

# On the Relevance of the German Concept of "Social Market Economy" for Korea

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## 1. Introduction

(South) Korea has reached a critical stage in its economic development. Per-capita income has reached a rather high level, but social cohesion and politically enforced coercion, which were critically important for past growth, are fading away. Moreover, liberties and freedom will be important for creativity to flourish, which in turn is vital for future economic growth. This raises the question of the future social frame of the economy, because if this frame is not taken care of, the free and unchecked market economy may severely undermine the development process. In this context it is important to monitor how other countries dealt with the issue.

The paper is organised into 3 major parts, apart from this introduction. In part 2, the concept of "Social Market Economy" as developed in post-war Germany and its implementation are presented. In part 3, the Korean situation is covered in some more detail. It will be shown that Korea's economy is at a cross-roads where SME experience is indeed relevant. In the 4th and final part, some lessons from SME experience for Korea are discussed.

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## **2. "Social Market Economy" in Germany: Concept and Experiences**

The concept of "Social Market Economy" (SME) was developed in the immediate post-war period. The term itself was coined by Alfred Müller-Armack, an economist who taught at the universities of Münster and Cologne. Today, in the general public, SME is more associated with Ludwig Erhard, who implemented major reforms in the late 1940s and who, as Economics Minister, guided Germany's hugely successful economic reconstruction until the early 1960s, with Müller-Armack being his closest aide from 1952 to 1963.<sup>1</sup>

According to Müller-Armack, SME tries to achieve a "new synthesis" between a free and unchecked market economy and a socialist-type centrally planned economy. To the market economy is added a social component. The term "social" here encompasses several shades of meaning.<sup>2</sup> Firstly, market imperfections (oligopolies, monopolies, inverse elasticities of supply in the labour market or for farm products, etc.) need to be corrected by a workable competitive order. Secondly, society may wish to change the distribution of income as an outcome of market processes from the point of view of social justice. Thirdly, the market economy has to be stabilised by introducing mechanisms of social balance and security. Finally, there is a need for an encompassing "societal policy" (Gesellschaftspolitik), because the market economy is understood to put severe strains on the substance of historical legations; therefore, societal integration has to be assisted by promoting joint attitudes and ways of thinking and by developing a "humane economy" which views man not only as a producer or consumer, but "beyond supply and demand"<sup>3</sup>, in his personal importance and relevance as a human being.

From the vantage point of the late 1990s, the idea of a "new synthesis" may not seem particularly spectacular. First of all, we have come to realise that there is no "third way" as a logically consistent and dynamically stable alternative to the market and the centrally planned economies. Seen from the

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<sup>1</sup> Important texts are available in English translations: Peacock/Willgerodt (eds.) 1989a and 1989b.

<sup>2</sup> See Müller-Armack 1952, p. 234-235.

<sup>3</sup> This is actually the title of an important book on this issue by Wilhelm Röpke (1958).

perspective of immediate post-war Western Germany, though, the concept of SME seemed quite daring. Almost all political forces had subscribed to a more or less socialist political-economic programme. Even the "conservative" party, the CDU, called in its "Ahlen Programme" of February 1947 for companies with monopolistic characteristics to be socialised, e.g. in the mining and steel industry.<sup>4</sup> Despite of this atmosphere, Müller-Armack emphatically argued to learn the adequate lessons from two phases in German economic history: The first phase was the introduction of liberal economic principles during the 19th century which was very successful economically: it led to an unprecedented growth and catching-up vis-à-vis the UK, the leading power of its time. Still, the free market became unsustainable when hardships for the population at large became ever more pronounced. In order to preempt on the political forces demanding a radical revolution of the whole system, already Bismarck found it necessary to introduce a basic social security system in order to appease the workers. The second phase to be noted were the crisis-ridden 1920s with frantic interventions in the market economy which came to little, called the "era of economic policy experiments" by Walter Eucken; this showed that the state lacked the expertise to intervene at will in a complex economy. Learning these lessons implied, as Müller-Armack stressed, to rely on the market as a basic organising principle for the economy, but not to forget the social dimension of political economy.

The idea of a "new synthesis" may nowadays look rather uninspiring from yet another viewpoint. Today, it is well accepted that there are limits to the achievements of free markets, for instance, if market imperfections are involved. The real issue nowadays is which kind of "socially motivated" activities are permissible and to what extent they should be implemented. SME offers as the guiding criterion that measures should be "compatible" with the market in principle.<sup>5</sup> However, even Müller-Armack himself acknowledges that this criterion may be indeterminate sometimes. Still, Müller-Armack argued that as for practical matters the qualitative criterion was still operational enough to help improve the policy process.<sup>6</sup> At a more fundamental level, one should not misinterpret SME, however, as a "mechanistic" socio-technology. Rather, Müller-Armack understood SME

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<sup>4</sup> See Harbach 1979, p. 167.

<sup>5</sup> A helpful additional criterion may be the principle of subsidiarity. See Zohlnhöfer 1990, p. 30f.

<sup>6</sup> See Müller-Armack 1956, p. 246.

dynamically as a guiding principle for reform, with reform measures recurrently necessary in response to endogenous or exogenous changes. This he characterised as a progressive idea for a socio-economic "style" in need of continuous interpretative elaboration.<sup>7</sup> Applying the spirit of SME does not make a discursive political decision-making process superfluous - rather the opposite. What it does achieve, is to give it focus and direction.

It should be stressed that SME does not offer a very stringent criterion for demarcating which policy action is allowed to achieve the social concerns. Usually, the request that is should in principle be market compatible as a qualitative criterion is seen to be satisfactory. Thus, SME is more of a "slogan", not in a negative sense of being just pretension, but in a positive sense to structure public debate and to guide policy making.

