingly unequal distribution of property income and wages/salaries would occur, if government concentrated on rapid growth only without full consideration of distributive aspects. An increasing inequality can never be an inevitable price of rapid growth. A certain amount of short-run inequality might be tolerated by the population so long as chances for the long-run improvement are readily available. However, in a situation where the sense of relative poverty increases and where chances for improvement in income distribution are not significant, the

situation will become serious. Various redistributive policy measures should be strengthened and initiated to restrain income growth rates of upper income classes to less than and raise those of the absolute poor and low income classes above the projected economic growth rates. Thus, there would be a balanced advance across a broad spectrum of Korean society.

### 1. Policy Measures

In order to accomplish egalitarian growth various redistributive policy measures should be comprehensively introduced to achieve the target levels of income distribution.

First, it will be imperative for the Korean economy to maintain its sustained economic growth based on stability and balance. This will absorb the growing labor force and expand opportunities for more employment .

Secondly, fair rules of the game have to be ensured by providing equal opportunity in every sphere of economic activities. To this end, there should be a move to less intervention and more freedom for business decision making, while more active government intervention is required in certain areas where market force can not work well for the distributive improvement. And thus social equity and upward mobility would be facilitated. In particular, the following should be considered.

- The opportunities for speculative profits, windfall gains and uneven capital gains should be curtailed.

- Measures for encouraging savings for low income group should be strengthened.

- Selective modification of basic strategy, which is focused on the provision of excessive incentives, in financing and tax, is required.

Thirdly, quality and opportunity of education should be improved to increase the benefit of education for the low income families, including increase in scholarships in higher education, vocational education system, enlargement of research and relatively sophisticated technology training.

Fourthly, some measure to increase rural income should be devised through appropriate farm price policy, diversification of income or off-farm income, and productivity improvement.

Fifthly, government expenditure and revenue structure should put more emphasis on distributive and welfare purposes. With rising income and rapid urbanization the growing demands for social services on top of continuing needs for defense and economic infrastructure are likely to require substantial growth and improvement of the fiscal apparatus. In particular, the following should be considered.

- Welfare programs should be strengthened and widened to the maximum possible extent.

- All policies and measures dealing with government revenues and expenditures are related to the size distribution of real income. Thus government policies and measures should followed the basic direction for promoting distributive equality.

- In raising government revenue the dependence on regressive indirect tax should be reduced by increasing the role of progressive direct taxes to a considerable level. In this respect, a comprehensive income tax should be settled on as soon as possible.

- Accumulation of capital gains should be discouraged through heavier direct tax in order to prevent the further concentration of wealth and consequent property incomes.

Sixthly, the "basic needs" approach can also contribute to equality. Basic needs is not a new concept, and one can find most of Korea's "basic needs" in previous development plans. The major difference emanates from the perspective from which they are viewed. In previous development plans, social development and equity were considered to result from overall economic growth. Now the important thing is that the needs of the poor must be kept constantly in mind. An improvement in the distribution of the goods and services in basic needs will also tend to

narrow real income differentials and this may have indirect effects on social mobility.

And finally, interdependence of political, socio-economic factors should be kept in mind and a national consensus for a more equal income distribution should be fostered. When we consider these factors, we should take into account not only the economic factors affecting the distribution of income, but also the political and institutional context in which these factors operate.

## 2. Conclusion

Korea's economic development in the past two decades has been characterized by rapid growth with a fairly equal distribution of income. Korea's ability to achieve a relatively equal distribution of income in the process of economic growth was the result of institutional and policy measures which allowed the Korean people equal access to the three major factors of production.

In pursuing egalitarian growth and advancing distributive and redistributive policies, the fundamental consideration to be made is how to maintain the delicate trade-off between equity/ public welfare and the incentives needed to sustain rapid growth. Fortunately, the Korean economy in the 1960's did not need to tackle this fine point, since these two policy goals were in harmony with the export-

led labor-intensive development strategy. However, from the latter half of the 1970's this good relationship began to show undesirable signs in contrast to the earlier performance. This does not mean, however, that Korea should be removed from the category of countries achieving growth with equity. Korea is among the few countries of successful growth without deteriorating income distribution. Needless to say, if there exists alternative ways where more equal distribution can be accomplished without damaging overall development goals, these ways ought to be pursued.