With respect to the question of how strictly the criterion of market compatibility should be applied, there are somewhat diverse opinions. Müller-Armack himself, who became a "political bureaucrat" in the 1950s, took a rather permissive stance. He wrote in 1959: "Experience has shown that the market economy can endure a considerable degree of non-market conforming measures..."<sup>8</sup> For him, it was only critical that the basic structuring concept remained the market economy. Within these limits, other principles could be "tolerated" in some policy arenas for political stability or to develop a convincing societal policy.

Müller-Armack never discussed East Asia, to my knowledge, but he did discuss the applicability of SME in developing economies, for instance, with respect to Latin America. Whereas he was very cautious to recommend a specific concept like SME, he did stress the importance of a "clear-cut policy of economic order, rule of law and nurturing a spiritual infrastructure".<sup>9</sup> Still, he would accept engaging in some infant industry protection, something quite unacceptable to "market purists" in the

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<sup>7</sup> See Lampert 1990, S. 36.

<sup>8</sup> Müller-Armack 1959, p. 258; my translation

<sup>9</sup> Müller-Armack 1963, p. 377; my translation.

1960s and beyond.<sup>10</sup> However, other proponents of SME have taken much stricter views on what is acceptable under the guiding rule of SME.

This is related to the interesting question of the theoretical roots and of the SME concept and how they influenced the viewpoints of leading proponents. I can only offer a few remarks here. The major point is that SME was very much influenced by neo-liberals. Still, one cannot reduce it to this stream of ideas. As Tuchtfeldt (1973, p. 84) argues, neo-liberalism is no homogeneous School with a single outlook on policy. In particular, SME is to be seen as broader: It deals not only with the economy and the role of competition, but with the wider societal framework as well.<sup>11</sup> Still, even this does not allow for a clear demarcation, if one thinks of ordo-liberal economists, like Walter Eucken and his ideas on the interdependence of economic, social and political order.<sup>12</sup>

Dealing with these wider issues, the relationship between SME and cultural values or traditions is worth taking note of. There are two sides to this coin. Firstly, there are certain normative elements to be found in the writings of leading scholars. Of course, authors emphasise that the market economy is helpful in bringing about economic growth or, in the context of the post-war situation, reconstruction - but this is actually not overly stressed. Writers like Müller-Armack, W. Röpke or A. Rüstow seem to be more interested in the idea of a market economy helping to achieve humanistic ideals, i.e. freedom, openness of choices and the capability of man to follow his/her individual goals, whatever they may be in given circumstances.<sup>13</sup> The market economy achieves this through the indirectness of the order it sets, i.e. by not making specific prescriptions about how to act, but by setting only boundaries. From this point of view, a market economy or SME may be understood as compatible with many different cultures, as it does not decree specific objectives to be adhered to.

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<sup>10</sup> See *ibid.*, p. 385.

<sup>11</sup> See Müller-Armack 1959, pp. 253-254.

<sup>12</sup> Lampert 1990, p. 35, argues that SME is closer to reality and lays more stress on social policy than neo- or ordo-liberalism.

<sup>13</sup> See Lampert 1990, pp. 33-34.

The "other side of the coin" is related to which kind of cultural prerequisites are needed for a market economy. Authors like Alexander Rüstow stress that "pure markets" may destabilise society, because they foster ways of behaviour, which are morally and socially dangerous, such as cheating, aggressive ambition, ostentation, envy. To counteract this, a "social sub-system" has to be promoted, which not only establishes a political frame like ideological and political pluralism, federalism and checks-and-balances in economic policy-making - all of which are helpful for a market economy -, but which also supports a "spiritual-moral climate" counteracting simplistic materialism. As the market is unable to deliver this climate, this task has to be entrusted to legitimised social institutions, like family, school or church.<sup>14</sup> It may be noted in passing that as the scholars proposing the concept were raised in a Christian environment, it is natural that they thought of the Christian religion in this context. However, ideas of humanism and overcoming restrictive self-interest are by no means limited to Christianity, but are typical of all leading world religions like Buddhism, Islam, etc. Therefore, SME is not limited to a Christian framework.

As for the actual implementation of SME in Germany, two events are usually cited as the decisive turning-point towards a market-oriented economy. The first is the currency reform of June 20, 1948, which actually draws on a plan developed in May 1946 under American guidance and can thus not be attributed to SME. The second and closely related event, is the law on price liberalisation of June 24, 1948. It was the brainchild of Ludwig Erhard, at that time Director of the Economic Administration and the leading figure to implement SME thinking in the years to come.

Interestingly enough, at that time most socio-political forces were against this important pillar of any market economy, and it is largely attributed to Erhard's personality that his central piece of legislation was pushed through.<sup>15</sup>

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<sup>14</sup> See *ibid.*, p. 35.

<sup>15</sup> The move was not even unilaterally approved by the business community. Industry was concerned that purchasing power would be overtly drawn into the consumer goods sector. Erhard was not in favour of longer term credits for the capital goods industry to compensate for this; he was more concerned with the danger of inflation than with the possibly negative impact on (short-term) growth (see Kollmer 1995). Even the Allies were concerned about Erhard's policy; they also feared that growth might turn sluggish. Actually, there was a strict Allied regulation not to change the fixed prices without prior consultation. Erhard boldly circumvented that by arguing not to have changed the fixed prices, but to have abolished (many of) them (see Hardach 1979, p. 172).

The following success story of West Germany's reconstruction is well known and need not be repeated here. What is more important is to what extent this success is attributable to SME. While most would agree that the introduction of the market economy was indeed critical for West Germany's economic success<sup>16</sup>, supporting factors should not be neglected<sup>17</sup>:

- Erhard's optimism and steadfastness were decisive at a historical turning-point.
- Reconstruction allowed for a very thorough technological modernisation which helped to sustain growth.
- During the 1950s, labour supply was almost unlimited.
- Limited foreign currency income was enhanced by the so-called "Marshall Plan" aid, allowing for necessary imports.
- Business cycles were rather weak, apart from the exogenous "Korea Boom".
- Business cycle policy consisted mainly of rather traditional monetary policy, which worked well because of limited international interdependence.
- Domestic politics was stable, with Adenauer serving as Federal Chancellor and Erhard as Economics Minister from 1949 to 1963.

Apart from introducing central elements of the market - large exceptions notwithstanding, for instance in foreign trade and agriculture - it should be asked in what way "social" ingredients played a role. During the 1950s, we find a couple of initiatives in social policy:

- Safeguard measures for employees, especially with respect to lay-offs (1951), to mothers (1952), and to severely handicapped people (1953).

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<sup>16</sup> Abelshauser (1983, pp. 32-63) argues that the economic take-off actually originated well before the currency and price reform of June 1948 and that the immediate effect of these measures was rather to cool the economy down, until the outbreak of the Korean War enabled Germany to make use of its idle capacities. Whereas this latter point is accepted, as there naturally were adjustment problems (price rises in 1948 and increasing unemployment in 1949/50), the first point is rather controversial: Some challenge Abelshauser's statistical estimates, but even if they are correct, this does not imply that short-term successes in 1947, for instance due to overcoming severe transport shortcomings, would have been sustainable well into the 1950s without more fundamental reforms.

<sup>17</sup> See Tuchtfeldt 1973, p. 87.

- Assistance for war victims and "Lastenausgleich" (1950, 1952) [compensation paid to individuals for damage or losses during or after the Second World War].
- Housing programme (from 1950).
- Revision of the pension scheme with so-called "dynamic pensions" from 1957.
- Children allowance from the third child onwards (1954).

Moreover, some societal policy measures deserve attention:

- (Re-)introduction of a democratic social and labour market order, including the autonomy of employers and employees to negotiate contracts.
- Co-determination rights in the mining and steel industries (1951) and, on a much more limited scale, in other workplaces (1952).<sup>18</sup>

It is noteworthy, though, that when writing about the main successes of SME in the 1950s, Müller-Armack did not emphasise these "social" measures. Rather, he stressed the rise in income levels across all social strata, diversified consumer goods markets, reduction of unemployment and the work load becoming lighter (reduction of working hours, etc.).<sup>19</sup> Thus he concentrated on what the market processes achieved. Actually, despite all the social and societal policy measures mentioned, the share of social and health-related expenses in the government budget did not significantly change compared to the pre-war period: It was 30% in 1930, 21% in 1935 (due to rearmament), 31% in 1950 and 26% in 1960.<sup>20</sup> Moreover, there is one important area where SME did not leave as decisive a mark as originally hoped: competition policy. After some early post-war deconcentration measures, executed by the Allies, concentration again rose significantly. The share of the 50 largest enterprises among total sales changed from 25% in 1954 to 42% in 1967. Also, the de-cartelisation move of the Allies - with pre-war Germany being notorious for its cartels with some 3,000 of them in 1930 - lost much force. The 1957 Federal Cartel Law is described by Hardach as a "Swiss cheese"

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<sup>18</sup> See Lampert 1990, pp. 38-39.

<sup>19</sup> See Müller-Armack 1959, pp.259-260.

<sup>20</sup> See Hardach 1979, p. 258.

because of the many holes it left open.<sup>21</sup> Although the Allies had demanded a tough anti-monopoly and anti-cartel policy in the immediate post-war period, the Americans altered their position as early as the Korean War. They pushed for some centralised planning to direct resources into the defence industry. As the SME-inclined German government did not want to lose face, it is said to have compromised on allowing some industrial "self-regulation" under the auspices of the Federal Association of Industries (BDI). Even though this specific system was rather soon abolished again, it might be considered as the beginning of first moves towards a "corporative market economy".<sup>22</sup>

Towards the end of the 1950s, Müller-Armack saw the need for a "second stage SME". Whereas he considered the introduction of the market economy to have been a success, he noticed that associations and unions had a chance to form powerful interest groups and began to clash in an atmosphere of emotional agitation and unrest. By means of a new societal policy, he hoped to install social stabilisers, which he understood as "institutions able to give man, drawn into isolation, the consciousness and objective security within a holistic societal concept".<sup>23</sup> Among measures to be taken, he proposed policies for those seeking self-employment to improve safety and health measures in enterprises, to take care of the spatial order (including the set-up of national parks), to enhance education, etc.

However, this plea was not taken up. Actually, Erhard took a similar stance several years later, when in 1965/66 he called for - using a somewhat unfortunate terminology - a "formed society" (formierte Gesellschaft), by which he meant a society made up of self-conscious, informed citizens capable of freely following common objectives, going beyond securing only their individual existence.<sup>24</sup>

There may be four major structural reasons why these pleas did not significantly influence the political process. The first is that the new concepts were too vague. It is difficult to perceive a strong thread combining all issues raised. Secondly, SME experienced a kind of "curse of success": Sooner or

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<sup>21</sup> See *ibid.*, p. 177.

<sup>22</sup> See Abelshauser 1983, pp. 76-84.

<sup>23</sup> Müller-Armack 1960, p. 272, my translation.