The Korean economy now confronts significant changes in domestic requirements. The improvement in standards of living with substantial increases in income is bringing with it a shift in economic and social objectives that the government can no longer ignore. Better housing, improved health care, a larger public contribution to education, urban transportation, and demands for pollution control and improvement in the quality of the environment, all represent pressing needs.

In the early stage of economic development some kinds of incentives may be essential to foster the rapid growth of economy as a whole. Now at the turning point of Korean economy, as noted in the Fifth Five-Year Plan, more attention shall be paid to the distributive or qualitative aspects. Already the Korean government has initiated wide-ranging



reforms to achieve these interrelated objectives: continued high growth, price stability and equality in income distribution. These urgent requirements are reflected its Fifth Five-Year Plan for 1982 through 1986. All relevant policy measures coincide with the basic direction of the Fifth Five-Year Plan, therefore greater efforts should be concentrated into the achievement of goals of the plan.

The future of Korean economy is still bright and it is possible to keep on the right track toward the state of democracy, justice, and welfare.

Endnotes for Chapter VI

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1. Adelman, I. and Robinson, S., Ibid., pp. 198-199.

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ECONOMIC GROWTH AND INCOME DISTRIBUTION:  
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AN ABSTRACT OF A MASTER'S REPORT

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MASTER OF ARTS

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## ABSTRACT

Income distribution has recently been a widely discussed topic both within LDCs and within the international development community. Much research effort has gone into attempts to identify and quantify the factors affecting income distribution. Though there are still conflicting views, we can tentatively conclude that sound policy measures can reconcile economic growth targets and a relatively equal distribution of income in developing countries.

Along with the rapid economic growth in the 1960s the performance of the Korean economy in income distribution was impressive. However, this good relationship showed a slight tendency towards less equality with sustained economic growth in the 1970s. Nevertheless, Korea's income distribution is still relatively more equal than most other countries at similar income levels.

This study concentrates on the relationship between economic growth and income distribution in the Korean economy. The main purpose is to determine sources of relative equality in the 1960s and reasons for inequality (or less equality) in the 1970s.

The relative equality of Korea's income distribution is attributable to many factors: historical, social and economic. Among them are Korea's legacy as a Japanese

colony, the Korean War, land reform, education, and the labor intensive export-led development strategy. In the early 1960s Korea had a favorable social and economic base from which to launch its development.

In contrast to the earlier good performance, recent data shows signs of inequality (or less equality). The overall policy failure in economic management--the too heavy emphasis on rapid growth (quantitative targets) only--brought about a number of undesirable consequences such as inflation, inefficiency and inequalities between income classes and regions. Those factors are interrelated and contributed to less equality in the course of rapid economic growth. Apart from overall policy failure, several factors were responsible for this disappointing result: changed "rules of game", a financial system dominated by excessive incentives for a limited group, concentration of economic power, inflation and speculation, unsuitable fiscal structure for redistributive purposes, reduced opportunities in high level education and wage gap. The interactions of the first three factors appear to be very important determinants of relative inequality.

Some might argue that Korea is still in the negatively-sloped part of the Kuznets U-shaped curve, or that recent tendency toward increasing inequality is a transitory phenomenon leading to a better situation in the long-run. Although a certain amount of short-run inequality may be

tolerated, a profound or increasing sense of relative poverty will become serious if it is neglected by the government. Policy measures are required to reduce the major sources of inequality. In contrast to the quantitative advances of the past, the qualitative one has to be pursued on the basis of a balanced advance across a broader spectrum of Korean society.

These policy requirements have already been initiated by the Korean government. The Fifth Five-Year Plan includes these relevant policy measures. Korea has a strong background for sound development which harmonizes economic growth and a more equal distribution of income. Therefore great effort should be devoted to achieving the goals of the Plan.