<sup>24</sup> See Erhard 1966, p. 80.

later, all major forces began paying lip service to it. The leftist party SPD switched in 1959 to a formula of "as much competition as possible, and as much (central) planning as necessary", and the German Trade Union Congress (DGB) followed along similar lines in 1963. Below the surface, however, the concept was hollowing out as vested interests grew into well entrenched seats of power. The stock of un(der)-employed people was used up by around 1960, and it became possible to follow a much more egoistically oriented approach to labour issues. Although organised employers and employees often clashed and their struggle became more intense, both had good reasons to strike agreements in benefiting themselves and to discriminate against unorganised interests. Thirdly, the "easy" phase of reconstruction came to an end. It became more difficult to achieve growth, huge investment into new social capital and infrastructure were necessary, and the distribution issue turned more controversial. Fourthly, a new analytical fad started to influence economic policy making: Scholars were getting increasingly optimistic about their aptitude to stabilise the business cycle by "sophisticated" macro-economic policies (Globalsteuerung). The working of the market came to be taken for granted, and the Stability Law of 1967 heralded a new phase of German post-war development.<sup>25</sup>

Although many observers today still casually refer to Germany as a social market economy<sup>26</sup>, this is somewhat misleading. First of all, the many additions to the social or welfare policies since the 1950s and 1960s contain many severe shortcomings if analysed from the viewpoint of market compatibility.<sup>27</sup> At the very least, one has to acknowledge that there was a considerable "degeneration" of applying the stylistic principle of SME. Secondly, as mentioned before, apart from paying lip service, SME is not a concept or idea any more which structures public debate. Thirdly, one should not mistake elements of a "consensus model" or "corporatist market economy" for "SME in action". True enough, the originators of the SME concept hoped for consensus to develop due to the implementation of policies in line with SME. Still, with their strong inclinations towards neo- and ordo-liberal ideas, they certainly did not have in mind the corporatist collusion of various associations

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<sup>25</sup> See Tuchtfeldt 1973.

<sup>26</sup> For a recent example, see the renowned Economist of London with its title story of May 4, 1996.

<sup>27</sup> This cannot be shown in detail here. For instance, see Zohlnhöfer 1990 for ample evidence. Already the so-called "dynamic pension formula" of 1957 was dubious, because linking the rise of pensions to gross wage increases, disregarding taxes, contained an element of redistribution not adequate for an insurance scheme.

and unions, enterprises and banks etc., which characterises so many policy arenas of today's Germany.

As for the recent past, it is well known that the German welfare system has increased in a dramatic manner. Many feel that it is not sustainable any more. Quite a few of its mechanisms are not market compatible any more. Comparing inputs and outputs of the welfare system across countries, it seems obvious that Germany pays too much into it than it receives from it. German unification has added to the fiscal problems, but it is said to be responsible for only a quarter of the public deficit.

As is shown by the parliamentary speech of Chancellor Kohl of April 26, 1996, the government sees the dangers. It wants to cut several welfare provisions and achieve considerable savings, but this has led to an uproar of the unions and of the opposition SPD. Nevertheless, many influential economists think that the government has actually not gone far enough, that its programme is an incoherent mess and that there is no clear strategic vision.

Summing up, SME came into being as a somewhat lofty concept. Under the favourable circumstances of the 1950s and after basic ingredients of a market economy had been introduced by an authoritarian shock, it was quite successful to install a sense of consensus in the population. This helped to achieve rapid growth while safeguarding the market processes through societal cohesion. When a second stage of SME was asked for, with more complex societal policies at stake, the power of the concept to structure public debate was not strong enough, however, to balance the rising power of vested interest.

Despite these rather gloomy remarks, it should be stressed that when comparing Germany with other advanced countries, the country has enjoyed remarkable political and social stability. This allowed for building up an enormous social capital, which can be enjoyed by everyone. This was achieved with equally enormous cost, though, which seems unsustainable in the current global environment characterised by ever more intense competition.

### **3. (South) Korea's Situation**

As has been well reported, Korea has reached the threshold level of 10,000 US\$ in 1995, and it is widely expected to join the OECD, the "rich nations' club", by the end of 1996. Compared to these achievements, the level of social policy expenditures is generally understood to be quite low. Social development expenses make up only 9.05% of the government's general account, and related to GNP it is only 1.31%<sup>28</sup> (in 1994; see MHW 1995, p. 3). Looking at the changes in recent years, the share of social development expenses has risen only little. It already stood at some 6 to 7% of the general account in the early 1980s, and it reached a maximum of 10.2% in 1991, from which it has recently declined (see NSA 1996, p. 199). In a cross-country comparison, Korea also ranks low.

This holds although most would agree that there still is a great need to provide more social welfare to the citizens. To quote but one very basic statistics, the expectation of life for males at birth is 67.7 years in Korea (1991), compared to around 68 in China, 67 in the Argentine or former Czechoslovakia, and around 72-73 in Canada, the US or Germany (see MHW 1995, p. 322).

Still, it is to be acknowledged that since the 1960s the usual basic pillars of social security schemes have been installed in Korea.<sup>29</sup>

- Health insurance, formalised as a programme in 1977, started on a small scale in the 1960s. It was subsequently enlarged to cover more social groups, and meanwhile, reaches 97.3% of the population (in 1994; see MHW 1995, p. 234).
- After initial pension programmes for selected social groups, a national pension (insurance) scheme was installed in 1988. Since 1993, employees in workplaces with at least 5 permanent workers

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<sup>28</sup> Kwon 1993a, p. 156, does a different tabulation and reaches a percentage of 3.24% of GNP for 1991.

<sup>29</sup> For a thorough overview, see Kwon 1993a. A short and practical information can be found in DKIHK 1995.

are insured mandatorily; others can join voluntarily. Some 5.4 mio. people were insured by 1994.<sup>30</sup>

- Since 1963, there has been an industrial accident compensation insurance.
- The latest addition, completing the line-up of "normal" insurances, is employment insurance as of 1995. The basic rule is that regular employees in workplaces with at least 30 permanent workers are insured, if they have contributed to the scheme for at least 12 months. Unemployment assistance is paid for a maximum of 10 months.
- In addition, covering those unable to help themselves or falling "through the net" of the schemes mentioned above, there is a public assistance programme with cash benefits and benefits-in-kind, such as medical aid. However, the amount spent on this is quite small, with a ratio of 0.53% to GNP in 1992. Moreover, this ratio has even declined during the years up to '92. Even those who are considered "hard-core poor", i.e. who are not employable, on average received only 49,000 won per month while on home care, and they make up about 1% of the population (see Kwon 1993b, pp. 116-130).

Korea thus does possess the basic elements of social policy. Compared to other countries at similar level of development though, it has relied much more on the families taking care of welfare issues, or - where that did not work - on forcing individuals to endure personal hardship. Up until recently, this system has worked remarkably well from a technocratic point of view. The following points, however, deserve careful attention.

- Urbanisation and the nuclearisation of families should make it much more difficult to rely on this valve in the future. Up until the 1980s, a clear link between urbanisation and social welfare expenses could not be found<sup>31</sup>. Nevertheless, a long time lag may be involved. Family ties have

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<sup>30</sup> Apart, there are mandatory company-based so-called severance allowances based on the Labour Standards Act.

<sup>31</sup> See Kim 1989, p. 101.

proved rather resilient, perhaps because until lately, the urban workers were themselves still raised in the countryside under the strong impact of traditional norms. Another factor may have been that due to the rather small size and enhanced means of transport, it was possible to stay in close contact with the older generation. Adults of any generation also shared the experience of the devastating Korean War, which intensified the family links, almost the only type of social organisation offering some safety under such circumstances.<sup>32</sup> Given this lag structure, in the future it may be too simplistic to believe in the unchallenged functioning of traditional values.

- Although the process of industrialisation took place in a highly compressed manner, its history is long enough for an industrial workforce to have developed with a consciousness of its common situation and needs.<sup>33</sup> It is ever more difficult to suppress these needs by coercion. The Chun regime has tried it, but the issue returned with even more ferocity during the 1987 - 89 period. As is also well known, a complex advanced economy demands decentralised creative decision-making, and this attitude cannot be contrived to business, but will spill over into the social and political spheres. Consequently, it is ever more difficult for the ruling government to remain passive vis-à-vis social needs.
- Furthermore, the liberalisation and deregulation of the economy will result in additional competitive pressure. As the country prepares to enter OECD and faces the next WTO round, possibly a "green and blue round", this process will continue for the time being and possibly even gain momentum. One result of the added pressure will be that more people may feel unable to compete successfully in the marketplace and hope for some social assistance.
- Finally, there may be some further need for action, because current social welfare is still of rather little help to legitimise the overall social systems. This is not only due to its small size, but to the fact that it has only been introduced very hesitantly. As compared to Bismarck's social reforms, it

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<sup>32</sup> See *ibid.*, pp. 101, 103, 127.

<sup>33</sup> Koo 1993 calls this, somewhat unfortunately, "proletarianization".

did at first not concentrate on the poor, but for political reasons on the middle-class.<sup>34</sup> Although it made good economic sense to extend these schemes to other groups only when financial soundness could be guaranteed, this "cold" step-by-step approach helped little in the long run to make people feel comfortable about the social system they were being exposed to.

When evaluating the Korean situation, it is important not to limit one's view to social policy in a narrow sense, but to understand it as part of societal policy at large. In this wider field, I will concentrate here on three particularly noteworthy policy arenas: distribution, labour and competition.

With respect to income distribution, it has meanwhile become established thinking that Korea has achieved a rather even distribution during its development, at least in comparison with many other developing countries. The Gini coefficient<sup>35</sup> deteriorated somewhat during the late 1970s to somewhere near 0.39, due to the widening wage differentials during the heavy and chemical industry promotion phase and due to the upcoming recession, but it later returned to around 0.32 in 1990, a remarkably low figure. Absolute poverty, defined as a certain income level, declined as well, although it was still close to 10% of the population in 1988 according to KDI calculations.<sup>36</sup>

Despite these data, a strong sense of "felt-inequality" prevails. There are several reasons for this. A strong longing for equality seems almost a trait of the national character. After the devastating Korean War, everybody started from the same level, and grossly differential outcomes are therefore seen to be somewhat unfair by many. Still, there are also many objective points lending support to such a perspective. It is now clearly understood<sup>37</sup> that during the years of President Rhee and later, during the bureaucratic-authoritarian development push, an important element of the system was to favour selected entrepreneurs over the rest of the population. True enough, those fortunate enough to receive favours were also meant to "deliver", in terms of securing the regime, raising exports, or else.

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<sup>34</sup> See Lee 1993. For instance, government employees and the military were the first to receive public pensions (from 1962 and 1963 respectively), "thereby to secure their continuous loyalties to the new regime" (ibid., p. 154).

<sup>35</sup> This coefficient is a statistical concept to put all information into one single number, a coefficient of 1 implying totally uneven distribution, and of 0 totally equal distribution.

<sup>36</sup> See Kwon 1993a, pp. 54-66, on these figures and how they were derived. According to the World Bank's definition of absolute poverty, the percentage below this line was 5% in 1990 (see ibid., p. 65).

<sup>37</sup> See, for instance, Eckert 1993.

But there is little doubt that the favours were highly selective and supported a widespread culture of favouritism, corruption and nepotism. Moreover, illicit wealth could be created or increased by manoeuvring on the shadowy financial markets, especially on the curb loan market, and by land speculation.<sup>38</sup> Based on that, wealth distribution is much more unequal than (reported) income distribution. Moreover, until recently, it was quite easy to hide wealth, for instance, by using "alias accounts" at banks or by not reporting true land ownership status to the authorities. Although this has changed somewhat because of laudable reform measures taken by the Kim Young-Sam government, it still seems almost impossible to estimate what the true wealth- and income-distribution really is. It is easy to understand that many citizens, watching ever new scandals being exposed since the late 1980s, fear the worst and are consequently irritated about the "whole system".

As regards labour issues or industrial relations<sup>39</sup>, at the time of writing, this arena is in a continuous flux, with President Kim Young-Sam just having appointed a committee to make recommendations about timely changes in the labour legislation. It seems that he wants to strike a balance between more rights of organisation for the workers and a liberalisation or reduction of individual workers' rights and safeguard measures. There is something to be said in favour of such a balancing reform<sup>40</sup>, but it will be extremely difficult to achieve it because of the deep mistrust between employers and employees, at least as represented through their organisations. This mistrust is the price to be paid for the long-term coercion of workers during compressed industrialisation. In a way, both sides have a point. The employers fear the militancy of the unions, and probably to some extent rightly so<sup>41</sup>. FEER-correspondent, Mark Clifford, notes a "culture of rage" (1994, p. 11) for Korea, and this may not be wide off the mark. On the other end, labour representatives have come to experience employers for decades as oppressive, trying to crush an independent labour movement and the voicing of grievances by all means<sup>42</sup>.

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<sup>38</sup> On the first, see, for instance, a list of scandals reported by Clifford 1994, *passim*, on the latter, for instance, Lee 1994.

<sup>39</sup> For a survey, see Kim 1994a.

<sup>40</sup> Actually, individual worker rights have reached a rather unconvincingly high level - including some truly bizarre regulations, like a monthly menstruation day-off for female employees -, precisely because they were meant as compensation for extremely curtailed rights of organisation. In a time of liberalisation, it seems not far-fetched to change both.

<sup>41</sup> For new evidence on this, see Hoon 1996.

<sup>42</sup> For a lively account from labour's point of view, see Ogle 1990.

Finally, a few remarks are in order on the competition issue. As is well known, during compressed industrialisation and under the umbrella of government support, the large industry groups, commonly known and somewhat maliciously named "chaebol" (financial clique), exhibited an extremely strong growth, also vis-à-vis the rest of the economy. The share of the biggest groups to GNP, sales or value-added is much larger than in almost all other countries with a similar economic set-up.<sup>43</sup> Many problems are related to this biased structure: high market concentration in many industries, difficulties for small and medium enterprises to strive and to build advanced production networks of larger and smaller companies, reliance on imports (particularly from Japan) as a substitute and related balance-of-payments problems, disadvantages of smaller or "new" enterprises to move into promising industries. It is quite difficult to overcome the deficiencies. On the one hand, the chaebol have greatly increased their power, so they can effectively counteract any move to curtail their strength<sup>44</sup> - and even if such decisions are made, the groups have internationalised to an extent that they could to some extent circumvent the enforcement of stricter rules. On the other hand, they have truly become the cutting edge of Korea's economy, with respect to making inroads into foreign markets, developing new technologies, etc. Any hasty move to restrict them may seriously endanger Korea's competitive position on the world markets.

Summing up, severe difficulties with respect to distribution, labour, and competition challenge the socio-economic cohesion in Korea. If one accepts the notion - underlying the whole paper - that it is important, particularly for pluralising economies, to stabilise the socio-economic basis<sup>45</sup>, then it can now be seen that improving and extending social policy in a narrow sense is only one important imperative. The other is to support it with a wider ranging societal policy, covering distribution, labour and competition, among others.

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<sup>43</sup> It is difficult to give exact numbers due to severe data problems. Some estimates even in scholarly contributions seem to be exaggerated though. A couple of data series seem to converge on a value of some 40% for the major 40-50 groups by the late 1980s. On this problem, see Jones 1994, particularly Figure 16.2 on p. 503.

<sup>44</sup> It would go too far, however, to consider them as a "hegemonic power", as they suffer from a clear legitimacy defect. See Eckert 1993.

<sup>45</sup> For a similar view developed in book length, see Cho 1992.

#### **4. SME in Germany - Lessons for Korea?**

Before any other considerations, two important "starting points" should be emphasised: The first is that the problem dealt with in SME is actually a universal issue: to strike a compromise between economic efficiency and progress on the one, and social stability, on the other hand. Thus, conceptual issues raised and experiences made elsewhere are clearly meaningful for Korea. Someone could raise the argument that due to Korea's different socio-cultural background (Neo-Confucianism, Buddhism, etc.) SME may not relate to Korea's situation, because SME - as discussed in part 2 - is concerned with bringing about a humane liberalism and makes use of the existing "spiritual-moral climate". However, when talking about a "humane liberalism" in the context of SME, one has in mind the opening of choices as a necessary precondition for man to lead a meaningful life. This is relevant for all cultures. SME's concern is not to promote (or rely upon) "individualism" in the sense of selfish egocentrism.

The second "point of departure" for discussing lessons for Korea is that the successful implementation of SME in Germany and the successful reconstruction of the economy following it are related to peculiar conditions in historical time and space. It would therefore not be meaningful to argue in favour of any simplistic "duplication" or "introduction" of SME in Korea. What can only be hoped for are some rather general points which should be taken into due consideration when Korea searches for its own balance between economic performance and social stability.

Evaluating the Korean status-quo with a few broad sketches, part 3 of this paper leads to the conclusion that Korea has already reached a level which the ideological fathers of SME had in mind with respect to the "first stage": a market economy is developed, although quite a few impurities remain, and a basic social security system has been installed. What is left to do is the "second stage": elaborating on societal issues ("Gesellschaftspolitik"), and, doing so, keeping the basic principle of a market economy with a competitive order intact and, if possible, even improve upon past shortcomings. As was shown in part 2, Germany was rather unsuccessful with respect to this stage, so lessons to be learned are rather "ex negativo", i.e. about mistakes or dangers to be avoided.

Let us start on a more positive note, though: Most observers would agree that the social policy measures taken in Germany in the 1960s, 1970s and beyond, on the whole, did make a positive contribution to enriching the life of the population. What went wrong was that policies were devised carelessly, with too little steadfastness vis-à-vis vested interests and consideration for unfavourable future circumstances.

Although the challenges faced by Korea in terms of social policy - making ends meet with fiscal discipline - and societal policy may seem formidable, I am rather optimistic that solutions can be found. Consider the following arguments:

- As for social policy, some improvements are certainly desirable, particularly as concerns poverty alleviation for the very poor (see Kwon 1993b), where fiscally (almost) neutral insurance schemes will not help very much. However, the fiscal strain can be curtailed in many ways.
  - One can think of incentive schemes to motivate people to help each other. In recent Korean history, there are a number of examples which show that innovative mechanisms of the "stick-and-carrot" variety can bring about remarkable results.<sup>46</sup> One idea might be to introduce a "time bank" system: Hours worked in voluntary social service activities are registered as "savings", which later on would constitute a right for the same number of hours.
  - Another interesting mechanism has already been implemented: since this year, junior and senior high school students are expected to do some social work, which is to be registered in their comprehensive school record. Sungkyunkwan University has just instituted this as a requirement for graduation as the first institute of higher learning to do so (see Korea Times, 14 May, 1996).
  - One may also be inclined to rely more on welfare activities pursued by (large) enterprises. Business groups have already set up private foundations, although their combined donations are considered to have been less than 2% of the respective government budget until the later

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<sup>46</sup> For instance, the Saemaul ("New Village") movement of the Park regime comes to mind. Government assistance was given to those villages which could produce a checkable record to have helped themselves. For an account of how allocating cement to the villages was integrated in a clever incentive scheme, see Kim 1994b, pp.91-92.

1980s (see Eckert 1993, pp. 123 - 124, based on information collected by Ku-Hynn Jung). Of course, one should not expect such philanthropy to be a perfect substitute for public spending. The enterprises will primarily engage in such activities for PR reasons in order to improve their image, and this will influence the distribution of the funds in a way which is not necessarily fully compatible with perceived social needs.<sup>47</sup>

- It should be stressed that when advocating some "improvements in social policy", I most certainly do not have a welfare state of European proportions in mind. I do, however, contend that Korea still has some leeway for a more active social policy raising the legitimacy of the system. As mentioned before, Korea now spends only 1.3% of its GNP on social policy. Even doubling this amount would not lead to serious fiscal problems; the KDI does recognize in its new long-term vision that the state sector will have to grow by a few percentage points of GNP sooner or later. As long as a marginally rising share of the state truly helps to stabilize the society, it does not endanger Korea's "national competitiveness" - if this concept can be meaningfully applied -, but it will actually foster it.
- With respect to distribution, several measures have already been taken to rectify the past accumulation of illicit wealth, including the noteworthy introduction of the "real-name-financial-system" by the Kim Young Sam government, although these measures can hardly be said to be a "perfect solution". Still, that may actually not be necessary anyhow. As history teaches, people will normally accept some degree of past injustice as long as they may expect to have a fair chance in the future to improve their lot. What seems to be particularly infuriating for many people nowadays, is how difficult it is to purchase a decent living or to rent it under reasonable conditions. There are many options open to rectify this situation, including improved housing estate development, loan system for financing a purchase, deregulation of land supply, etc. (see, for instance, Hoffman/Struyk 1994).

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<sup>47</sup> As a warning sign, it is revealing to notice that enterprises shun setting up rather unglamorous child care facilities at work. According to a survey of the Ministry of Health and Welfare, only 5.2% of those (large) companies have set up such a facility although they are actually required to do so by law (see Korea Times 3 May, 1996).

- On labour issues, although the fears of the employers are understandable, it is hard to believe that they can really oppose the tide of a pluralising society by not acknowledging independent labour representation. However, the ensuing problems may not be as big as they seem. The historical precedent of countries, like the US, Germany or Japan, shows that organised labour loses its attractiveness when the economy advances beyond a certain limit. It is said that Samsung in the late 1980s contended: "Within five years or so, ..., Korean workers will be so grounded in the values of individualism that they ...will prefer working in a non-union atmosphere" (Ogle 1990, p. 126). What Samsung cunningly had in mind was to delay labour reform for a few more years until interest in it may have declined. However, as long as the heavily curtailed labour movement is still surrounded by the mystique of martyrdom and by the mirage that it can solve all concerns of the workers if only it is allowed to act freely, this will not happen. Therefore, one should reach just the opposite conclusion from Samsung's observation: Once the labour movement is allowed more freedom and is accepted as a legitimate dialogue partner, the population and the workers in particular will soon find out the limits of the union movement: its difficulties to adequately treat the peculiarities of individual enterprises, the selfishness also of union leaders and of the movement as a going concern, the neglect of those not organised well etc. Disenchantment will follow and the overheated labour problem will cool down. It is better to liberalise labour organisation now and bargain it for a reform of individual labour regulation than to have this liberalisation forced upon society at some later stage with nothing in return.
  
- Finally, with respect to competition, the problems facing policy making of course should not be belittled either. Still, as in labour, time will reduce some tension. In a globalising economic environment, chaebols are under increasing competitive pressure from foreign enterprises - both abroad and at home. Taking the domestic market as the relevant market in the past, concentration in many markets may have been formidable and allowed considerable monopoly rents. Once other players have to be reckoned with, this problem declines in importance. Moreover, competing at a global level means that chaebols have to develop enduring core competencies, in terms of brands, distribution channels, technologies or else. The time of

expanding into any kind of new activity because some interesting opportunity arises in a somewhat sheltered environment is (almost) over.<sup>48</sup> This will also open new chances for small and medium enterprises to develop skills and utilise them in niche markets, thus alleviating some of the structural shortcomings of the Korean economy.

Summing up these sketchy remarks on a few policy arenas, it could be shown that despite of major challenges, sensible courses of action can well be found. What is important is to make these changes acceptable to society and thereby gain enough momentum to overcome adverse vested interests. Because in different policy arenas the benefits and costs of reform are unevenly distributed, it is important to promote overarching reform "package deals" which in their sum are considered fair and reasonable. This was exactly Müller-Armack's idea with respect to "second-stage SME". Although much can be said in favour of a gradual approach, an encompassing reform move has greater chances of overcoming entrenched interests.<sup>49</sup>

That this strategy did not work satisfactorily in the Germany of the 1960s, is largely due to the fact that the government had lost clout with regard to organising such a deal. The ill-fated appointment of Erhard as Federal Chancellor in 1963 and the end of Erhard's and Mueller-Armack's responsibility for the Economics Ministry certainly dealt a blow. Korea may be in a somewhat better situation due to its historical trait of government-led economic policy-making. In this respect, I agree with Lee-Jay Cho's and Yoon Hyung Kim's conclusion based on thoughtful analysis that an American model of development, relying on a free enterprise system, would still be premature and that Korea should rather keep or strengthen a "state-oriented co-operative capitalism" (1994, p. 709) along the lines of Germany or Japan. Both countries represent "institutionally reformed versions that combine the

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<sup>48</sup> Such a view is shared for Asian conglomerate groups in general, by Michael Porter (1996).

<sup>49</sup> That this is meaningful can be shown by the struggle of Oriental physicians and Western pharmacists on who should be allowed to dispense Oriental drugs and herbs. Due to existing government regulations, lucrative profit margins can be made in this business. Although hardly an existential policy problem of Korea, this conflict has recently made headline news with strikes being declared, furious Oriental doctors having their heads shaved, etc. The government has great difficulties to manage an agreement in this rather small scale health care issue (see, for instance, Korea Times reports in May 1996). As part of a larger reform deal, the vested interests involved would hardly matter.

merits of state corporatism and Western liberalism and harmonise these merits with their traditional ways of thinking and acting" (ibid.).

Endorsing this view, the differences between Germany and Japan and the problems both economies now face should not be belittled. There is no easy principle that Korea could follow. Actually, arguing in favour of some sophisticated "corporatism" could actually increase the danger of vested interests entrenching themselves and impeding desirable changes. On a conceptual level, constitutional reforms would be asked for, which make sure that rules are enforced which hinder vested interests to dominate the political economy. However, how to institutionalize such rules in the Korean environment where relational ties are much stronger than any rule of (abstract) law is a problem well beyond the scope of this paper.

Even with the approaches outlined above, historical contingencies and timing are crucial for success, for instance the important upcoming dateline, when a new President will take up office.

When selecting policy instruments for a social or wider societal policy, the impact of likely future events should be carefully considered beforehand, because policy reversals are extremely difficult to accomplish as German experience has shown. In the Korean context, important future developments to account for include slower growth as a maturing economy and unification with its strains on the economy and on public finance.

As for the mechanism to bring about the overall reform, Cho and Kim, quoted before, recommend "co-operative efforts of the government, industrial associations, banks, economic advisory organs, and the mass media" (1994, p. 714). Apart and on top of the danger of not soliciting the cooperation of labour and thus running the risk of continuing student and worker unrest<sup>50</sup>, such an alliance may be overly restricted to those who already ran the bureaucratic-authoritarian regime since the 1960s. For instance, the memory of how the Chun regime cracked down on the media and used

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<sup>50</sup> See Koo 1993 on the organised political articulation of those who are or at least feel alienated from the "system".

it for its own purposes is still vivid<sup>51</sup>, and ordinary people may be quite sceptical of any move to a similar "mobilisation", even if it is for allegedly socio-economically progressive reforms (what Chun claimed as well). Political entrepreneurs running the government must therefore seek a workable compromise between narrowing the alliance down to such forces which allow for an effective mobilisation of power and enlarging it wide enough to promote and guarantee legitimacy.

Drawing on German SME experience, it will be important to find a theme for the overarching reform to catch people's hearts and goodwill.<sup>52</sup> Of course, one might consider just to pick up the expression "Social Market Economy" and make use of the positive connotations it conveys, even though in terms of content it would have to be quite different from its original usage in post-war Germany. Still, it would be better if the catchword to be selected could make use of some time-honoured Korean value patterns, in order to mobilise nation-oriented energy. One should be careful, however, about not only making references to traditional hierarchical values in a simplistic move to persuade people to follow the reform in a obsequious manner. This would be dangerous, because such values have been consistently abused to some extent by past regimes. To gain legitimacy, it is important to draw a clear line with respect to the past. Therefore, one should - not exclusively, but additionally - make use of what Harvard historian Carter J. Eckert called "a robust egalitarian ethic in Korean popular culture that has coexisted with or confronted the hierarchical values of traditional Korean aristocratic society" (1993, pp. 114-115).

Korea, reaching advanced nation status as a latecomer, has a good chance of learning from SME experience and use the dynamism of its (still) high-growth economy to transform itself into a thriving and open-minded market economy supported by a stable society with sustainable mechanisms of safeguarding equity, fairness and justice.

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<sup>51</sup> For an overview, see Jung 1989.

<sup>52</sup> Although KDI's new long-term vision for the economy until 2020, whose interim report was presented to the President in May 1996, contains many important points, such an overarching theme which could move people seems lacking (see KDI 1996).

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